

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNES ROBINSON
TO INTERROGATORIES OF GREETING CARD ASSOCIATION
[GCA/USPS-T1-1-2]

The United States Postal Service hereby provides the responses of witness Maura Robinson to the above-listed interrogatories of Greeting Card Association, filed on May 10, 2005. The interrogatories have been redirected from witness Potter to witness Robinson for response. The interrogatories are stated verbatim and are followed by the responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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May 24, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

Michael T. Tidwell

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

GCA/USPS-T1-1. In your testimony at page 2, starting at line 18, you state “We currently face serious economic and operational challenges. The need to raise rates prematurely for any reason will not help us meet them, and will burden our customers and the economy.” In the same manner, you stated publicly and in greater detail at recent Senate Committee hearings on postal reform: “Electronic diversion continues to erode First-Class Mail volume, this product will become more price-sensitive than ever. Higher rates will likely increase the pace of change, accelerating the volume decline, resulting in falling revenue . . .”.

- a. Do you understand your statement at the Senate Committee hearings on postal reform to be what economists call a situation of absolute own price elasticity with a value greater than the absolute value of -1?
- b. Why is the Postal Service proposing to raise rates at all for FCM in this case if it believes the lost volume from the increase will reduce, rather than raise, revenue for the Postal Service?
- c. Do you agree that USPS witness Thress and you cannot both be correct in assessing the true value of the own price elasticity for the FCLM subclass?
- d. How do you reconcile your statement above at the Senate Committee hearings on postal reform with the “rate case elasticity” submitted by USPS witness Thress in this case, which shows an own price elasticity for FCM below the absolute value of -1 , albeit higher than the relatively inelastic rate case elasticity for FCM that he submitted in last rate case?
- e. Is your statement at the Senate Committee hearings on postal reform and in your testimony as referenced above one of the reasons the Postal Service considered phased rates preparatory to filing this case, i.e. to avoid a highly publicized double digit increase in the face of increasingly elastic demand conditions in FCM?
- f. Are there other elasticity perspectives than those proffered by rate case witnesses of which you or any staff advising you are aware which have helped inform your opinion of the issues? If so, please provide all such materials, including, but not limited to, materials developed under the direction of Margaret Crenshaw within the USPS or any individuals or groups outside USPS, other internal source(s) or external source(s).

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RESPONSE to GCA/USPS-T1-1:

In his April 14, 2005 testimony before the Senate Committee on Homeland Security and Governmental Affairs, witness Potter was not discussing the empirical estimation of own-price elasticities. Witness Potter testified on the Postal Service's long-term financial and operational outlook. These concerns are not solely focused on FY 2006 (the test year in this docket) but rather look at the longer term. I see no inherent contradiction with the fact that a measured price increase may produce a net increase in contribution and the concern that raising prices is not always the preferred or optimal solution for every given circumstance. In this instance, the Postal Service believes a measured across-the-board increase is the most appropriate means to meet the escrow requirement. However, the long-term viability of almost any organization is not its ability to unilaterally raise prices. Instead, it is the ability of the organization to provide the products or services its customers or constituents need at reasonable prices.

- a. Holding all else constant, if the own-price elasticity for a product is greater than one in absolute value, then total revenue will decrease if the price of the product increases. However, the cited section of witness Potter's Senate testimony does not discuss a circumstance where all else is held constant. Witness Potter discusses a scenario where electronic diversion reduces the demand (shifts the demand curve) for First-Class Mail. This

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RESPONSE to GCA/USPS-T1-1 (continued):

scenario may be associated with, for instance, changes in the actual or perceived substitutability of electronic messages for First-Class Mail. This effect is modeled by witness Thress who states “

The Internet has had a very strong negative effect on First-Class single-piece letters volume, explaining annual losses that have averaged 4 percent per year for nearly a decade.

- USPS-T-7 at 55. Even with the consideration of the effect of electronic diversion as measured by witness Thress, the estimated test-year elasticity of demand for First-Class Mail is less than one in absolute value.
- b. As shown in Exhibit USPS-27A and Exhibit USPS-27B, I do not believe that the proposed increase in First-Class Mail rates will reduce revenue for the Postal Service. Test-year revenues from First-Class Mail are projected to increase by \$1.4 billion. This projected revenue increase incorporates the volume reduction that occurs as a result of the proposed increase in rates.
- c. See the response to (a) above. In addition, witness Potter’s Senate testimony focuses on a longer period than does witness Thress’s testimony.

Witness Potter’s Senate testimony discusses the long term performance of the Postal Service beginning with postal reorganization and focusing on the Postal Service’s success in addressing more recent concerns expressed by the General Accountability Office, Congress and others. He

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RESPONSE to GCA/USPS-T1-1 (continued):

specifically notes “[t]he future of America’s postal system, however, will depend on much more than the next rate case” and continues to discuss long term planning initiatives including the Strategic Transformation Plan 2006-2010. On the other hand, witness Thress’s testimony including the elasticity estimates are focused on the test year.

- d. See the response to part (c).
- e. As discussed in the Postal Service’s testimony, in this docket, witness Potter determined that the escrow requirement could be best met through an across-the-board rate request, not a “phased rate increase” or any other possible rate proposal.
- f. The only estimates of elasticity relied upon in the preparation of this rate case were those provided by witness Thress in his testimony. I have been unable to locate any other elasticity estimates prepared “within the USPS or [by] any individuals or groups outside USPS, other internal source(s) or external sources(s)” for the Postal Service.

**RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF DOUGLAS CARLSON**

GCA/USPS-T1-2. In your testimony at page 2, starting at line 18, you state “We currently face serious economic and operational challenges. The need to raise rates prematurely for any reason will not help us meet them, and will burden our customers and the economy.” In the same manner, you stated publicly and in greater detail at recent Senate Committee hearings on postal reform: “Declining First-Class Mail volume, coupled with a market shift from higher-margin to lower margin products, will result in insufficient revenue to support our infrastructure and the costs of an ever-expanding delivery network.” In a letter to Sen. Susan Collins dated February 24, 2005, USPS Board of Governors, Chairman James C. Miller III stated: “On the other hand, the Service faces significant challenges. Its decades-old business model, in which a continually-growing First-Class Mail volume with its large per-piece contribution defrays the major portion of infrastructure costs, is no longer valid.”

- a. Are your statements consistent with that of Chairman Miller? If your answer is not an unqualified “yes,” please explain.
- b. Please state specifically what “lower-margin products” you are referring to by subclass.
- c. Combined with your statement about increasing elasticities in FCM, isn't the inevitable conclusion of the points made above that today's lower margin volume drivers for the Postal Service will have to have larger per-piece contributions than at present, while FCM will have to have lower per-piece contributions than at present? Please explain fully your answer.
- d. Do you agree that the proposed across the board rate increase in this case, whatever its merits on other grounds, does not address the relative rate issues implied by the above statements?
- e. When does the Postal Service plan on starting to address the relative per-piece contribution issues raised in the above statements insofar as rate setting is concerned?
- f. Would you agree that if per piece contributions are lowered for FCM, and raised for Standard, some Standard mail that is price inelastic may migrate to FCM, thus helping to ameliorate the current decline in FCM volume?
- g. Is rapid growth from targeted advertising FCM at relatively higher per piece contributions to overhead, albeit lower than current, combined with higher-than-current per- piece contributions from advertising mail that remains in the Standard Class the most likely new business model that the USPS will need to adopt to remain financially viable? Please explain fully your answer.

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GCA/USPS-T1-2 (continued):

- h. Was any costs benefit test applied to the question whether the costs of avoiding the issues raised in a. through g., above, were worth the benefits of an across-the-board revenue raising initiative that does not address those issues? If your answer is not an unqualified “no,” please describe that test fully and state the conclusions it yielded.

RESPONSE:

- a. Yes. I believe the statements of witness Potter and Chairman Miller are consistent.
- b. The context of the quote suggests that witness Potter was discussing products with lower cost coverages (“lower margins”) than the First-Class Mail Letters and Sealed Parcels subclass. The estimated test-year-after-rates cost coverage for the First-Class Mail Letters and Sealed Parcels subclass is 229.8 percent. All other subclasses with the exception of Standard Mail Enhanced Carrier Route have lower cost coverages. Exhibit USPS-27B. While I do not believe that any subclass would be exempted from a future rate increase, the volume growth of Standard Mail Regular in contrast to the decline in First-Class Mail Letters would suggest that this subclass might be one possible source of additional contribution.
- c. No. The quoted statement suggests that the decline in First-Class Mail Letters volume and the possible resulting decline in total contribution from this subclass will need to be offset. However, I cannot reach the conclusion that First-Class Mail Letters subclass per-piece contribution will necessarily decline, it may remain constant or even increase somewhat

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RESPONSE to GCA/USPS-T1-2 (continued):

depending on the Postal Service's evaluation of the circumstances surrounding a future rate request. In addition, while larger per-piece contributions may be necessary from other subclasses, the need for any such increases may be, in part, offset by volume growth.

d. Yes.

e. The Postal Service considers the full context in which pricing decisions are made and develops a pricing proposal that meets its revenue requirement and that is consistent with the pricing criteria and other statutory requirements of the Postal Reorganization Act. While the structure of future rate proposals is unknown, I expect that the Postal Service will consider all relevant factors, including those discussed in the testimony of witness Potter and Chairman Miller in formulating its next rate request.

f. No. Migration between Standard Mail and First-Class Mail would depend on the relative prices of those products not the absolute per-piece contribution. For example, it is possible that per-piece contribution for First-Class Mail could decrease, per-piece contribution for Standard Mail could increase and the actual prices for each of these products would be the same.

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RESPONSE to GCA/USPS-T1-2 (continued):

- g. I do not know. It is unclear what hypothetical you are describing. This question assumes future rates, rate relationships and changes that are outside the scope of this docket.
- h. No. The Postal Service did, however, evaluate this proposal within the context of the nine pricing criteria and the unique circumstances surrounding the escrow requirement as described in my responses to VP/USPS-T27-1c and VP/USPS-T27-9e.