

DOCKET SECTION

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

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POSTAL RATE AND FEE CHANGES, 1997

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY
Docket No. R97-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS BERNSTEIN TO INTERROGATORY OF
ADVO, INC.
(ADVO/USPS-T31-2)

The United States Postal Service hereby provides the response of witness Bernstein to the following interrogatory of Advo, Inc.: ADVO/USPS-T31-2, filed on September 17, 1997.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
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October 1, 1997

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF ADVO

ADVO/USPS-31-2. Please refer to your discussion of the Ramsey workshare discount on pages 87-89 of your testimony. You refer to the difference between the Ramsey single-piece and workshare rates as a "discount" and when, that rate difference is greater than the USPS avoided cost difference, you describe it as causing a productive inefficiency.

Assume a class of mail that offers an optional discount for presortation. In that class there are two general types of mailers. Type A mailers are significantly more price sensitive than Type B mailers. Many A mailers have a user cost of sortation that is lower than the USPS presort discount and therefore presort and take advantage of the USPS presort discount, although a significant number of A mailers do not presort. All B mailers have a higher user cost for sortation and do not presort. Further assume that the USPS discount is the same for both mail types and is based on an accurate estimate of avoided cost, and that the price elasticities of type A and type B mailers are accurately estimated.

- a. Do you agree that the different demand elasticities and user costs for type A and type B mailers will result in different Ramsey prices for these mail types? If not, explain why not.
- b. Do you agree that separate type A and type B Ramsey prices would result in an increase in allocative efficiency? If not, explain why not.
- c. Do you agree that if separate type A and type B Ramsey prices were developed, the same presort discount (equal to the USPS avoided cost) could be applied to both prices? If not, explain why not.
- d. If the presort discounts are based on USPS avoided costs for both the type A and type B mail, would rates as described in (c) above generate any productive inefficiency? Please explain your response.

RESPONSE:

While I will try to be responsive, I find this question somewhat confusing. There appear to be two separate issues addressed in this interrogatory. The first issue regards the optimal prices to be charged for Type A and Type B mailers. However, the Postal Service does not set rates for mailers, it sets rates for mail. Therefore, my responses to this interrogatory depends on whether the Postal Service can distinguish

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between Type A and Type B mailers based on the type of mail that they send. The second issue regards the optimal presort discounts for Type A and Type B mailers (or mail?). As explained in my testimony, the optimal workshare discount depends on the cost difference between workshared and nonworkshared mail, but also on the presence of any demand elasticity differences between workshared and nonworkshared mail. Therefore, the optimal presort discount for Type A mail depends in part on whether within Type A mail there exists a different price elasticity for presorted and nonpresorted mail, but not on whether there exist differences in the demand elasticities of Type A and Type B mailers.

Furthermore, the interrogatory states, "all B mailers have a higher user cost for sortation and do not presort." If this is the case, I do not understand the attention subparts (c) and (d) pay to the presort discount for Type B mailers since by construction, your interrogatory presumes that no Type B mailers presort. Perhaps the quoted statement means that no Type B mailers can send Type A mail (which may be presorted), but there again the confusion between mailers and mail complicates the answer.

a. For simplicity, let us assume that, in the absence of presortation, the Postal Service per-piece costs for mail sent by type A and type B mailers are identical. In that case, the Ramsey prices for type A and type B mailers would be different, with the less price-elastic type B mailers facing a higher Ramsey price. However, this answer requires that it is possible for the Postal Service to distinguish between type A and type B mailers and to charge type A and type B mailers different prices. Otherwise, type B mailers would send mail at the lower type A mail price. For example, it may be that

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within First-Class single-piece mail there are mailers with different own-price elasticities. However, I see no way in which the Postal Service could charge less price-elastic single-piece mailers a higher price than the price charged to more price-elastic single-piece mailers. Instead, a Ramsey price can be determined for all single-piece mail based on the price elasticity of demand of all single-piece mail, which is an aggregate of the (probably) different price elasticities of the individual mailers who comprise single-piece mail.

Consider now the role that presortation plays in price setting. In your hypothetical, some A mailers may presort but no B mailers presort. Therefore, it can be presumed that the Postal Service's per piece costs for mail sent by A mailers is less than the cost of mail sent by B mailers, since some A mail is presorted. The lower average cost for Type A mail would, along with the greater own-price elasticity of Type A mailers, lead to a lower price for Type A mail than for Type B mail.

b. Assume that it is possible to charge different mailers different prices. The Ramsey prices based on different own-price elasticities discussed in sub-part (a) would yield an increase in allocative efficiency as compared to the case where all mailers are charged the same rate. However, if there is no way for the Postal Service to distinguish between Type A and Type B mailers so as prevent less price-elastic type B mailers from sending mail at the lower price set for more price-elastic type A mailers, then separate prices could result in an decrease in allocative efficiency.

c. Again, assume that it is possible to charge type A and type B mailers separate prices. If this is the case, then it is certainly possible to establish the same presort

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discount for these two types of mailers. Whether it is optimal to do so would depend, in part, on whether within the class of type A or type B mailers there exist important differences in demand elasticities for presorted and nonpresorted mail.

d. If presort discounts are set at the Postal Service's cost savings from mailer presorting, then no productive inefficiency will occur. As noted in sub-part (c), this level of presort discount could yield an allocative inefficiency if the demand elasticities for presorted and nonpresorted mail were different. Moreover, as I stated in the preamble to this response, I am confused by the attention in sub-parts (c) and (d) to the presort discount for type B mailers since in your interrogatory you state, "all B mailers have a higher user cost for sortation and do not presort."

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 that reads "Peter Bernstein". The signature is written in dark ink and is positioned above a horizontal line.

(Signed)

September 30, 1997

(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.



Eric P. Koetting

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