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

RESPONSES OF GREETING CARD ASSOCIATION WITNESS JAMES A. CLIFTON TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION (DMA/GCA-T1-7-9)

(October 11, 2006)

The Greeting Card Association ("GCA") hereby provides the responses of James A. Clifton to the following interrogatories of the Direct Marketing Association filed on September 15, 2006: DMA/GCA T1-7-9. Each interrogatory is set out verbatim followed by the response.

Respectfully submitted,

/s/ *James Horwood*
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Date: October 11, 2006

DMA/GCA-T1-7. Please refer to your response to DMA/GCA-T1-1. 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. Also, please assume that mail volumes do not change in response to your proposed decrease in First-Class Single Piece rates and your proposed increase in Standard Mail rates.

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 calculate the coverage for Standard Regular Mail under your proposal.

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

f) 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.

RESPONSE:

a. – e. Please see my response to DMA/GCA-T-1 a. You are asking me in a. to assume there is no relationship between volume and price, but my entire testimony contradicts such a premise under the new types of competitive conditions faced by single piece letter mail. My testimony for GCA and my rate proposal for GCA was based on an implicit assumption of de-linking. The GCA testimony stands insofar as I am assuming de-linking. Without de-linking, I still propose a one cent cut in the single piece rate proposed by the Postal Service, but under the traditional "linked rates" discount methodology as between single piece and workshared, I must also propose an identical one cent cut in all of the USPS-proposed worksharing rates for FCLM. The revenue loss from that under my proposal without de-linking would also fall on Standard A Regular letter mail rates. I can easily justify this based on the same unit cost contribution arguments made in my testimony for single piece, and because workshared FCLM as well as single piece have been negatively impacted by Internet diversion. However, USPS witness Thress' forecasting model equations are built only around an assumption of linked rates, which is inconsistent with the proposal for de-linking submitted by the USPS in this case.

With all of these caveats, I attempt to respond to your question below utilizing spreadsheets from USPS witnesses Thress and Taufique. I cannot verify the accuracy of the numbers because of fundamental flaws with the Thress model.

Under de-linking, without the GCA proposal to cut single piece rates by one cent from the USPS proposed rates, the institutional cost burden as measured by unit cost contributions would drift upward for single piece since the last litigated rate case. I measure this burden as <u>the difference</u> between the unit cost contribution of single piece and Standard A Regular. That difference was 12.7 cents in R2000-1. Under the USPS proposed rates it would rise to 13.5 cents (and with witness O'Hara's use of revised data to 14.2 cents). Under the GCA rate proposal it would be 12.8 cents, a little more than in R2000-1. Without volume changes, the resulting implicit cost coverage for single piece would be 183.2% compared to the USPS proposed implicit cost coverage of 186.4%. Intense competition from Internet diversion causing falling volumes in FCLM is the reason behind the GCA proposal. The revenue loss of $337,676,000 would be shifted to Standard A Regular mail, whose cost coverage would increase from the USPS proposed 176.5% to the GCA proposed 180%. The unit cost contribution for Standard A Regular would increase from 10 cents to 10.5 cents.

Under “linked rates” , all First Class letters subclass first ounce rates would decline by one cent. Under this variant of the GCA rate proposal, the unit cost contribution difference between single piece and Standard A Regular would be 12.7 cents, identical to R2000-1. The resulting implicit cost coverage for single piece would be 183.8% compared to the USPS proposed implicit cost coverage of 186.4%. The resulting implicit cost coverage for workshared FCLM would be 307.6% compared to the USPS proposed implicit cost coverage of 312.3%. Intense competition from Internet diversion causing falling volumes in FCLM is the reason behind the GCA proposal. The revenue loss of $519,259,000 would be shifted to Standard A Regular mail, whose cost coverage would increase from the USPS proposed 176.5% to the GCA proposed 181.8%. The unit cost contribution for Standard A Regular would increase from 10 cents to 10.7 cents.

f. Standard A Regular Letters only with de-linking. Without de-linking, possibly ECR as well, in part because I believe the elasticity for ECR, while clearly greater than Standard A Regular, is also inelastic.

Table One
R2006-1 Baseline

First-Class Mail — **Financials for Single-Piece and Presort Letters**

Standard Mail — **Financials for Standard Mail Regular**

Test Year After Rates Financials		Single Piece		Presort	Test Year After Rates Financials		Commercial		Nonprofit		Total Regular	Difference SP - STD	Difference WS - STD
Total Revenue	$	19,430,640	$	16,440,420	Total Revenue	$	15,521,094	$	1,843,032	$	17,364,127		
Volume		37,206,438		48,542,760	Volume		62,815,558		12,372,554		75,188,113		
Revenue per Piece	$	0.522	$	0.339	Revenue per Piece	$	0.247	$	0.149	$	0.231		
Rollforward Cost	$	10,423,261	$	5,265,124	Rollforward Cost					$	9,836,572		
Cost per Unit	$	0.280	$	0.108	Cost per Unit					$	0.131		
Per Unit Contribution	$	0.242	$	0.230	Per Unit Contribution					$	0.100	$ 0.142	$ 0.130
Implicit Cost Coverage		186.4%		312.3%	Implicit Cost Coverage						176.5%	9.9%	135.7%

FCM data are obtained from R2006-1, USPS-LR-L-129, WP-FCM-12 Revised
STDM volumes and revenues are obtained from R2006-1, USPS-T-36, WP-STDREG-30 through 32.
Rollforward costs are obtained from R2006-1, USPS-T-10, FY 2008 After Rates D Report, Exhibit USPS-10M Revised

R2000-1 Baseline

First-Class Mail — **Financials for Single-Piece and Presort Letters**

Standard Mail — **Financials for Standard Mail Regular**

Test Year After Rates Financials		Single Piece		Presort	Test Year After Rates Financials	Commercial	Nonprofit		Total Regular	Difference SP - STD	Difference WS - STD
Postage Revenue	$	22,746,522	$	13,229,830	Postage Revenue						
Total Revenue	$	22,913,594	$	13,252,350	Total Revenue			$	9,070,437		
Volume		52,877,658		46,979,736	Volume				40,998,656		
Revenue per Piece	$	0.433	$	0.282	Revenue per Piece			$	0.221		
Rollforward Cost	$	13,326,042	$	5,019,464	Rollforward Cost			$	6,823,933		
Cost per Unit	$	0.252	$	0.107	Cost per Unit			$	0.166		
Per Unit Contribution	$	0.181	$	0.175	Per Unit Contribution			$	0.055	$ 0.127	$ 0.120
Implicit Cost Coverage		171.9%		264.0%	Implicit Cost Coverage				132.9%	39.0%	131.1%

FCM revenue, cost, and volume are obtained from R2000-1, USPS-T-33, Workpaper, page 2, revised 4/17/00.
STD mail revenue, cost, and volume are obtained from R2000-1, USPS-LR-I-166, WP1, pages 21 & 25.

Source: R2006-1, USPS response to GCA-T31-1.

Table Two
R2006-1
GCA Proposal with "De-Linked" Rates

First-Class Mail
Financials for Single-Piece and Presort Letters
SP Price Reduced to 41 Cents from USPS Proposed
42 Cents without Accounting for Volume Changes

FY 2008 Test Year After Rates Financials				
		Single Piece		Presort
Postage Revenue	$	18,880,310,999	$	16,376,070,440
NSA Adjustment				37,803,000
Fees	$	213,324,435.000	$	26,528,032.000
Total Revenue		19093635434		16440401472
Volume1	$	37,206,438,437	$	48,542,759,437
Revenue Per Piece		0.513		0.339
Rollforward Cost	$	10,423,260,976	$	5,265,124,393
Cost Per Unit	$	0.280	$	0.108
Per Unit Contribution		0.233		0.230
Implicit Cost Coverage		183.2%		312.3%

Standard Mail
Financials for Standard Mail Regular

FY 2008 Test Year After Rates Financials		Total Regular *	Difference SP - STD	Difference WS - STD
Total Revenue	$	17,701,803		
Volume		75,188,113		
Revenue per Piece	$	0.235		
Rollforward Cost	$	9,836,572		
Cost per Unit	$	0.131		
Per Unit Contribution	$	0.105	$ 0.128	$ 0.126
Implicit Cost Coverage		180.0%	3.2%	132.3%

* Revenue loss of $337,676 (in 1,000) due to SP price reduction is added to the Standard Regular R2006-1 baseline revenue.

R2006-1
GCA Proposal with "Linked" Rates

First-Class Mail
Financials for Single-Piece and Presort Letters
SP Price Reduced to 41 Cents from USPS Proposed
42 Cents and Accounting for Volume Changes

FY 2008 Test Year After Rates Financials				
		Single Piece		Presort
Postage Revenue	$	18,942,349,733	$	16,132,605,168
NSA Adjustment				37,803,000
Fees	$	213,324,435	$	26,528,032
Total Revenue	$	19,155,674,168	$	16,196,936,200
Volume1	$	37,328,755,707	$	49,293,592,008
Revenue Per Piece		0.513		0.329
Rollforward Cost	$	10,423,260,976	$	5,265,124,393
Cost Per Unit	$	0.279	$	0.107
Per Unit Contribution		0.234		0.222
Implicit Cost Coverage		183.8%		307.6%

Standard Mail
Financials for Standard Mail Regular

FY 2008 Test Year After Rates Financials		Total Regular *	Difference SP - STD	Difference WS - STD
Total Revenue	$	17,883,386		
Volume		75,188,113		
Revenue per Piece	$	0.238		
Rollforward Cost	$	9,836,572		
Cost per Unit	$	0.131		
Per Unit Contribution	$	0.107	$ 0.127	$ 0.115
Implicit Cost Coverage		181.8%	2.0%	125.8%

* Revenue loss of $519,259 (in1,000) due to SP & WS price reduction is added to the Standard Regular R2006-1 baseline revenue.

Source: FCM Data are obtained from R2006-1, USPS-LR-L-129, WP-FCM-12 Revised after making appropriate changes to WP-FCM-11a.

DMA/GCA-T1-8. Please refer to your response to DMA/GCA-T1-4, where you state, ". . . Standard A Regular rates . . . are artificially low because of the delivery cost subsidy they receive." Please define "subsidy" as you use the term in that response. Please discuss whether this definition corresponds with the standard economic usage of the word.

RESPONSE:

My use of the word "subsidy" corresponds with standard economic usage. First Class Mail subsidizes the total delivery costs of Standard Mail. One cannot "see" the subsidy by looking at attributable delivery costs because most delivery costs are "declared" to be non-attributable even though common sense would dictate that a straightforward distribution key such as "per piece by shape" could make most all delivery costs attributable. Because of the higher cost basis from which higher cost coverages for First Class are imposed under postal ratemaking, compared to what are imposed for Standard A Regular, namely lower cost coverages from a lower cost basis, First Class Mail ends up paying a disproportionately large share of most delivery costs, those that are buried in so-called "institutional costs" of the USPS. Nearly all delivery costs could easily be made attributable by class and subclass by introducing a straightforward distribution key as stated above. Once a carrier has First Class letter mail and Standard A Regular letter mail in his/her hands, there is no difference in costs delivering one versus the other. As matters now stand, even on several days per week when I get only Standard Regular Mail in my mailbox, it is the high First Class Mail letter rates that are paying a good share of the costs for that delivery through the higher institutional cost contribution of FCM. Formally, the clearest way to make the American subsidy for Standard A Regular Mail directly visible would be to apply the European mathematical models of full liberalization and look at the total costs for the entrant's delivery system. The resulting assignment of costs by the entrant as between First Class and Standard would look entirely different than today's USPS assignments of so-called non-attributable delivery costs and attributable costs. Given respective volumes, the share of First Class delivery costs in the entrant's delivery system would be less and the share of Standard A Regular mail would be considerably more.

DMA/GCA-T1-9. Please provide a complete cite to the Frank Ramsey 1925 article that you cite in your response to DMA/GCA-T1-6. Please provide a copy of the article.

RESPONSE:

The editing process missed a typo and the correct year is 1927. The full citation is: F.P. Ramsey, *The Economic Journal*, Vol. 37, No. 145. (Mar., 1927), pp. 47-61. The article is available from: http://links.jstor.org/sici?sici=0013-0133%28192703%2937%3A145%3C47%3AACTTTO%3E2.0.CO%3B2-K. Because it is subject to copyright protection, a copy is not being provided, but is available for inspection at GCA counsel's office.