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Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Rate Adjustment Due To Extraordinary	:	
or Exceptional Circumstances	:	Docket No. R2013-11

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

The Reply Comments of the Greeting Card Association (GCA) are filed pursuant to Order No. 1847 and Presiding Officer's Ruling No. R2013-11/1. In them, we first discuss significant analytical work presented in the initial comments of some other participants that is consistent with or complements GCA's analysis. We show (i) how it is that for some postal products diversion may have accelerated during (though not necessarily because of) the 2008-09 recession while remaining on the same trend line for Single-Piece First-Class mail, and (ii) how some of the other participants' analyses combine with GCA's[1] to rebut the Postal Service's ascription of its claimed losses to the 2008-09 recession. Next, we comment on issues raised by certain other participants' initial comments.

I. GCA'S UNQUALIFIED OPPOSITION TO THE EXIGENT INCREASE AND THE REASONS FOR IT

A. GCA Opposes the Postal Service's Exigent Rate Increase Without Qualification

In our Comments as well as Dr. Clifton's Statement focusing on a detailed analysis of the Postal Service's case in R2013-11, GCA has stated that it opposes any exigent rate increase. It believes rate design issues raised in the November 26 Comments of various Intervenors should be raised in the ACR process,

[1] In the *Statement of Dr. James A. Clifton on Behalf of the Greeting Card Association* ("Clifton Statement"), forming part of GCA's Initial Comments.

not in this case. GCA has not hedged its bet as with the positions taken by yet other Intervenors. It does not have a “second-best” position in this case in the event the Commission decides on a smaller across-the-board increase or a targeted increase.

Simply put, GCA believes the Postal Service missed its opportunity some years ago in 2010 to show a cause and effect relationship between the 2008-2009 recession and volume losses primarily in letter mail. Even after the Commission in a timely manner complied with the order of the Court of Appeals for the D.C. Circuit to elaborate more fully the meaning of “due to”. All other rate increases associated with past recessions were made within nine months of the end of those recessions.[2] As MPA et al point out at pages 4-5 of their “Initial Comments” the Postal Service has now had “ample time …. to adapt to the reduced volume it can reasonably expect in a world of electronic communications.” The Postal Service certainly has not met its burden of proof this time around either for an exigent rate increase because the econometric models of witness Thress that it solely relies upon to prove cause and effect are fundamentally and, in our estimation, irretrievably flawed. The same diversion of letter mail caused by long-run and *not* cyclical factors that GCA has studied extensively starting with the R2006-1 rate case for Single-Piece has now taken over the volume dynamics of all other major mail categories of the Postal Service: Presort, Standard Regular, ECR and Standard non-profit.

Dr. Clifton’s economic analysis continues where it left off in the past exigent rate case and Docket R2006-1, focused on the econometric work of USPS witness Thress in the Single-Piece demand equation. In some measure it is also focused on Presort First-Class Letter Mail (FCLM), especially the question of the Presort own-price elasticity in witness Thress’s Presort demand equation. In Section III. B. of Dr. Clifton’s analysis figures are presented which show the quarterly

[2] GCA, Clifton Statement, page 51. Based on timing of increases in Single-Piece first ounce rates and NBER timing of the end of recessions.

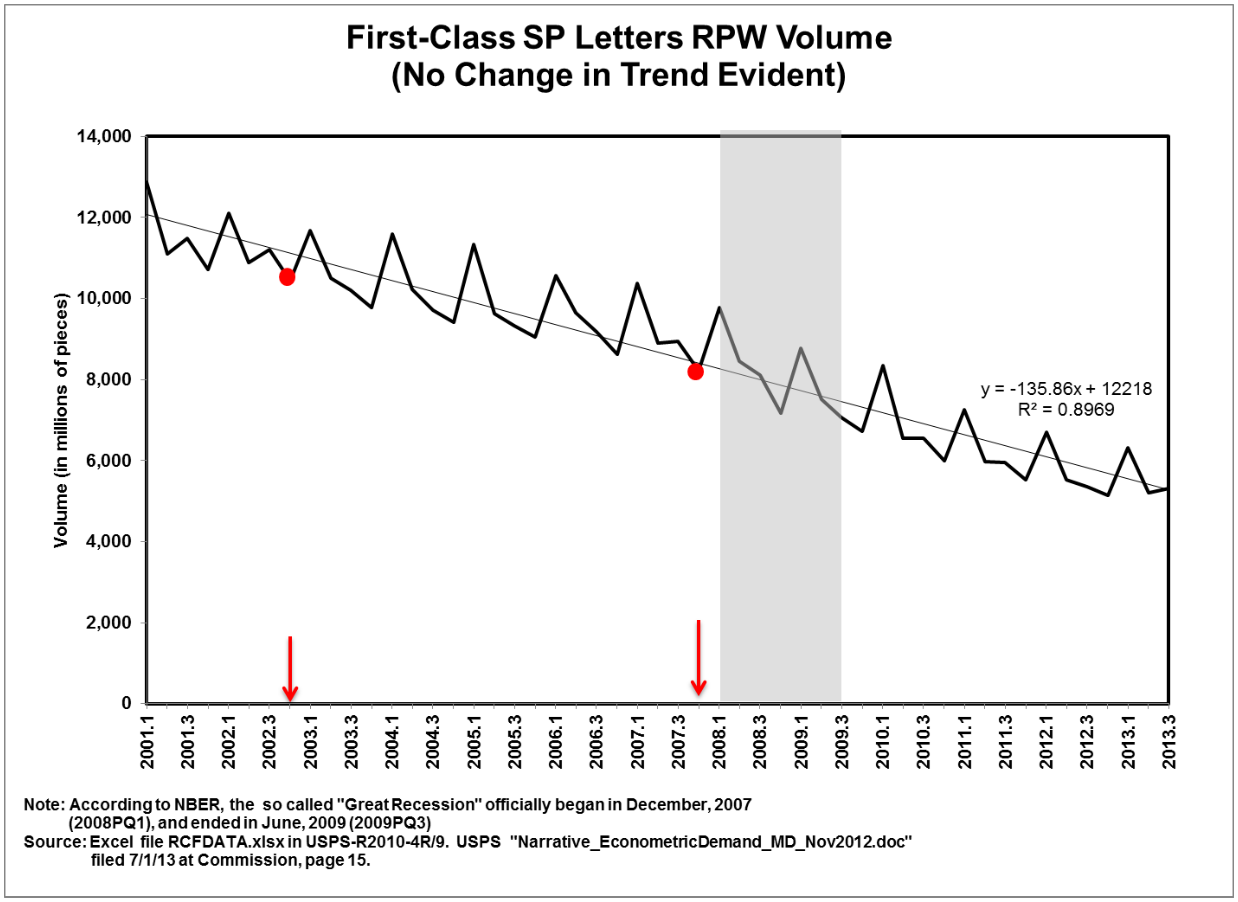
volume over several years of the four major letter products: Standard Regular; ECR; Presort; and Single-Piece. Dr. Clifton states that “Presort volume was hurt by the recession” (see page 15) but concludes on page 16 that the drop in volume in Presort during and since the recession was not “caused by” the recession. That is, the drop in Presort volume was not caused by the exigent event. The Comments filed by MPA et al as well as other direct mail Intervenors on November 26th provide compelling evidence that the drop in Standard Mail and ECR volumes associated with the 2008-2009 recession were also in the main not caused by the recession.

The arguments of NPPC et al and MPA et al center on a belief from evidence presented that Internet diversion of their respective mail products accelerated during the recession. Diversion caused by long run factors rather than the recession per se explains the timing of the changes in volume trends from growth to decline that began at various points over the 2008 – 2009 period. Be that as it may, there can be no disputing that in the U. S., quarterly RPW data for Single-Piece FCLM shows a very steady rate of diversion that was the same before, during and since the recession, a single trend as it were. The linear regression run for a single trend without any econometric manipulation of the raw RPW data has a remarkably high R^2 value of 0.8969, and is reproduced below in the figure.[3]

There is no contradiction in the apparent fact that diversion has accelerated in recent years for some postal products but remained steady for Single-Piece. In fact there is a very straightforward explanation for this. It is well-known that diversion has been going on far longer for Single-Piece than for other letter mail products. Worksharing mailers in First Class have with a considerable lag begun to catch up with the diversion trend created by their customers. They are still in a catching-up phase which is consistent with an acceleration in diversion to reflect their customers’ wishes. For example, in transactions mail, the number of customers using esubstitutes for payments greatly exceeds the number of work-

[3] Clifton Statement, p. 10.

sharing mailers sending bills to those customers via electronic means. The acceleration in diversion by Presort mailers can be expected to continue until there is a rough balance between customers making payments by esubstitutes and Presort mailers sending invoices to them by esubstitutes. At that point, it is likely that the diversion trend for Presort will revert to whatever is happening going forward with its customer base.



Advertising mail is in the same accelerated phase of catch-up with its customers using the Web. For example, as more and more people switch from hard copy news to internet-based news sources, advertisers have followed by ramping up their presence on the Web and have made extraordinary strides in the past decade in the effectiveness of Internet advertising. Generally speaking, this acceleration of diversion began some years after the early diversion phase of Presort.

Most intervenor Comments including GCA's recognize that the recession caused some volume losses in all major letter products, albeit very small losses. (See, for example "Initial Comments" of MPA et al filed November 26, page 1.) In the case of Single-Piece letter mail, Dr. Clifton states the amount of volume loss in Single-Piece during the recession was a *de minimis* amount, 9.5 million pieces per quarter, or about 5% of the total quarterly loss. MPA et al puts the figure for all mail at 3.7% for FY2012 well after the recession ended.[4] The volume losses across all products which can be attributed to the recession rather than diversion are so small that they do not warrant any exigent rate increase, whether temporary, smaller than the Postal Service's request, or of some unknown magnitude based on yet another exigent case filing by the Postal Service.

B. <u>Three Major Pieces of Economic Evidence Introduced by MPA et al, NPPC et al, and GCA in This Case are Remarkably Consistent and Complementary in Their Criticisms of USPS Witness Thress' Econometric Modeling.</u>

Economic evidence of MPA et al. MPA et al sponsored an economic and financial analysis of USPS witness Thress's econometric demand analysis that was by prepared by Christian T. Lundblad, Professor of Finance, University of North Carolina at Chapel Hill Business School. NPPC et al sponsored a survey and economic analysis conducted by Lawrence Buc, President of SLS Consulting, who is an experienced analyst in postal matters. The findings of Lundblad, Buc and Clifton are compelling in part because they arrive at many of the same conclusions about the weakness of Mr. Thress' model using different approaches and conducted independently of each other.

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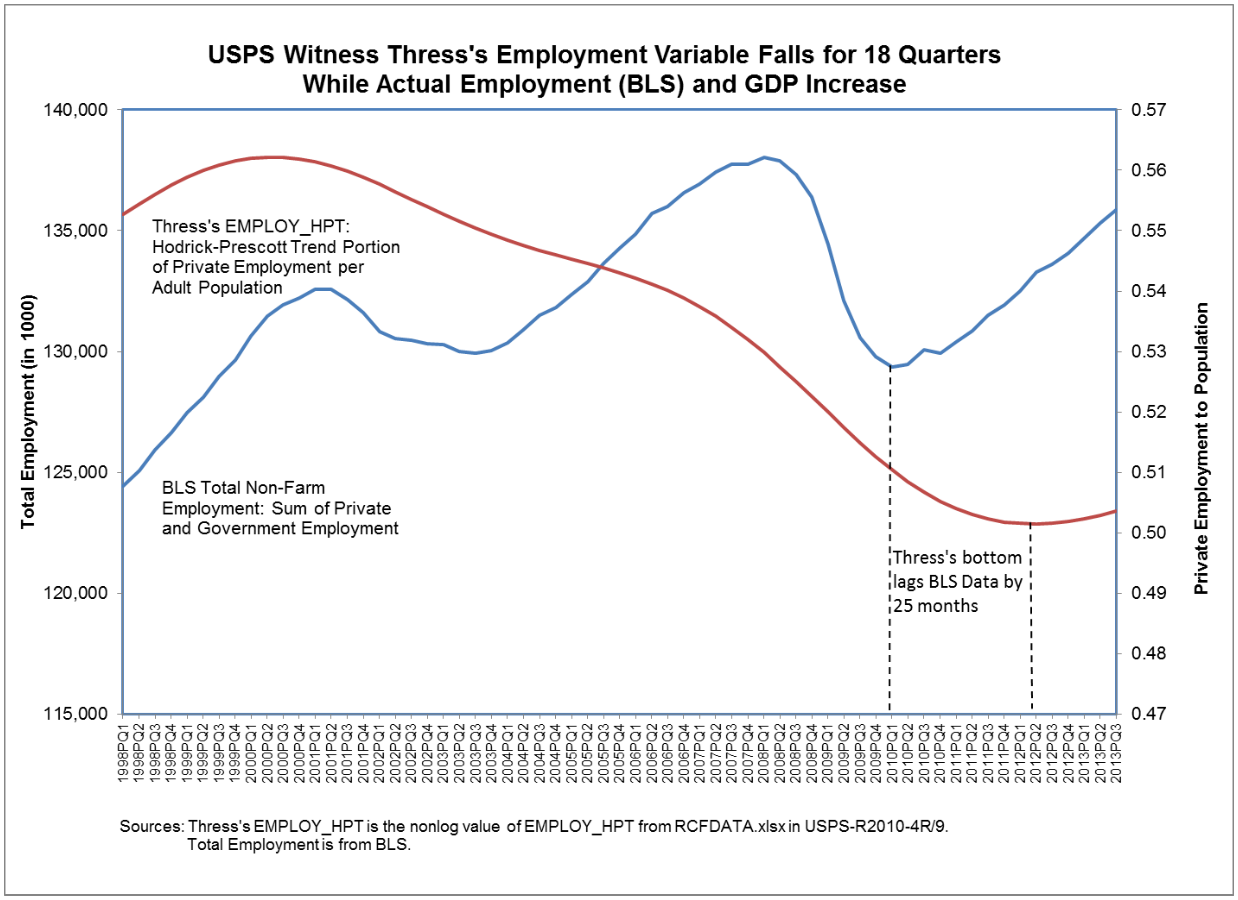
[4] MPA et al, Initial Comments, p. 4.

MPA et al has painted with a broad brush covering all mail in parts of its critique of USPS witness Thress' econometric modeling, and most of its critique is correct. GCA's analysis and findings are highly consistent with that of MPA et al, and amplify those findings by painting with a very narrow brush, and a somewhat more technical and specific critique, focused on Single-Piece. The survey and analysis of Lawrence Buc sponsored by NPPC et al is highly complementary to the findings of GCA that the own-price elasticity for First Class mail is much more price elastic that USPS witness Thress claims it is in his model. Buc's analysis reinforces in great detail the summary conclusion reached by GCA that the recession and post-recession trends in Presort volume were caused by long run diversion decisions of mailers and not the recession.

MPA et al state that "Mr. Thress's model further inflates the losses attributable to the 2007-2009 recession by excluding the positive macroeconomic effects of the post-recession recovery that has been under way since 2009." (MPA et al, Initial Comments, p. 3.). GCA fully concurs with this finding in its discussion surrounding Figure 11 in the Statement of Dr. Clifton at pages 29-33. That figure is reproduced below for purposes of showing concurrence between the GCA and MPA et al findings.



The point made by MPA et al is shown on the right hand side of the figure, namely that Thress's Macro employment variable (in the case of Single-Piece) continues to fall thus contributing to further exigent losses for a full 25 month period after the macro-economy started its recovery and expansion.

GCA makes the additional point that this flaw in witness Thress's model also applies to the entire economic recovery period *before* the 2008-2009 recession started. This reinforces by adding to the argument of MPA et al. that the: "**shape** or **time path** of the Postal Service's estimates of the impact of the 2007-2009 recession on mail volumes is also anomalous." (MPA et al, Initial Comments, page 16.) During that entire 54 month period of economic and employment growth from 2003 through 2007, witness Thress' Hodrick-Prescott trend filter shows employment falling, creating a negative impact on Single-Piece volumes allegedly due to Macroeconomic factors for years before the recession even began! As Dr. Clifton states on page 32 of his Statement, all Thress' employment variable is reflecting during those 54 months is long-run diversion of Single-Piece, not adverse macroeconomic conditions.

Having such a long period of spurious correlation in his employment variable *before* the recession does help witness Thress add several years of additional data points to the time series regression of his Macro conditions employment variable on Single-Piece volume. The sign of the correlation is negative from FY 2003 through mid-FY2012. All Mr. Thress has to do at that point in the design of his econometrics is assert the trend line due to adverse Macro conditions simply became steeper after the start of the recession. This exercise in trying to identify separate trends on this account would not have worked if the pre-recession employment variable had the correct positive sign as it did in the actual history preceding the recession.[5] MPA et al draw the same conclusion concerning Thress that GCA does. "The implausibly large volume losses that Mr. Thress' methodology attributes to the 2007-2009 recession are not an accident, but the result of a series of methodological choices that systematically overstate the effect of the recession." (MPA et al, Initial Comments, page 21.)

GCA as well as NPPC et al and MPA et al have each made the point in their own way that econometric modeling must " (1) make real world sense, and (2) "fit" the dependent variables well (i.e. that minimize the mean square error of the individual data points from the curves fitted by the model to the data)." (MPA et al, Initial Comments, page 23). GCA amplifies MPA et al in stating: "The term 'manufactured' is used here to describe variables for which complex transformations have been made to basic data from BLS, BEA, Global Insight and related sources in order to serve the purposes of the econometric demand equations, the over-riding objective of which is to produce high R^2 for multiple regressions

[5] It is for specific reasons such as this that GCA believes the design of witness Thress's regression model is just as flawed as his interpretation of its results, whereas the limits of MPA's approach in digging into the econometrics lead it to conclude "the biggest error involves not the design of his regression model, but his interpretation of its results." (MPA et al, Initial Comments, page 3.)

run against historical data. The danger of such a unilateral focus is that, in return for marginal improvements in R^2, it can distort the true micro- and macro- economic relationships between independent variables, especially as they actually exist in the historical context under investigation." (GCA, Clifton Statement, page 17, footnote 8.) See also GCA Comments, page 9.

MPA highlights a 2012 USPS OIG report which states: "A careful analysis of the Internet's effect on the demand for mail indicates that volume is shifting to the Internet *because it is a cost effective substitute.*"[6] GCA could not agree more with USPS OIG or MPA et al. It is for that very reason that Dr. Clifton stresses the importance of looking at relative prices between mail and esubstitutes in the econometric demand equations sponsored by the Postal Service. This can be done directly using time series of esubstitute prices where available such as from government data in Finland, or by simulating the relative prices based on such incomplete data as we have for the U. S., since we know what the long run direction of those relative prices has been if not the actual rates of change in any particular time period. (See Clifton Statement, pages 40-43 and Appendix VI.)

GCA also fully agrees with another citation included in the Initial Comments of MPA et al. "**What the U.S. is experiencing is not unique: many internet-enabled countries in Europe and Asia have been experiencing declines in mail volumes for years due to online alternatives."** [7] GCA would add that the experience of other countries is as important when assessing whether the Commission should grant the Postal Service's request for an exigent rate increase in Docket R2013-11. Econometric demand models beyond those of the Postal Service have been estimated for several other countries in recent years, the UK, France, Finland, Switzerland. In general the own-price elasticities from these studies are much higher than those of the Postal Service for major

[6] USPS OIG Report No. RARC-WP-12-010, State of the Mail, (April 27, 2012) at ii (emphasis added). Cited on page 11 of MPA et al, Initial Comments.

[7] Cited on page 12 of the Initial Comments of MPA et al. From: The Boston Consulting Group, Inc., "Projecting U. S. Mail Volumes to 2020, (March 2, 2010). Report commissioned by USPS.

volume letter categories, in part because cross-price elasticities grounded in the theory of relative prices under competitive conditions are included in the demand equations. These elasticities have been found to be rising over time because of diversion. (See Clifton Statement, pages 35-48, Appendix IV and Appendix V.)

Evidence from such studies can augment the record in this case and help inform the Commission in its decision-making. Examining such evidence has a scientifically valid rationale in decision making referred to as Bayesian statistics in order to differentiate it from the “classical” approach to statistical inference used by Mr. Thress. Other Bayesian techniques such as surveys have been used successfully to augment or replace to some degree the classical statistical techniques used by Mr. Thress.

Unlike MPA et al, GCA did not undertake any investigation as to the magnitude of the errors Mr. Thress committed in estimating lost postal volume from the recession for all mail. Our investigation was limited to Single-Piece mail, and focused exclusively on the single question, pertaining to diversion and recession, of whether Mr. Thress’ claim was behaviorally plausible and mathematically and statistically defensible: that linear Trend 3 starting with FY2007Q4 had twice the negative slope of linear Trend 2 starting in FY2002Q4. His conclusion was that there was a significant acceleration in diversion of Single-Piece mail (letters, cards and flats) associated with the onset of recession that could not be explained by long run diversion causes; therefore it must have been caused by the recession. Witness Thress in fact maintains that the trend in pure long run diversion of Single-Piece remained constant throughout the downturn and since the recession ended.

GCA agrees with three cogent observations made by MPA et al in their Initial Comments as well as their general approach to examining witness Thress's estimates of the volume losses caused by the recession.[8]

> The single biggest reason for the exaggerated volume losses attributed by the Thress analysis to the recession is his handling and interpretation of several "trend" and "intervention" variables in his model—and, in particular, his unjustified interpretation of several of these variables as entirely recession-related.
>
> It is critical to understand, however, that trend and intervention variables have no intrinsic economic meaning: as measures of economic reality, they are shadows on the wall of Plato's cave. The underlying causes of these variables *must be inferred by the analyst from information outside the regression analysis itself.*
>
> Mr. Thress has jettisoned this approach, arbitrarily reinterpreting all of the trend and intervention variables beginning around the time of the recession as related to the recession rather than the deepening of electronic diversion. If a trend appeared or changed course after 2007, Mr. Thress stuffed it into the recession box.

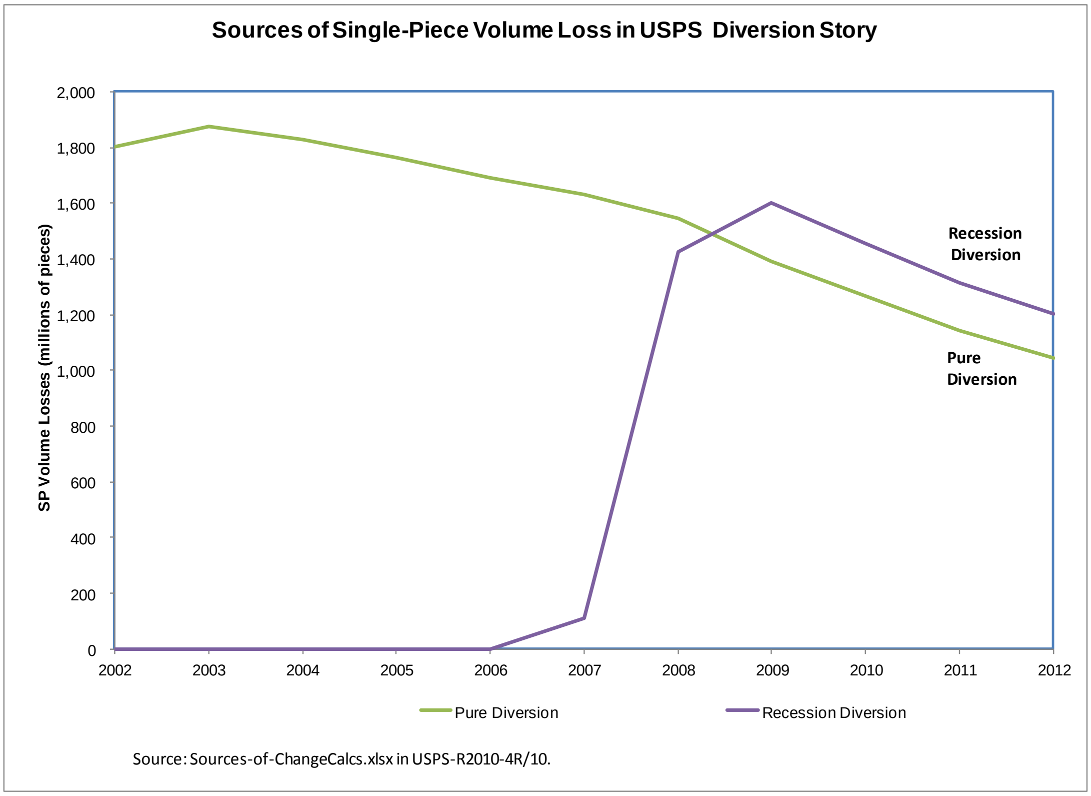
Based on GCA's own analysis, we especially agree with the MPA et al finding that "Mr. Thress has picked and chosen his macroeconomic and trend variables on an essentially *ad hoc* basis to find the trend start dates…".[9] Even accepting Mr. Thress' argument at the technical conference that, in addition to his own judgment, he also in part used spikes in initial computer runs of his recursive residuals to choose the trend start dates in his econometric demand equations, what is the likelihood each of the three spikes for Single-Piece would occur in the same fourth quarter of a postal fiscal year: 1993Q4, 2002Q4 and 2007Q4?

There is concurrence and consistency between the findings of GCA on the causes of volume losses and the findings of MPA et al. These can best be summarized by the discussion of Dr. Clifton around the following figure below, which

[8] MPA et al, Initial Comments, pages 22, 23 (italics in original) and 25 respectively.

[9] MPA et al, Initial Comments, page 45.

graphically show the separation of diversion by Mr. Thress between pure or long run diversion and diversion caused by the recession.



One of the great ironies in the task witness Thress set for himself in this case is that on the one hand, he had to argue that there was no acceleration in the diversion of Presort, Standard Regular and ECR during the recession, while on the other hand he had to argue that there was an acceleration in the diversion of Single-Piece during the recession. This should give renewed meaning in the deliberations of the Commission in this case to the old story about the need for an economist with only one arm in order to render a decision.

The Initial Comments of MPA et al are forceful in citing numerous business facts and statistics demonstrating that acceleration in diversion, and not the recession, caused the postal volume paths of major mailers to shift from growth to decline at various points over the 2008-2009 period. (See especially Initial Comments at pages 36-42.) Their citation of a UK study claiming the same acceleration story for non-presort is, unfortunately, taken out of context.[10] The way in which witness Thress develops his story that most of the volume decline in Single-Piece during and since the recession was mainly due to the recession is completely different than the story he develops for bulk letter mail.

The figure above shows two trends in the diversion of Single-Piece, pure long run diversion throughout the period of 2002-2012, and diversion attributed to the recession starting in 2007 and running through the end of the period. Unlike his story about the causes of falling volume for bulk letter being *directly* caused by the recession, witness Thress makes no such claim for falling volumes in Single-Piece. In the Single-Piece story, Thress claims that (almost) all declines in Single-Piece are caused by diversion, some caused by pure long run diversion just as before the recession, but an increasing share caused *indirectly* by the recession from 2007Q4 forward to the present. In his Statement on behalf of GCA, Dr. Clifton notes that recession diversion in the figure "suddenly appeared out of the clear blue at the exact date NBER dated the start of the recession and then accelerated so rapidly that it overtook long-period diversion quantitatively as an explanation of falling volumes in Single-Piece FCLM". (GCA Initial Comments, Clifton Statement, page 27). The figure implies such a dramatic and instantaneous change in the behavior of consumers underlying their decisions to opt for esubstitutes over mail that it renders Thress's story one of complete incredulity. Dr. Clifton explains it this way:

> If we are to believe witness Thress's model, after barely coming into existence in 2007, by the end of 2008, rec/div suddenly exploded onto the scene in consumers' minds, practically rivaling in importance all the technological innovation, price and other non-price reasons that drove the

[10] MPA et al also cite one study using UK data and time trends that non-presort in that country also experienced an acceleration in mail diversion to esubstitutes. One has to be careful to put such citations in context. That finding only applies to non-presort in First Class. Second Class non-presort experienced a decline in the corresponding time trends, from -5% per annum prior to 1987 down to -4% after 1987. The time trends for Presort in the UK study were positive throughout the sample period (1976/77 – 2011/12), not negative. (See, Jarosik et al, 2013, "Letter traffic demand in the UK: some new evidence and review of econometric analysis over the past decade", in Crew, M. and Kleindorfer, P. (eds.), *Reforming the Postal Sector in the Face of Electronic Competition,* page 204.

> momentum of Internet substitution gradually but steadily over the previous twenty years. Moreover, during the last year of the recession in 2009 and ever since, consumer behavior has been so focused on switching to esubstitutes and out of the mail because of the recession and its aftermath, that consumers have lost their memories of all the price and non-price factors which drove their diversion behavior exclusively for the previous twenty years, including the aftermath of the 1987 stock market crash, the 1990-1991 recession and the 2001 and 2002 recessions. (Clifton Statement, page 28)

USPS witness Thress has stated on multiple occasions in R2013-11 that the rate of long run diversion of Single-Piece remains steady and unchanged in his Single-Piece model, but the quantitative evidence from his actual model belies that claim. The rate of pure or long run diversion in the figure above actually declines from 2008 onwards in Thress' Single-Piece model. To borrow a term from MPA et al, Mr. Thress evidently could not help himself from "stuffing" even more pure diversion into his recession/diversion box so as to contradict his own claims about the course of pure diversion.

In summary, Dr. Clifton reaches the same conclusions about the Thress model as MPA et al do: that it has not produced a "credible inference, nor has the witness or the Postal Service, that the recession caused material exigent volume losses ….. [I]t has simply assumed that it did" in the design of its manufactured econometric demand modeling. (Clifton Statement, page 28).

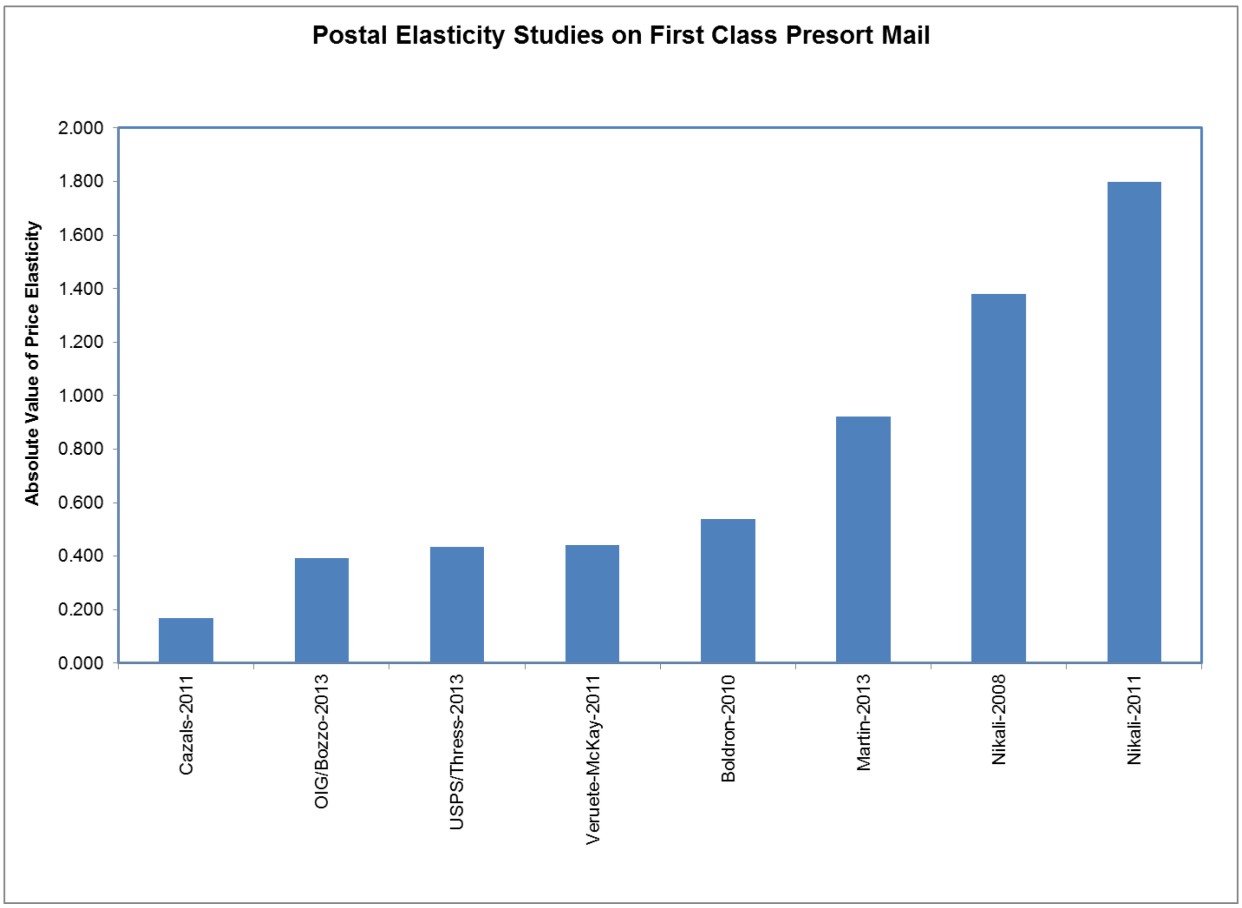
Finally, with regard to the substantial consistency between the GCA Initial Comments and economic analysis and those of MPA et al, there is complete concurrence and virtually identical positions taken by GCA and MPA et al concerning Internet substitution being a set of S-shaped growth curves for specific esubstitute products that have developed in succession, one replacing another, over history without any apparent showdown in diversion to date. Both MPA et al and GCA point out in contrast to Mr. Thress that as a "fundamentally transformative innovation" Internet substitution itself has not been subject to any S-shaped growth curve as Thress claims, citing the slowdown in the growth of the broadband variable used in previous demand models as the reason for abandoning that or any other Internet variable in this case. GCA's discussion of the S-curve is found at pages 24-25 of Dr. Clifton's Statement in its Initial Comments. MPA et al's discussion is found at pages 30-35 of its Initial Comments.

Economic evidence of NPPC et al; the Buc Declaration. The Buc Declaration and the NPPC Comments summarizing it complement the Clifton Statement in the Initial Comments of GCA.[11] Both analyses using very different methods conclude that the Postal Service's own-price elasticities are "quite low" or "statistical outliers" and cannot be used by the Commission in this case. Both analyses conclude that the own-price elasticities of First Class Single-Piece and Presort are much higher than the Postal Service and witness Thress contend they are. Both analyses conclude that own-price elasticities are increasing, and both analyses conclude that the recession was not a material factor in the decisions of Presort mailers in First Class to accelerate diversion around the time of the 2008-2009 recession.

NPPC et al state in their Comments in connection with the statement of Lawrence G. Buc at page 4 that "the demand for mail (First Class and Standard Regular) is likely to be significantly more price elastic than the Postal Service and

[11] GCA was a co-sponsor along with NPPC and others of the surveys designed and conducted by Lawrence Buc. GCA saw a preliminary draft of the results before filing its Initial Comments. However, neither GCA nor Dr. Clifton participated at all in the design or conduct of the surveys nor did they participate in the conclusions drawn from the surveys.

other recent studies have estimated. In some instances, the price elasticity may exceed an absolute value of one." (NPPC Comments, page 4). While GCA did not directly examine the own-price elasticity of Standard Regular, it did examine various independent studies which conducted econometric model analyses of the own-price elasticity of Presort. The results are shown in the figure below and support the Buc Statement sponsored by NPPC et al that Presort own-price elasticity in the presence of competition from Internet substitutes is substantially higher than the models being reported by the Postal Service and the 2013 USPS OIG report from outside consultant Christensen Associates, Inc.



Specifically, what GCA found in the analysis conducted by Dr. Clifton is that multi-country estimates of Presort own-price elasticity are uniformly low when there is no cross-price elasticity variable for esubstitutes included in the Presort demand equation. Where the design of the econometric demand equation does include such a cross price variable, as in two studies by Nikali in the figure above, the own-price elasticity of demand for First Class Presort exceeds -1.0. Since the *relative* own-price elasticities among Single-Piece, Presort and Standard Regular have likely remained the same as among these three mail products, one can draw a reasonable inference that the own–price elasticity of Standard Regular bulk mail is above that of Presort, hence also greater than -1.0. The Buc Statement confirms this in his Table 4, which shows from his survey results that the own-price elasticity for Standard Regular is between -1.12 and -1.17 depending on the size of the proposed rate increase facing Standard Mailers. (Buc Statement, page 15).

Dr. Clifton's Statement on behalf of GCA found compelling evidence in the vast majority of econometric studies examined that the own-price elasticity of Single-Piece has been increasing over time with the expansion and deepening of Internet diversion. Mr. Buc found similar evidence for bulk mail from his surveys of Presort mailers. Mr. Buc states "mailers present a number of reasons why smaller real price increases in the future could be met with larger volume drops than predicted by elasticity estimates." (NPPC Comments quoting Buc Statement, pages 6-7). The cost of mailing is an increasing percentage of total costs in the Presort mail business. This also has implications for increasing Presort own-price elasticities. Mr. Buc states "postage has become such a large percentage of the cost of mailing that postage increases (particularly above-CPI increases) can actually increase the resources available to promote further diversion." (NPPC Comments quoting Buc Statement, page 7.)

GCA agrees with Mr. Buc's observation that econometric modeling is difficult and fraught with possible problems when the explanatory variables do not exhibit much variation. In his Statement Mr. Buc highlights the recent price cap regime under PAEA as being one where there is almost no variation in real prices by the very nature of a CPI based annual adjustment in nominal postal rates. He points out correctly that this creates a problem for estimating own-price elasticities. Infrequent price changes in some postal rates in other countries create similar problems for some econometric demand models insofar as estimating own-price elasticities. At least for the first ounce rate in Single-Piece, nominal postage rates have tracked CPI inflation quite closely well before enactment of PAEA in 2006. Thus, Mr. Buc's criticism of USPS econometric demand modeling is valid well before the recent period under PAEA.

In Dr. Clifton's Statement on behalf of GCA, he points out that under competitive conditions, the only prices that count in a postal demand equation are relative prices. (See Clifton Statement, pages 40-43). He elaborates on the point in Appendix VI. One reason why focusing on relative prices and including cross-price elasticities in postal demand equations under competitive conditions is important is that it substantially increases the variation in prices necessary for accuracy in econometric time series estimation. Nominal postal rates and real postal rates may not exhibit much variation, but the price of postage relative to esubstitutes has experienced significant variation for at least two decades now. One cannot capture such variation without including cross price elasticities in postal demand equations, or simulations of such.

Dr. Clifton's Statement on behalf of GCA makes the following observation about the dynamics of Presort volumes in recent years:

> Did the recession cause the private sector's substitution of electronic products for bank and credit card statements? This diversion would very likely have happened anyway but the planning and execution became timed differently as a result of the recession. Therefore, it is difficult to answer whether the decline in Presort during the recession was "caused by" the exigent event or by plans in the making associated more with pure or long run diversion. The business facts and the continuation of the same new trend since the recession ended point to the latter explanation. (Clifton Statement, pp. 15-16.)

The Buc surveys and his discussion thereof provide more than ample evidence supporting the Clifton Statement. Table 8 in the Buc Statement summarizes the results of a survey of bulk mailers as to what factors motivated their reason for using mail less and esubstitutes more over the period spanning the recession. Of the eight possible answers, the 2007-2009 recession was ranked at the bottom as a reason for the increased diversion of bulk mail. Especially insightful were the additional remarks of several bulk mailers:

> "Whether the recession was there or not, our company would have been going down the path of electronic anyway."
>
> "We developed our 'move to electronic communications' plans in 2006 and vetted he plans for approval in March of 2007. This was before the recession began. That the start of our implementation occurred in the early part of the recession time period was not planned."
>
> "Adoption of [the] digital are occurred more so after the recession, not due to the recession rather than when the clients became more interested in alternative/readily available information and ability to complete transactions at their finger tips."
>
> (See Buc Statement, pages 4, 5 and 4, respectively.)

In summary, GCA believes that both the Buc surveys as well as Dr. Clifton's Statement looking at multi-country studies of own-price elasticities are compelling and alternative evidence to that presented by the Postal Service and witness Thress in this case. Theoretical econometric perspectives on postal demand modeling in the presence of Internet substitution such as Feve et al (2010) stress that such Bayesian techniques are critically important additional information to the classical statistical models submitted by witness Thress in rendering any decision in this case. In GCA's estimation, the surveys designed and conducted by Mr. Buc and sponsored by NPPC et al in R2013-11 are by every measure fully professional and independent, and certainly more trustworthy than some survey exercises filed in the past by the Postal Service.

II. ISSUES RAISED BY CERTAIN INITIAL COMMENTS

A. Some First-Class parties' advocacy of rate design changes is out of place

Introduction. Cato the Censor is said to have wound up every speech in the Roman Senate, regardless of the subject, with "Also, in my opinion, Carthage must be destroyed."[12] Some participants appear similarly unable to resist raising their long-pursued rate issues at every possible opportunity.[13] GCA would suggest that these issues belong not in this proceeding but in the annual compliance docket that presumably will soon be opened.

First-Class Presort rates. A fair example is November 26 filing by the Joint Commenters. They argue, as does GCA, against any exigent increase. Their discussion of how the Postal Service underestimates the price sensitivity of First-Class Mail in general coincides largely with GCA's views as well. But they also advocate using this case to increase discounts for Presort mail, stating that "[i]f the Commission adjusts rates, it should correct these inefficient pass-throughs."[14]

In this case, the Postal Service has proposed an across-the-board exigency increase of about 4.3 percent. It regards this as the proper means of satisfy-

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[12] See Plutarch, *Life of Cato the Elder,* 27.1.

[13] GCA, it is true, raised a rate issue in Docket R2013-10 and discussed it briefly in this case, though without recommending Commission action since in Order No. 1890 the Commission deferred the question to the next annual compliance determination. But GCA's was a brand-new issue, concerning a rate differential introduced for the first time in this year's price-cap docket and perpetuated in this Docket.

[14] Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement in Opposition to Exigent Rate Increase ("Joint Commenters Comments"), p. 40. The "inefficient pass-throughs" referred to are apparently those for 5-Digit Automation Letters and Nonautomation Presort Letters.

ing the "equitable" rate adjustment mandate of sec. 3622(d)(1)(E).[15] This position may or may not be sound, but it clearly is plausible enough to require some discussion by a participant urging the Commission to depart from it in order "to reduce the price charged [the Service's] largest and most important category of mail[.]"[16]

The Joint Commenters, however, do not suggest how their proposed reduction in Presort rates would contribute to the equity of the (hypothetical) rate adjustment they are addressing. They state that their proposal would reduce postal costs, make the mail more competitive, and send "more accurate price signals,"[17] but fail to explain how these objectives outweigh the Postal Service's effort to achieve equity by an across-the-board increase (or, perhaps, why that effort is itself misconceived). We would suggest that if the Commission is expected to consider dismantling the across-the-board structure of the Service's proposal for the benefit of particular mail categories, participants urging it to do so should explain why.

Much the same applies to Pitney Bowes' initial comments.[18] Pitney Bowes, indeed, scarcely mentions the question whether the Postal Service should receive an exigency increase at all, but concentrates entirely on the redesign of Presort rates. It briefly responds to the Postal Service's "equality is equity" argument, and proposes some category-level deviations which it says would preserve the Service's across-the-board policy, but most of its discussion seems aimed at having the Commission decide something resembling a section 2 case under the Sherman Act.[19]

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[15] See Postal Service Request, pp. 7, 35; Statement of Altaf Taufique on Behalf of the United States Postal Service, pp. 11-13.

[16] Joint Commenters Comments, p. 39.

[17] Ibid.

[18] Comments of Pitney Bowes Inc. ("PB Comments").

[19] Id., pp. 11-12, 14-15. Pitney Bowes says (p. 15) that

Most significant is the fact that Pitney Bowes' discussion of the Commission's power to modify Postal Service rates omits any discussion of sec. 3653. In its view, the relatively narrow limits on the Commission's authority to review rates in a price-cap case are balanced (solely) by its broad authority to do so when examining an exigent request. A reader unfamiliar with PAEA would not realize that in an annual compliance determination the Commission – invoking any applicable provision of ch. 36 or regulations thereunder – may

> If . . . a timely written determination of noncompliance is made . . . the Postal Regulatory Commission shall take appropriate action in accordance with subsections (c) and (e) of section 3662 (as if a complaint averring such noncompliance had been duly filed and found under such section to be justified).

The Commission's (very broad) powers under sec. 3662(c) explicitly include "ordering unlawful rates to be adjusted to lawful levels[.]" There is no apparent reason why these powers – which, as noted earlier, will presumably become relevant in about a month – should be ignored in a proceeding which already requires difficult and contentious issues to be decided in a restricted timeframe.

GCA suggests, accordingly, that the Commission defer these (and, as appropriate, other) issues of detailed rate design to the more suitable forum of the upcoming annual compliance determination.

> [T]he Postal Service's persistent practice of setting discounts below avoided costs is unfair and exclusionary. It is an abuse of the Postal Service's monopoly power in restricting access to its downstream delivery services and its monopsony power over upstream workshare services.

B. <u>The Public Representative's already meritorious argument can be usefully reinforced</u>

Introduction. The Public Representative's initial Comments[20] reach a sound conclusion – that "the Postal Service has not justified its exigent Request"[21] – which GCA endorses. Two important aspects of the PR Comments are (i) the proposition that what the Postal Service has filed is not a request for relief from shortfalls caused by the 2008-09 recession, but, in fact, a cost-of-service rate increase, impermissible under the PAEA ratemaking system, and (ii) the concern that the Service might in future file a further case, still claiming recession-induced losses. but based on the unrequested portion of claimed FY 2012 losses, and/or a year other than FY 2012. In this section, GCA offers comments on both.

Recession or liquidity problems? The Public Representative calls attention to a series of statements by Postal Service witness Nickerson which suggest that the instant Request is really a cost-of-service increase masquerading as an exigency case.[22] Mr. Nickerson stated that the Service has an "ongoing liquidity challenge"; that but for that challenge it might not have begun this proceeding; that the purported exigency increase would not cure the liquidity problem but would provide "breathing room"; that he did not anticipate the financial problem vanishing; that the Service might seek a further increase based on the same re-

[20] Public Representative Comments in Response to the Exigent Request of the United States Postal Service ("PR Comments").

[21] Id., p. 10.

[22] The proposition that because the filing was motivated by liquidity concerns it is really a cost-of-service proposal is interesting and quite possibly sound, but in GCA's view is not essential to the Public Representative's most important point. Against the Public Representative's view, it might be argued that the problem is not an increase in unit cost to serve – as the "cost-of-service" label would suggest – but that volume is falling faster than the Service claims it can adapt to. This counterargument is not necessarily valid; if volume declines mean that more fixed cost must be recovered from each piece remaining in the system, that is arguably a "cost-of-service" problem too. But since the real issue is the causal relation – or lack of it – between the volume losses and the recession, whether the present filing is really a cost-of-service case of the kind PAEA was meant to eliminate may turn out to be a secondary question.

cession; and that he did not see how the increases could be rolled back.[23] These statements certainly could be taken as indications that Postal Service management, badly in need of funds, cast about for a mechanism by which to obtain them and lit upon sec. 3622(d)(1)(E). In collecting them and pointing out how they undermine the Service's present arguments regarding the causal relation between the recession and its revenue requests, the Public Representative has usefully clarified the record.

In GCA's view, the strongest of the items the Public Representative adduces are those set out at PR Comments, pp. 11-13: the extracts from the Postal Service's August 2013 Form 10-Q and its five-year business plan of February 2012.[24] In a financial reporting form intended to be comprehensive, a series of statements attributing the Service's liquidity problems to an unmanageable retiree health care prefunding schedule and to electronic diversion, but not mentioning the recession, is a good indication that Postal Service management did not hold the recession responsible for volume losses until it became necessary to do so in connection with this case. Even more persuasive is the line graph from the 2012 business plan, which the Public Representative reproduces on p. 13: it is headed "The Economy is NOT the Main Cause of Diversion" (emphasis in original).

We believe these items are the most probative because statements, like those of witness Nickerson, that the Service's liquidity problems *motivated* the filing of this case arguably are not inconsistent with the proposition that the recession is responsible for the loss of volume and contribution. Someone opposing the Public Representative's position might advance a distinction between (i) management's choosing an exigency filing rather than some other means of alle-

[23] Id., p. 9.

[24] *Plan to Profitability* (February 16, 2012). This is a Postal Service publication issued early in 2012, more than two years after the recession ended, and thus is unlikely to incorporate only a hasty horseback opinion about the nature and significance of its effects.

viating the liquidity problem, and (ii) the proposition that the recession did in fact cause the loss of volume, and urge that the two are not incompatible. That liquidity problems motivated the filing of this case, the argument would run, does not mean that the volume declines largely responsible for those problems were not recession-induced.

No such argument would be available, however, when the Postal Service itself has said or strongly implied in public documents that the volume losses were caused, not by the recession, but by statutorily-created financial obligations and by the long-term trend toward substitution of electronic for paper communications. When management commits itself to a public statement that "The Economy is NOT the Main Cause of Diversion", and subsequently files an exigency case claiming substantially the opposite, skepticism about the latter is clearly well justified.

Possible additional recoveries? The Public Representative also raises pertinent questions suggested by the Postal Service's decision to request only part of its claimed FY 2012 loss ($1.78 billion of a claimed $6.65 billion) and by its specification of losses for other years:

> . . . The first issue is whether or not the Postal Service will, in the future, seek to recoup the remaining $4.87 billion ($6.65 billion - $1.78 billion). The Postal Service states that it "has no present intention to pursue the balance of the estimated exigent harm." Response to POIR No. 5, question 2(b). The Postal Service adds a caveat requiring approval of the separately filed CPI-U market dominant price increases. *Id.* The Public Representative urges the Commission to not allow the Postal Service to use the recession exigency as a line of credit that can be tapped anytime the Postal Service's liquidity/cash flow problems arise. Sufficient time has passed since the onset of the recession for the Postal Service to be able to estimate its exigent needs "due to" the recession.
>
> The second issue is whether the Postal [Service] will in the future seek to recoup losses from periods other than FY 2012. If the Commission establishes a precedent that an exigency exists based on the recession, and that the Postal Service properly estimated losses due to that recession in FY 2012 alone, there is nothing to prevent the Postal Service

> from seeking additional exigent increases based on FY 2008, FY 2009, FY 2010, FY 2011, or FY 2013, etc. Once the precedent is established, it will be difficult for the Commission to arbitrarily limit future requests.[[25]]

GCA would agree that the Postal Service's hints and reservations naturally suggest the issues the Public Representative outlines. Where we find the Public Representative's treatment problematic, however, is in its seeming acceptance of the *theoretical* possibility of recession-induced losses in years falling outside the recession itself. As we said in our Initial Comments, this notion is logically dubious. If economic conditions during the 2008-09 recession[26] determined mail volume during that period, it is incoherent to argue that the same (generic) conditions in FY 2012 did not determine mail volume then. We pointed out that the Postal Service appeared to be entertaining a misleading analogy, treating the recession as capable of causing persisting compensable damage in the same fashion as a negligence-caused permanent disability.[27] Since an economy is a dynamic system, this analogy would be fundamentally invalid. We of course agree with the Public Representative that the Commission should not establish the precedents he warns of, but his arguments could be substantially reinforced by recognizing and relying on the proposition that once the recession ended the losses it may (or may not) have induced ended as well.

This reasoning, however, leads GCA to disagree with one aspect of the Public Representative's discussion:

> Instead of basing its Request on the estimated total effect of the recession, the Postal Service bases its Request on the estimate of only one year's losses, FY 2012. The Public Representative takes issue with the arbitrary selection of one year over another. It appears that FY 2012 was selected because it demonstrates the largest volume loss for which other

[25] PR Comments, pp. 18-19 (fn. omitted).

[26] Strictly, FY 2008Q1 to FY 2009Q3, as determined by the National Bureau of Economic Research.

[27] The Public Representative points out (PR Comments, p. 22, citing Tr. 2/223-224) that Mr. Nickerson apparently endorses just such a mistaken analogy.

> supporting data was available. If the point of this request was to recover from the recession, the request should be based on the total effects of the recession.[[28]]

In GCA's view, the "total effects of the recession" can mean only the effects experienced *during* the recession; that is, in FY 2008-2009. The Public Representative's formulation seems to imply that effects in FY 2012 are "effects of the recession" on the same footing as those experienced during the recession itself. It seems inconsistent with the Public Representative's subsequent argument[29], with which we do agree, against treating recession-induced losses as a perpetual burden on Postal Service finances.

Collecting "exigency rates" through a surcharge. Assuming for argument's sake the granting of some increase in this Docket, the Public Representative proposes[30] that it be constructed as a surcharge on existing (i.e., Docket R2013-10) rates rather than built into them and, accordingly, rolled forward into subsequent price-cap proceedings. The surcharge would be designed to expire when "the Postal Service recoups the fixed contribution the Commission approves due to the exigency."

Such a mechanism would make any exigency increase more likely to pass the reasonableness test of sec. 3622(d)(1)(E). Once the Commission quantifies the financial impact of the exigency, the recovery target is not a certain number of cents per piece or a certain percentage increase in rates; it is a definite dollar amount. To allow it to be recovered repeatedly by baking it into the base rates would be unreasonable in the statutory sense. A surcharge mechanism would probably have to incorporate some assurance that all funds recovered through it would be counted as contribution, and not simply as undifferentiated revenue.

[28] PR Comments, p. 18.

[29] Id., pp. 20 et seq.

[30] Id., pp. 22-23.

C. <u>Valassis offers a cogent argument on the interpretation of the necessity requirement</u>

Valassis Direct Mail, Inc., makes a persuasive argument that Rule 3010.61(a)(3) and the explanation given in Order No. 547 demonstrate that the Postal Service must not only quantify the financial impact of the exigency but also show that its proposed rate adjustments are a reasonable, equitable, and necessary response to that impact.[31] Valassis agrees that the Commission did not reach the latter issue in Order No. 547, but argues that the statements it quotes are still to be taken as the Commission's interpretation of sec. 3622(d)(1)(E). It advances this argument to meet what it understands to be the Postal Service's contention that the "necessity" standard has no relation to the quantified exigent impact, but is elastic enough to encompass any financial stringency the Service encounters, exigent or not.

GCA agrees with Valassis' position on this issue. We would add one further consideration, also discussed in our Initial Comments in this case. Valassis correctly points out at pp. 30 et seq. of its comments that the price elasticities the Postal Service used in its econometric work are out of touch with reality. It proceeds to some cogent observations on how the increasingly competitive environment for all mail relates to the "necessary" branch of the statutory test. Our own focus, here as in our Initial Comments, is more on the "reasonable" branch. We pointed out[32] that a price hike which will not materially increase, and may actually reduce, revenue is not a reasonable response to financial need. Because the Postal Service price elasticities on which we concentrated were so low (in relation, particularly, to similar studies assuming variable rather than constant elas-

[31] Initial Comments of Valassis Direct Mail, Inc. ("Valassis Comments"), pp. 8 et seq.

[32] GCA Initial Comments, pp. 20 et seq., particularly pp. 22-25, and see Statement of Dr. James A. Clifton, pp. 33 et seq.

ticity and making significant use of Internet price data or relative price simulations), we suggested that the proposed adjustments were not statutorily reasonable, since they would drive away so much volume as to make the expected revenue increment unattainable. (This would be true, incidentally, even if the revenue request had been satisfactorily linked to the 2008-09 recession.) We believe these facts, which simply complement Valassis' argument, should be similarly taken into account by the Commission in considering whether the proposed rate adjustments are "reasonable" and "necessary" within the meaning of sec. 3622(d)(1)(E).

D. The Mail Handlers Union presents a largely circular argument and misreads Order No. 864

The Mail Handlers Union initial comments[33] support the Postal Service Request, in large part by arguing that the claimed losses were indeed the result of the 2008-09 recession. Some key aspects of this argument, however, are simply circular.

At pp. 2-3, for example, NPMHU states that

> Some parties participating in these proceedings have expressed skepticism regarding the Postal Service's econometric evidence, suggesting that electronic diversion accounts for a greater proportion of contribution losses than calculated by Postal Service witness Thomas Thress. Although these criticisms may nibble at the edges of witness Thress's quantification of losses, there is nothing to suggest that his calculations are erroneous to the magnitude necessary to bring the losses attributable to the Great Recession below the $1.87 [sic] billion rate adjustment sought by the Postal Service here.[1] And, the Commission has made clear that the Postal Service need not prove its case with "absolute precision," so long as it is plain that the adjustment sought does not exceed the losses attributable to the extraordinary or exceptional circumstances.
>
> ________

[33] Comments of National Postal Mail Handlers Union in Support of Postal Service Request for Rate Adjustment ("NPMHU Comments").

1 Indeed, adding together the contribution losses for each year of the Great Recession, as found in Table 2 of the Postal Service's Renewed Request at p. 11, the cumulative total of contribution losses through Fiscal Year 2012 attributable to the Great Recession is well over $20 billion. The Postal Service seeks here to recover only a very small portion of that – less than 10% -- through its annual adjusted rate.

First, NPMHU attempts to refute criticisms of Mr. Thress's analysis by emphasizing how little of the losses that analysis ascribes to the recession would actually be recovered by the rate adjustment. To do this, of course, NPMHU must ask the reader to accept (i) that Mr. Thress's ascription of (any or all of) the volume losses to the 2008-09 recession (that is, to the sole exigent event which could justify an increase) is correct, (ii) that, although the Commission has already defined the exigency as the 2008-09 recession as defined by the National Bureau of Economic Research, claimed losses extending out to FY 2012 were nonetheless caused by it and hence recoverable through rate increases[34], and (iii) that because the Commission said in Order No. 864[35] that the Service need not *quantify* the net adverse impact of the exigency with "absolute precision" it is also somehow absolved from proving the causal nexus between the exigency and its financial losses.

In other words, NPMHU dismisses criticisms of Mr. Thress's quantification of the claimed losses as merely "nibbling at the edges" of a quantification which itself is the subject of those criticisms. One might reasonably expect, for example, in view of the extended discussion during Mr. Thress's appearance at the November 19 public hearing, that NPMHU would specify what it thinks those criticisms might be and answer them directly. One instance would be the question[36] of how long the impact allegedly caused by the exigency can be thought to continue. Instead of offering reasons to credit the Postal Service's expansive view of

[34] On this point, see GCA's Initial Comments, pp. 3-8.

[35] See, e.g., Order No. 864, pp. 3, 25.

[36] See Tr. 1/103 et seq.

its duration, NPMHU argues that it would take more than ten years to recoup all $20+ billion of cumulative claimed losses, and that within that time the Commission, in its ten-year review of the ratemaking system under 39 U.S.C. sec. 3622(d)(3), will (at least in NPMHU's view) have "conduct[ed] a thorough review of the rate system, including any exigent adjustment implemented pursuant to this docket[.]"[37] The effect on mailers (and mail volume) of several years of unexamined rate increases is not discussed. In other words: Let us make sure that as many horses as possible have bolted before we consider whether to lock the barn door.

NPMHU's argument thus proceeds largely by first assuming its conclusion and then rejecting criticisms because they disagree with that conclusion. In addition, the third of the three earlier-mentioned propositions which NPMHU requires to be assumed is simply a misreading of Order No. 864. Before its statement (p. 25) that absolute quantitative precision is not required, the Commission clearly defined the mandatory causal nexus as meaning that rate adjustments are permitted "only if, and to the extent that, they compensate for the net adverse financial impact of the exigent circumstances" and, further, that "'[f]inancial impact of the exigent circumstances' means the impact of the exigent circumstances on the Postal Service's finances." (ibid., fn. 26). NPMHU reads Order No. 864 as meaning that the Service need not "prove its case" – apparently meaning any of it, *including the causal nexus* – with "absolute precision." That is plainly not what the Order says. The Postal Service must *first* show what the exigency is and how it is causally connected with the financial impact, and *then* quantify the losses from it with reasonable, though not absolute, precision.

III. SUMMARY AND CONCLUSION

[37] NPMHU Comments, p. 5. NPMHU never addresses the issue of whether what appears from the plain language of sec. 3622(d)(3) to be a mandate for a forward-looking structural review of the ratemaking system would include authority to revise, retroactively, a previous rate decision on which the Postal Service, at least, had relied. In GCA's view, it was not the intent of sec. 3622(d)(3) to do so.

GCA maintains the position it presented in its Initial Comments: that the Postal Service has not proved either that the 2008-2009 recession caused a $6.65 billion contribution loss or that the $1.78 billion revenue increase it proposes satisfies the reasonableness test of sec. 3622(d)(1)(E). The initial comments of some other participants, as explained above, confirm this view; to the extent some other comments attempt to support the increase, or some part of it, they fall well short of doing so. The Commission should, therefore, neither accept the Postal Service's overbroad claims of recession-induced financial impact nor find the proposed rate adjustments consistent with the reasonableness, equity, and necessity criteria of sec. 3622(d)(1)(E).

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Respectfully submitted,

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