

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAYMAN TO INTERROGATORY
OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T6-57)

The United States Postal Service hereby provides the response of witness
Tayman to the following interrogatory of the Office of the Consumer Advocate:
OCA/USPS-T6-57, filed on December 10, 2001.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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December 19, 2001

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OCA/USPS-T6-57. Please refer to your testimony at 53, lines 19-30, wherein you discuss economic risks. Presumably these risks can potentially affect revenues, costs, and the need for a contingency. For purposes of responding to the following subparts asking for the impact of adjusting a basic assumption, please assume that all other facts and assumptions would remain constant, *i.e., ceteris paribus*.

- (a) Please confirm that the underlying economic information supporting the projections of a need for a contingency was based on DRI-WEFA economic forecasts produced in June of 2001 and, therefore, based on DRI-WEFA's understanding of the economy as of that date. If you do not confirm, please state the date(s) of the forecast(s) used by you and any other witnesses on whose testimony you rely as well as which underlying economic data series correspond to which forecast dates.
- (b) How would your estimate of a need for a contingency be impacted by a GDP growth estimate that was one percent higher than originally projected for each of the years in your forecast through 2003, the test year? Please explain all reasoning and calculations.
- (c) How would your estimate of a need for a contingency be impacted by a GDP that was one percent lower than originally projected for each of the years in your forecast through 2003, the test year? Please explain all reasoning and calculations.
- (d) Please state the assumptions for inflation in the forecast you used and then explain how the need for a contingency would be impacted by an inflation rate that was one percent higher than originally projected for each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.
- (e) Please state the assumptions for inflation in the forecast you used and then explain how the need for a contingency would be impacted by an inflation rate that was one percent lower than originally projected for each of the years in your forecast through 2003, the test year? Please explain all reasoning and calculations.
- (f) Please state the assumptions for the index of consumer confidence in the forecast you used and then explain how the need for a contingency would be impacted by an index that was five points higher than originally projected each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations. Please explain all reasoning and calculations.
- (g) Please state the assumptions for the index of consumer confidence in the forecast you used and then explain how the need for a contingency would be impacted by an index that was five points lower than originally projected for each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.
- (h) Please state the assumptions for the unemployment rate in the forecast you used and then explain how the need for a contingency would be impacted by an unemployment rate that was one percent higher than originally projected for each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.
- (i) Please state the assumptions for the unemployment rate in the forecast you used and then explain how the need for a contingency would be impacted by an

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unemployment rate that was one percent lower than originally projected for each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.

- (j) Please state the assumptions on the level of business investment in the forecast you used and then explain how the need for a contingency would be impacted by a level of investment that was 10 percent higher than originally projected for each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.
- (k) Please state the assumptions on the level of business investment in the forecast you used and then explain how the need for a contingency would be impacted by a level of investment that was 10 percent lower than originally projected in each of the years in your forecast through 2003, the test year. Please explain all reasoning and calculations.

RESPONSE:

Because you are asking for *ceteris paribus* responses,¹ I need preface my response to the subparts of your question by explaining that development of the contingency provision is not a *ceteris paribus* exercise. The contingency provision is not something that is built up block by block, brick by brick, or step by step. It is neither a forecast nor a mathematical calculation. Rather, the *raison d'être* of the contingency provision is to correct for the inherent inability of step-by-step, line-item forecasting exercises to supply the financial foundation that is necessary to support the capital needs and ongoing operations of the Postal Service. The contingency provision is explicitly intended to be an amount *in addition to* total forecasted costs in order to ensure that the Postal Service will break even. The greater the risk that the Postal Service faces, the larger the contingency needs to be. Changing a brick or a block (or a macroeconomic forecast) does not change the need for a contingency provision adequate to protect against potential risks. As I stated at page 47 of my testimony, “there is always the potential for the unknown and the unknowable.” None of the changes in specific line item forecasts

¹ Please note as well that the *ceteris paribus* premise of the question is itself questionable. For instance, it seems unrealistic to assume that the unemployment level could change without affecting the level of consumer confidence, or that the level of business investment could change without affecting GDP.

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or the specifics of any particular forecast postulated in the subparts of your question necessarily change the risks inherent in those forecasts. Nor do those changes eliminate or correct for the fact that the future is fraught with unknowns.

Macroeconomic forecasts are subject to considerable risk regardless of whether those forecasts are favorable or unfavorable and regardless of whether those forecasts are decreased or increased. Similarly, the Postal Service is vulnerable to financial shocks regardless of whether the macroeconomic forecasts are increased or decreased and regardless of whether those forecasts are favorable or unfavorable.

Rather than being a forecast, the contingency provision reflects a general assessment of how the risks are stacked up against the Postal Service and how well the Postal Service is able to absorb those risks. The Postal Service's assessments in this regard have been good. In the mid-1990s we reduced the contingency provision when it appeared that the Postal Service was in a position to perform well financially. The Postal Service did perform well. However, in the last rate case, our financial fortunes began to shift and we sought to increase the level of protection. Again, we were right, but unfortunately were not heeded.

Even if one or other of the economic factors cited in the question were to improve in some sense, now would not be the time to reduce the contingency provision proposed by the Postal Service. The Postal Service has not broken even over time, which means that it has not had an adequate financial cushion. We are getting very close to the statutory debt limit. This is not the time to risk reducing the level of protection against the risk of not breaking even that is provided by the contingency provision proposed by the Postal Service. The law requires that rates and fees cover costs, and rates and fees over time have failed to achieve that mandate. Particularly in this time of extraordinary uncertainty and risk, the Postal Service's ability to reach break even should not be compromised in any way.

- (a) Not confirmed. The contingency provision was not derived from any particular DRI/WEFA forecast. Rather, the contingency provision was developed by

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reviewing the Postal Service's exposure to risks and the Postal Service's capacity to absorb those risks. At the time the contingency provision was developed, those risks appeared to have been increasing and the Postal Service's capacity to absorb those risks was rapidly dissipating. As discussed above, these risks do not change necessarily as result of changes in macroeconomic forecasts.

- (b & c) A one percent higher or lower GDP forecast would not have any necessary impact on the risks facing the Postal Service or on the Postal Service's capacity to absorb risk.
- (d & e) The inflation assumptions used in my testimony are documented in Library Reference J-50. If projected Inflation rates had been one percent higher or lower, these would not have any necessary impact on the amount of risk inherent in the forecast, on the risks facing the Postal Service, or on the Postal Service's capacity to absorb risk.
- (f & g) I did not use an index of consumer confidence in the preparation of my testimony. However, because of the risks the Postal Service is facing and the limited capacity of the Postal Service to absorb risk, under current circumstances I believe the Postal Service would require a substantial contingency provision whether or not consumer confidence projections have grown or declined.
- (h & i) I did not use an unemployment rate in the preparation of my testimony. However, because of the level of risk and the limited capacity of the Postal Service to absorb risk, under current circumstances I believe the Postal Service would require a contingency provision at least as high as presented in my testimony whether or not unemployment rate projections have grown or declined.

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- (j & k) I did not use a level of business investment in the preparation of my testimony. However, because of the level of risk and the limited capacity of the Postal Service to absorb risk, under current circumstances I believe the Postal Service would require a contingency provision at least as high as presented in my testimony whether or not business investment projections have grown or declined.

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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