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 VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
WITNESS ROBERT W. MITCHELL TO INTERROGATORIES OF
THE UNITED STATES POSTAL SERVICE (USPS/VP-T3-1-2)
(October 18, 2006)

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") hereby submit responses to the following institutional interrogatories of the United States Postal Service: USPS/VP-T3-1-2, filed on October 4, 2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T3-1.

Please refer to pages 9-11 of your testimony. There you indicate that Ramsey Pricing does not automatically ensure that prices are free of cross-subsidization. You also state that the "argument that cross subsidies are bad and should be avoided is a fairness argument, not an economic one," and that '[n]othing in notions relating to the efficiency of resource allocation argue that cross subsidies are bad or explain how to avoid them." VP-T-3 at 10-11. Please refer to the previous testimony of Prof. Panzar on this subject, USPS-T-11 at 8-12 (Docket No. R97-1), where he concludes (pg. 11) that "in addition to their intuitive fairness properties, there are important efficiency reasons for the Postal Service to attempt to set rates that are free of cross-subsidy." Please discuss why or why not his testimony is inconsistent with your assertions as quoted above.

Response:

I do not see an inconsistency, as it is not a focus on achieving economic efficiency that leads to the cross-subsidy test. However, Professor Panzar does add an important complement to the argument that cross subsidies should be avoided.

A widely recognized prescription is that regulators should seek to bring about cost-based rates of the kind unrestrained competition would tend to generate if competition were practicable. Professor Panzar points out that if one product is priced below its incremental cost, then the other products as a group are priced above their stand-alone cost, and that this is not a condition that could survive in a competitive system, for competitors would compete successfully for the other products, which could qualify as inefficient entry.

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T3-2.

Your testimony (e.g., page 11, lines 15-18) appears to be premised on the presumption that the Postal Service's operational treatment of saturation letters is caused by the presence of saturation flats. Please confirm that your fairness concerns do not apply if the policy of maximizing DPS processing of saturation letters were independent of the existence of saturation flats. If not confirmed, please explain fully.

Response:

The question you raise is an interesting one. Suppose no saturation flats exist and the Postal Service is analyzing the costs of alternative ways of accomplishing the delivery of saturation letters. It sees itself as having two options. Option A involves handling the letters as extra bundles and has a cost of 3 cents per piece. Option B involves DPSing the letters (and taking them out as part of a tray of DPS'd letters) and has a cost of 5 cents. (Assume it is clear that DPSing the letters costs less than casing them.) The question becomes: Acknowledging that extra bundles have been standard operating procedure for some years, does the Postal Service have the right and the freedom to decide that it has a preference against extra bundles and therefore that the only service it will offer is the higher-cost 5-cent service – *i.e.*, to select an operating system that is not efficient in the cost-minimizing sense? I contend that it does not. However, if that decision is made, then I agree that the fairness questions I raise would not arise. The analysis needs to be done.