

Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Annual Compliance Report : Docket No. ACR2007

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these comments in response to certain points made by commenters in the initial (January 30, 2008) round. GCA endorses the view expressed in several comments that the existing rates are not subject to revision in this proceeding. We also criticize a specific proposal concerning future rate relationships between Single-Piece and Presort First-Class Letters.

I. Status of the R2006-1 rates

The Postal Service in its FY 2007 Annual Compliance Report, and several commenters¹, state that the current rates, having been duly established in a proceeding conducted under the former Postal Reorganization Act of 1970, are not subject to revision in this proceeding. GCA agrees. This docket combines existing rates set under the 1970 Act and a compliance review process which had no counterpart in that statute and invokes some criteria newly enacted by the Postal Accountability and Enhancement Act (PAEA). It is, necessarily, unique;

¹ See United States Postal Service FY 2007 Annual Compliance Report, p. 1; Comments of Alliance of Nonprofit Mailers and Magazine Publishers of America, Inc., pp. 1-3; Initial Comments of Pitney Bowes Inc. in Response to Notice of Filing of Annual Compliance Report, p. 2; Comments of National Postal Policy Council, pp. 1-6.

so far as non-reviewability of existing rates is concerned, it cannot furnish any precedent for future practice under 39 U.S.C. §§ 3652-3653.

II. Rate relationships in First-Class Letters

In this section, GCA rebuts arguments presented by National Postal Policy Council (NPPC) with respect to (future) relationships between Presort and Single-Piece First-Class Letter rates.

A. Like some other commenters, NPPC seeks to have the Commission use this proceeding as a quasi-rulemaking to influence future rate changes under 39 U.S.C. § 3622(d)(1). We leave aside the question whether this annual compliance review, which as noted above concerns rates established in a proceeding under the old statute, is an appropriate forum for such questions, and focus instead on the substantive problems raised by some of NPPC's suggestions.

At pp. 6-7 of its Comments, NPPC attacks as "excessive" what it calls the "rate preference" for single-piece First-Class Mail. It appears to find this preference expressed in two different ways:

. . . the rate preference for Single-Piece Mail is still excessive. According to the Postal Service's data, the average Presort letter still pays approximately 3.4 cents more in unit contribution^[2] than the average Single-Piece letter, a relationship contrary to the Efficient Component Pricing Rule. . . . The same CRA data show that Presort letters have only 38 percent of the unit attributable cost of Single-Piece letters (11.8 cents vs. 31.2 cents), and that the cost coverages of the two kinds of First-Class Mail are 279 percent and 157 percent, respectively. . . . These cost coverages equate to percentage markups of 179 percent and 57 percent, respectively.

² The unit contributions, as shown in the CRA data (Postal Service Library Reference FY07-LR-1), are \$0.211 for Presort and \$0.177 for Single-Piece, a difference of about 19.2 percent.

Even Ramsey pricing theory cannot justify these disparities. Not even the most ardent advocates of low Single-Piece rates have contended that the demand for Single-Piece First-Class Mail is three times more [sic] price-elastic than the demand for Presort First-Class Mail. To the contrary, the demand elasticity data submitted by the Postal Service two weeks ago indicate that the long-run own-price elasticities of the two categories of First-Class letters are virtually identical: -0.232 for Single-Piece letters vs. -0.246 for Workshared letters. [Footnote omitted.] In future rate adjustments under 39 U.S.C. § 3622(d), the Postal Service should move to eliminate the rate preference enjoyed by Single-Piece Mail.

As to the first issue: NPPC does not attempt to justify using the Efficient Component Pricing (ECP) principle in a situation where Single-Piece and Presort First-Class Letters have been redefined as separate products, rather than as worksharing-defined rate categories within a single subclass. As NPPC itself says, “[t]he two are separate products under the recently implemented Mail Classification Schedule, *and should be priced separately.*”³

The ECP principle, however, applies where certain Postal Service functions required for a particular product can instead be performed by the mailer or its agent at a cost different from the Service’s. When both Single-Piece and Presort Letters were considered subsets of First-Class Letters, it was straightforward (in theory, at least) to argue that mailers of Single-Piece First-Class Letters could undertake worksharing if it seemed remunerative to do so, and abstain from it if not. In that situation, the ECP principle served to indicate which choice would produce the lowest overall cost for the mailing in question and, correspondingly, to discourage inefficient use of either Postal Service or private-sector resources.⁴ But there is no basis for assuming, as NPPC

³ Comments, p. 6; italics added. NPPC applauds this separation (“ . . . the Postal Service has properly delinked rates for Presort First-Class Mail from Single Piece First-Class Mail.”).

⁴ See PRC Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products (Order No. 43), ¶ 2119.

apparently does, that this theoretical option survives the bifurcation effected by the new Mail Classification Schedule. In describing its restructuring of First Class, the Postal Service pointed out that

. . . The costs are clearly different for those letters/postcards that are entered in bulk and meet the many eligibility characteristics for bulk prices, as opposed to those pieces that are entered individually; indeed, the costs for bulk First-Class Mail have been separately reported in the CRA for many years. Also, on a broad level, the nature of the communication and its purpose differ between bulk and single piece letters/postcards, with the former generally used for business applications involving groups such as customers and the latter generally used for individual correspondence or transactions. Thus, from both a cost and a market perspective, bulk letters and postcards are a much different product than are single-piece letters and postcards.^[5]

Thus, as a matter of basic mail classification, the mailer option to which the ECP principle applies is no longer assumed to exist as between workshared First-Class in general⁶ and Single-Piece. And, as the Commission said in its Docket R2006-1 opinion,

. . . it seems to be fundamentally fair that mailers pay the costs they impose upon the Postal Service plus the same contribution per piece that all the mailers make *within the same subclass*. This is the definition of an ECP price.^[7]

Thus the situation in which the unit contributions of Single-Piece and Presort letters could be compared for purposes of applying the efficient component pricing rule no longer exists. Consequently, there is no foundation for NPPC's argument that, because Presort Letters make a somewhat larger unit contribution

⁵ PRC Docket No. RM2007-1, United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26 (September 24, 2007), p. 12.

⁶ Presumably it would still govern decisions *within* the workshared category as to what, if any, further worksharing would promote overall efficiency.

⁷ PRC Op. R2006-1, ¶ 4032 (italics added).

to institutional costs than Single-Piece Letters, ECP may require⁸ that Single-Piece rates be raised. The Commission, accordingly, should not urge or instruct the Postal Service to base future rate filings on the dubious notion that ECP calls for more nearly equal unit contributions as between workshared and Single-Piece First-Class Letters.

B. Does the separate-product status now accorded to Single-Piece and Presort suggest, however, that their markups should be equalized on the basis of the long-run own-price elasticities cited by NPPC? GCA submits that it does not.

First, in transmitting the demand materials relied on by NPPC, the Postal Service made it clear that they constituted an update of demand analyses presented by it in Docket No. R2006-1.⁹ That is, they offer analyses of a state of affairs in which Single Piece and Presort First-Class Letters were *not* separate products, but a single subclass subdivided on the basis of worksharing characteristics (or their absence). This fact by itself would make them an inappropriate basis for future rate policy.

But the most salient issue concerning First-Class demand, in GCA's view, is not whether Presort or Single-Piece has the more price-elastic demand, but how that demand is affected by the increasing competition from nonpostal alternatives.

⁸ We recognize that NPPC's argument might be read as calling for lower Presort rates, and not, or not necessarily, for greater burdens on Single-Piece. In that regard, two points should be made: (i) in the PAEA context of an extrinsic price cap covering all market-dominant mail, it is far from certain that the Postal Service will be able to restrain rates in one category of First-Class Letters without drastically increasing rates in the other; and (ii) NPPC has chosen to characterize the present relationship as a "rate preference" for Single-Piece, and not as an undue burden on Presort.

⁹ They "update the demand analyses for categories of domestic mail and services presented by postal witnesses in Docket No. R2006-1, using the more recent (i.e., through Quarter 4 of FY 2007) volume and price data." Letter from R. Andrew German, Esq., to Hon. Steven W. Williams, January 16, 2008, p. 1.

The practice of comparing estimates of price elasticity as a guide to assigning attributable cost shares grew up (under the 1970 Act) in an environment where growing volume was regularly experienced and indeed may have been taken as a given. But when, for many transactions such as bill presentment and payment, workshared and Single-Piece First-Class are interdependent, and both subject to large-scale displacement by e-media, the argument that their relative prices should be adjusted because their own-price elasticities are almost equal is a serious oversimplification. It may well be that optimal rates for these products will not correspond to those generated by a Postal Service demand model constructed for use under a very different ratemaking statute and a now-superseded classification structure.

The Postal Service's problem today, we would suggest, is to design rates – independently – for Presort and Single-Piece First Class that will preserve their viability.

Respectfully submitted,

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