

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VAL-PAK REDIRECTED FROM
WITNESS TAUFIQUE [VP/USPS-T28-17(d) and T28-18(a)&(b)]
(May 4, 2005)

The United States Postal Service hereby provides the responses of witness Robinson to the above-listed interrogatories of ValPak Direct Marketing Systems, Inc. and ValPak Dealers' Association, Inc., dated April 20, 2005.

The interrogatories have been redirected from witness Taufique to witness Robinson for response. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.

Chief Counsel, Ratemaking

Michael T. Tidwell

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.

Michael T. Tidwell

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VP/USPS-T28-17. Please address the following questions relating to costs, economic efficiency, and competition:

- d. Please assume that there are no cross elasticities and that all own-price elasticities are at the same non-zero level. Now consider two markup measures: Measure A is the per-piece (unit) markup, as in the rate being 6 cents above cost, and Measure B is the percentage markup, as in rates being 30 percent above cost (implying a cost coverage of 130 percent).
- (i) If one were interested in improving the efficiency of resource allocation and in reducing losses in economic efficiency, please explain which of the two measures would be most useful in gauging the distance of the rates from their costs, *i.e.*, which measure of distance-above-costs is indicative of the efficiency loss associated with the rate?
 - (ii) Under the elasticity assumptions of this question, would you agree that all rates should have the same percentage markup, but not the same per piece markup. If you do not agree, provide references to the economic literature supporting your position.
 - (iii) Please explain whether you agree that, even if the elasticity assumptions are relaxed and the efficiency formulas become more complex, it is still measure B and not measure A that has a reasonably simple and straightforward relation to notions of economic efficiency.
 - (iv) Please explain whether you agree that under notions of economic efficiency, absent externalities and cross elasticities, one could say that the more elastic products would have a lower measure B (cost coverage) but one could not say whether the more elastic products would have a lower measure **A** (per-piece (unit) markup).

RESPONSE:

- d. In this example, it is unclear whether you are referring to marginal costs or total costs of providing a product. Generally, economically efficient pricing exists when price equals marginal cost (assuming total costs are covered). As witness Taufique describes in his response to

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(c), this can be problematic, particularly in organizations with substantial network infrastructures. Therefore, I do not believe, given the break-even constraint and the level of institutional costs, that the pricing of Postal Service products could necessarily result in rates and fees equal to marginal costs for every product. Nevertheless, the Reorganization Act does not require that postal prices be economically efficient, it requires that prices be established that are consistent with the nine, section 3622(b), pricing criteria, several of which require consideration of factors that could run counter to purely economically efficient rates.

(i) In evaluating economic efficiency, a markup measure based on a percentage may be simpler to use than a markup measure based on calculating the lump sum, cents-per-piece markup. However, the amount of efficiency loss would depend on the amount by which the price deviates from the marginal costs, not on whether this difference is measured on a lump sum basis or on a percentage basis.

(ii) No. The Commission is required to recommend rates based on the nine pricing criteria. Application of these criteria can and has resulted in rate recommendations with varying markups (cost coverages.) As the Commission noted in Docket No. R2000-1, "Economic efficiency is neither the exclusive nor even

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the paramount ratemaking objective under the Act.” PRC Op.

Docket No. R2000-1 at 210.

- (iii) See my response to part (i).
- (iv) Under certain assumptions, economic efficiency increases if markups measured on a percentage basis increase as own-price elasticity decreases in absolute value. The same claim cannot be made for a markup measured on a “lump sum” or per-piece basis.

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VP/USPS-T28-18.

Please refer to the following statement from the Commission's *Opinion and Recommended Decision* in Docket No. MC95-1, pages V-161-62, ¶ 5388, in reference to a separate automation subclass of Standard Mail:

The alternative of creating separate subclasses and considering the issue of lowest combined cost when selecting the associated markups is not a rational alternative. Selecting the markups in such a constrained way provides rates that are no different from those that result from offering worksharing discounts through rate categories. . . . One has to question the logic of creating subclasses and then constraining the outcome in accordance with a result that would be obtained without creating the subclasses.

- a. Please explain whether the cost coverages of the current ECR and Regular Standard subclasses, whose relative levels are being perpetuated by the across-the-board proposal, are or should be constrained in any way to achieve "a result that would be obtained without creating the subclasses."
- b. Has the Postal Service done any analysis to determine whether the proposed ECR rates differ from those that would likely exist if ECR had **not** been made into a separate subclass? If so, please provide that analysis.

RESPONSE:

- a. The cost coverages for the Standard Mail Regular and ECR subclasses have not been and should not be constrained "to achieve 'a result that would be obtained without creating the subclasses.'" The Postal Service proposes cost coverages for all subclasses of mail based on the application of the pricing criteria of section 3622(b) of the Postal Reorganization Act.
- b. No.