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

Postal Rate and Fee Changes, 2006	:	Docket No. R2006-1

OBJECTIONS OF THE GREETING CARD ASSOCIATION AND RESPONSE TO FIRST INTERROGATORIES OF DIRECT MARKETING ASSOCIATION BY WITNESS JAMES A. CLIFTON (DMA/GCA T-1-1-6)

(September 15, 2006)

The Greeting Card Association ("GCA") hereby objects and otherwise provides the response of witness James A. Clifton to the following interrogatories of Direct Marketing Association (DMA) filed on September 13, 2006: DMA/GCA T-1-1-6. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

/s/ James Horwood

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Date: September 15, 2006

DMA/GCA-T-1-1. Please assume for the purpose of responding to this interrogatory that your proposed rates for First-Class Single-Piece Letter Mail were accepted by the Postal Rate Commission.

a) How much revenue would be lost in First-Class Single-Piece Letter Mail as compared to the rates proposed by the Postal Service?

b) Please calculate the implicit coverage for First-Class Single-Piece Letter Mail under your proposed rates.

c) Please calculate the average rate increase for First-Class Single-Piece Letter Mail under your proposal.

d) Please confirm that you propose collecting the revenue lost from First-Class Single-Piece Letter Mail from Standard Regular Mail.

e) Please calculate the coverage for Standard Regular Mail under your proposal.

f) Please calculate the average rate increase for Standard Regular Mail under your proposal.

g) Do you have recommendations as to how the increase in Standard Regular Mail rates should be distributed among letters, flats, and parcels? If so, please provide them and your rationale.

h) Does your proposal apply to all shapes in First-Class Single-Piece Letter Mail or only to a selected set of shapes? If only to a selected set, please specify the shapes to which it applies.

RESPONSE:

a.-c. and e.-g. To answer your questions would require me to re-do the entire Thress forecasting model in LR-L-66, not just the single piece demand equation that I did re-estimate. Such a large task was and is beyond the scope of my testimony. What is clear from my testimony, however, is that witness Thress' model does not produce reliable results for ratemaking purposes for single piece First Class letters.

d. Confirmed.

h. USPS witness Thress' own price demand elasticities are based on data for "all shapes". My proposal is limited to First Class single piece letter mail and Standard A Regular letter mail.

DMA/GCA-T-1-2. Please assume that the Postal Rate Commission accepted your proposal for First-Class Single-Piece Letter Mail, but also decided that the overall coverage for First-Class Mail Letters as proposed by the Postal Service was correct.

a) Please confirm that this would result in an increase in rates for Presort Letters.

b) Please confirm that you have sponsored testimony on behalf of the American Banker's Association in this case.

c) Please confirm that banks use First-Class Presort Mail for both operational and marketing purposes.

d) Would banks that use First-Class Presort Mail for statement and marketing pay increased postage under this scenario?

e) Do you believe that banks would be pleased with this outcome? Please explain any affirmative answer.

RESPONSE:

a. Not confirmed. I stated in my testimony for GCA at page 58, lines 16-21, that all First-Class Automation Presort rates be set at the levels proposed by the Postal Service in this case. Your hypothetical is in my view inconsistent with de-linking First Class workshared rates from single piece rates. With de-linking in First Class, the Postal Service has emphasized separate unit cost contributions made to institutional costs, not any single overall cost coverage. Across classes, as I state in my testimony for GCA at page 59, lines 4-13, not only is there a substantial gap of well over a dime between the low unit cost contribution of Standard A Regular Mail and the high unit cost contribution of First Class single piece mail. That gap has increased by 1.5 cents since the last litigated rate case according to an interrogatory response provided by USPS witness O'Hara..

b. Confirmed that I have sponsored testimony on behalf of the American Banker's Association for automation First Class presort letter rates only, and not for any other rates.

c. Please see my answer to 3.b. below.

d. Please see my response to a.

e. GCA objects on grounds of relevance, burden and harassment to discovery on what witness Clifton "believe[s]" with respect to matters that he has not opined on in his GCA testimony. Without waiving its objections, GCA provides witness Clifton's response as follows: Please see my response to a.

DMA/GCA-T-1-3. Please assume that the Postal Rate Commission accepted your proposal for First-Class Single-Piece Letter Mail to reduce the price by a penny, shifting the resulting burden to Standard Regular.

a) Please confirm that banks also use Standard Regular Mail for marketing mail. If you are unable to do so, you may wish to refer to various NSA testimony in which banks discuss their use of Standard Regular Mail for marketing.

b) Do you believe that banks would be pleased with this outcome? Please explain any affirmative answer.

RESPONSE:

a. In terms of material use, confirmed for some very large banks.

b. GCA objects on grounds of relevance, burden and harassment to discovery on what witness Clifton "believe[s]" with respect to matters that he has not opined on in his GCA testimony. Without waiving its objections, GCA provides witness Clifton's response as follows:

The banking industry, if not each and every individual bank, should be pleased with such an outcome. I do not represent any individual banks. I represent ABA, the industry trade association representing small, medium-sized, as well as large banks. From the latest publicly available reliable data I have seen, a majority of the banking industry's mail volume in First Class continues to be mailed at the full single piece rate. This probably reflects the fact that banks outside of urban and suburban areas do not necessarily have access to a presort bureau and do not have enough mail volume to warrant leasing or purchasing automation machinery. Less than 6% of the banking industry's volume of mail and cost of mail is posted at Standard A Regular Rates according to the publicly available reliable data I have seen. This latter figure may have increased in very recent years despite the NSAs, but I do not have any reliable data source to confirm that. In any event I do not represent ABA or any banks on Standard A Regular rates, as is clear from my answer to 2.b. above.

DMA/GCA-T-1-4. Please consider how banks market their credit cards …

a) As an economist, would you agree that it would be rational for them to evaluate the efficiency of alternative marketing channels? Please fully explain any disagreement.

b) As an economist, would you agree that if prices of Standard Regular Mail increase relative to the prices of alternative marketing channels, some marketing will shift to the alternatives, all else being equal?

RESPONSE:

a. and b. Yes. However, the present mix of marketing mail between First Class and Standard A Regular is in my opinion as an economist due to incorrect relative price signals being sent to such mailers. First Class mail pays a disproportionate share of the Postal Service's delivery costs (attributable plus "institutional"), so marketing mail that would be sent by First Class under correct relative price signals is instead sent by Standard A Regular rates, which are artificially low because of the delivery cost subsidy they receive. In recent years, NSAs were formed in part to reduce the flow of such marketing mail from First Class to Standard A Regular caused by the relative rate problem. Profit maximizing or cost minimizing firms, if rational, will always take advantage of such rate disequilibria. To date, I do not believe the NSAs have solved this fundamental relative rate problem.

DMA/GCA-T-1-5. You estimate the elasticity of First-Class Single-Piece Letter Mail to be -0.456. GCA-T-1 at 3.

a) Please confirm that if some segments of this mail stream are more elastic than this, others must be less elastic. If you do not confirm, please explain fully.

b) Please confirm that if rates increased from their current level to 43 cents and your elasticity is correct, Postal Service revenues would increase all else being equal. If you do not confirm, please explain fully.

c) Please confirm that if rates increased from their current level to 43 cents and your elasticity is correct, Postal Service costs would decrease all else being equal. If you do not confirm, please explain fully.

d) Please confirm that with increased revenues and decreased costs, the contribution to overhead would increase all else being equal. If you do not confirm, please explain fully.

RESPONSE:

a. Confirmed, with the caveat that the Postal Service is losing substantial volumes of single piece mail such as bill payments in areas that appear to me to be the more elastic areas, an outcome that raises “the contribution to overhead” that Standard A Regular mailers as well as First Class letters subclass mailers end up paying. Under current market conditions, when the Postal Service refuses to compete on price as aggressively for single piece mail as it does for other mail, every mailer ends up losing.

b. and c. Confirmed that raising the rates of any inelastic rate category, including Standard A Regular, will lead to higher revenue and reduced costs. What my elasticity findings make clear, however, is that it is relatively easier to raise rates on Standard A Regular mail than on First Class single piece because the former is relatively more price inelastic. Moreover, Standard A Regular mail can afford the modest increase in its unit cost contribution burden as volume growth is healthy, whereas volume continues to fall since the last litigated rate case for single piece mail due to intensified price and non-price competition in the markets in which it competes. Raising prices on products for which the demand is markedly falling, and in areas that may exhibit relatively high elasticity such as bill payments, is a mistake.

d. Please see my answer to a.

DMA/GCA-T-1-6. Your testimony seems to suggest that based on the elasticities you estimate for Standard Regular Mail and First-Class Single-Piece Letter Mail, the Rate Commission should reduce the Postal Service's proposed rate by one cent for First-Class Single-Piece Letter Mail and increase Standard Regular Mail rates to offset the revenue leakage.

a) Please confirm that this is an accurate representation. If you do not confirm, please provide cites to your testimony that explain why you do not confirm.

b) Do you believe that the Postal Rate Commission should consider all the pricing factors of the Act in setting rates?

c) Is there a pricing factor that deals exclusively with price elasticity? If so, please provide a citation to it.

d) Please provide any example of an instance when the Postal Rate Commission based its recommended coverage for classes or subclasses exclusively on the basis of the elasticities for these classes and subclasses.

e) To the best of your knowledge, did the Postal Service ever propose Ramsey prices in rate cases? Is so, please explain why and when it stopped doing so.

RESPONSE:

a. Confirmed.

b. – e. All factors in the Act should be considered in rate making and generally are (if not always in the right proportions), including elasticities. The purpose of my testimony was to point out that the Postal Service has been using highly flawed elasticities as one of the factors used in its proposed rate increases. In the face of intensified electronic competition for single piece letters, and to some degree for the entire First Class letters subclass, I believe that the Postal Service should compete more aggressively on price in key volume-driver markets like the U. S. payments market than they have been with respect to single piece letters especially. Recognizing these competitive factors just leads to smart pricing, it is not any mechanistic application of the inverse elasticity rule derived from Frank Ramsey's 1925 <u>Economic Journal</u> article.