

DOCKET SECTION

BEFORE THE RECEIVED
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-10001 FEB 17 1 46 PM '98

U.S. DEPARTMENT OF COMMERCE
OFFICE OF THE CONSUMER ADVOCATE

Postal Rate and Fee Changes, 1997

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Docket No. R97-1

ANSWER OF THE OFFICE OF THE CONSUMER ADVOCATE
TO FOLLOW-UP INTERROGATORY OF UNITED STATES POSTAL SERVICE
WITNESS: ROGER SHERMAN (USPS/OCA-T300-10)
(FEBRUARY 17, 1998)

The Office of the Consumer Advocate hereby submits the answer of Roger Sherman to interrogatory USPS/OCA-T300-10, dated February 3, 1998. The interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,



KENNETH E. RICHARDSON
Attorney
Office of the Consumer Advocate

ANSWER OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORY USPS/OCA-T300-10

USPS/OCA-T300-10. Please refer to your response to USPS/OCA-T300-8(b). In that subpart, when asked about the efficient pricing of two mail categories in the absence of any cross-price or discount elasticities, you stated that it is "possible" that the marginal cost of one of the two services can be estimated best using information about the other service's marginal cost and the cost difference.

(a) If that possibility were not the case, and you had no reason to believe that the best estimate of the marginal cost of either service came from anywhere other than direct measurement of the marginal cost of that service itself, would you then agree that the efficient prices of these mail categories should be based on their own-price elasticities and own marginal costs, and not on the estimated cost difference between the categories? If you do not agree, please explain fully.

(b) Would you agree that difficulties in measuring or estimating marginal costs may be more of a concern when mail pieces with potentially different cost characteristics are shifting between categories on the basis of relative prices, and are likely to be less of a concern when there is no shifting between categories on the basis of relative price, as assumed in these questions? If you do not agree, please explain fully.

A. (a) If two services have demands that are independent and costs that are totally separate and unrelated, and costs are best estimated by examining the services independently, then it is true that efficient prices could be properly based on each service's cost and demand. The original question in USPS/OCA-T300-8(b) asked me to confirm that the absence of cross-price or discount elasticities between two mail categories alone would make efficient prices free from effects of cost differences, and this claim I could not confirm. With demand independence it is still possible for the cost difference to be relevant. For example, consider a case in which the demand for all letter mail is estimated without any cross-elasticity effect. Suppose that worksharing is offered as an option, and those who workshare are granted a discount from the regular letter-mail rate. The amount of worksharing might then be explained by a supply elasticity, reflecting the response of worksharing mailers to the discount. There is no

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cross elasticity, but the discount clearly should depend on the cost difference.

(b) If mail pieces with potentially different cost characteristics are grouped together in the same mail category, estimating costs for the mail category may be difficult. Merely having a change in the mixture of the pieces can affect measured cost, which is undesirable. And if pieces are shifting between classes when relative prices change, that may cause costs to be badly estimated, since they would have been based on the mixture before the shift. Such shifting is possible, but I didn't think it had always been "assumed in these questions."

DECLARATION

I, Roger Sherman, declare under penalty of perjury that the answers to interrogatory USPS/OCA-T300-10 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed Feb. 13, 1998

Roger Sherman

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

A handwritten signature in black ink, reading "Kenneth E. Richardson". The signature is fluid and cursive, with the first name "Kenneth" and last name "Richardson" clearly legible.

KENNETH E. RICHARDSON
Attorney

Washington, DC 20268-0001
February 17, 1998