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

POSTAL RATE AND FEE CHANGES, 2005) Docket No. R2005-1

AMERICAN BANKERS ASSOCIATION AND NATIONAL ASSOCIATION OF PRESORT MAILERS ADDITIONAL INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS TO UNITED STATES POSTAL SERVICE WITNESS THOMAS E. THRESS (ABA&NAPM/USPS-T7-6-11)

(June 10, 2005)

Pursuant to sections 26 and 27 of the Postal Rate Commission rules of practice, American Bankers Association and National Association of Presort Mailers hereby submit these joint interrogatories and document production requests. If necessary, please redirect any interrogatory and/or request to a more appropriate Postal Service witness.

If data requested are not available in the exact format or level of detail requested, any data available in (1) substantially similar format or level of detail or (2) susceptible to being converted to the requested format and detail should be provided.

Responses to requests for explanations or the derivation of numbers should be accompanied by workpapers. The terms "workpapers" shall include all backup material whether prepared manually, mechanically or electronically, and without consideration to the type of paper used. Such workpapers should, if necessary, be prepared as part of the witness's responses and should "show what the numbers were, what numbers were added to other numbers to achieve a final result." The witness should "prepare sufficient workpapers so that it is possible for a third party to understand how he took data from a primary source and developed that data to achieve his final results." Docket No. R83-1, Tr. 10/2795-96.

Respectfully submitted,

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ABA&NAPM/USPS-T7-6.

With respect to your answer that it is "not clear" what is referred to in the introductory sentence to the interrogatory, here are some quotes from your recent rate case testimonies.

"While it would certainly be better if one could include an explanatory variable that is more pleasing theoretically than simply "time" or a "trend", the failure to include any variable to account for observed behavior may bias one's other coefficient estimates. In cases of this type, it may therefore be necessary to introduce some type of trend variable into certain demand equations.

Several mail volume equations include some type of trend. For example, the First-Class letters equations include logistic trend variables which are discussed above." (R2001-1, USPS-T-8, p. 115, lines 1-7)

"As recently as the R2000-1 rate case, for example, the Internet was not explicitly included as an explanatory variable in any of the mail demand equations used for forecasting." (R2005-1, USPS-T-7, p. 24, lines 6-7.)

"It is always desirable to be able to explain the behavior of a variable that is being estimated econometrically as a function of other observable variables. Occasionally, however, the behavior of a variable is due to factors that do not easily lend themselves to capture within a time series variable suitable for inclusion in an econometric experiment. It is not uncommon for such phenomena to be modeled in part through the use of trend variables." (R2005-1, USPS-T-7, pp. 33-34.)

In a general demand equation, including that for a postal product such as FCLM, where the quantity demanded is represented on the lhs in the equation as the dependent variable, the independent explanatory variables which appear on the rhs of the equation include the price of the good, the prices of competing substitutes , income and other variables which may affect quantity demand of the good in question. You have used "time trend" variables and also "logistics market penetration variables" in place of data on the prices of competing substitutes, and until this rate case in place of any type of explicit consideration of the Internet competing substitute and the electronic payments system competing substitute for FCLM. In this rate case you have used an "Internet Experience" variable which you have constructed out of Global Insight's ISP expenditures time series.

a. You state the ISP price index has "not exhibited any discernible trend over the past several year." (R2005-1, USPS-T-7, p. 27, lines 5-6.) However, that impact of the earlier price declines you have noted likely operate with a long lag period, as banks and others make investments to eventually take advantage of the new competing substitute. Did your experimental modeling include estimating the lagged impact of the ISP price index declines on the demand for FCLM? If so, what were the results, if not why did you not perform such an experiment?

b. You state on p. 32, starting at line 10 of your testimony in this case that using NACHA time series "tended to be less robust within the econometric demand equations. I think this is because electronic diversion of the mail is a very generalized risk." Have you tested the robustness of this data, [or the quarterly time series data on commercial check volumes, which exists back to at least 1995Q1] against the specific portions of FCLM volumes that electronic payments systems divert, such as billing statements and bills paid through the mail (or for checks, the impact on extra ounce volume, which is a reasonable proxy for bank statements sent through the mail with canceled checks in the mail piece)? If your answer is

"yes", please provide a complete answer to what your findings were. If your answer "is no", please explain why you have not done such tests.

c. In your answer to a. you agree that "In general, it is true that high cross-price elasticities of demand are often associated with high own-price elasticities of demand…" Since you have price data, both nominal and real on postal prices, and since there is voluminous time series available for revenue and/or volume variations for the Internet competing substitute and the electronic payments system (both transactions data and check volume date), econometric modeling of cross price elasticities is possible. Have you conducted any such estimates of cross price elasticities? If so what were the results and how high were those elasticities, if not why not?

ABA&NAPM/USPS-T7-7.

a. You assert in your answer to ABA&NAPM/USPS-T7-2 parts b. and c. that your estimated own price elasticity for single piece FCLM is "stable" across various sample periods, but do not state what it is. What is that "stable " value?

b. You assert that your estimated own price elasticity for workshared FCLM is "stable" across vary sample periods, but do not state what it is. What is that "stable " value?

c. Your econometric specification presumes constant elasticity of substitution (CES), it does not offer any proof, or derive any conclusion whatsoever, that postal demand curves are in fact CES demand curves. In your tests over sample periods, have you also presumed a CES specification? Have you run your sample data under any econometric demand specification that allows for varying elasticity of substitution, as opposed to CES? If you are testing, as you claim, whether elasticities are varying over time by choosing different sample periods, how can you conduct such a test when you largely (if not entirely) rule out by virtue of the CES functional form, the very question you are trying to investigate, i.e. variation in own price elasticities?

d. What do you mean by "changes in econometric methodology", the last of four factors you mention in your answer to b. as being possible causes of changes in demand elasticities for FCLM? Under that term, are you including the use of explicit variables for competing substitutes? If not, then why would you not include the influence of competing substitutes as one factor that could influence estimated own price elasticities, or would this be a "fifth" "possible factor"?

e. You state in your answer to b. that in your experiments with various sample periods, the own price elasticity for single piece and also for workshared emerged as stable across various sample periods. However, in c. you appear to contradict that statement by stating that three changes to the workshared demand equations "appear to have had the most significant impact on my estimate of the workshared First-Class letters own price elasticity", and you go on to list those three changes, among them shortening the sample period to start at 1991Q1 rather than 1983Q1. Please reconcile these two statements.

f. You indicate in your answer to b. that you included the number of Broadband subscribers in your workshared equations. Did you include the number of Broadband subscribers in your

single piece equations, as well as your workshared equations? If so, what were the results? If not, why not, given your statement to the effect that households are increasingly paying bills online?

g. For workshared letter demand equations, you state your experiments were "generally" supportive of a stable own price elasticity since 1991. This appears to be a somewhat weaker statement than you made in your answer concerning single piece elasticities. In what specific non-general areas did you find evidence that workshared elasticities were not necessarily stable? Please provide all details of your conclusions.

h. In your answer to e. you state the changes to your demand elasticities in this case "were the result of changes to the demand specifications used in this case". Over the historical period between R2001-1 and R2005-1, as indicated from the (latest available) 2003 Household Diary Study and considerable other evidence, there has been substantially greater diversion of payment mail (bills sent and bills paid) to electronic payments systems and substantially greater diversion of what the Diary defines as "transactions" related mail to the Internet. Are you saying these impacts had no influence on your demand elasticities? Or, that you are unable to measure these impacts because your demand equations presume constant elasticity of substitution? Or, by the term "demand specifications" are you including the impact from competing substitutes such as the Internet and electronic payments systems?

ABA&NAPM/USPS-T7-8.

a. In your response to ABA&NAPM/USPS-T7-3, question b., there was a typo. "R2001-1" should have read "R2000-1". With that correction, please answer the original question, parts b. as well as c.

b. With respect to your answer to part c. in this original interrogatory, you avoid a direct answer to the question about rising postal rates influencing the decline in check volumes by stating that check volume "is affected by many factors beyond the price of additional ounces charged by the postal service" and you note that the total volume of checks has "fallen consistently" since "1995".
Do you have any evidence that increasing postal rates, including the extra ounce rate since the implementation of that rate increase from R2000-1, have <u>not</u> been one of the "many factors" causing the decline in check volumes?
Do you have any evidence that the extra ounce rate hike emerging from R2000-1 was not the predominant factor after 2001Q4 that continued to reduce check volume further, and accelerated the decline?

ABA&NAPM/USPS-T7-9.

a. In your response to ABA&NAPM/USPS-T7-4. part a., you were asked whether you "have ever computed the impact on postal volumes in FCLM from any nominal cut in FCLM rates". Your answer was non-responsive, focusing instead on "real Postal prices". Please answer the original question as asked, and provide any elasticity estimates you have of the results on postal volumes from cutting the nominal prices of FCLM.

b. If your answer to a. is "No." please answer the following question. How can you then conclude as you did in answering part b. that your elasticity estimates (all of which are generated for rate cases when an increase in FCLM rates is being requested) provide "strong empirical evidence" that a "decrease in First Class letter prices will produce lower First-Class revenues"?

ABA&NAPM/USPS-T7-10.

In your response to ABA&NAPM/USPS-T5, you define your use of the term "long run", whereas the question specifies precisely the context in which it uses the term "long run", namely your use of data that goes all the back to 1991 for workshared letters and all the way back to 1983 for single piece letters.

a. Would you agree that the competitive market environment for Postal Services in 1983 did not include Internet competition and electronic payments systems?
b. Would you agree that if there were enough rate data from cross-sectional variation in real and/or nominal postal rates were the setting a free market rather than a regulatory one for postal services, that you would have a more accurate estimate of current own price elasticities for postal products than is possible by using time series data dating back to 1983?
c. Would you agree that whatever the short run "lagged prices" that impact TY2006 post rate increase volumes are, that your use of, for example 1983-1987 data, in estimating CES own price elasticities is also influencing those test year volume forecasts? If your answer is anything other than an unequivocal "yes", please fully explain your answer.

ABA&NAPM/USPS-T7-11.

Please confirm from your testimony in this case that the computed own price elasticity for FCLM workshared letters is greater than that for Standard A Regular letters, namely –0.376 versus –0.267.