RECEIVED
APR 14 4 49 PM '00
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

POSTAL RATE AND FEE CHANGES, 2000	Docket No. R2000–1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS BERNSTEIN TO INTERROGATORIES OF
UNITED PARCEL SERVICE
(UPS/USPS–T41-7 - 8)

The United States Postal Service hereby provides the response of witness Bernstein to the following interrogatories of the United Parcel Service: UPS/USPS–T41-7 - 8, filed on April 5, 2000.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268–2992 Fax –5402
April 14, 2000

UPS/USPS-T41-7. In your response to UPS/USPS-T41-2, you confirm that "If the nonpostal firm's marginal costs vary with the level of output, then changes in postal prices can lead to a change in the nonpostal firm's price." Please verify that your confirmation implies that if, in fact, marginal costs do vary with output, then there are relevant elements of the Ramsey formula (i.e., $E_{12}[dP_2/dP_1 \bullet P_1/P_2]$ in equation (8a) on page 42 of USPS-T-41) that you do not account for in your estimate of Ramsey prices.

RESPONSE:

Please see my revised response to UPS/USPS-T41-6.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO FOLLOW-UP INTERROGATORIES OF UPS

UPS/USPS-T41-8. Refer to your responses to UPS/USPS-T41-3(a) and (b). You characterize the package delivery market as "a competitive market with free entry." You also state that "it is well known that many private carriers offer discounted prices to select customers. Firms might charge above marginal cost prices for some customers, while charging prices equal to marginal costs to their most price sensitive customers. . . ." And on page 46 of USPS-T-41, you state that "Private firms operating in competitive markets with free entry can be expected to be pricing at marginal cost."

(a) If private suppliers of package delivery services do not set marginal cost prices for all of their products, then please explain why it is appropriate to focus on "the Ramsey model without cross-elasticities of nonpostal firms," as you do when estimating Ramsey prices in your testimony at page 46.

(b) If your answer to (a) involves an assertion similar to the assertion on page 46 of USPS-T-41 that "the Ramsey model without cross-elasticities of nonpostal firms is likely to yield results quite similar to those that would result from a model with nonpostal firms," provide the details of all analyses that you have performed to justify this assertion.

RESPONSE:

a. Consider the following market for package deliveries. The Postal Service competes with one (or more) private firms. There exist two types of package delivery customers. One type of customer chooses the delivery company primarily based on price. The second type of customer chooses the delivery company based on non-price considerations such as quality of service, convenience, past experience, etc. Type one customers will have a package delivery demand with a high cross-price elasticity whereas type two customers will have a package delivery demand with a very low or negligible cross-price elasticity. In this case, it is quite reasonable that the private delivery company would set a price above marginal cost for Type 2 customers (who are not basing their delivery choice on price), while providing discounts toward marginal cost pricing for type 1 customers (who are basing their delivery choice on price). Therefore, the Ramsey model without cross-price elasticities is appropriate because 1) the segment of the market that has a cross-price elasticity between the postal product and the nonpostal product (type 1 customers) is priced at marginal cost and 2) the segment of the market that does not have marginal cost pricing (type 2 customers), has no cross-price elasticity between the postal product and the nonpostal product.

b. I have no detailed information about the costs of nonpostal firms. The conditions I discuss in my response to (a) seem quite reasonable. That is, it is reasonable that different consumers have different degrees of price sensitivity in choosing a package delivery firm (i.e., cross-price elasticities that range from zero to a fairly large positive number). It also seems reasonable that the nonpostal firm (which has pricing flexibility that the Postal Service does not) would price more competitively (i.e., close to or equal to marginal cost) for those customers whose package delivery choice is based primarily on price (i.e., a high cross-price elasticity) while pricing above marginal cost for those customers whose package delivery chose is not based on price (i.e., a low or zero cross-price elasticity).

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.

Peter Bernstein

(Signed)

4-14-00

(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

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268–2992 Fax –5402
April 14, 2000