

Before the  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Price Elasticities and Internet Diversion )

Docket No. RM2014-5

COMMENTS OF THE  
AMERICAN POSTAL WORKERS UNION, AFL-CIO  
(September 19, 2014)

**Background**

On May 2, 2014 The National Postal Policy Council (“NPPC”), the Association for Mail Electronic Enhancement (“AMEE”), the Association of Marketing Service Providers (“AMSP”), GrayHair Software, Inc. (“GrayHair”), the Greeting Card Association (“GCA”), the International Digital Enterprise Alliance, Inc. (“IDEAlliance”), the Major Mailers Association (“MMA”), and the National Association of Presort Mailers (“NAPM”) (collectively the “Petitioners”) requested the Postal Regulatory Commission (“PRC” or the “Commission”) “to initiate and conduct a proceeding to review and improve the econometric volume demand model and the associated factors relating to price elasticity estimates and Internet diversion used by the Commission and Postal Service.”<sup>1</sup> On May 9, 2014, the Postal Service filed a response in opposition to the petition that stated such “a proceeding would serve no useful purpose, and therefore opposes the petition. The interests of both the Commission and the Postal Service are better served by focusing their scarce resources elsewhere.”<sup>2</sup> On May 19, 2014, the Petitioners replied in support of the original petition.<sup>3</sup> On July 9, 2014, the Commission filed a notice establishing RM2014-5 “for consideration of the matters raised by the Petition filed May 2, 2014,” scheduled a technical conference for August 13, 2014, and attached a draft paper by Commission staff members that was to be discussed at the

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<sup>1</sup> *Petition to Improve Econometric Demand Equations for Market-Dominant Products and Related Estimates of*

*Price Elasticities And Internet Diversion*, May 2, 2014, p. 2

<sup>2</sup> *Answer of The United States Postal Service in Opposition to Petition to Initiate a Proceeding Regarding Postal Demand Analysis*, May 9, 2014, p. 1

<sup>3</sup> *Reply in Support of Petition*, May 19, 2014

technical conference (“July 9 Paper”). In its Order No. 2117, the Commission agreed that in its Order No. 203, it did not require the Commission’s advance review of the methods of calculating demand elasticities, but reiterated its responsibility to review elasticities and evaluate the methods used to calculate them.<sup>4</sup> The Commission also stated “[t]he Commission considers the Petition a request to identify areas of possible improvement in demand analysis and forecasting. To the extent that the Petition would require amendment to the Commission’s rules, it considers the Petition a request pursuant to 5 U.S.C. 553(e) to amend the Commission’s rules in 39 CFR part 3050.”<sup>5</sup> On August 13, 2014, a technical conference was held to present the July 9 Paper, and elicit questions from the parties attending the conference. However, the Commission also stated that this paper represented the views of the authors and had not been reviewed or endorsed by the Commission.<sup>6</sup> Rather as “an initial step in this docket, the Commission finds it would be worthwhile to consider the elasticity of demand issue by exploring alternative methods that have already been developed and can be presented for discussion.”<sup>7</sup> Among the documents filed as library references (PRC-LR-RM2014-5/2 ) to the Technical Conference was a second version of the July 9 Paper (the “August 13 Revision”), and various other files that provided the data and model, and output on which the August 13 Revision was based. Filing of comments on the paper were scheduled for no later than September 19, 2014.

### **Comments of the APWU**

The American Postal Workers Union, AFL-CIO (“APWU”) respectfully files the following comments with reference to the materials presented at the August 13 Technical Conference. While personal research by Commission staff into postal issues may bring about areas for further discussion, the authors of this research stressed during the technical conference that they were wanting to elicit comments on the structure of the model rather than a focus on the elasticities generated by their model.

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<sup>4</sup> *Notice and Order Scheduling Technical Conference*, July 9, 2014, p. 4 (Order No. 2117)

<sup>5</sup> *Id.*, p. 4 (footnote omitted)

<sup>6</sup> *Id.*, p. 5

<sup>7</sup> *Id.*

Given the comment by one of the participants at the conference about wanting to know what the CORRECT numbers were to present to policy makers, it is important to reiterate that these elasticities are not PRC reviewed or endorsed. Furthermore, given the relatively large differences in some of the estimates that appear in the July 9 Paper versus the August 13 Revision, it is clear that the numbers being generated may be sensitive to relatively minor changes in the model structure.

As to the structure of the model itself, some explanatory variables may be missing. There is a heavy emphasis on different ways in which the diversion variable can be specified to provide a better explanation of why postal volumes continue to weaken when internet penetration shows little change. In addition numerous dummy variables have been used to explain some past abrupt changes in demand. These do not seem to present a clear and convincing picture of which factors drive current demand. In its statement on its Opposition to the Petition the Postal Service points out one of the difficulties in understanding the current situation:

as part of an attack on the Postal Service's approach to modeling the totality of factors affecting mail volume, the opinion is expressed that "the Postal Service's econometric model may be specified in such a way as to subsume price effects in other factors," and that "to the (unknown) extent that trends and intervention factors are reflecting what in fact are price effects, then the price elasticities generated by the model will be inaccurate." But on the very next page, the Petition acknowledges that a consequence of this stability in real prices is that there has been very little price effect on volumes over [the years before and since the PAEA took effect], precisely because real prices have remained essentially unchanged." Yet simple logic dictates that if price effects have been minimal in recent years, they cannot possibly be the source of the enormous changes in actual mail volume which occurred over that period.

The Postal Service's market research presented in the N2010-1 and N2012-1 dockets certainly suggest some important explanatory variables that may be missing from the model and certainly should be considered in the future.<sup>8</sup> The Postal Service's announcements as it filed these cases made it clear to its customers that it was planning on reducing service in various ways, and its own research indicated that it

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<sup>8</sup> Even though the Postal Service did not do any market survey to test its customers' reaction to its load leveling plans presented in N2014-1, the amount of mail that has been impacted by that service standard change is another indicator that customers may be reassessing their use of the Postal Service as a reliable partner.

would lose volume if it implemented those plans. However, the announcements themselves put customers on notice that the Postal Service was not going to be a reliable partner in the future. In addition, the very public discussions of large Postal deficits, carriers delivering mail late into the evening, and plans to reduce hours at Post Offices have also put customers on notice that the Postal Service may not deliver in the future. It is not easy to think of what type of variable might capture this concern about degradation of postal services, and how those may feed into Postal Service's customers using the mail less but the Postal Service's limited research indicates it is a real issue that will have negative impacts on mail volumes. In fact it probably already has had negative impacts.

The authors of these two papers indicated that they did not feel a lag structure related to the prices was required in the equation structure. However, intuitively that raises a question as to how the change in the Postal rate setting process over the period of time the data represent can properly reflect the relationships between volumes and prices. A change from a system where prices experienced a relatively large change and then did not change for several years, compared with a system where prices are expected to change by a smaller amount every year, would seem to have a different pattern of expected volume changes implicit in it. (Even deflated, this pattern will cause a differing pattern in the real price variables. It is also likely that the expectations that controlled the reaction to those price changes may also have been somewhat different.) Similarly, the question raised at the technical conference about the treatment of NSA volumes, indicates that perhaps there are some data problems for some of the subsectors that could have an impact on the coefficients.

In general it is known that if variables are omitted from a model, that the coefficients generated by that model may well be biased. For that reason, it is important to consider whether the explanatory variables are the correct ones to capture the potential causes of changes in volumes. In this structure, it is also important to determine if the variables to determine the changes in market shares, including the Postal Service's market share relative to the broader communications and advertising markets is incorporating the variables that may be influencing a shift. More importantly, before relying on a particular set of estimators as being the CORRECT ones for policy

analysis, one needs to remember the various quotes of past econometricians, such as the one attributed to Theil “Models are to be used, but not to be believed,” or Feldstein’s remarks that “in practice all econometric specifications are necessarily ‘false’ models... The applied econometrician, like the theorist, soon discovers from experience that a useful model is not one that is ‘true’ or ‘realistic’ but one that is parsimonious, plausible and informative.”

In sum, there is no basis in the record to support a change in the Postal Service’s methodology for calculating price elasticities. There must further study and an opportunity for further comment before any change is undertaken.

Respectfully submitted,

Darryl J. Anderson  
O’Donnell, Schwartz & Anderson, P.C.

Counsel for the APWU