

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

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OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN  
TO ABA&NAPM INTERROGATORIES ABA&NAPM/USPS -T10-1 - 7  
(December 10, 2001)

The United States Postal Service hereby provides the response of witness Bernstein to the following interrogatories of ABA and NAPM: ABA&NAPM/USPS-T10-1 - 7, filed on November 26, 2001. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:



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December 10, 2001

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-1 Starting on page 6 of your testimony, you discuss past efforts you or Dr. Tolley at RCF have engaged in with respect to technological diversion.

- a. Why did the separate demand equations for workshared mail from single piece that you refer to as part of the effort in R97-1 (page 8, lines 6-11) not continue as your analytical method for R2000-1?
- b. Why have you re-introduced that decomposition in R2001-1?
- c. Why in this discussion have you not mentioned the results contained in LR-179 from R2000-1, the work RCF did for the GAO study?
- d. Please confirm that the work referenced in c. above showed strong diversion of workshared letter mail, not just single piece mail, in the volume models that were projected out for several years beyond year 2000.
- e. Please confirm that the GAO study in which the RCF volume projections appear is based on the following environment from which RCF was to render its projections. "Notably, the combination of consumer movement to alternative bill payment methods and the consolidation in the financial sector would reduce the number of bills, statements and payments in the mail stream." (GAO/T-GGD-00-2, page 5).
- f. Please confirm that this scenario was based on a USPS scenario for the next decade.

RESPONSE:

- a. Separate demand equations for single-piece and workshared letters were used in R2000-1.
- b. Please see my response to (a) above.
- c. The volume forecasts presented in LR-179 from R2000-1 were not based on an RCF analysis of mail diversion. Instead, RCF's role was limited to mechanistically including diversion assumptions developed exogenously into our existing volume forecasting model. As the underlying analysis was not prepared by RCF, I saw no reason to discuss it in my testimony.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

- d. The exogenous diversion assumptions include the diversion of workshared letters.
- e. Confirmed, recognizing that the RCF projections simply involved a mechanistic incorporation of the exogenous diversion analysis.
- f. My understanding is that it represents one of many scenarios investigated by the Postal Service.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-2 You spend considerable time discussing “technological diversion” methods that do not seem to have yet developed serious competitive consequences for the Postal Service, and seek to explain why they have not, e.g. EBPP or online banking. You hardly devote any time to the current technology that does appear to be diverting substantial amounts of mail volume, Automatic Funds Transfer (“AFT”), to which you devote only 4 lines of your testimony at page 24, lines 8-12.

- a. Please confirm that of your “sub-total technological share” of methods used to pay household bills (Table 4) two thirds comes from AFT.
- b. Why in your view has AFT usage grown from 16.7% of the Household Diary sample in 1995 to 33% in 2000.
- c. How, if at all, is this competitive substitute explicitly accounted for in estimating demand elasticities for FCM workshared letters?
- d. Has the Postal Service done any future projections of diversion from AFT? If not, why not? If so, please provide a copy of all such studies.
- e. Has the Postal Service explored competitive (including technological) responses to the acceleration in diversion from AFT? If not, why not? If so, please provide a copy of all such plans, studies, etc.

RESPONSE:

- a. Confirmed.
- b. Growth in the use of automatic funds transfers is consistent with the greater acceptance of technological alternatives, as evidenced by the growth in household computer ownership and Internet access.
- c. Table 4 shows how households pay their bills. Bill payments mailed by households are sent as single-piece letters, not as workshared letters.
- d. As part of my analysis of technological diversion, I have made forecasts of the future shares of household bill payments by mail, in person, and by electronic methods (including, but not limited to, AFT). Those forecasts are attached to this response.
- e. I do not know the full extent of responses explored by the Postal Service. I know that the Postal Service has introduced its own electronic bill payment service.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

**Actual and Projected Shares of Household Bill Payments  
(By Payment Method)**

Method	2000 (actual)	2001 (projected)	2002 (projected)	2003 (projected)	2004 (projected)	2005 (projected)
Electronic	11.1%	13.7%	16.7%	20.3%	24.5%	29.2%
In-Person	9.5%	9.2%	8.9%	8.6%	8.3%	8.0%
By Mail	79.4%	77.1%	74.4%	71.1%	67.2%	62.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-3 Using your terminology, please confirm that the “incremental diversion” from AFT is now large “relative to cumulative diversion.”

RESPONSE:

I have not made forecasts of diversion specifically from AFT. The forecasts attached to ABA&NAPM/USPS-T10-2 indicate that incremental diversion of household bill payments to electronic alternatives is likely to be greater than the cumulative diversion that has already occurred.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-4 Please confirm that between 1998 and 2000, the growth in technological diversion from FCM bill payments (+4.45, from bottom row of Table 4, page 20) was greater than the diversion of all advertising, including direct mail, to the Internet (2.6% from Table 11, page 46).

RESPONSE:

I can confirm that the increase in the share of household bill payments paid electronically exceeds the increase in the share of advertising dollars spent on the Internet. I would not agree that this implies that growth in technological diversion from bill payments exceeds growth in diversion of all advertising from Internet advertising. The share numbers are not directly comparable as one represents the share of a subset of total First-Class letter mail where as the other represents a share of total advertising. Furthermore, changes in shares do not in themselves measure diversion as there may be other factors responsible for changes in these shares.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-5 Referencing your Table 11, on page 47, lines 3 and 4, you argue that much of the Internet-induced diversion of advertising has come from direct mail.

- a. Please confirm that your table since 1995, as much ad diversion to the Internet has come from newspapers as from direct mail.
- b. Please confirm that even more diversion from broadcast TV has been induced by the Internet than for direct mail since 1995, using the method of looking at your table 11 to judge such.

RESPONSE:

a and b. I can confirm neither supposition. First, I have not analyzed the impact of the Internet on newspaper or broadcast TV advertising. Second, declines in the shares of these advertising media are not necessarily reflective of diversion to the Internet. As I discussed in my testimony, both newspapers and broadcast TV have been experiencing declining advertising shares for many years, and the decline clearly begins well before the introduction of Internet advertising. In contrast, direct mail advertising share grew steadily from 1980 to 1995, before starting a decline at the same time that Internet advertising began. Furthermore, the econometric analysis of Thomas Thress (USPS-T-8) shows that increases in Internet advertising have a statistically significant negative impact on the volumes of Standard Regular and Standard ECR mail.



RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-6

- a. For rate making purposes, please confirm that the letters subclass for FCM includes both single piece and workshared letters.
- b. Please re-calculate Table 2 on page 54 at the FCM letters subclass level, i.e. "total First Class letters".

RESPONSE:

- a. First-Class Mail includes both single-piece and workshared letters.
- b. A table corresponding to Dr. Tolley's Table 2 (which I have reprinted in my testimony) for total First-Class letters cannot be calculated exactly. The information from Table 2 is based on the econometric analysis of single-piece letters. Dr. Tolley's Table 3 is based on econometric analysis of workshared letters. An exact calculation of the impacts on total First-Class letters would require a single econometric equation for total First-Class letters, which does not exist. However, I have developed a "reduced-form" version of Table 2 for total First-Class letters, which aggregates the impacts of different variables and gives some indication of the relative importance of different kinds of variables on total First-Class letter volume over the past five years. That table is attached to this response.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

Table Accompanying Witness Bernstein's Response to ABA&NAPM/USPS-T10-6

Approximate Impact of Different Factors on the Volume of Total First-Class Letters  
Over the Five-Year Period Ending in 2001Q3

Factor Affecting Volume	Approximate Impact of Factor on Volume Over the 5-Year Period Ending 2001Q3
Growth in Adult Population	+4.5 percent
Increases in Economic Activity (Real Change per Adult)	+5.5 percent
Changes in Postal Prices (own-price, discounts, cross-prices)	+2.5 percent
Technological Diversion	-5.5 percent
Total Change in Volume	+7.0 percent

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-7 You assert on Page 70, lines 1-3, that reduced contribution from technological diversion requires rate increases.

- a. Please confirm this assertion assumes away the alternative possibility of reducing costs.
- b. Please confirm that the Postal Service has raised FCM single piece rates twice this year alone already, once in January and again (for extra ounces) in July.
- c. Please confirm that preliminary data for AP's 1 and 2 for current PFY show a tremendous drop off in advertising mail and priority mail volumes; and please confirm that these are factors, whatever their cause, which also cause reduced contribution and either require rate increases or cost cuts.

RESPONSE:

- a. I do not assume away the alternative possibility of reducing costs. However, whatever cost reductions might be realized, the loss of contribution due to technological diversion would require rate increases that are higher or more frequent than would be required given those cost reductions but without the lost contribution from technological diversion. Furthermore, reductions in volume due to technological diversion have the effect of increasing cost per piece because the non-volume variable costs of the Postal Service (*sometimes referred to as institutional or common costs*) must be spread out over fewer pieces of mail. Thus, diversion makes cost reductions more difficult to achieve.
- b. Confirmed, recognizing that the increase in the extra ounce rate occurring in July was a result of the Postal Rate Commission's decision to give the Postal Service a reduced revenue request in the implementation of its rates in January.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES FROM ABA & NAPM

c. I can confirm that preliminary data suggest volume declines in the categories that you mention, that those volume declines lead to reduced contribution, and that rate increases and/ or cost reductions are likely responses to reductions in contribution.

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.

A handwritten signature in cursive script, appearing to read "Peter Bernstein", is written above a horizontal line.

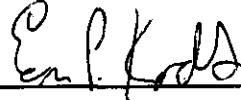
(Signed)

12-7-01

(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.



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