

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS BERNSTEIN TO INTERROGATORIES OF
THE GREETING CARD ASSOCIATION
(GCA/USPS-T41-65 - 76)

The United States Postal Service hereby provides the responses of witness
Bernstein to the following interrogatories of the Greeting Card Association:

GCA/USPS-T41-65 - 76, filed on March 23, 2000.

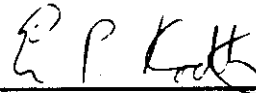
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
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April 6, 2000

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T41-65. Please refer to your response to GCA/USPS-T41-4.

- a. Is the set of "pure Ramsey prices" referred to in this response the only alternative set of prices you considered? If not, please describe fully any others.
- b. Did you prepare a set of "pure Ramsey prices" before deciding not to present such prices? If so, please provide it.

RESPONSE:

a. My testimony includes a set of Ramsey prices with the prices of the Periodicals subclasses constrained to reflect possible interpretations of the ECSI value of this mail. I considered replicating the approach used in the R97-1 testimony of Roger Sherman (OCA-T-300), in which he presented several different versions of Ramsey prices. Ultimately, I did not pursue this approach.

b. No.

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CA/USPS-T41-66. Please refer to your response to GCA/USPS-T41-6(b) and (c).

- a. Under the approach you describe in your answer to part (a) of this interrogatory, is it possible to quantify *separately* the value to the recipient which you state is jointly reflected, along with the value to the mailer, in the demand curve?
- b. If your answer to part a. is negative, do you assert that the value recipients attach to the receipt of mail is identical with the value to the mailer?

RESPONSE:

- a. I am not aware of any approach that would allow one to separately quantify the value to the recipient and the value to the mailer reflected in a postal demand curve.
- b. No.

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CA/USPS-T41-67. In GCA/USPS-T41-7, you were asked to confirm that your testimony does not provide or reflect quantified consideration of "losses, whether or not of an economic nature associated with increases in mailing costs" (emphasis added). Your response discusses dead-weight losses but does not appear to state whether losses of a non-economic nature were considered. Were they?

RESPONSE:

I am not sure what is meant by losses of a non-economic nature in this case. My testimony examines the impact of changes in postal prices on postal volumes. Any reduction in the volume of some mail product is, in my mind, by definition an economic loss -- it is a loss of volume that occurs in response to a specific economic change, e.g., an increase in price. The loss to mailers from a rise in price is equal to the loss of consumer surplus, which reflects the sum of i) the increase in expenditures for that mail which is still sent at the higher price and ii) the lost net value of mail that is no longer sent because of the price rise.

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GCA/USPS-T41-68. Please refer to your response to GCA/USPS-T41-8(a). Please confirm that your reference to Table 11, as regards to First-Class Mail, is to a sum of \$18,304.2 million and that your reference to Table 13, as regards First-Class Mail is to a sum of \$2,611.1 million. If you do not so confirm, please supply the correct values for First-Class Mail.

RESPONSE:

I assume that you are referring to the First-Class letter subclass and not the entirety of First-Class Mail. With respect of GCA/USPS-T41-8(a), the dead-weight loss associated with the increase in the price of First-Class letters is the sum of the increase in Postal Service net revenues and the decrease in mailer consumer surplus, both measured at the Ramsey prices relative to the R97-1 Index prices. For the First-Class letter subclass, the calculations based on results presented in Tables 11 and 13 are shown below, with all numbers in millions.

Ramsey First-Class Letter Net Revenue	=	\$18,304.2
R97-1 Index First-Class Letter Net Revenues	=	\$16,011.2
Increase in Net Revenues	=	\$2,293.0
Change in Consumer Surplus	=	-\$2,611.0
Dead-Weight Loss	=	-\$ 318.0

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GCA/USPS-T41-69. Please refer to your response to GCA/USPS-T41-9. Please provide your understanding, if any, of the effect on Postal Service revenues of any cross-elasticities that affect the volume of (i) First-Class Mail, and (ii) single-piece First-Class Mail.

RESPONSE:

Again, I assume that you are referring to the First-Class letter subclass and not to First-Class Mail. With respect to First-Class letters, the most important cross-elasticity is with Standard A Regular mail, as well as a cross-price elasticity with First-Class cards. As I explained in my testimony, when a cross-elasticity exists between two postal products, an increase in the price of one product, say First-Class letters, leads to an increase in the volume of any other substitute product(s), in this case, First-Class cards and Standard A Regular mail as some mailers shift from First-Class letters to First-Class cards or Standard A. Therefore, some of the net revenue that "leaks" away from First-Class letters is recovered through increased volume of cards and Standard A. The same impact occurs when the price of First-Class cards or Standard A mail is raised, as some mailers would shift to First-Class letters. Therefore, with cross-price elasticities, price increases lead to greater increases in overall postal revenues (and net revenues).

The same logic applies to the demand for single-piece letters, which have a strong cross-price elasticity relation with workshared letters. An increase in the price of single-piece letters causes a decline in single-piece letter volume. To the extent that some of that decline represents a shift to workshare letters (because the single-piece price increase leads to an increase in the workshare discount) then Postal Service revenues and net revenues are greater than if there was no shift of volume between the two categories. Please also see my testimony at pages 34 to 36.

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GCA/USPS-T41-70. Please refer to your response to GCA/USPS-T41-10. Given that the range of possible sets of prices is limited by the constraint imposed by the requirement that the Postal Service breakeven, do you assert that your Ramsey-based prices would provide the optimal sum of Postal Service net revenues and total consumer (mailer) surplus which is possible under the breakeven constraint?

RESPONSE:

No. I assert that the Ramsey-based prices yield \$1,272 million increase in total consumer surplus as compared to the R97-1 Index prices. I also assert that postal prices that reflect Ramsey pricing principles will yield higher consumer surplus than postal prices that do not.

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GCA/USPS-T41-71. Please refer to your response to GCA/USPS-T41-11. Would you agree that marginal benefit to an individual (i) is sometimes path-determined, and (ii) may not be governed by, or expressible in, economic terms? Please explain your answers.

RESPONSE:

I do not know what you mean by "path-determined" marginal benefit unless it is that the n th unit of a good has greater marginal benefit than the $n+1$ th unit of the good. With respect to whether marginal benefit may not be expressible in economic terms, I suppose this is largely a question of semantics. Economists tend to think in economic terms and view people's decisions as reflecting a kind of cost-benefit analysis even if those costs and benefits are not always measured in dollars. A person can choose between buying a puppy or buying a kitten without much regard for the cost of either pet. Still, economists would argue that in choosing one over the other, the person is weighing marginal costs and marginal benefits and therefore, their decision is governed by and expressible in economic terms.

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GCA/USPS-T41-72. Please refer to your response to GCA/USPS-T41-15. Please assume that certain costs of the Postal Service both (i) are not attributable to classes and services and (ii) are inefficiently incurred. As to these costs, please confirm that, if they were allocated to classes and services on the basis of Ramsey pricing, they will be allocated preferentially to captive (inelastic demand) customers. If you do not so confirm, please provide and explain your understanding as to why Ramsey prices would not place on inelastic classes most of the burden of the productive inefficiency represented by these costs.

RESPONSE:

Under Ramsey pricing, costs that are not attributable (not volume variable) will be allocated to a relatively greater degree to mail products that have a relatively less elastic demand curve. This holds however these costs are incurred.

For the record, however, I see no reason why non-volume variable costs should be particularly prone to "inefficiency" and they certainly should not be viewed as a measure of the inefficiency of the Postal Service. In fact, a higher level of non-volume variable costs would generally be seen as evidence of greater efficiency of the system since greater non-volume variable costs imply lower volume variable costs and, hence, lower marginal costs. From an efficiency standpoint, one should prefer an operation that has lower marginal costs to one that has higher marginal costs.

For my general view of this issue of postal efficiency, please see my response to NAA/USPS-T-13.

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GCA/USPS-T41-73. In your response to GCA/USPS-T41-19(d) you state that the "impacts of these higher prices [viz., for subscriptions to periodicals] are captured by the analysis presented in my testimony. Are the "impacts" referred to in the quotation only reduced volumes of mail sent in the affected subclasses? If your answer is not an unqualified "yes," please describe any other impacts and state where they are discussed in your testimony.

RESPONSE:

No. The impacts of higher prices of Periodicals mail are the increase in expenditures that must be made on those Periodicals that are still mailed at the higher price as well as the decrease in net value resulting from the small decline in Periodicals volume that occurs due to the rise in price. The demand curve for Periodicals reflects both these impacts as explained in Chapter 1 of my testimony.

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GCA/USPS-T41-74. Please refer to your response to GCA/USPS-T41-20(a). Do you have an opinion regarding the level of the first-ounce rate for First-Class single-piece letters (i.e., the rate corresponding to the present 33-cent letter stamp) which is implied by your Ramsey-derived fixed-weighted index price for First-Class letters? If you do, please state it and indicate how it was derived.

RESPONSE:

My testimony addresses rates at the subclass level and does not address issues of rate design for particular rate categories. My Table 14A at page 101 shows that the Ramsey price of First-Class letter subclass is 7.8 percent greater than the before-rates price. My testimony does not examine how this subclass rate increase would be applied to individual letter mail categories. Mathematically, applying a 7.8 percent price increase to the present one-ounce rate of 33 cents would yield a price of 35.57 cents. However, I have not analyzed the efficiency implications of assigning the First-Class letter subclass percentage price increase identically to single-piece and workshare letters.

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GCA/USPS-T41-75. Please described and provide any materials you rely on for your conclusion that "the logarithmic constant elasticity demand specification has an excellent record of explaining the response of mail volume to changes in postal rates."

RESPONSE:

The Postal Service and the Postal Rate Commission have been using the logarithmic demand specification to make volume forecasts for the past 20 years. With respect to the current case, the Forecast Error Analysis found in the Technical Appendix of the testimony of Dr. George Tolley (USPS-T-6) shows the performance of the forecast model over the past five years. In particular, the Forecast Error Analysis shows that for most mail products, the five-year mechanical net trend is close to 1.000, meaning that over the most recent five-year period, actual volume was very close to the volume predicted by the econometric model.

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GCA/USPS-T41-76. Please refer to your response to GCA/USPS-T41-30(c). Does the term "worth," in the example you give there, refer to (i) the willingness of a person to pay for an apple, (ii) the ability of a person to pay for an apple, (iii), the combination of such willingness and ability, or (iv) some other referend. If your answer is affirmative to subpart (iv), please explain fully.

RESPONSE:

In GCA/USPS-T41-30(c), "worth" refers to what someone is willing and able to pay.

DECLARATION

I, Peter Bernstein, declare under penalty of perjury that the foregoing answers are true and correct to the best of my knowledge, information and belief.

A handwritten signature in cursive script, appearing to read "Peter Bernstein", written over a horizontal line.

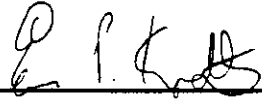
(Signed)

4-5-00

(Date)

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



Eric P. Koetting

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April 6, 2000