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

POSTAL RATE AND FEE CHANGES, 1997 | Docket No. R97–1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS BERNSTEIN TO INTERROGATORIES OF
THE AMERICAN BUSINESS PRESS
(ABP/USPS–T31—1–6)

The United States Postal Service hereby provides responses of witness Bernstein to the following interrogatories of the American Business Press: ABP/ USPS--T31—1–6, filed on August 20, 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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September 3, 1997

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF ABP

ABP/USPS-T31-1. You state at page 2 that your purpose is to present prices that achieve the dual goals of satisfying the break even requirement and minimizing the "burden on mailers" based on Ramsey pricing.

a. That is a description of your testimony. What is your understanding of the "purpose" of your testimony as part of the overall Postal Service presentation in this case? In other words, in your view, how does this testimony support the rate increase request filed?

b. What were your instructions from the Postal Service prior to the preparation of this testimony?

RESPONSE:

a. My understanding of the purpose of my testimony as part of the overall case is to provide the Postal Service and the Postal Rate Commission with an understanding of economic efficiency as it relates to postal rate making, present postal rates for the 1998 Test Year based on the principle of economic efficiency, and give all interested parties a methodology for evaluating the costs -- in terms of lost economic efficiency -- of other considerations that they may use to propose and establish postal rates.

I do not know how my testimony supports the specific rate changes proposed by the Postal Service. For a discussion of the use of Ramsey price principles in postal rate making, please see the testimony of Donald J. O'Hara (USPS-T-30).

b. I was instructed by the Postal Service to present theoretical, intuitive, and empirical Ramsey price analysis of postal rates for the 1998 Test Year

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ABP/USPS-T31-2. You show that at page 4 that if Ramsey pricing were implemented, the average postage for periodicals would increase from 22.56 cents to 47 24 cents, or by 109%.

a. Confirm that but for the fact that rates for preferred subclasses of periodicals are tied to the regular rates, this increase would have been greater. By how much?

b. Given the increase for periodicals under Ramsey pricing, please explain how its implementation would minimize the burden on periodical mailers.

c. If your answer is that the burden on periodicals mailers would not be minimized, explain on what mailers the burden would be minimized.

RESPONSE:

a. A discussion of the pricing of Regular Periodicals is presented in my testimony at page 62, lines 7 through 18 and repeated here for convenience.

> Periodicals Regular mail is not completely inelastic, but its own-price elasticity of only -0.143 suggests that large amounts of net revenue could be raised from this product with very little social loss. However, the mark-up of the three preferred subclasses of Periodicals mail is tied to the mark-up of Regular Mail. Therefore, while there would be little social loss in Regular mail from a large increase in Regular mail price, there would be a potentially large social loss from the corresponding higher prices for the three preferred subclasses of Periodicals mail. Therefore, the price of Periodicals Regular mail is constrained below its "true" Ramsey price. Since Periodicals mail is less elastic than First-Class letters, it should have a higher mark-up. To maintain the relative mark-ups called for by Ramsey pricing, Periodicals Regular mail is assigned a mark-up of 113.62 percent, or 1.1 times the 103.29 percent Ramsey mark-up for First-Class letters.

Thus, there were two considerations involved in the pricing of Regular Periodicals: i) the link between the mark-ups of the Regular and Preferred subclasses as noted in this interrogatory and ii) the decision to constrain the Ramsey mark-up of Regular Periodicals to be ten percent greater than the First-Class letter mark-up to reflect the fact that Regular Periodicals is less price elastic than First-Class letters.

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As explained in my response to NAA/USPS-T31-1(d), I did not calculate Ramsey prices independent of the constraints on the mark-ups of the preferred subclasses.

b and c. Ramsey pricing does not minimize the burden on users of any particular mail product, which would be achieved by setting the price of that product equal to its marginal cost. Instead, Ramsey pricing yields mark-ups above marginal cost on all products (imposing some burden on users of all products) in a way that minimizes the total burden across all users.

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ABP/USPS-T31-3. Do you agree that if Ramsey pricing were to be implemented as you propose it, there would be fewer periodicals mailed than there would be if the rates proposed by the Postal Service were implemented? How many fewer?

RESPONSE.

As the accompanying table shows, under the Ramsey prices proposed in my testimony, total volume of the Periodicals class is forecasted to be 9,479.917 million pieces, or 778.056 million pieces less than the forecasted total volume under rates proposed by the Postal Service.

TABLE A
Forecasted Test Year Volumes of Periodicals Mail
(in millions of pieces)

Subclass	Test Year Volume (Ramsey Rates)	Test Year Volume (USPS Proposed Rates)	Volume Effect of Ramsey Pricing
In-county	745.225	901.870	-156.645
Nonprofit	2,011.876	2,161.077	-149.201
Classroom	26.825	47.452	-20.627
Regular	6,695.991	7,147.574	-451.583
Total	9,479.917	10,257.973	-778.056

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ABP/USPS-T31-4. Do you agree that if Ramsey pricing were to be implemented as you propose it, there would be more advertising mail than there would be if the rates proposed by the Postal Service were implemented? How much more?

RESPONSE:

The definition of advertising mail is less clear than the definition of Periodicals mail referred to in the previous interrogatory, ABP/USPS-T31-3. While most advertising mail is sent as Standard A, some First-Class mail is advertising and obviously catalogs sent as Standard B mail could be considered advertising. Table B compares the Test Year volumes of Standard A mail (excluding single-piece mail) under Ramsey pricing and under the rates proposed by the Postal Service. As Table B shows, the volume of advertising mail so defined is forecasted to be 8,355.697 million pieces more under Ramsey pricing than under the rates proposed by the Postal Service.

TABLE B
Forecasted Test Year Volumes of Standard A Bulk Mail
(in millions of pieces)

Subclass	Test Year Volume (Ramsey Rates)	Test Year Volume (USPS Proposed Rates)	Volume Effect of Ramsey Pricing
Regular	32,477.211	37,627.555	-5,150.344
ECR	42,218.488	28,686.181	+13,532.307
Nonprofit	9,827.207	10,550.968	-723.761
Nonprofit ECR	3,268.778	2,571.283	+697.495
Total	87,791.684	79,435.987	+8,355.697

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ABP/USPS-T31-5. You state at page 62 that "large amounts" of additional revenue could be raised from periodical mailers with "very little social loss." Please define "social loss" as you have used the term and describe the small amount of social loss that would be in your opinion be experienced.

RESPONSE:

The social loss as it relates to my testimony is defined as the sum of the change in consumer surplus and the change in Postal Service net revenues. This sum is negative because raising net revenues requires pricing above marginal cost and prices above marginal cost lead to a decline in consumption. The social loss is related to this decline in consumption since units not consumed provide no benefit to mailers or the Postal Service. Any postal rate schedule that satisfies the break-even requirement will result in a social loss. Ramsey pricing minimizes this social loss and therefore minimizes the loss of mailer consumer surplus since Postal Service net revenues are the same under any pricing schedule.

In the case of Regular Periodicals mail, the social loss is small because an increase in price causes only a relatively small decline in volume. Table C shows the reduction in consumer surplus, the increase in Postal Service net revenues, and the social loss (equal to the sum of the loss of consumer surplus and gain in net revenues) from Regular Periodicals mail.

TABLE C

Subclass	Loss of Consumer Surplus Under Ramsey Pricing *from Table 13 (USPS-T-31)*	Increase in Net Revenues under Ramsey Pricing *from Table 11 (USPS-T-31)*	Difference (Social Loss due to decline in consumption)
Regular Periodicals	-$1,396.2 million	$1,342.4 million	-$53.8 million

Table C shows that Ramsey pricing of Regular Periodicals mail raises $1,342.4 million of net revenue while causing a social loss of only $53.8 million.

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ABP/USPS-T31-6. Your colleague, Professor Tolley, describes the trend toward growth in specialty magazines. Assume that there would be fewer such magazines if periodical postage rates doubled. Would this factor enter into your calculation of social loss? Explain.

RESPONSE:

I did not distinguish between specialty and non-specialty magazines in my calculations of change in consumer surplus or change in Postal Service net revenues. Any decline in volume of specialty magazines that would result from Ramsey pricing is included in the estimated change in Regular Periodicals consumer surplus, net revenues, and social loss.

DECLARATION

I, Peter Bernstein, declare under penalty of perjury that the foregoing answers are true and correct to the best of my knowledge, information and belief.

Peter Bernstein
(Signed)

August 28, 1997
(Date)

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

E. P. Koetting

Eric P. Koetting

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