

DOCKET SECTION

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

RECEIVED  
SEP 24 4 36 PM '97

POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

RESPONSE OF UNITED STATES POSTAL SERVICE  
WITNESS PANZAR TO INTERROGATORIES OF  
THE DIRECT MARKETING ASSOCIATION, INC.  
(DMA/USPS-T11-1-2)

The United States Postal Service hereby provides responses of witness Panzar to the following interrogatories of the Direct Marketing Association, Inc.: DMA/USPS-T11-1-2, filed on September 10, 1997.

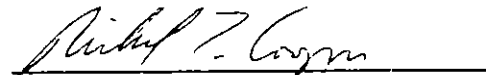
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.  
Chief Counsel, Ratemaking



Richard T. Cooper

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
(202) 268-2993; Fax -5402  
September 24, 1997

RESPONSES OF POSTAL SERVICES WITNESS PANZAR TO  
INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/USPS-T11-1. Please refer to pages 3 and 4 of your direct testimony where you describe an operating plan as "a set of reasonably stable practices and procedures which the Postal Service uses in order to serve the mail volume it receives. Under this interpretation, the Postal Service's accounting data represents the costs of implementing the operating plan under various levels of mail volumes."

(a) Does your definition of operating plan require that the practices and procedures be economically efficient? Please explain fully.

(b) Please refer to your article, William J. Baumol, John C. Panzar & Robert D. Willig, "Contestable Markets: An Uprising in the Theory of Industry Structure: Reply," *American Economic Review*, June 1983, at 494, in which you state that "... increased ease of entry and exit improves the welfare performance of firms and industries." Please describe the ease of entry in the markets for the carriage of first-class and Standard A mail. From a theoretical perspective, would an increase in the ease of entry and exit in a contestable market provide an increased incentive to a producer to minimize costs as compared to a regulated monopolist? Please explain fully.

(c) From a theoretical perspective, does a producer who sells some products in markets with a monopoly and some in markets that are competitive have an incentive to produce more efficiently in those markets which are competitive? Please explain fully.

(d) Does the empirical evidence in general support the theory provided in response to subparts (b) and (c) above? Please explain fully and provide references to discussions of such empirical evidence.

(e) Please refer to your article, John C. Panzar, "Regulation, Deregulation, and Economic Efficiency: The Case of the CAB," *American Economic Review*, May 1980, at 313, in which you state that "[r]ecent history would seem to indicate a clear triumph of economic efficiency over the 'dead hand' of regulation. While I would be among the last to suggest that deregulation was a mistake, I argue that the issues are more complicated than is commonly thought; since, if anything, recent results in regulatory theory suggest that regulation by enlightened, but not omniscient, regulators could in principle achieve greater efficiency than deregulation." Please explain how an enlightened regulator would increase the efficiency of the Postal Service. In doing so, please address the fact that "... governments and regulated firms are notoriously inept at limiting the wage demand of their employees." John C. Panzar, "Is Postal Service A Natural Monopoly", in Competition and Innovation in Postal Services (Michael Crew & Paul Kleindorfer, eds., 1991).

RESPONSES OF POSTAL SERVICES WITNESS PANZAR TO  
INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

ANSWERS to DMA/USPS-T11-1:

(a) No. The purpose of my testimony is to explain how to go about measuring the marginal and incremental costs *incurred by the Postal Service*. This is what is most relevant for pricing purposes.

(b) It is my understanding that entry into the provision of the mail services you cite is limited by the Private Express Statutes.

The theory of contestable markets does not directly analyze the incentives operating within a firm. In the context of contestable market theory, the reason that "increased ease of entry and exit improves the welfare performance of firms and industries," is that firms which operated inefficiently would be replaced by more efficient rivals.

(c) It is certainly the conventional wisdom that *profit seeking* firms are under greater pressure to produce efficiently in their competitive markets than in their monopoly markets. However, I am not aware of a detailed theoretical analysis of this question in the context of an enterprise such as the Postal Service, which is not accountable to private shareholders.

(d) It is my understanding that empirical evidence does generally support the theoretical propositions stated. However, it is not at all clear that that evidence is relevant to the Postal Service, for the reason cited in my answer to (c). I cannot, without further study, provide specific references to the empirical literature.

RESPONSES OF POSTAL SERVICES WITNESS PANZAR TO  
INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

(e) The passage cited was written in the context of the *airline industry*, and referred to regulatory policies designed to improve the efficiency of that multi-firm *industry*, rather than the efficiency of any particular firm. Similarly, in the postal and delivery industry, regulatory policies with regard to the level of worksharing discounts can affect the economic efficiency of the *industry* without necessarily having any effect upon the productive efficiency of the Postal Service, or the wages it pays.

RESPONSES OF POSTAL SERVICES WITNESS PANZAR TO  
INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/USPS-T11-2. In recent decisions, the Postal Rate Commission has attributed the cost of single subclass stops in Cost Segment 7. See R90-1 RD on Remand at 26 - 56 (Sept. 27, 1994); R94-1 RD at III-28-46 (Nov. 30, 1994); R94-1 Further RD at 7 - 40 (June 7, 1995).

(a) Do you consider these costs to be incremental rather than marginal? Please explain your reasoning fully.

(b) Please refer to your testimony at p. 28, lines 7-8. Should these single-subclass-stop costs be part of the "basis for the mark-ups required to satisfy the break-even requirement"? Please explain fully.

(c) Please confirm that the Postal Service's prior practice of attributing incremental costs (including specific fixed and volume variable costs) is contrary to your direct testimony in this filing that mark-ups should be based on marginal costs (equivalent to volume variable costs).

ANSWERS:

(a) It is my view that the costs of single subclass stops are incremental costs of the subclass in question. They tend to be larger, on a per unit basis, than the marginal (or unit volume variable) costs of the subclass. My reasoning is explained in detail in my testimony in that Docket.

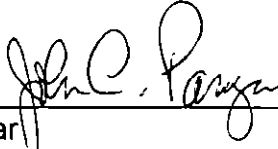
(b) The question is misleading. The basis for mark-ups should be marginal (unit volume variable) costs. The issue was not whether or not the costs of single subclass stops should be included in this basis. Rather, the issue was that the costs of both single subclass stops and multiple subclass stops should be analyzed jointly when attempting to measure the marginal (unit volume variable) costs of any subclass.

RESPONSES OF POSTAL SERVICES WITNESS PANZAR TO  
INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

(c) It is my understanding that the Postal Service has in the past attributed specific fixed costs, along with volume variable costs, which is contrary to my testimony. I am not aware that the Postal Service has made it a practice to attribute incremental costs.

# DECLARATION

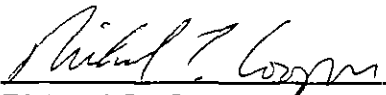
I, John C. Panzar, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

  
\_\_\_\_\_  
John C. Panzar

Dated: 9-24-97

## 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.

  
Richard T. Cooper

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
September 24, 1997