

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

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POSTAL RATE COMMISS
OFFICE OF THE SECRET

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS O'HARA TO INTERROGATORIES OF
THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T30-5-7)

The United States Postal Service hereby provides responses of witness O'Hara to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS-T30-5-7, filed on August 6, 1997.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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August 20, 1997

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OCA/USPS-T30-5. Please refer to your direct testimony. At page 2 you set forth the criteria of 39 U.S.C. §3622(b). At page 20 you state that Ramsey pricing "does provide a useful framework for demonstrating the effects of different pricing decisions and 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. At the same time, the Postal Service recognizes that the Act directs that postal ratemaking consider a variety of factors, not all of which are directed toward economic efficiency." As a professional economist, do you regard Ramsey pricing of postal services and products to be compatible or incompatible with the criteria of 39 U.S.C. §3622(b)? Please fully explain your answer as to each criterion.

RESPONSE:

- (1) Fairness and equity: I regard Ramsey pricing as generally compatible with the fairness and equity criterion. For example, if two subclasses differed in their own-price elasticities (economic value of service) but received equal evaluations on all other aspects of the criteria, I believe it would be fair and equitable for the subclass with the higher economic value of service to be assigned a higher cost coverage, as Ramsey pricing would indicate.
- (2) Value of service: Ramsey pricing is clearly compatible with economic value of service, (although economic value of service has traditionally considered only a subclass's own-price elasticity, whereas Ramsey pricing includes the effect of cross-price elasticities more explicitly). When a subclass's intrinsic value of service differs from its economic value of service, there would be a conflict between Ramsey pricing and the intrinsic value of service portion of the criterion.
- (3) Cost: It is theoretically possible for revenue from Ramsey prices to be less than incremental cost, which would result in a conflict between this criterion and pure

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Ramsey pricing. However, this conflict can be resolved by imposing the constraint that revenue cover incremental cost, as witness Bernstein does. USPS-T-31 at 47.

- (4) **Effect of Rate Increases:** This criterion considers the effect of price changes, whereas Ramsey pricing deals with price levels. Thus, while it might well indicate that a movement to Ramsey prices should be made in several steps rather than all at once, it does not seem to me to be incompatible with the general principles of Ramsey pricing.
- (5) **Availability of Alternatives:** Limited availability of alternatives generally points toward some reduction in cost coverage from that which would otherwise apply. To the extent that this limited availability of alternatives generates a low own-price elasticity, Ramsey pricing will indicate a relatively high cost coverage. Thus, criterion 5 may conflict to some degree with Ramsey pricing, just as it may conflict with the value of service criterion (see my response to UPS/USPS-T30-3).
- (6) **Degree of Preparation:** This criterion addresses matters that have been increasingly taken into account at the level of rate design within a subclass, rather than at the level of the cost coverage for the subclass as a whole, which is the domain of Ramsey pricing, but I do not believe that it is incompatible with Ramsey pricing.
- (7) **Simplicity:** *This criterion addresses matters that are largely outside the scope of Ramsey pricing, but I do not believe that it conflicts with Ramsey pricing in any essential way.*
- (8) **ECSI:** This criterion clearly directs the consideration of matters that are not considered by Ramsey pricing, and thus a conflict with Ramsey pricing is obviously

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possible, as in the case of Periodicals where Ramsey pricing leads to a high cost coverage and high ECSI value indicates a relatively low cost coverage.

- (9) Other Factors: Compatibility or incompatibility would depend on the specific factor advanced for consideration under this criterion.

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OCA/USPS-T30-6. On page 21 you state: "I make no formal use of the Ramsey prices developed by witness Bernstein in USPS-T-31. In general, however, all else being equal, I view movement of rates in the direction of Ramsey prices to be beneficial. Therefore, whether a particular rate level would move rates closer to, or farther away from, Ramsey prices was one of the many factors I considered in evaluating potential rate levels." You conclude that "the consideration of movement toward or away from Ramsey prices did not have a major effect on my conclusion."

- a. Confirm that consideration of Ramsey pricing goals had some, and more than a *de minimis* effect on your conclusions. If not confirmed, please explain fully.
- b. Describe in detail as to each of the classifications set forth at pages 45-46 of your direct testimony the specific effect Ramsey pricing had on your conclusions to proposed percentage changes in rates. Replicate and describe fully each specific numerical calculation that was altered through consideration of Ramsey pricing analysis, and specify the percentage change that consideration of Ramsey pricing caused.
- c. Please supply all documents that you consulted in the preparation of your testimony (including data calculations supporting such testimony) relating to Ramsey pricing.

RESPONSE:

- a. I am unable to give a more precise or detailed description of the degree to which a consideration of Ramsey prices affected my conclusions than in the Section of my testimony referenced in the question.
- b. Please see my response to part a; no numerical calculations were utilized.
- c. I consulted witness Bernstein's testimony.

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OCA/USPS-T30-7. At page 4 you discuss the "value of service" criterion. You state that the lower (in absolute value) the own-price elasticity, the higher the value of service.

- a. 39 U.S.C. §3622(b) (2) also refers to "the value of the mail service actually provided each class or type of mail service to both the sender and the *recipient*." [Emphasis added.] Please explain whether or not you have considered value of service to the recipient in your analysis.
- b. Comment on the proposition that mail recipients in general place a higher value of service on their receipt of First-Class Mail than mail of other classes.
- c. Comment on the proposition that household recipients of mail place a higher value of service on their receipt of First-Class Mail than mail of other classes, e.g., households arguably place a relatively high value on receiving First-Class Mail from other households, and from companies with which they do business. Note in your consideration that the 1995 Household Diary Study states that in terms of percentage of First-Class Mail volume, the largest current users are banks, credit card companies, and insurance companies. See Diary at I-12. Note further that significant percentages of First-Class Mail received by households consist of Total Personal (7.1%), Bill/Invoice/Premium (15.9%) and Financial Statement (5.2%). See Diary at IV-26, Table 4-10.
- d. At page 10 you set forth the so-called ECSI statutory criterion (educational, cultural, scientific, and informational value to the recipient). You state that "[t]he Postal Service's rate-level proposals conform to this practice." However, you provide no additional explanation. Please discuss ECSI in terms of both households' and non-households' receipt of First-Class Mail versus other classes of mail. In your discussion of households, discuss specifically households' receipt of personal, bill/invoice/premium, and financial statement mail versus receipt of mail containing only advertising.

RESPONSE:

- a. In my view, the various factors that I discussed as affecting the value of service actually provided, such as mode of transportation and priority of delivery, are relevant to both sender and recipient (access to the collection system be primarily of interest to the sender). Even in cases of unsolicited

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communications, the sender is likely to consider the recipient's point of view in these matters.

- b. This is quite plausible, at least relative to the value of service provided to Standard Mail, but perhaps not relative to Express Mail and Priority Mail. Note that as I understand the criterion it refers to the value of service provided, not to the value of the contents of the mailpiece, whether information or merchandise. The recipient may well consider timely delivery of periodicals, sale announcements, or merchandise to be just as valuable as timely delivery of personal correspondence or financial statements.
- c. Please see my response to part b. of this question.
- d. It is my understanding that the Commission's determination that First-Class Mail deserves consideration under the ECSI criterion (paragraphs 4101-2 and 5032 of its Opinion and Recommended Decision in Docket No. R87-1) primarily referred to personal correspondence and greeting cards, rather than utility bills or mail containing only advertising.

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.


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