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

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

REVISED RESPONSES OF GREETING CARD ASSOCIATION WITNESS JAMES A. CLIFTON TO INTERROGATORIES OF THE NEWSPAPER ASSOCIATION OF AMERICA (NAA/GCA-T1-1-5)

(October 20, 2006)

The Greeting Card Association ("GCA") hereby provides the response of James A. Clifton to the following interrogatories of the Newspaper Association of America filed on October 4, 2006: NAA/GCA-T1-1-5. This replaces the responses filed on October 18, 2006. The revision is necessitated by the omission of proper identification of each response as required by the Commission's Rules of Practice and Procedure § 3001.26(b). Revised responses are being filed contemporaneously herewith.

Each interrogatory is set out verbatim followed by the response.

Respectfully submitted,

/s/ James Horwood

James Horwood
Spiegel & McDiarmid
1333 New Hampshire Ave. NW, 2nd Floor
Washington, D.C. 20036

Date: October 20, 2006

NAA/GCA-T1-1: Please refer to pages 2 and 3 of your testimony, where you state that an incorrect elasticity estimate ". . .leads to flaws in rate proposals and the revenue requirement, and flaws in the assignment of institutional cost coverages based on faulty demand elasticities and other perceptions of market conditions." One of the components used to determine rates and to determine an appropriate institutional cost contribution for a mail subclass is that subclass's value to mailers.

(a) Were one to know only the *correct* own-price elasticity of demand for a particular mail subclass, would that information be sufficient to accurately determine the value of that subclass to mailers? Put differently, are there factors other than the elasticity of demand that determine the overall value of the subclass and therefore inform the appropriate contribution of that subclass to institutional costs?

(b) Is it possible that a mail subclass with a demand that is significantly more elastic (at current price of that subclass) than some other mail subclass (at the current price of that other subclass) offers value to mailers that significantly exceeds the value to mailers of the other (more *in*elastic) subclass? Please explain, and in particular explain the role played by the volume of each subclass in determining the total value of that subclass.

RESPONSE:

a. Yes, there are other factors that matter in determining the value of that subclass to mailers beyond own price demand elasticities in general. However, with respect to the particular situation described in my testimony, it is my belief that the Commission especially, but also the USPS itself, must be far more savvy about pricing in light of market conditions rather than business-as-usual cost plus pricing than it seems to have been in the past or with its proposals for the single piece rate in this case. In its recommendation for the First Class single piece rate in this case the Commission cannot realistically assume that we are in the same market environment that existed, or was perceived to exist in the last litigated case in R2000-1. We have seen dramatic drop-offs in single piece volumes since that last rate case, future uncertainties are high with respect to further large drop-offs, and those are the key realities that need to be considered in setting the single piece rate in this case. The rate should be set it as low as possible, even below the 41 cent rate GCA proposes, given the competitive realities. Please see my entry under "competitive market processes" in The New Palgrave, 1987 edition, MacMillan, New York and London, for a fuller discussion of the intensity of modern competitive processes such as those USPS faces.

b. What I discovered using VES demand curves that overcome most all the flaws of the Thress model is that First Class single piece mail is somewhat more elastic than Standard A Regular and, correspondingly, more elastic than was heretofore believed. The previous belief was that single piece was more inelastic. In either calculation, we are speaking about roughly 39 billion pieces of single piece and 51 billion pieces of Standard A Regular, utilizing actual PFY2005 billing determinant data. Single piece, even with the corrected elasticity, offers more value than a Standard letter; privacy, return, forwarding, priority in sortation. However, there is a wide gap between single piece rates and Standard A Regular rates at USPS proposed rates in this case, and that relative rate difference greatly exceeds the relative value difference in my view. To bring the relative rates into closer alignment with the relative values, the single piece rate should be lower than the USPS proposed rates and Standard A Regular rates should be higher than those proposed by the

USPS in this case.

NAA/GCA-T1-2: Is it a fair interpretation of your testimony that the emergence of the Internet, including email and electronic payment systems, should have (and did) make the own-price elasticity of demand for single-piece First Class letters relatively more elastic over time, but that the Postal Service's volume forecasts would suggest that that demand has become *less* elastic?

RESPONSE:

Yes.

NAA/GCA-T1-3: Please explain your qualitative understanding as to why the price elasticity of Standard Regular mail appears to be declining during the periods of time covered by your testimony. Please address what effect you believe that the growth of the Internet may have on Standard Regular mail.

RESPONSE:

I am not an expert on Standard mail, so I am speculating here in my answer. The competitive alternatives to Standard Mail are well known, have been in place for a long time, are not in rapid and unpredictable evolution as is the Internet as a competitive alternative for single piece (and workshared) FCLM. Possibly, price and non-price factors for competing alternatives to marketing mail, like the price of a 30 second spot during the Super Bowl, have rendered mail as an especially desirable medium with higher value added over time, as demonstrated by the falling elasticity in Standard A Regular. My impression is that advertising on the Internet has not been a particular success, and that would be a very close substitute for mail advertising. Internet selling having been tried but found wanting, possibly the recent growth of marketing mail is a direct result of advertisers redirecting resources from the Internet and back toward the tried and true method of Standard Mail. And perhaps that shift has also demonstrated higher than previously recognized value of Standard A Regular mail, as also reflected in its falling elasticity.

NAA/GCA-T1-4: Please refer to page 53, lines 17 to 21, of your testimony. Please explain what you mean by "At the margin for the R2005-1 rate case" and the meaning of the -0.765 and -0.190 price elasticities presented there.

RESPONSE:

By "at the margin" I mean that the elasticity number from our VES regression runs shows a value at the last margin of time (namely 2005) in that data series equal to -0.765. See Appendix Table A2. Similarly, see Appendix Table A6 for the -0.190 number.

NAA/GCA-T1-5: Please refer to page 59 of your testimony, where you compare the unit contributions to institutional costs of First-Class single piece and Standard Regular mail. Please explain how comparisons of unit contributions should be used in postal ratemaking.

RESPONSE:

The Postal Service itself seems to have highlighted the concept of "unit contributions" in its approach to ratemaking for this case for the FCLM subclass, namely expressing a desire to make them equal as between single piece and workshared under de-linking.

It occurred to me that the same principle ought, possibly, to be emphasized across classes and subclasses, not just within a subclass, in lieu of or in addition to the more traditional "cost coverage" or mark-up ratios approach. As a result a unit cost contributions table was created for a GCA interrogatory, GCA/USPS-T31-1, which looked at a time series of unit cost contributions for single piece and workshared in FCLM, and in addition for Standard A Regular as well. The table showed that the unit cost contributions for single piece and workshared were not only substantially greater than that for Standard A Regular, but that the gap since the last litigated rate case assuming the USPS proposed rates in this case for TY2008 would grow. USPS witness O'Hara's response to the GCA interrogatory confirmed the table's results generally, and his updated data for some cells in the table showed the gap was widening even more than seen from the original table. Reducing that growing gap in unit cost contributions is one of the reasons for my rate proposals for GCA: (1) assuming de-linking; and (2) assuming no de-linking. Please see my response to DMA/GCA-T1-7.