

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 OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T41-1 - 4)

The United States Postal Service hereby provides the responses of witness Bernstein to the following interrogatories of the OCA: OCA/USPS-T41-1 - 4, filed on March 28, 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.
Chief Counsel, Ratemaking



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April 11, 2000

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-1. Please refer to your response to interrogatory MOAA/USPS-T41-3. You state, "An equal across-the-board rate increase approach does not take account of changes in relative costs which will generally lead to rates that are not economically efficient."

- (a) Would you agree that an attempt to minimize deviations from an "equal across-the board rate increase approach" in order to mitigate rate increases for categories of mail that have experienced relatively larger increases in volume variable costs "will generally lead to rates that are not economically efficient"? If not, why not?
- (b) Would you agree that a ten-year history of attempting to mitigate rate increases for categories of mail that have experienced relatively larger increases in volume variable costs will almost certainly "lead to rates that are not economically efficient"? If not, why not?

RESPONSE:

a. I do not completely agree with the point made in your interrogatory because efficient pricing needs to take account of both cost and demand considerations. My response to MOAA/USPS-T41-3 focused on changes in relative costs only. Putting demand considerations aside, I stated that an equal across-the-board rate increase will generally lead to rates that are not economically efficient. However, taking account of demand elasticity differences, it may be the case that movements toward equal across-the-board rate increases could be economically efficient even when there have been changes in relative costs. For example, suppose there is a mail product that currently has a mark-up that is greater than its Ramsey mark-up. If this product experiences a large increase in costs, assigning it an average rate increase will tend to lower its mark-up (since the percentage cost increase exceeds the percentage price increase). In this case, movement toward equal across-the-board rate increases would raise economic efficiency.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

b. A ten-year history of mitigating rate increases (i.e., relative rate increases less than the product's relative cost increases) can increase economic efficiency if the resulting decrease in the product mark-up moves the mark-up closer to the Ramsey mark-up.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-2. Please refer to your response to interrogatory GCA/USPS-T41-60(b). You state, "Products can be substitutes without being price substitutes. It may be the case that any substitution between First-Class letters and electronic alternatives is based on service characteristics and not price."

- (a) Would you agree that there will be at least one consumer on the price margin (i.e., "on the fence") between using First Class Mail and using an electronic alternative during the period that proposed rates are in effect? If not, why not?
- (b) Are you suggesting that all consumers who switch from First Class Mail to electronic alternatives do so without comparing future costs and benefits of such a switch? If not, what point are you trying to make?
- (c) Are you suggesting that *all* consumers contemplating a switch from First Class Mail to electronic alternatives would do so without taking account of the expected future price path of First Class Mail? If not, what point are you trying to make?
- (d) Please provide citations to the economic literature that support the point you are trying to make.

RESPONSE:

a. Yes.

b and c. The point I was making in GCA/USPS-T41-60(b) is simply that the emergence of electronic alternatives may not have a meaningful effect on the price elasticity of First-Class letters. It may be the case that while there are some consumers who move to electronic alternatives due to an increase in the price of letters, there may not be many consumers who do so. Put differently, my point is that any cross-price elasticity between First-Class letters and electronic alternatives may be small, indicating that price considerations are not dominant in the decision of consumers to substitute electronic alternatives for letter mail.

d. Evidence to support the view presented in parts b and c comes from the

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

experience of the past ten years, during which time there has been tremendous growth in fax messaging, E-mail, electronic funds transfers, and electronic data interchange, and there has not been much change in the own-price elasticity of First-Class letters.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-3. Please refer to your response to interrogatory GCA/USPS-T41-60(e). You state, "Consideration of years in the future, namely 2003 to 2008, should not be incorporated into elasticity estimates used to make forecasts for 2001 and 2002."

- (a) How should consideration of the future price path of First Class Mail be incorporated into volume forecasts for 2001 and 2002?
- (b) Are you suggesting that expectations about future prices have no effect on the current volume of First Class Mail? If not, what point are you trying to make?
- (c) Are you suggesting that volumes of First Class Mail in the years 2003 to 2008 are unaffected by prices in 2001 and 2002? If not, what point are you trying to make?
- (d) Please provide citations to the economic literature that support the point you are trying to make.

RESPONSE:

a and b. Volume forecasts for 2001 and 2002 should use the prices and price elasticities expected to prevail in 2001 and 2002. The econometric work of Thomas Thress in R97-1 and R2000-1 and the work of Dr. George Tolley before him do not use the future price of First-Class letters as a variable explaining current volume. Their work suggests that future prices do not have significant impact on the current volume of letter mail.

c. No and I did not say this in my response to GCA/USPS-T41-60(e). I said that prices in 2003 through 2008 are not included in the forecast of volumes in 2001 and 2002.

d. See the econometric work of Thomas Thress in R2000-1 and R97-1 and the work of George Tolley in the present and earlier rate cases.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

OCA/USPS-T41-4. Please refer to the response to ABA&NAPM/USPS-3.

- (a) Do you agree with the Postal Service's response to part (a) of that interrogatory? Please provide a factual foundation for your response.
- (b) Do you agree with the Postal Service's response to part (b) of that interrogatory? Please provide a factual foundation for your response.
- (c) Do you agree with the Postal Service's response to part (c) of that interrogatory? Please provide a factual foundation for your response.
- (d) Please explain why the "rate increases in First-Class worksharing of the variety proposed by the Postal Service in this proceeding" do not affect the speed with which bills and bill payments mail leaves the Postal Service.

RESPONSE:


- a. If "susceptible to electronic diversion" means potentially, but not necessarily, lost to electronic diversion some time in the future, then I agree.
- b. Yes.
- c. In its response, the Postal Service is stating that it is "appropriate for the Postal Service to raise rates for First-Class worksharing mail." I did not estimate separate prices for single-piece and workshare letters for my testimony in this case. The Ramsey price of the First-Class subclass is greater than the before-rates price, and therefore it seems reasonable for there to be some increase in the price of workshare letters.
- d. I did not make the statement addressed in your question. The Postal Service

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF OCA

may be making the point that a comparison of the before- and after-rates volume forecasts shows a relatively small change in workshare letter volume due to the proposed increase in workshare category rates. The small volume change is evidence that the rate increases are not expected to have much impact on the volume of bills and bill payments lost to electronic alternatives.

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.



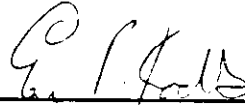
(Signed)

4-10-00

(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.

A handwritten signature in black ink, appearing to read "Eric P. Koetting", is written over a horizontal line.

Eric P. Koetting

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