

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Postal Rate and Fee Changes, 2001

Docket No. R2001-1

**INTERROGATORIES OF GREETING CARD ASSOCIATION
TO UNITED STATES POSTAL SERVICE
WITNESS PETER BERNSTEIN
(GCA/USPS-T10-8-23)
(November 26, 2001)**

Pursuant to Rules 25 through 28 of the Rules of Practice of the Postal Rate Commission, Greeting Card Association ("GCA") directs the following interrogatories to United States Postal Service witness Peter Bernstein.

Respectfully submitted,



Alan R. Swendiman

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GCA/USPS-T10-8. You state your testimony does not address "past technological developments such as the telephone", page 2, line 8.

- a. Isn't telecommunications deregulation over the past twenty (20) years right through to the present a major factor reducing the growth in demand for First-Class letter mail communications?
- b. Is the growth of long distance communications from the reduction in long distance prices the past two decades a variable that has ever entered RCF's demand equation work? Please fully detail your answer.
- c. If your answer to b. is "No.", please explain why you have not included what is arguably the strongest substitute for FCM letter mail in your demand work.
- d. Was it to make the own price elasticity appear lower than it really is?
- e. In your view, over the longer term has the advent of "universal" telephone service acted as a strong substitute for FCM letter mail, e.g. personal letters, holiday calls and greetings, birthday calls, etc.

GCA/USPS-T10-9. On page 56 of your testimony you discuss diversion from telephone price declines as part of the other factors you estimated for the past five years. Would not the major impact from this telephone factor have been in the first ten years following telecom deregulation in the early 1980s?

GCA/USPS-T10-10. You argue on page 4 starting on line 8 that "technological diversion" weakens the "Postal Service's financial position". You go on to state: "Consequently, diversion of mail makes rate cases more frequent or makes rate increases larger than they would otherwise be."

- a. Are you familiar with the term "right-sizing" as it is used in the private sector? Please define the concept as you understand it to be used.
- b. Other firms faced with competition from new technologies either retain market share by innovating themselves, or have to cut costs, including labor and capital costs. Don't you agree that this is also an option for the USPS, as opposed to larger or more frequent rate increases?
- c. Isn't the larger or more frequent rate increase (or both) strategy you propose tantamount to a business that loses volume, trying to make it up by charging higher margins to its remaining customers? Isn't that a self-defeating strategy under competitive conditions?

GCA/USPS-T10-11.

- a. Please confirm that your view of the impact of "technological diversion" on the Postal Service is that, on balance, it will have a negative impact.
- b. Please confirm that this is not an estimate based on economy-wide efficiency or welfare considerations, just the narrow consideration of the Postal Service's own welfare.
- c. Please confirm that the "technological diversion" on which your testimony focuses is a very good example of what the late economist Joseph Schumpeter meant by the process of "creative destruction".
- d. In Schumpeter's view, please confirm that on balance for the economy as a whole, technological processes of "creative destruction" are viewed as a positive, and indeed, necessary occurrence for economic progress?

GCA/USPS-T10-12.

- a. Please confirm that in Schumpeter's theory, the process of creative destruction almost always involves the creation of new organizations to grow and manage the new technology due to the inability or unwillingness of the older institutions to do so.
- b. Please confirm that in the context of your discussion of diversion due to the Internet, relatively new firms like AOL are leading the process of "creative destruction".
- c. Has the Postal Service contemplated alliances with companies like AOL for universal electronic delivery of letter mail as, for example, it has consummated with FedEx in a different arena of new competition?

GCA/USPS-T10-13. Are you implying by your testimony that "technological diversion" is responsible for there being two rate increases (January and July) and another rate case filing to further raise rates, all in 2001?

GCA/USPS-T10-14. Is the main point of your testimony to argue that Ramsey pricing is warranted because of technological diversion?

GCA/USPS-T10-15. With respect to your Table 6, what percentage of total households served by the Postal Service, under your universal delivery mandate, with hard copy delivery services would be included in your May, 2005 estimate of 168.9

million active internet users? Between today and that date, does this represent a movement toward your universal delivery address totals?

GCA/USPS-T10-16.

- a. With respect to your argument on pricing and demand inelasticities on page 66, lines 1-10, please confirm that the own price demand elasticity for Standard A Regular mail is less than one in absolute value.
- b. Please confirm that such a numerical in elasticity in a. renders the service a price inelastic one, not a price elastic one.
- c. Please confirm the textbook proposition that for price inelastic goods, raising the price results in greater revenue even factoring in the volume loss from the price increase.
- d. Why would substitutes for FCM letter mail such as you discuss affect elasticities "not much" while substitutes for advertising mail are alleged to explain the less inelastic own price elasticity found for those subclasses than those traditionally found for FCM letters?

GCA/USPS-T10-17. With reference to your discussion on page 68, lines 20-22, please cite all factors that would lead current own price elasticity of FCM letters to be less than what it was in the last case, given the fact it is greater for FCM single piece letters.

GCA/USPS-T10-18. Please refer to page 35 in your testimony and your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "USER FORECASTS"

- a. Please confirm that the formula you have given on this page of your testimony is correctly specified.
- b. If your answer to a. is negative, please provide the correct formula.
- c. If your answer to a. is affirmative, explain why the formula used in your Excel file under the column titled "Fitted" differs from the one in your text and how you would reconcile the two.

GCA/USPS-T10-19. Please refer to your LR-J-133, Excel file, Forecasts of Internet Variables.xls," worksheet "USER FORECASTS."

- a. Please describe in detail, what initial values you used for the model coefficients (m, p, q, d), what constraints (if any) you imposed on these

coefficients in the solver, and how did you run the solver to obtain the final parameter estimates.

- b. If you did not impose any constraints on the coefficients, please explain, why using your final parameter estimates as initial values without any constraints yields completely different parameter estimates.

GCA/USPS-T10-20. Please refer to your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "USER FORECASTS."

- a. Please confirm that the minimum ESS you have obtained equals 60.521993.
- b. Please confirm that by using the following parameter estimates $m=274.6$, $p=0.008398$, $q=0.002309$, and $d=0.418733$ in your model the ESS would equal 60.458634.
- c. If your answer to both a. and b. are affirmative, then m , the ceiling on the active users or as you define it "the maximum size of the market or ceiling value" equals 274.6 rather than your estimate of 306.7. Please explain how this affects your reviewing of the statistical results on line 17, page 37 of your testimony.
- d. If your answer to b. is affirmative, explain how these parameter estimates affect your results in the other sections.

GCA/USPS-T10-21. Please refer to your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "\$ per USER FORECASTS" and Table 7 on page 39 of your testimony USPS-T-10.

- a. Please confirm that adjusted R-squared is 0.938 rather than 0.983 as you have reported in your Table 7.
- b. Please confirm that the values you have reported in Table 7 of your testimony for intercept are not from the regression summary output you have provided in your Excel file (where you must have used time trend input of 1 to 25) rather from an unreported regression output where you have used time trend 0 to 24.
- c. Please confirm that if you had used a quadratic model where the square of the time trend was also included in the model you would have obtained a better fit.
- d. If your answer to c. is affirmative please describe how this would have affected your forecasts of dollar per user spending on ISP (Table 8 and Table 9 page 40 and 42 of your testimony) and ultimately Dr. Tolley's volume forecasts.

GCA/USPS-T10-22. Please refer to your testimony USPS-T-10 page 48. You state, "Total advertising expenditures are projected to grow by 1.5% from 2000 to 2001 and then increase at the same rate as personal consumption expenditure." In your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "advertising" you provide the following figures for the personal consumption expenditure growth rate: 5.29%, 5.47%, 5.30%, and 5.59% for the years 2002, 2003, 2004, and 2005, respectively.

- a. Please provide the source for the personal consumption expenditure growth rate.
- b. Given the current projection of deeper than expected recession, do you confirm that these projected personal consumption expenditure growth rates are highly unlikely?
- c. If your answer to b. is affirmative, then provide a more realistic projections available (if any) which has incorporated the recent events and other recent economic concerns as well as your revised projected Internet advertising expenditures based on these new growth rates. Furthermore, explain how this will affect the First-Class mail diversion to Internet and ultimately Tolley's volume forecasts, in other words, how it affects "the magnitude of the impact of ISP expenditure on single-piece letter volume" (USP-T-10, page 53) and Table 2 of Dr. Tolley you have provided on page 54 of your testimony.
- d. If your answer to b. is affirmative, please explain whether it is reasonable to state on page 57 of your testimony that "Between the Base Year and the Test year, ISP expenditures are projected to increase from \$20.4 billion to \$48.3 billion. This increase is projected to reduce single-piece volume by about 7.8% over a period of slightly more than two years."
- e. If your answer to b. is negative, please elaborate in detail why these projected personal consumption expenditure growth rates would still entail and thus would not have any impact on the magnitude of the diversion of First-Class mail to Internet as you and Dr. Tolley have projected.

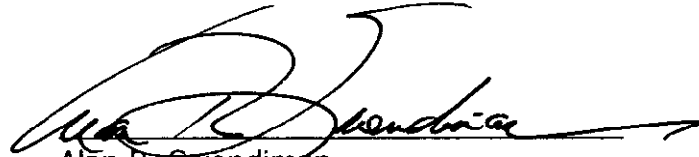
GCA/USPS-T10-23. Please refer to pages 65-67 of your testimony USPS-T-10.

- a. Please confirm that in your discussion of technological diversion and postal pricing, whether you are assuming that the technological diversion has no impact on the USPS costs.

- b. If your answer to a. is affirmative, then isn't it reasonable for the USPS to cut back on some services to reduce costs rather than employing very large increases in rates in order to break-even?
- c. If your answer to a. is negative, explain in detail in which direction the technological diversion affects the USPS costs and the alternatives that USPS may pursue to break-even other than "...rate cases occurring either more frequently, with greater increases, or both." (USPS-T-10, page 66).

CERTIFICATE OF SERVICE

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

A handwritten signature in black ink, appearing to read "Alan R. Swendiman", with a long horizontal flourish extending to the right.

Alan R. Swendiman
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GREETING CARD ASSOCIATION