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

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

SUPPLEMENTAL TESTIMONY OF THOMAS E. THRESS ON BEHALF OF THE UNITED STATES POSTAL SERVICE IN RESPONSE TO ORDER NO. 1294

July 21, 2000

SUPPLEMENTAL TESTIMONY OF THOMAS THRESS
ON BEHALF OF THE UNITED STATES POSTAL SERVICE

I. Purpose of Testimony

The purpose of this testimony is to explain why, even under the circumstances in which cost estimates are updated to account for FY 1999 data, the test year volume forecast filed by the Postal Service at the beginning of the case (USPS-T-6 and USPS-T-8) is still the most appropriate forecast to use in this proceeding. This conclusion is supported by the fact that the initial forecast is performing quite well compared with the most recent actuals, and by the special difficulties that would be associated with any attempt to update the forecast under current circumstances. My autobiographical sketch can be found in my direct testimony, USPS-T-7.

II. Issues Associated with Updating the Volume Forecast

A. Accuracy of Volume Forecast as Filed Through the First Three Quarters of 2000

At the time when R2000-1 was filed, all available volume data were used in making the Test Year volume forecast. As a result, unlike the cost forecast, the volume forecast presented in USPS-T-6 and USPS-T-8 incorporated complete information from FY 1999. Since that time, however, three quarters of additional volume data are available. A comparison of actual volume for the first three Postal quarters of 2000 with the volume forecast for these three quarters filed in this case is summarized in Table 1 below.

Overall, domestic mail volume for the first three quarters of 2000 has been within one-half of one percent of the R2000-1 forecast, and special service volume has been within two-thirds of one percent of the forecast. Of course, the forecasts by mail subclass are somewhat less accurate, although the forecasts by major class and subclass of mail have generally been accurate to within one to two percent.

Table 1

Actual Volume versus R2000-1 Volume Forecast

First Three Quarters of 2000

	R2000-1	Actual	Difference Pieces	Percentage
First-Class Letters	69,314.631	68,995.015	319.610	0.46%
– Single-Piece	38,136.004	37,308.120	827.884	2.22%
– Workshared	31,178.627	31,686.895	(508.268)	-1.60%
First-Class Cards	3,792.357	3,862.673	(70.316)	-1.82%
Total First-Class Mail	73,106.987	72,857.693	249.300	0.34%
Priority Mail	845.709	879.215	(33.506)	-3.81%
Express Mail	48.221	49.154	(0.933)	-1.90%
Total Periodical Mail	7,275.187	7,170.202	104.985	1.46%
Standard Regular	29,024.193	29,836.151	(811.958)	-2.72%
Standard ECR	23,151.141	23,268.747	(117.606)	-0.51%
Nonprofit & Nonprofit ECR	10,164.604	10,196.503	(31.899)	-0.31%
Total Standard A Mail	62,339.938	63,301.401	(961.463)	-1.52%
Total Standard B Mail	761.596	772.206	(10.610)	-1.37%
Total Domestic Mail	144,675.291	145,308.824	(633.533)	-0.44%
Total Special Services	568.944	565.219	3.725	0.66%

In past decisions, the Postal Rate Commission (PRC) has evaluated the accuracy of the Postal Service's volume forecast for the three or four quarters of data which became available through the course of the proceeding. In the two most recent omnibus cases, R94-1 and R97-1, the PRC concluded that "the forecasts submitted by the Postal Service do not appear to have any overall bias," and that "it [was] unnecessary ... to correct and update the forecasts of volumes submitted by the Postal Service." (Opinion and Recommended Decision, Docket No. R94-1, pp. II-39-40).

In its Opinion and Recommended Decision in Docket No. R94-1, at page II-38 (para. 2108), the PRC described the R94-1 forecast errors thusly:

> "Typically, the percentage errors for the major categories of First- and third-class mail lie within a range of plus or minus 3 percent. The errors tend to be larger in magnitude for the smaller classes of mail. On the whole the comparison indicates that the forecasts submitted for R94-1 are an improvement to those submitted in R90-1."

In R97-1, the PRC stated much the same position.

> "Typically, the percentage errors for the major categories of First-Class and Standard A Mail lie within a range of several percent. The errors tend to be larger in magnitude for the smaller subclasses of mail. On the whole the errors exhibit a pattern that could be explained by a fair amount of sampling error in the RPW statistics. Sampling errors would affect the RPW statistics for the smaller mail categories more severely that (sic) the larger or aggregated categories.
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> "As in most earlier proceedings, the Commission finds that a comparison of predicted to observed overall volumes of mail does not support the hypothesis that the forecasts submitted by the Postal Service will systematically understate volumes during the test year. That is, the forecasts submitted by the Postal Service do not appear to have any overall bias." [Opinion and Recommended Decision, Docket No. R97-1, Appendix H, page 16.]

These descriptions are also applicable to the accuracy of the R2000-1 forecasts, as shown in Table 1. The accuracy of the R94-1 and R97-1 forecasts are compared to the accuracy of the R2000-1 forecast to date in Table 2 below.

Table 2
Forecast Accuracy: R2000-1 versus R97-1 and R94-1

	R2000-1 (2000Q1-3)	R97-1[1] (1997Q3-98Q2)		R94-1[2] (1994Q1-3)
First-Class Letters	0.46%	-0.05%	First-Class Letters	0.00%
– Single-Piece	2.22%	1.06%	– Nonpresort	2.28%
– Workshared	-1.60%	-1.50%	– Presort	-3.81%
First-Class Cards	-1.82%	3.54%	First-Class Cards	-0.12%
Total First-Class Mail	0.34%	0.14%	Total First-Class Mail	-0.01%
Priority Mail	-3.81%	-3.36%	Priority Mail	-4.78%
Express Mail	-1.90%	-4.97%	Express Mail	-2.36%
Total Periodical Mail	1.46%	-0.39%	Total Second-Class Mail	2.01%
Standard Regular & ECR	-1.75%	-1.25%	Third-Class Bulk Regular	-1.27%
– Standard Regular	-2.72%	-0.67%	– Noncarrier-Route Presort	-0.50%
– Standard ECR	-0.51%	-1.84%	– Carrier-Route Presort	-1.97%
Nonprofit & Nonprofit ECR	-0.31%	-0.17%	Third-Class Bulk Nonprofit	1.56%
Total Standard A Mail	-1.52%	-1.06%	Total Third-Class Mail	-0.74%
Total Standard B Mail	-1.37%	2.70%	Total Fourth-Class Mail	-13.39%
Total Domestic Mail	-0.44%	-0.42%	Total Domestic Mail	-0.21%
Total Special Services	0.66%	6.11%	Total Special Services	-0.15%

The figures presented in Table 2 above indicate that the forecast errors associated with the current forecast are comparable in magnitude to the forecast errors observed in the two most recent rate cases.

As in Docket Nos. R94-1 and R97-1, the accuracy of the volume forecast as filed to date provides sufficient grounds to conclude that there is no compelling need to update the Postal Service's test year forecast.

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[1] Source: Opinion and Recommended Decision, Docket No. R97-1, Appendix H, page 15. The numbers shown in Table 2 are calculated from the data presented by the PRC in Table H-1.

[2] Source: Opinion and Recommended Decision, Docket No. R94-1, page II-39.

B. Problems with Macroeconomic Data used in Forecasting

In October of 1999, the United States Commerce Department began to provide income and consumption data in 1996 dollars instead of 1992 dollars. Over the next several months after this, the Commerce Department systematically restated much of its historical data. The special difficulties created by this restatement were very briefly discussed in the Postal Service's institutional response to OCA /USPS-82, appearing at Tr. 21/9131. In many cases, this restatement did more than simply re-base data, but, in fact, affected the historical growth rates for certain variables.

For example, according to the historical data provided by DRI in June of 1999, which was used to develop the test year volume forecast, real personal consumption expenditures per adult grew at an average annual rate of 2.0 percent from 1992 through 1997. In contrast, the historical data currently provided by DRI indicates that real personal consumption expenditures per adult grew at an average annual rate of 2.3 percent over this same time period. While this difference in growth rates is not very large, it may nevertheless be important from an econometric standpoint.

The growth rates associated with some explanatory variables have changed over the period over which the Postal Service's elasticities are estimated. Because of this, the estimated elasticities associated with these variables will likely be different using the new Commerce Department data than they were using the old Commerce Department data.

In addition, more recent DRI forecasts of these variables are based on the restated Commerce Department data. Hence, for consistency, if one were to use DRI's newest forecast, one would also need to re-estimate the Postal Service's demand equations, to ensure that the elasticities used in making the volume forecast were estimated using the same macroeconomic data as the macroeconomic forecasts themselves relied upon. Otherwise, the forecast results would run the risk of being nonsensical.

Further, because the data are different throughout the sample periods over which these equations are estimated, a simple mechanical re-estimation of the equations used in R2000-1 may be inappropriate, as the relationship between mail volume and certain macroeconomic drivers of mail volume may need to be re-evaluated in light of the new macroeconomic data. Such an analysis is not practical within the brief time permitted for the Postal Service to address this issue in this case. This argues strongly against attempting to update the Test Year volume forecasts, particularly in light of the satisfactory performance to date of the existing forecast as discussed above.