

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

SIX-DAY TO FIVE-DAY STREET DELIVERY  
AND RELATED SERVICE CHANGES, 2010

Docket No. N2010-1

RESPONSES OF THE UNITED STATES POSTAL SERVICE  
TO GCA INTERROGATORIES GCA/USPS-T2-1 – 2,  
REDIRECTED FROM WITNESS CORBETT  
(May 17, 2010)

The United States Postal Service hereby provides its responses to the following interrogatories of GCA, filed on May 3, 2010: GCA/USPS-T2-1 – 2, redirected from witness Corbett. Each interrogatory is stated verbatim and is followed by the response.

UNITED STATES POSTAL SERVICE

By its attorney:

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May 17, 2010

**RESPONSES OF THE UNITED STATES POSTAL SERVICE TO  
INTERROGATORIES OF THE GREETING CARD ASSOCIATION  
(REDIRECTED FROM WITNESS CORBETT)**

**GCA/USPS-T2-1**

Please refer to your prefiled testimony at page 4, lines 5-9, where you list four causes of the Postal Service's present financial situation.

(a) Please provide your estimate of the relative contribution of the "ongoing effects of the economic recession" to (i) the FY 2009 decline in mail volume cited on page 3, lines 11-12, and (ii) associated declines in revenue.

(b) Please furnish all documents on which your estimates rely.

**RESPONSE:**

(a) (i) While it is a relatively straightforward process to compare one historical year's volume with the next and calculate the observed volume increase or decline with a high degree of confidence, it is a much more daunting proposition to attempt to decompose the observed absolute difference into constituent parts and determine, for example, a precise and unique reason why individual pieces were *not* mailed. The nature of an econometric time-series demand analysis facilitates attempts to conduct a decomposition exercise, but it is nonetheless important to keep firmly in mind that the resulting outputs are still only estimates, particularly if one is looking at outputs from a single year in isolation.

With that caveat, the Postal Service estimates that macro-economic factors caused mail volume to decline in FY 2009 by about 21.7 billion pieces, or approximately 85 percent of the 25.6 billion piece total decline in that year. (Within the econometric demand equations, the "ongoing effects of the economic recession" are reflected in the variable for macro-economic factors.) Note also, however, that because there were offsetting factors (such as adult population) pushing volume up, if one examines only factors which pushed volume down (e.g., macro-economic variables, the Internet, postal prices, etc.), the cumulative volume loss estimated to be associated with those factors (31.2 billion pieces) exceeds the 25.6 billion piece *net* loss referenced above. In other words, while the macro-economic factors may have lead to a piece decline that constitutes approximately 85 percent of the observed 25.6 billion net decline, those factors contributed a smaller percentage of the total pieces (31.2 billion) estimated to be lost by virtue of all of the effects of exclusively negative factors. Specifically, macro-economic effects account for approximately 69 percent of all of the exclusively

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downward effects on volume (total market dominant and competitive products) in FY 2009. Obviously, of course, macro-economic factors are thus still explaining a substantial majority of the observed decline, but not as much as the 85 percent figure might suggest on its own. Broadly speaking, it seems fair to say that the effects of the recession appear to account for something in the general neighborhood of two-thirds of the volume decline experienced in FY 2009.

(ii) No estimate has been made regarding the relative contribution of macro-economic factors on Postal Service revenues.

(b) The figures cited in response to part (a) come from the Excel spreadsheet (GCA.1.Sources.Change.xls) that is attached to this response electronically. Specifically, see rows 303 and 307 of the spreadsheet. The data underlying these estimates were provided to the Postal Regulatory Commission by the Postal Service within the demand analysis materials filed on January 20, 2010, and are available on the Commission's Daily Listings for that day. The construction of these Sources of Change tables was described in the Direct Testimony of Thomas E. Thress on behalf of the United States Postal Service in Docket No. R2006-1, USPS-T-7, at pages 363 through 365.

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**GCA/USPS-T2-2**

Please refer to your prefiled testimony at page 8, lines 9 to 16, and page 9, line 11, to page 10, line 11.

(a) Please furnish all studies, reports, or other documents consulted or relied on by you, which discuss, analyze, or offer proposals regarding –

(i) The onset and/or the duration of Internet substitution as a significant influence on First-Class Mail volume;

(ii) The basis for the belief that the recession may have accelerated diversion of First-Class Mail to the Internet; and

(iii) The basis for the belief that loss of First-Class Mail volume to the Internet is permanent.

(b) Please state your understanding of when the Postal Service concluded that loss of First-Class Mail volume to the Internet is permanent.

**RESPONSE:**

(a) (i) The Internet measure used in the Postal Service's econometric equations for First-Class Mail begins to grow starting in 1988. Keeping in mind the caveats noted in response to part (a) of the Postal Service's response to GCA/USPS-T2-1 (redirected from witness Corbett) regarding the approximate nature of yearly decomposition estimates, the econometric estimates of the impact of the Internet on First-Class Mail volume, by year, are as follows:

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<u>Internet Diversion</u> (millions of pieces)	First-Class Mail			
	<u>Yearly</u>		<u>Cumulative</u>	
	<u>Pieces</u>	<u>Percent</u>	<u>Pieces</u>	<u>Percent</u>
1988	(927.4)	-1.2%	(927.4)	-1.2%
1989	(827.1)	-1.0%	(1,754.5)	-2.0%
1990	(568.4)	-0.7%	(2,322.9)	-2.7%
1991	(911.9)	-1.0%	(3,234.8)	-3.6%
1992	(629.5)	-0.7%	(3,864.3)	-4.1%
1993	(308.1)	-0.3%	(4,172.4)	-4.2%
1994	(1,220.0)	-1.3%	(5,392.4)	-5.5%
1995	(1,984.4)	-2.0%	(7,376.8)	-7.4%
1996	(2,210.1)	-2.2%	(9,586.9)	-9.6%
1997	(1,758.0)	-1.8%	(11,344.9)	-11.3%
1998	(1,334.0)	-1.3%	(12,678.9)	-12.4%
1999	(2,501.4)	-2.4%	(15,180.3)	-14.7%
2000	(2,766.3)	-2.6%	(17,946.6)	-17.1%
2001	(2,045.8)	-1.9%	(19,992.4)	-18.9%
2002	(2,065.3)	-2.0%	(22,057.8)	-21.2%
2003	(2,301.8)	-2.2%	(24,359.6)	-23.7%
2004	(2,400.2)	-2.4%	(26,759.8)	-26.7%
2005	(3,006.1)	-3.0%	(29,765.9)	-29.7%
2006	(3,413.0)	-3.4%	(33,178.9)	-33.0%
2007	(4,164.9)	-4.2%	(37,343.8)	-37.7%
2008	(4,092.2)	-4.3%	(41,436.0)	-43.2%
2009	(4,052.8)	-4.6%	(45,488.7)	-51.6%

(ii) Examining the table above, and focusing on the yearly “Percent” column, one sees a bump in estimated diversion from figures in the 2-3 percent range from 2002 to 2006, up to figures above 4 percent in the 2007-2009 period, coinciding with what we now believe to be the beginning of the recession. While disentangling various effects is not an easy task, these data support the hypothesis that the recession may have accelerated diversion of First-Class Mail to the Internet. The intuitive logic behind the hypothesis is that, as companies and households struggle in a recession and pressures mount to cut costs, the balance can start to swing between what were previously perceived as obstacles to electronic diversion, and the cost economies associated with a switch to non-postal modes for communication and transactions. Thus, for example, data from the Household Diary Study show that the decline in the share of bill payments by mail accelerated during 2008 and 2009.

(iii) On the one hand, just looking at the cumulative “Pieces” and “Percent” columns in the above table should, by itself, be sufficient to alleviate any possible lingering doubts that the volume losses to the Internet are permanent. Declines which

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have not been reversed in over twenty years, but instead have consistently climbed from one percent to over fifty percent, hardly seem likely to be temporary. For a more textual discussion of the underlying factors and trends, however, a detailed summary can be found in the Direct Testimony of Peter Bernstein (USPS-T-8) in Docket No. R2006-1. Mr. Bernstein's testimony, for example, closely examines Household Diary Study data, and in both the years he examine in his Docket No. R2006-1 testimony, and in the years since, the share of household bill payments by mail reported in the Household Diary Study has declined every year. Clearly, even if individual bill payers on occasion switch back and forth, these data -- reflecting net changes in payment method across all mailers -- are consistent with permanent losses, not temporary losses. Likewise confirming the sustained nature of the losses to diversion are the materials prepared by the Boston Consulting Group, as cited in witness Corbett's response to APWU/USPS-T2-5 (May 7, 2010).

(b) On an organization-wide basis, the Postal Service rarely has occasion to address and resolve, in a discrete fashion, matters as broad and as abstract as whether volume losses to the Internet are permanent or not. Therefore, it is difficult to identify precisely "when" the Postal Service "concluded" that First-Class volume losses to the Internet are permanent. What can be said, however, is that testimony about electronic diversion was included in the forecasting testimony of Prof. George Tolley on behalf of the Postal Service as early as Docket No. R84-1. In Docket No. R84-1, Prof. Tolley (USPS-T-6, p. 16) said that, at that point in time, the "buoyant" effects of computers outweighed the negative effects. Prof. Tolley, though, gave considerably more weight to the negative aspects of diversion in Docket No. R87-1 (USPS-T-6, pp.42-44). In Docket No. R90-1, Prof. Tolley had much more to say (USPS-T-2, 51-66), and referenced an internal Postal Service study ("Looking to the 1990's: History of and Prospects for Electronic Diversions of Mail") authored by Grady Foster. While Prof. Tolley in Docket No. R90-1 does not appear to explicitly characterize any particular diversion as "permanent," the testimony includes discussion of trends such as automatic payment deductions, direct deposits, and electronic filings of income tax returns. The

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nature of these types of diversions is such that, once initiated, each would seem highly unlikely to be reversed back to a hard-copy mailing.

In Docket No. R94-1, Prof. Daniel Spulber presented extensive and detailed rebuttal testimony (albeit not on behalf of the Postal Service, but rather on behalf of a consortium of mailer associations) that was exclusively devoted to emerging trends in electronic technology and their effects on postal volumes. Docket No. R94-1, Tr. 19/9183-9239. Prof. Spulber's testimony included the following memorable passage:

Technological and market changes are increasing the benefits and reducing the costs of electronic transmission. These factors are responsible for the rapid expansion of electronic transmission. These ongoing and fundamental changes are entirely independent of postal rates. They can no more be diverted or slowed by a change in postal rates than a reduction in the cost of feeding horses would have halted the development of the automobile.

Id. at 9195. It would seem fair to suggest that, by the time Prof. Spulber testified in the later part of 1994, implicit consensus existed that the technological alternatives emerging represented potential volume diversions that, once lost, would in many instances be permanent. Prof. Spulber, for example, quoted a speech from the previous year by PMG Runyon, acknowledging that in all of the Postal Service's core markets, change was occurring. Id. at 9225. To the extent that there was little if any explicit discussion of the *permanence* of the potential volume losses in these testimonies, it was presumably because the more pressing questions at the time (as today) focused on the timing and magnitude of those losses. Cost/benefit comparisons of the type presented by Prof. Spulber in 1994, however, illustrate beyond cavil why the vast majority of mail diverted to electronic alternatives is not going to convert back, barring drastic and unforeseen changes in circumstances.

## **CERTIFICATE OF SERVICE**

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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