Postal Rate Commission
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USPS-T-28

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

DIRECT TESTIMONY
OF
JOSEPH D. MOELLER
ON BEHALF OF
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

Autobiographical Sketch

My name is Joseph D. Moeller. I am an Economist in Pricing and Product Design at Postal Service Headquarters. Prior to my assignment in Pricing, I was a Marketing Specialist for Advertising Mail in Product Management. I joined the Postal Service in 1987 as a Staff Economist in the Rate Studies Division of the Office of Rates.

I have testified on behalf of the Postal Service in several Postal Rate Commission proceedings. In Docket No. R90-1, I presented direct testimony regarding second- and third-class presort-related and shape-related cost differentials. I also presented rebuttal testimony in that proceeding regarding the third-class minimum-per-piece rate structure. In Docket No. MC93-1, I presented cost estimates and proposed rates for the Bulk Small Parcel Service. I offered testimony in support of the Postal Service's proposals for Standard Mail (A) in Docket No. MC95-1, and in Docket No. MC96-2, Nonprofit Classification Reform. In Docket No. R97-1 and Docket No. R2000-1, I presented the rate design for Standard Mail (A).

My previous experience includes work as an Industrial Engineer for the Batesville Casket Company of Hillenbrand Industries. My responsibilities included time study analysis of indirect labor.

I received a Master of Science Degree in Management in 1986 and a Bachelor of Science Degree in Industrial Management in 1983 from Purdue University.

I. PURPOSE OF TESTIMONY

The purpose of my testimony is to present the Postal Service's proposed rate levels. Following the well-established precedent used by both the Postal Rate Commission and the Postal Service, the proposed rate levels are described in terms of cost coverages (revenue divided by cost), and the proposed rate and fee increases are presented in the form of percentage changes. For each subclass, the testimony describes how the Postal Service's proposed rate levels conform to the ratemaking criteria of the Postal Reorganization Act.

My testimony concludes with five exhibits. Exhibit USPS-28A shows the test year (FY 2003) finances of the Postal Service on a subclass-by-subclass basis without a rate change, or the "before rates" scenario. Exhibit USPS-28B shows the test year finances with the proposed rate changes, or the "after rates" scenario. Exhibit USPS-28C shows the revenues associated with the intervening years, FY 2001 and FY 2002. Exhibit USPS-28D shows the proposed percentage rate increases for the major classifications. Exhibit USPS-28E provides a summary of test year after rates revenues and incremental costs.

Library Reference USPS-LR-J-138 contains the Exhibits. This library reference is incorporated by reference in my testimony.

II. GUIDE TO TESTIMONY AND SUPPORTING DOCUMENTATION

This testimony is structured as follows. In Section III, the ratemaking criteria set forth in section 3622(b) of the Postal Reorganization Act are discussed in general. In Section III, I also discuss changes in the treatment of preferred rate subclasses to reflect the enactment of Public Law 106-384, which establishes the relationship between certain nonprofit and commercial subclasses of mail. In Section IV, I discuss the pricing criteria of section 3622(b) and how they were considered during the development of the proposed rate levels for the individual subclasses.

III. GENERAL DISCUSSION

A. Ratemaking Criteria

Section 3622(b) of the Postal Reorganization Act lists nine specific criteria to be considered in determining postal rate and fee levels. Those criteria are listed below and are followed by a discussion of how they were used in developing the Postal Service's proposed rate levels. The criteria are:

1. the establishment and maintenance of a fair and equitable schedule;

2. the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

3. the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributed to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

4. the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

5. the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

6. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

7. simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

8. the educational, cultural, scientific and informational value to the recipient of mail matter; and

9. such other factors as the Commission deems appropriate.

For ease of reference, these nine pricing criteria are often referred to by their statutory subsection numbers or by an abbreviation. The following table lists the pricing criteria by number and abbreviated form:

Table 1. Pricing Criteria

Criterion Number	Abbreviated Form
1	Fairness and Equity
2	Value of Service
3	Cost
4	Effect of Rate Increases
5	Available Alternatives
6	Degree of Preparation
7	Simplicity
8	ECSI
9	Other Factors

B. Discussion of Criteria

1. Fairness and Equity

The first pricing criterion specified in section 3622(b) of the Postal Reorganization Act is that the established schedule be fair and equitable. The Postal Service's proposals in this case have fairness and equity as their most fundamental objectives. Fairness and equity form the framework within which the additional eight criteria are considered, providing a basis upon which to properly balance the sometimes conflicting factors indicated by these other criteria and serving as a check against undue influence by any one of the other non-cost criteria.

Because it may embody different meanings to customers, competitors, and other interested parties, the "fairness and equity" criterion is perhaps the most subjective of the nine criteria. In its proposals, the Postal Service must responsibly balance the needs and concerns of all parties in accordance with the policies reflected in the Postal Reorganization Act.

2. Value of Service

Subsection 3622(b)(2) instructs that the value of the mail service actually provided to both the sender and the recipient be considered when establishing rate levels. The subsection specifically mentions the following operational aspects of mail service: collection, mode of transportation, and priority of delivery. These operational features provide for a general comparison of the relative levels of service among mail classes and between postal and non-postal alternatives. Other aspects of the service often considered include such factors as the level of privacy afforded by the mail class, the reliability and image associated with the mail class, the presence of features such as free forwarding, and the availability of such ancillary services as insurance or Delivery Confirmation. Such illustrative considerations affect postal customers' perceptions of the value of service they receive from the Postal Service when they use different classes of mail and contribute to what is sometimes referred to as the intrinsic value of a class of mail. The actual service level achieved is due in part to the mailer preparation, and not solely dependent upon (or a result of) the Postal Service's expended effort.

Another way to look at value of service is by considering the degree to which usage of the service declines in response to price increases, indicative of what has been referred to as the economic value of service. The own-price elasticity of demand is measured as the percentage change in usage (mail volume) that results from a one-percent increase in price. The lower (in absolute value) the own-price elasticity, the higher the value of service.

If a small increase in price results in a large volume decline (i.e., demand for the product is highly elastic), it can be inferred that the product has relatively low value due to the ease with which its customers are willing to substitute another product or forgo the use of the product altogether. A small response to a price change indicates that customers value the product highly and do not pursue substitutes as readily. Legal restrictions on competition or the lack of reasonable alternatives will reduce the measured price elasticity. Therefore, such conditions should be considered when using the own-price elasticity to evaluate value of service.

The price elasticities mentioned in my discussions of individual subclasses are the long-run elasticities provided by Dr. Tolley (USPS-T-7) and Dr. Musgrave (USPS-T-9). For convenience, they are summarized in Table 2 below.

Table 2. Long-run Own-price Demand Elasticities

First-Class Letters	
Single-piece	-0.311
Workshared	-0.071
First-Class Cards	
Stamped	-0.808
Private	-1.157
Priority Mail	-0.754
Express Mail	-1.492
Regular Periodicals	-0.166
Standard Regular	-0.388
Standard ECR	-0.770
Parcel Post	-1.194
Bound Printed Matter	-0.231
Media Mail	-0.144

Source: Priority Mail and Express Mail, USPS-T-9; all others, USPS-T-7.

An additional consideration is the availability of alternative services that have features valued by customers, but which are not available in the comparable postal services. For example, one postal service may be of higher value than another postal service in terms of delivery standards, ease of entry, the availability of access to the collection system, or air transportation, but may lack the reliability or service features offered by another provider of a similar service.

3. Cost

This criterion is considered the most objective of the nine pricing criteria, specifying that each class of mail bear the direct and indirect postal costs attributed to that class in addition to bearing some reasonable portion of the remaining costs of the postal system. As in Docket No. R2000-1, the Postal Service is presenting information regarding the estimated incremental costs for each class and subclass of mail. As witness Kay (USPS-T-21) explains in her testimony, incremental cost represents an accurate measure of the total cost caused by a product. Witness Kay's testimony builds upon the earlier work by Postal Service witnesses Panzar and Takis[1] in Docket No. R97-1, and witness Bradley's testimony in Docket No. R2000-1[2], and provides updated incremental costs. These costs are used to test whether the Postal Service's proposed rate levels result in revenue that will cover the incremental costs and thus preclude cross-subsidy.

The approach to measurement of volume-variable costs introduced by Postal Service witnesses Bradley (USPS-T-14) and Degen (USPS-T-12) in Docket No. R97-1, and refined by Postal Service witnesses Bozzo (USPS-T-15), Degen (USPS-T-16), and Van-Ty-Smith (USPS-T-17) in Docket No. R2000-1, is again presented in this case. The use of this costing approach in support of the Postal Service's request affects the measured volume-variable costs of different mail classes to differing degrees (when compared to costs estimated by the method used by the Postal Rate Commission in Docket No. R2000-1). The carrier cost methodology introduced by the Postal Service in Docket No. R2000-1 is not replicated in the current request, and this, too, affects mail classes by differing degrees compared to the previous proposal. The rate levels now proposed by the Postal Service, therefore, are not directly comparable to those proposed by the Postal Service in Docket No. R2000-1, nor to those recommended by

[1] Docket No. R97-1, USPS-T-11 and USPS-T-41, respectively.
[2] Docket No. R2000-1, USPS-T-22.

the Postal Rate Commission in that same docket. The proposed rate levels must recognize these changes in relative cost levels. However, as in previous dockets, the Postal Service has not mechanistically applied coverage or markup indices based on previous cost information. This is in particular deference to criterion 4 which requires that the effect of rate increases on mailers be considered, as well as to the requirement that the proposed rate levels balance the full set of pricing criteria. It is not just the variety of cost methodologies that warrant the avoidance of using mechanistically applied coverages, however. Even if there were one consistently-used costing methodology, it would not necessarily result in stable costs, and criterion 4 would be have to be considered.

4. Effect of Rate Increases

This criterion provides for consideration of the effect of rate increases on both mailers and private-sector competitors of the Postal Service. Due to the relatively large proposed rate increases, the relationship of the increases to forecasted inflation,[3] and the relatively short time between recent and future rate adjustments, this criterion is especially important in this proposal. As the Commission noted in its initial Docket No. R2000-1 Recommended Decision, although all of the non-cost criteria of the Act are considered, “unique circumstances” may compel the emphasis of a particular criterion.[4]

For mailers, comparison of the percentage rate increase for their class of mail to other classes of mail, to the system average, to the general rate of inflation, and to

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[3] The July, 2001 DRI forecast for the time period January 2001 to October 2002 is 4.9 percent.

[4] PRC Op., R2000-1, para. 4036.

increases they have incurred in the past few years are useful indicators of the effect of the rate increases.

In developing its proposals in this case, the Postal Service also considered the effect of its proposed rate increases on competitors to ensure that no particular set of proposed rates or fees was designed with the specific goal of harming a competitor or group of competitors. It also is the Postal Service's objective to avoid unfair price competition. The incremental cost test is used by the Postal Service to ensure that rates for competitive products adequately cover costs, so that these products or services are not being cross-subsidized by other postal services or products.

5. Available Alternatives

This criterion requires the consideration of the availability, at reasonable cost, of alternate means of sending and receiving mail matter. For some categories of mail matter or service, the alternatives may be direct substitutes for postal services, such as private-sector providers of expedited or package delivery services or delivery of advertising matter by alternate delivery systems. For other categories of messages or materials delivered through the mail, the alternatives may include other media, such as newspapers, radio, and television for the delivery of advertising messages, and the various electronic alternatives for First-Class Mail and some applications of Periodicals and Standard Mail.

6. Degree of Preparation

Criterion 6 addresses the degree to which the mailer has prepared the mail before entering it into the postal system and the effect of this preparation on postal costs. As a result of the introduction of worksharing discounts, this criterion plays a direct role at the level of rate design within each subclass. Discounts have been incorporated to reflect the varying means by which mailers prepare mail to bypass postal operations and reduce postal costs. Not only have rate elements been introduced to reflect the various levels of mail preparation, but in recent rate and classification cases, the Postal Service has proposed and the Commission has recommended rate designs that generally reflected expanded “passthroughs” of the worksharing cost differences where practicable. In addition, by fulfilling the requirements to qualify for many of the worksharing discounts, the mailer undertakes activities which tend to reduce costs, but which are not routinely quantified and incorporated into the discounts.

The more highly-prepared the mail, the lower the postal cost attributed to that category of mail. The lower the costs attributed to a category of mail, the lower the cost base to which the rate level is applied. If the same cost coverage is assigned to two categories of mail differing only in the degree to which the mailer has prepared the mail, the more highly-prepared mail would have a reduced unit contribution. Thus, as the degree of preparation increases over time, all else equal, the coverage required to obtain the same contribution also increases. This has implications for the systemwide cost coverage, as well, given that institutional costs must, nevertheless, be recovered from postage and fees charged for postal services. Worksharing removes attributable costs but leaves institutional costs unchanged. Thus, as the overall level of worksharing increases, the percentage of total cost that is attributable can be expected to shrink and the required system-wide average cost coverage will increase, all else equal.

7. Simplicity

The seventh criterion points to the desirability both of simplicity in the rate schedule as a whole and of simple, identifiable relationships between different rates and fees. The implications of this criterion must be balanced with criterion 1, that the rate and fee design be fair and equitable, and the sixth criterion, which requires consideration of the degree of mailer preparation.

Over time, efforts to reflect the various degrees of mail preparation have increased the complexity of rate schedules for bulk-entered mail. However, technically sophisticated mailers commonly use computers and software in the preparation and rating of bulk-entered mail. These mailers have been willing to accept a greater degree of complexity in rate schedules in order to pay rates that more directly reflect the worksharing they have performed. For mail classes used primarily by the general public, however, simple rate schedules and understandable relationships are more important than the ability to reflect complex cost structures in rate designs.

The seventh criterion, as was true of the sixth criterion, is most immediately reflected in the rate design. It calls for simple, identifiable relationships between the rates charged for various postal services. The Postal Service and the Commission have adjusted rate schedules in the past to ensure that, for example, the rate for a piece of Express Mail of a particular weight and origin-destination pair was higher than the Priority Mail rate for a similar piece and the Priority Mail rate was, in turn, higher than the Parcel Post rate for that piece.[5] In general, classes in which rates vary by weight or by distance exhibit increasing rates as distance or weight increases, a relationship that customers who do not know the underlying cost structure would view as reasonable.

8. ECSI

The final specified criterion directs that the educational, cultural, scientific, and informational (ECSI) value of the mail content to the recipient be considered when determining rate levels for each type of mail. In the past, the Commission has acknowledged the relatively high ECSI value for First-Class Mail Letters, Regular Periodicals, Media Mail and, to some degree, Bound Printed Matter, when setting rate levels.

9. Other Factors

In addition to the first eight criteria specified in the Act, a final criterion provides for the consideration of any other factors not specified that may be deemed appropriate by the Commission in setting rate levels. Changes in the determination of rates for preferred rate categories is an example of how this criterion is helpful in the consideration of rate levels. For example, since costs are no longer separately available for Standard Regular and Standard Nonprofit, the applicable measure of cost coverage uses the combined costs and revenues for these two subclasses. As a public policy measure, Nonprofit has been seen as warranting a lower cost coverage than its

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[5] While these rate relationships can usually be accommodated in the rate design for the affected subclasses, the rate levels may play a minor role in achieving the rate relationship. In Docket No. R97-1, the rate level for ECR was cited as facilitating the rate relationship between ECR Basic and 5-digit automation letters. (Docket No. R97-1, USPS-T-30 at 36).

commercial counterpart.[6] Therefore, it is appropriate that the combined coverage for commercial and nonprofit reflect this element of the combined rate grouping.

C. Ramsey Pricing

The issue of Ramsey pricing has arisen in previous postal rate proceedings. The Postal Service recognizes that the Act directs that postal ratemaking consider a variety of factors, many of which are not directed toward economic efficiency. Therefore, the Postal Service does not advocate a mechanistic application of this approach to pricing. Nevertheless, the Ramsey model provides a useful framework for demonstrating the effects of different pricing decisions and it provides a sense of direction toward prices that reduce the excess burden of raising the revenue needed to operate the Postal Service on a breakeven basis.

While no formal use is made of the Ramsey-type prices developed by witness Bernstein (USPS-T-10), and those prices did not specifically affect any conclusions regarding the proposed rate levels, movement of rates in the direction of Ramsey prices, all else being equal, would be viewed as economically beneficial.

IV. RATE LEVEL – MAIL CLASSES AND SPECIAL SERVICES

In this section, I discuss how the nine criteria were applied to develop the rate level proposals for the subclasses.

[6] The statutes regarding the pricing of nonprofit mail are evidence of this public policy concern.

A. First-Class Mail

1. Letters and Sealed Parcels

The Postal Service is proposing a cost coverage of 212 percent over volume-variable costs for First-Class Mail Letters and Sealed Parcels.[7] This corresponds to an average rate increase of 8.2 percent for the subclass as a whole. For single-piece letters, the increase is 7.5 percent, including a three-cent increase in the first-ounce rate, to 37 cents, but no increase in the additional ounce rate. For workshared mail, the proposed increase is 9.2 percent, and the proposal includes a decrease in the additional ounce rate. At first blush, this cost coverage is higher than many traditional measures. Several factors should be noted, however, that help put this coverage in perspective. First, the proposed system-wide coverage is about 10 percentage points higher in the test year in this request than it was in the Docket No. R2000-1 request. For First-Class Mail letters, the coverage is about 15 percentage points higher in this proposal as compared to the last. So, given the increase in the system coverage, it should not be surprising to see significant coverage increases for individual subclasses. Second, as the Commission noted in its Recommended Decision, as "workshared letters have become a greater proportion of total First-Class Mail volumes, cost coverage for the class has generally increased over time."[8] This mix change noted by the Commission has continued, and is certainly a driver in the changing coverage for First-Class letters. The table below is a reproduction of a table from the Commission's Decision,[9] augmented with new data.

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[7] For purposes of shorthand, this subclass will be referred to as "Letters."
[8] PRC Op. R2000-1, para. 4021.
[9] PRC Op. R2000-1, p. 202, Table 4-1.

Table 3
First-Class Letter Mail
(Volumes in billions)

Year	Single Piece	Workshare	Total	Workshare as % of Total
1988	55.8	24.8	80.6	30.8
1990	56.8	27.6	84.4	32.7
1992	55.0	31.3	86.2	36.3
1994	55.0	35.5	90.5	39.3
1996	54.2	39.1	93.3	42.0
1998	54.3	40.6	94.9	42.8
1999	53.8	42.9	96.7	44.3
TY2001[10]	52.8	47.3	100.1	47.2
TY2003	46.9	51.3	98.2	52.3

The phenomenon noted by the Commission has accelerated. Clearly, this significant shift in the share of higher-cost-coverage workshared mail has increased the coverage for First-Class Letters overall. First-Class Mail consists of two components – single piece letters and workshare letters -- with disparate ratios of revenues to costs. As the mix of these components change, measures of cost coverage will change. One consequence of attempting to force First-Class Mail back to the traditional cost coverage would be that the unit contribution and total contribution from the entire class would decline, all other factors remaining equal. If this occurred, customers of other classifications would have to pick up higher burdens through no fault of their own.

An illustration can be constructed that demonstrates the shift in coverage that occurs as volume mix shifts within the subclass. The proposed rates produce a cost

[10] PRC Op. R2000-1, Appx. I, Table I-2.

coverage of 192.4 percent for First-Class Letters using PRC cost methodology.[11] Underlying that coverage is the mail mix in the table above for TY2003. If the unit cost and revenue underlying that coverage were instead applied to the mail mix for TY2001, the coverage would fall to 188.0 percent.[12]

In summary, First-Class Mail cost coverages cannot be examined in isolation or mechanistically. The First-Class cost coverage is not only determined by the revenue and costs of the product itself, but by the mix of two rather disparate components. These changes in mix also have an effect on the system-wide cost coverage and calculations of markup indices. One should be aware of the limitations of these comparisons when analyzing the cost coverages.

The cost coverage and the resulting percentage increases for First-Class Mail cannot be considered in isolation, given the overall significance of First-Class Mail. It represents 53 percent of the TYBR revenue. Any attempt to produce a percentage change much lower than the system average would cause large increases for the products composing the other 47 percent.

Another point to keep in mind while pondering the resulting cost coverage for First-Class Letters is the emphasis on the letter automation program over the past decade. Given the relative homogeneity of letter-sized pieces, and the sheer magnitude of volume, it is understandable that limited resources would be focussed in this area. The subclasses affected by this concentrated effort should benefit from the

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[11] USPS-LR-J-89.

[12] The unit cost per piece is $0.2922 for Single Piece, $0.1167 for workshare. Unit revenue is $0.4669 for Single Piece, $0.3116 for workshare. Weighting these figures by the TY2001 volume mix produces the coverage of 188.0 percent.

resulting cost stability. However, the prioritization of the automation effort, and its effect on other subclasses primarily comprised of pieces of other shapes, should be noted in those instances where cost stability has not yet been achieved and rate mitigation is required.

Value of service (criterion 2) for First-Class Mail letters is high in terms of both intrinsic and economic measures. With regard to the operational considerations specifically mentioned in section 3622(b)(2), First-Class Mail travels by air for trips involving considerable distance, benefits from an extensive collection system designed primarily for it, and receives a high priority of delivery relative to other non-expedited mail classes. It is sealed against inspection and receives forwarding without additional charge.

First-Class Mail letters have a relatively low price elasticity of demand (-0.311 reported for single-piece letters and –0.071 for workshared letters,[13] and a volume-weighted subclass elasticity, as discussed by witness Bernstein in USPS-T-10, of -0.197), indicating a high economic value of service, but this elasticity may be due in part to the restrictions on alternatives that result from the Private Express Statutes.

A product enhancement that improves the value of service relative to previous rate proceedings is the proposed availability of Delivery Confirmation and Signature Confirmation for a portion of First-Class Mail. The Postal Service proposes that these service options be extended to parcel-shaped First-Class Mail upon the implementation of the rates that result from this proceeding.

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[13] This is a discernable decrease from the –0.251 elasticity for workshared letters reported in Docket No. R2000-1, and suggests an even higher economic value of service. (Docket No. R2000-1, USPS-T-32 at 21).

The effect of the proposed rate increase (criterion 4) is considered and is deemed acceptable, given that it is consistent with the system average, and in fact slightly less. Consequently, First-Class Mail users are not being disproportionately burdened, when compared to other postal customers. This is especially true given the recent history of rate changes for First-Class Mail. The percentage change in Docket No. R97-1 was only 1.7 percent, and the percentage change as a result of Docket No. R2000-1 was 3.3 percent. In both cases, the systemwide increase was higher; significantly so in the latter case, when the systemwide increase was 6.3 percent.

For many mailers and applications, the available alternatives (criterion 5) to First-Class Mail letters are limited. In addition to the restrictions imposed by the Private Express Statutes, considerations of cost and accessibility mean that many mailers have few practical alternatives to the use of First-Class Mail letters for transmitting correspondence, bills, and bill payments. Nevertheless, the availability of alternatives to First-Class Mail letters is expanding, in the number of facsimile machines or faxing capabilities incorporated in computers, in the number of businesses and households with access to the Internet, and with increased availability and acceptance of electronic payment options.[14] The proposed increase does not unduly harm those customers with limited access to other alternatives.

The degree of preparation by the mailer and its effect on reducing Postal Service costs (criterion 6) is reflected in the rate structure, which provides an array of discounts for prebarcoded and presorted mail presented in bulk.

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[14] See, generally, USPS-T-10, for discussion of electronic alternatives.

The Postal Service is proposing one change to the First-Class Mail rate structure, as described in witness Robinson's testimony, USPS-T-29. The structural change involves splitting the Basic automation tier into two sub-groups. This distinction between the two presort levels does add a degree of complexity to the rate schedule (criterion 7), but will better reflect the degree of mail preparation (criterion 6) and may encourage finer presortation of the mail. Only the relatively more sophisticated mailers who participate in worksharing programs should experience a change in the rate structure, limiting the range of the impact of this increased complexity. Other changes that do not alter the rate structure, but do affect the "simplicity" of the rates, include the de-linking of the additional ounce rate for single piece and workshare-rated mail. Another change is in the re-definition of the nonstandard surcharge as a nonmachinable surcharge that will result in a wider application of the surcharge. Both of these changes can be viewed as adding a modicum of complexity, but as witness Robinson explains, the benefits outweigh this additional complexity.

In recent proceedings, the Commission has also recognized the informational value of the business and personal correspondence, as well as the cultural value of greeting cards (criterion 8).[15] Accordingly, the Postal Service has considered these factors for First-Class Mail as well.

As shown in Exhibit USPS-28E, at projected test-year after-rates volumes, First-Class Letter revenue is $37,873 million and estimated incremental cost is $19,188 million, so that revenue clearly and substantially exceeds cost (criterion 3).

[15] PRC Op. R2000-1, para. 5146.

In summary, the proposed rate level for First-Class Mail Letters and Sealed Parcels is fair and equitable (criterion 1) in accordance with a careful consideration of the section 3622(b) criteria.

2. Cards

The Postal Service is proposing a cost coverage of 158.7 percent over volume-variable costs for First-Class Mail cards, reflecting a markup of almost one-half of the markup for First-Class Mail letters. This markup corresponds to an average rate increase of 9.7 percent for the subclass. For single-piece cards, the 9.7 percent increase raises the single-piece rate two cents to 23 cents. For workshared cards, the average increase is 9.6 percent. While these increases are higher than the system average, the resulting cost coverage moves toward one that better reflects the characteristics of the subclass. In addition, it is consistent with the criteria and creates acceptable relationships with the other subclasses.

The intrinsic value of service (criterion 2) for First-Class Mail cards largely mirrors that of First-Class Mail letters, reflecting the same priority in transportation and delivery and availability of forwarding privileges. However, this value of service is somewhat reduced because cards have a limited message capacity and a lesser degree of privacy. The price elasticity for cards is much higher than for letters (-0.808 for postal cards and –1.157 for private cards), implying a lower economic value of service as well.

The percentage rate increase for cards is slightly above that of First-Class Letters. This is partly due to the whole-cent rounding constraint for the single-piece rate; a two-cent increase represents a larger percentage increase on card rates than does a three-cent increase on First-Class Mail letter rates. For administrative ease and to avoid unnecessary complexity for the general mailing public (criterion 7), the Postal Service is continuing the practice of proposing single-piece rates in whole cent increments for pieces on which the postage is affixed by the sender. While, in some instances that may result in a larger increase, it should be noted that the single piece rate for postcards had not increased since January 1995 prior to the July 1, 2001 increase of one cent. Given this history of rate changes for postcards, the effect of the proposed increase on mailers is clearly acceptable (criterion 4), and the whole-cent integer constraint is not a factor in the proposed cost coverage.

In addition to the electronic alternatives mentioned in the discussion of First-Class Letters above, senders of First-Class cards may use First-Class letters for messages and Standard Mail can be used as an alternative medium for sale announcements and other commercial messages. Thus, while available alternatives for cards are somewhat limited (criterion 5), they are not as limited as for First-Class Letters.[16]

The rate structure for First-Class Mail cards parallels that for First-Class Mail letters, so that considerations of mailer preparation (criterion 6) and simplicity (criterion 7) are also parallel. Furthermore, simplicity may be enhanced for both subclasses with the proposed equivalent rate (23 cents) for single-piece additional ounces and single-piece postcards. This could reduce the inventory of stamps a customer holds, and might reduce instances of overpayment on postcards and additional ounce pieces.

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[16] For example, the information conveyed in a postcard can be conveyed in a letter, but information in a letter cannot always be conveyed in a postcard.

At projected test-year after rates volumes, the First-Class Mail cards revenue of $1,120 million substantially exceeds the estimated incremental cost of $722 million (criterion 3).

The proposed rate level reflects a balanced consideration of all the relevant criteria and is, therefore, fair and equitable (criterion 1).

B. Priority Mail

The Postal Service is proposing a cost coverage of 173.8 percent over volume variable costs for Priority Mail, which corresponds to an average rate increase of 13.5 percent. While the cost coverage is slightly below the system average, the percentage rate increase is substantially above the system average. As will be discussed below, this coverage is driven in large measure by Criterion 4. At the same time, it is worth noting that while the other criteria are considered, any changes in the assessment of those criteria would not likely materially affect the proposed coverage in this request.

Although comparisons to previous proposed and recommended coverages are not perfect, it should be noted that the Commission-recommended coverage in Docket No. R2000-1 was 161.9 percent, and the proposed coverage using incremental costs in that proceeding was 162.7 percent. The proposed incremental cost coverage in this proceeding is 158.7 percent. (Exhibit USPS-28E).

Priority Mail has a fairly high intrinsic value of service (criterion 2), as it enjoys approximately the same priority of delivery as First-Class letters and makes use of air transportation. Priority Mail pieces weighing under one pound, which constitute over one-third of Priority Mail's volume, also enjoy the convenience of the collection system.[17] The availability of Delivery Confirmation Service also contributes to its intrinsic value of service. On the other hand, the Priority Mail price elasticity (-0.754) is considerably higher (in absolute value) than that of First-Class Letters, indicating a lower economic value of service. This measured own-price elasticity is also somewhat lower (in absolute value) than the Priority Mail own-price elasticity reported in Docket No. R2000-1 of (–0.819).

The value of service for Priority Mail can also be viewed in comparison to similar services provided by private companies. Priority Mail service does not necessarily include all of the product features, such as guaranteed service commitments, free insurance and free tracking service, offered as part of the service provided by competitors such as United Parcel Service, FedEx and other private service providers. The advent of Delivery Confirmation and Signature Confirmation services for Priority Mail may be helping to move the perception of Priority Mail service closer to the image of the services provided by the private firms. During the last rate proceeding, the assessment of the value of service for Priority Mail was a contentious issue, with some parties contending that the Postal Service's assessment was too high, and others contending that its assessment was too low.[18] Even if it were to be shown that there has been an appreciable improvement since the last omnibus proceeding, that would not necessarily warrant a coverage higher than that proposed here, in light of criterion 4

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[17] Metered mail of any weight, with certain restrictions, may also be entered in collection boxes.
[18] PRC Op. R2000-1, para. 5278.

considerations. On the other hand, an erosion of the value of service over this brief time period would not warrant a lower coverage, since lowering the coverage would place an even larger burden on other subclasses as a result of the need to mitigate the increased costs for Priority Mail.

The availability of alternatives to Priority Mail service was considered in two ways as pricing criterion 5 was examined. First, while private firms offer delivery services that could be considered comparable to Priority Mail service, some materials shipped as Priority Mail are subject to the Private Express Statutes. Second, as noted above in the discussion of criterion 2, the relative levels of service offered by Priority Mail and its competitors may not be strictly comparable. Merchandise shipped as Priority Mail could be sent as Parcel Post, or perhaps another category of Package Services, should the level of service provided by Priority Mail not be necessary.

The 13.5 percent rate increase, significantly above the system average, is also higher than the rate of general inflation in the economy as a whole, and can be expected to have an impact on Priority Mail users (criterion 4). Priority Mail received a rate increase more than twice the system average in Docket No. R97-1, and then another 17.2 percent increase as a result of Docket No. R2000-1. The latter increase was much more than double the system average of 6.3 percent.[19] In the current request, the large increase in costs would have led to a larger rate increase in this proceeding, in the absence of some tempering of the cost coverage. As the

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[19] These figures are from Attachment 4 to the Governors' Docket No. R2000-1 Modification Decision and represent the combined effect of rate changes implemented in January and July of 2001.

Commission noted in the context of cost changes for Media Mail in Docket No. R2000-1, large cost increases “can play havoc with mailers’ expectations.”[20] The coverage proposed for Priority Mail attempts to lessen the effect of cost-induced rate changes. It protects the users of Priority Mail, including those users whose mail falls within the monopoly segment of Priority Mail, from the impact of higher rate levels.[21]

The Priority Mail rate structure is relatively simple (criterion 7), although as described by witness Scherer, USPS-T-30, there are changes proposed which affect this simplicity. The rates will become more complex with the re-zoning of the currently unzoned rates from two to five pounds. On the other hand, a change that will tend to simplify matters is the application of the one-pound rate to the flat-rate envelope.

At projected test year after rates volumes, revenue is $6,200 million and estimated incremental cost is $3,907 million, so that revenues are substantially above the costs associated with Priority Mail (criterion 3). The substantial margin between the revenue and incremental cost, coupled with the significantly larger-than-average rate increase will ensure that the rate increase is not unfair to competitors (criterion 4). In fact, it is worth noting that if the Postal Service’s proposal is adopted, the Priority Mail rates will have increased a compounded 33 percent since January of 2001. The Postal Service is concerned about the impact of even larger increases on the ability of Priority Mail to remain a long-term viable contributor to covering the institutional cost burden of the Postal Service, especially given Priority Mail’s significant sensitivity to price.

[20] PRC Op. R2000-1, para. 4034.
[21] The Commission expressed this concern in its R2000-1 Recommended Decision. See PRC Op. R2000-1, para. 5317.

The proposed rate level is appropriate in light of a balanced and proper consideration of all relevant criteria. It is fair and equitable (criterion 1) to both mailers and competitors.

C. Express Mail

The Postal Service is proposing an Express Mail cost coverage of 229.1 percent over volume-variable costs. The product specific costs for Express Mail are significant. Thus, the comparison of the ratio of revenue to incremental cost may produce a more meaningful comparison to the Commission's Docket No. R2000-1 cost coverage, which was a 51.3 percent markup over attributable costs. The test year after rates revenue for Express Mail at the proposed rates in the current case shows a markup of 79.9 percent over incremental costs. However, due to changes in the transportation network for Express Mail, and the resulting changes in cost allocation for Express Mail, it is difficult to draw conclusions utilizing comparisons with previous cost/revenue relationships. Nevertheless, the proposed cost coverage can be deemed reasonable, given the resulting increase in rates of 9.7 percent, which is only slightly above the system average increase. This rate increase is acceptable, especially since the markup in previous cases was intentionally mitigated in order to preserve this mail class in the face of increasing competition. See PRC Op. R97-1, Vol. 1 at 264. The rate level proposed by the Postal Service in the current docket is suitable for an expedited and competitive service of relatively high value, and the cost coverage need not be reduced to mitigate the rate increase. A higher cost coverage would push the rate increase well above the system average, and would not be an especially efficient source of contribution in light of the high elasticity for Express Mail.

Express Mail's value of service (criterion 2) is very high when intrinsic factors are considered. It receives the highest priority of delivery and makes extensive use of air transportation. It also benefits from a substantial collection system, though one not as extensive as the general collection system used by First-Class Mail. Express Mail also includes tracking capability and a service guarantee. On the other hand, Express Mail's price elasticity, at (–1.492), is the highest own-price elasticity of all the subclasses, well above 1.0 in absolute value. This indicates an extremely low economic value of service. Express Mail's value of service, when compared to similar expedited services provided by private companies, does not appear to be as high as when it is compared to other postal services. At minimum, the overnight service areas of Express Mail are not as extensive as those offered by the dominant overnight service providers. Also, unlike many customers of private expedited delivery firms, users of Express Mail are expected to either pay when tendering the mailpiece to the Postal Service, or maintain a balance in their corporate account. The advantage of Express Mail for consumers in terms of ease of acceptance would also seem to be diminished with the installation of FedEx drop boxes at Post Offices.

With a not-insignificant 9.7 percent increase and a high price elasticity, there will be an effect on customers (criterion 4). At the same time, these customers are not captive. In fact, as discussed earlier, there are several alternatives for many Express Mail users to avoid the impact of the rate increase. Given Express Mail's small presence in the market for expedited delivery, its modest growth (about 3.3 percent in FY 2000 in the absence of a rate increase), and the higher-than-average percentage rate increase, the proposed rates will certainly not have a negative impact on competitors.

There are a number of private-sector alternatives available to Express Mail users (criterion 5). While additional service features or more extensive overnight service areas may be available from these private carriers, these alternatives may only be available at a higher price for the individuals and small-volume business users who appear to account for the bulk of Express Mail.

The Express Mail rate schedule provides for separate rates, depending on whether the customer picks up the Express Mail at the post office or has the item delivered by the Postal Service, and whether the piece is dropped off at the post office or picked up by the Postal Service. The customer who drops off or picks up the piece at the post office reduces postal costs and the rate schedule reflects lower rates for this cost-saving activity by senders and recipients (criterion 6). As in Priority Mail, this request includes a proposal regarding the rate applicability for the flat rate envelope. This will have a minor effect on the relative level of simplicity of the rate schedule (criterion 7).

At projected test year after rates volumes, revenue is $1,134 million and estimated incremental cost is $633 million, so that revenues clearly and significantly exceed the costs associated with Express Mail (criterion 3).

Criterion 8, ECSI value, did not result in an adjustment to the Express Mail cost coverage. The proposed rate level is fair and equitable (criterion 1), reflecting a consideration of all the relevant criteria, including the effects on Express Mail users as well as competitors.

D. Periodicals

1. Outside County

The proposed structure for Periodicals mailed using Outside County rates reflects the enactment of Public Law 106-384. For ratemaking purposes, that law combines three separate subclasses -- Regular, Classroom and Nonprofit – into one grouping. The preferred rate status of Classroom and Nonprofit mailers is maintained by providing for a discount off of the bottom line (excluding the charges for advertising pounds) after calculating the otherwise-applicable price on the Outside County rate schedule. Since separate costs are no longer tracked for the preferred component of the Outside County grouping, there is not a separate cost coverage for the preferred component, nor for the remainder of the Outside County grouping (i.e., the Regular Subclass). A separate markup, however, must be calculated in order to determine the RFRA-dictated markup for Within County as described in the next section.

A cost coverage of 108.6 percent over volume-variable costs is proposed for Outside County Periodicals, which is net of the effect of the 5 percent discount for Classroom and Nonprofit on the non-advertising portion of their rates. This cost coverage implies an average rate increase of 10.3 percent for the subclass, or about 1.6 points higher than the system average. As a result of the most recent omnibus case, rate increases for the Outside County Periodicals ranged from 9.7 percent for Nonprofit, to 12.8 percent for Regular Rate.[22] The system average increase was 6.3 percent. Those higher, yet restrained, increases for Periodicals were achieved in part due to an extremely low cost coverage, 100.3 percent for Outside County.[23]

The value of service (criterion 2) received by Periodicals is moderately high in terms of intrinsic service characteristics. However, it is not as high as First-Class Mail, since Periodicals are not afforded collection service, receive little air transportation, and are forwarded at no additional charge for a shorter period. Periodicals have a higher priority of delivery than Standard Mail. The own-price elasticity for Regular Periodicals is very low (-0.166), even lower than the own-price elasticity of single-piece First-Class Mail, which is presumed to be influenced by the Private Express Statutes. This indicates a correspondingly quite high economic value of service for Periodicals.

The educational, cultural, scientific and informational (ECSI) value (criterion 8) of Periodicals has historically led to relatively low cost coverages for this mail, and this factor has been fully considered in setting the proposed Outside County Periodicals coverage. However, in this case, as was the case in the two previous omnibus rate cases, the proposed coverage has been further reduced (beyond what ECSI would afford) due to consideration of the effect of rate increases (criterion 4). Without this consideration, the increase in costs relative to other products would have led to higher percentage rate increases for Outside County Periodicals. In contrast to the last rate

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[22] Ibid.

[23] Ibid. This cost coverage is calculated using the PRC costing methodology and the rates, as modified by the Governors. The Docket No. R2000-1 cost coverage prior to modification was 100.1 percent.

case, however, the percentage increase for Periodicals can be held relatively close to the system average without resorting to cost coverages that exceed 100 percent by mere tenths-of-a-percent. Although the magnitude is not great, a slightly higher coverage can now be proposed in order to help meet the objectives of both the Postal Service and the Commission in previous cases to move the cost coverages for Periodicals mail upward to provide a more meaningful contribution to other costs.[24] The Commission described the moderation of Periodicals coverage “as a temporary solution” and hoped that, in the long term, efforts to reduce flat processing costs would “bear fruit.”[25] The Postal Service continues in its efforts, in conjunction with Periodicals mailers, to understand what factors may have contributed to increases in flats mail processing costs, especially for Periodicals, and has incorporated significant cost reductions in its calculations to reflect expected further progress on this front.

Non-postal alternatives (criterion 5) include alternate delivery firms, newsstand sales and electronic transmission, but the degree to which different publications can use these alternatives varies considerably.

The Periodicals rate structure is far from simple, reflecting the various means by which Periodicals mailers may reduce postal costs by preparing their mail (criterion 6). New worksharing discounts described by witness Taufique, USPS-T-34, will increase complexity somewhat. However, the revised approach to rate design for Nonprofit and Classroom Periodicals has greatly reduced the number of rates and the possibility of

[24] The proposed coverage remains very low by historical standards. PRC Op., R97-1, Appx. G, page 32.
[25] PRC Op. R2000-1, para. 4032.

rate anomalies across subclasses. The imposition of a simple, bottom-line discount for preferred rate mailers off of their nonadvertising rates has improved the degree to which there are simple, understandable relationships between rates (criterion 7).

Revenue for the Outside County subclass at projected test year after rates volumes is $2,511 million, which adequately exceeds the estimated incremental cost of $2,342 million for this new subclass (criterion 3).

The proposed rate level is fair and equitable (criterion 1); it has been developed after a careful consideration of all the criteria, particularly taking into account the effect on users.

2. Within County

The RFRA requires that Within County Periodicals have a markup equal to one-half that of commercial Periodicals. As was described earlier in my testimony, changes in how Nonprofit and Classroom rates are determined have implications for how Within County rates are determined. Since costs are not separately tracked for the Regular Periodicals, there is not a separate cost coverage for Regular Periodicals, the subclass which has served as the benchmark for calculation of the Within County markup. As was initially described by Postal Service witness Mayes (USPS-T-32) in Docket No. R2000-1, the benchmark markup can be calculated by adding the revenue “leakage” from the 5 percent discount to the numerator in the cost coverage formula. This markup would approximate the markup that would exist on the Regular portion, if not for the accommodation of the 5 percent discount. The resulting “markup” is 9.34 percent, only slightly above the markup for the merged Outside County grouping. One-half that markup is 4.67 percent. The actual proposed markup for Within County, 4.7 percent, is reasonably close to that target.

E. Standard Mail

1. Regular/Nonprofit

The Postal Service is proposing a cost coverage of 146.2 percent over volume-variable costs for the merged Regular/Nonprofit subclass, which results in an average rate increase of 8.0 percent for the Regular portion, and 6.7 percent for the Nonprofit portion, after application of the provisions of Public Law 106-384. As a result of that legislation, there is now one cost figure reported that includes both the commercial and the nonprofit mail. As such, there is no distinct measure of cost coverage for these two individual mail groupings. Therefore, the merged cost coverage, and the implied markup, are used for evaluation of the nine pricing criteria. Since the two groupings have identical rate structures, are similar in cost, are generally used for promotional purposes, and receive the same level of service, the merging does not pose a significant problem when evaluating the criteria. There is one difference between the two groupings, however, that needs to be considered when establishing the markup. Under the Revenue Foregone Reform Act, the nonprofit portion was to have a markup that was one-half of the commercial counterpart. Public policy, therefore, viewed the nonprofit component as having some intrinsic feature that warranted a lower markup. The new legislation is intended to maintain the general rate relationship that was generated by this “half-the-markup” rule; therefore, the intrinsic feature apparently still exists from a public policy perspective. The resulting markup for the merged subclass should reflect the incorporation of this nonprofit mail and its intrinsic features that set it apart from the commercial mail. The resulting markup, then, should be lower than a markup that would be applied to a pure commercial subclass, and higher than the markup that would be applied to a pure nonprofit subclass. It should give due weight to the inclusion of the nonprofit mail. The most applicable criterion for this consideration is Criterion 9, "Other Factors," which appears to be designed for just this type of unforeseen situation. [26] It is certainly appropriate for the Commission to consider the effects of the merging when establishing the markup for the new subclass.

Regular/Nonprofit has a relatively low intrinsic value of service (criterion 2) due to its deferability for delivery, use of ground transportation, lack of access to the collection system and absence of free forwarding. Although the Postal Service may attempt to satisfy mailer requests for delivery within a specific time frame, these typically involve advance planning and coordination by the mailer in order to facilitate the achievement of these delivery requests. The price elasticity for Regular (-0.388) is higher than that of First-Class Letters, especially workshare-rated First-Class Mail.[27] However, it is lower than that of Enhanced Carrier Route, suggesting an intermediate economic value of service.

The 8.0 percent average rate increase for the commercial portion is above the rate of inflation, and near the system average increase, resulting in a significant impact

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[26] Some might maintain that ECSI considerations apply here to the extent that the nonprofit organizations using the mail might be furthering cultural, scientific, or educational concerns.

[27] Nonprofit has a lower elasticity than First-Class Single Piece.

on the users of Regular mail (criterion 4).[28] Compounding this impact is the rate increase experienced by Regular Standard Mail as a result of Docket No. R2000-1, which was 10.3 percent while the system average was only 6.3 percent. The fact that the Regular increase proposed in this case is near the system-average increase, (and that increase is on top of the above-average increase in 2001), along with the 146.2 percent cost coverage over volume-variable costs, suggests that competitors are not unfairly targeted by this increase.

The Regular/Nonprofit subclass is somewhat more suited to demographic targeting of commercial messages and the Enhanced Carrier Route subclass is somewhat more suited to geographic targeting. For this reason, the availability of alternatives (criterion 5) is somewhat less for Regular/Nonprofit, but a number of alternatives for demographically targeted advertising exist, including special-interest magazines, cable television, and internet websites.

The mail within the Regular/Nonprofit subclass all has a substantial degree of mailer preparation (criterion 6), with some of it being prebarcoded, 5-digit presorted, and entered at a destination SCF. Overall, however, it does not have the same degree of preparation as Enhanced Carrier Route (ECR), since line-of-travel or walk sequencing is required for ECR. The rate schedule for Standard Mail is explicitly designed to offer a range of rates to reflect the varying ways that the mailers may

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[28] The 6.7 percent increase for the nonprofit portion is a direct result of the law governing the establishment of the Nonprofit rates, as described in the Standard Mail rate design testimony, USPS-T-32. For simplicity, and since the percentage change for the commercial portion is the dominant driver of the percentage change for the merged subclass, the commercial change of 8.0 percent is used in this section for comparing the percentage change in this case versus previous cases.

choose to perform worksharing, preparing mail so as to bypass postal operations and/or transportation and reduce postal costs (criterion 6). As a result, the rate schedule is not particularly simple (criterion 7). However, as the rates for Standard Mail only apply to bulk-entered mail, the users of Standard Mail tend to be sophisticated users of the postal system or use the services of professional mail preparation services.

At projected test year after rates volumes, the $12,707 million revenue from the subclass easily exceeds its estimated incremental cost of $8,935 million (criterion 3).

The proposed rate level is fair and equitable (criterion 1), having appropriately balanced all the relevant criteria. It also recognizes the significant rate increases borne by Standard Regular over the past few years, and attempts to temper this string of increases, while still relying on Standard Regular/Nonprofit to make a significant contribution to covering the institutional costs of the Postal Service, as evidenced by the proposed coverage of 146.2 percent for the merged Regular/Nonprofit subclass.

2. Enhanced Carrier Route/Nonprofit Enhanced Carrier Route (ECR/NECR)

The Postal Service is proposing a cost coverage of 217.8 percent over volume variable costs for the ECR/NECR subclass, which results in a 6.2 percent average rate increase for ECR, and a 6.5 percent increase for NECR. These are somewhat below the system average increase, reflecting a desire to lower the very high cost coverage of this subclass. Of the major subclasses, only Express Mail has a higher coverage, using volume variable costs.[29] In fact, if one were to use incremental costs, Enhanced Carrier Route would have the highest ratio of revenue to costs among existing subclasses.

[29] Express Mail has a much lower coverage using incremental costs.

In common with Regular, the intrinsic value of service (criterion 2) for ECR is relatively low, since it lacks access to the collection system, receives ground transportation, has no free forwarding and its delivery may be deferred. Relative to Regular, the deferrability may actually be higher for ECR since it is less likely to have been merged with other non-deferrable mail and can therefore be recognized as deferrable at the delivery unit. The Postal Service may be able to accommodate mailer requests for delivery within a specific time frame, again requiring mailer preparation, coordination, and planning. The regularity with which some of the high-density and saturation rate category mailings are deposited may facilitate the delivery of the mailpiece within the mailer's desired time frame. The price-elasticity of ECR (-0.770) is higher in absolute value than that of Standard Mail Regular or First-Class letters, indicating a relatively low economic value of service.[30]

Even though the average rate increase for ECR is above inflation, it is lower than the system average, thereby limiting any adverse effect on mailers (criterion 4) to the extent possible. Given the very high cost coverage of the ECR/NECR subclass, and the fact that the proposed above-inflation increase is on the heels of two increases in calendar year 2001, it does not result in unfair competition for its competitors.

Users of ECR/NECR mail have available a range of alternatives (criterion 5); due to its geographic concentration, both alternate delivery firms and newspaper inserts may provide ways of delivering the same advertising message that would be carried in ECR. Relative to other mail, ECR has a very high degree of preparation by the mailer

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[30] The elasticity of NECR is not separately quantified from Nonprofit. The Nonprofit elasticity, at –0.230, is materially less than ECR, however the commercial ECR mail dominates the merged subclass.

(criterion 6); even the basic rate category must be line-of-travel sequenced, and the high-density and saturation categories are walk-sequenced. In addition, for pieces to be eligible for the High-Density and Saturation letter rates, the pieces must bear a barcode and be machinable on letter processing equipment. As was true for Standard Regular, the rate schedule balances the need for simplicity (criterion 7) with the desire to offer relatively sophisticated mailers, who are accustomed to rate complexity, a range of rates that depend on the degree of preparation of the mail they enter (criterion 6).

At projected test year after rates volumes, revenue is $5,881 million and estimated incremental cost is $2,865 million, so that revenue exceeds the costs associated with ECR by a wide margin (criterion 3).

Although the percentage rate increase proposed for this subclass is below the system average in this case, many of the factors considered above indicate a cost coverage lower than that actually proposed. However, a lower markup would mean shifting more of the burden of covering institutional costs to other subclasses.

As described in the section above, the merged subclass markup considers the incorporation of the nonprofit mail. The proposed markup does reflect the merger in that it would be higher if it applied only to commercial mail, and lower if it applied only to nonprofit mail. In view of the average ECR rate increase of 6.2 percent, the rate level proposed for ECR/NECR satisfies the fairness and equity criterion (criterion 1).

F. Package Services

1. Parcel Post

The Postal Service is proposing a Parcel Post cost coverage of 115.6 percent over volume-variable costs, which corresponds to an average rate increase of 10 percent for the subclass.

In general, Parcel Post exhibits a low intrinsic value of service (criterion 2); it has a low delivery priority and primarily uses ground transportation. Due to increased security concerns, it no longer enjoys its former access to the collection system. The Parcel Post own-price elasticity estimated for this case is above 1.0 in absolute value (-1.19), indicating a low economic value of service. Only Express Mail exhibits a higher (in absolute value) price elasticity. When compared to the service provided by private sector delivery firms, Parcel Post does not offer many of the standard features -- such as free insurance, tracking service and free pickup service -- that add value to the private services. However, in this proposal, Delivery Confirmation is being added as a built-in feature for Parcel Select.

The proposed 10 percent average increase is above the system average and may have a significant effect on some mailers who use Parcel Post (criterion 4), especially if they do not, or cannot, avail themselves of the worksharing opportunities offered. A higher cost coverage, and therefore higher percentage increase, would make the impact even more significant, and make it difficult to assert that the rates reflect consideration of criterion 4. There is little doubt that competitors of Parcel Post will continue to compete successfully given this above-average increase.

Although alternatives to Parcel Post are plentiful, especially for large-volume business shippers, these alternatives may not be uniformly accessible to individuals. Direct access to competitors' services may be limited to a few locations, while commercial mail sending and receiving services may charge a premium over the competitors' standard rates. For mailers in more remote locations, there may be no practical alternative to Parcel Post. Consideration of the impact of larger possible rate increases facing these individual mailers (criterion 4) provides further reason to mitigate the increase in rates at this time.

A number of changes to the Parcel Post rate structure have occurred since Docket No. R97-1. As a result of that proceeding, new presort, dropship and prebarcoding discounts were added. In Docket No. R2000-1, the nonmachinable surcharge was extended to DBMC and Intra-BMC pieces. In this case, the Postal Service is proposing a new discount for non-machinable pieces entered at the DSCF and presorted to 3-digit, which should not increase complexity appreciably (criterion 7).

At projected test year after rates volumes, revenue from Parcel Post is $1,203 million and estimated incremental cost is $1,048 million, so that revenue is well above cost (criterion 3).

In past rate proceedings, the Commission, as well as the Postal Service, mitigated rate increases for Parcel Post by reducing its cost coverage. In this proceeding, the Postal Service is again attempting to mitigate the increase for Parcel Post by holding down its cost coverage. This is evidenced by a comparison of the Commission's recommended cost coverage in Docket No. R2000-1 to the proposed coverage in this case. Despite the fact that the Postal Service cost methodology generally results in higher cost coverages (since there is a lower level of cost attribution), and the system-wide coverage is increasing under either cost methodology, the proposed coverage of 115.6 percent is very near the Commission's recommended coverage of 114.9 percent. Nevertheless, a higher coverage now would have undesirable consequences. If the coverage were higher, either the already relatively large rate increase for the single-piece mailer would have to be higher, or the cost-reducing price incentives offered for destination entry would have to be reduced. Either alternative is inappropriate.

The proposed rate level is fair and equitable (criterion 1), reflecting a balanced consideration of the relevant criteria and taking into consideration the interests of both large and small users of Parcel Post and its competitors.

2. Bound Printed Matter

The Postal Service is proposing a cost coverage of 128.3 percent over volume-variable costs for Bound Printed Matter (BPM); this results in an average rate increase of 9.1 percent. Similar to Parcel Post, the intrinsic value of service for Bound Printed Matter is relatively low (criterion 2). On the other hand, its own-price elasticity is (–0.231), significantly less than that of Standard Mail Regular, suggesting a moderately high economic value of service.

The 9.1 percent rate increase for Bound Printed Matter is slightly above the system average and will obviously affect users of Bound Printed Matter (criterion 4) to some extent. This negative impact on some mailers will be offset somewhat by the expansion of the passthroughs for the dropship discounts. However, many mailers will be receiving substantial increases in their rates. Had the Postal Service proposed rates with a cost coverage more consistent with historical patterns, the rate increase would have been significantly higher. The proposed cost coverage of 118 percent in Docket No. R2000-1 represented a substantial mitigation of the impact of cost increases that had occurred since Docket No. R97-1. Increasing the cost coverage in the current proceeding helps move in the direction of the historical level of coverage without incurring a rate increase that is significantly above the system average. The size of the rate increase and the proposed cost coverage will result in a substantial contribution and ensure that potential competitors are not unfairly targeted (criterion 4).

The alternatives available to Bound Printed Matter users vary (criterion 5). For mailers of books, the Media Mail subclass provides an alternative postal service in addition to private sector delivery firms. For mailers of catalogs and telephone directories, alternate delivery firms provide at least a potential alternative; although, there do not appear to be widespread efforts by such firms to develop service offerings targeted at this portion of Bound Printed Matter. Some of the uses for catalogs and directories may be satisfied by Internet access to the material and listings.

Over a period of years, a substantial number of books have been mailed as Bound Printed Matter. The Commission accordingly has given the subclass some ECSI consideration in setting rate levels,[31] and the Postal Service proposal in this proceeding does so as well (criterion 8). At the same time, Bound Printed Matter also includes catalogs and directories, items that do not merit the traditional ECSI consideration.

The introduction of a rate differential between parcels and flats in the Bound Printed Matter rate design will increase its complexity (criterion 7), but will help to create

[31] PRC Op. R2000-1, para. 5880.

rate relationships that correspond more closely to the cost variation between the shapes.

At projected test year after rates volumes, revenue is $696 million and estimated incremental cost is $545 million, ensuring that the estimated cost is more than adequately covered (criterion 3).

The proposed rate level reflects an appropriate balance among all of the criteria of section 3622(b) and is, therefore, fair and equitable (criterion 1).

3. Media Mail/Library Mail

The Postal Service is proposing a cost coverage of 114.9 percent over volume-variable costs for the merged Media Mail/Library Mail grouping, translating into a 4.0 percent average rate increase for Media Mail, and 3.3 percent for Library. This cost coverage compares favorably with Parcel Post coverage in that it is lower than the 115.6 percent cost coverage proposed for that subclass.

As is true for the other Package Services subclasses, the intrinsic value of service for Media/Library is relatively low (criterion 2), given the use of ground transportation and the lack of priority in delivery. Its price elasticity is (–0.144), near that for Periodicals, suggesting a moderately high economic value of service.

The 4.0 and 3.3 percent increases in rates are significantly below the system average and therefore are not expected to have an unacceptable effect on current users (criterion 4). For many business users of Media Mail who are shipping books or similar materials, the Bound Printed Matter subclass provides an alternative postal service (criterion 5), but for many individual users, alternatives are more limited.

The books, films, sound recordings and similar matter mailed in the Media/Library grouping have a significant ECSI value (criterion 8), and this has been taken into account in setting the cost coverage for this subclass. The incorporation of Library Mail into the grouping tends to moderate the assigned cost coverage, in keeping with the notion that the previous mechanism for establishing the markup for Library Mail resulted in a lower markup for Library Mail than for Media Mail.

No changes to the rate structure for Media/Library are proposed in this case. The rate structure is relatively straightforward (criterion 7), while still providing some rate incentives for mailers to prepare mail so as to avoid some postal costs (criterion 6). In fact, these rate incentives may be easier to obtain, given expected changes in the minimum volumes to qualify for discounted rates, as explained by witness Kiefer (USPS-T-33).

At projected test year after rates volumes, estimated revenue of $321 million will exceed the estimated incremental cost of $280 million (criterion 3).

The proposed rate level reflects a careful consideration of the applicable criteria and is therefore fair and equitable (criterion 1).

G. Special Services

The detailed development of the Postal Service's proposed fee levels is described in the testimony of Postal Service witnesses Mayo (USPS-T-36), Koroma (USPS-T-37) and Kaneer (USPS-T-38). They discuss in detail the proposed fee levels in the context of the section 3622(b) criteria and proposed classification changes in the context of the section 3623(c) criteria.