

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS THRESS
TO INTERROGATORIES OF ABA-NAPM (ABA-NAPM/USPS-T7-1 - 2)
(July 14, 2006)

The United States Postal Service hereby provides the response of witness Thress to the following interrogatories of ABA-NAPM, filed on June 30, 2006: ABA-NAPM/USPS-T7-1 – 2.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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July 14, 2006

**RESPONSE OF POSTAL SERVICE WITNESS THRESS
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ABA-NAPM/USPS-T7-1. In Docket No. R2005-1, your estimate for the own price elasticity of demand for workshared FCLM was -0.329. In Docket No. R2006-1, with only four extra quarters of data added, your elasticity estimate for workshared FCLM is -0.130, or less than half as elastic.

- a. What factors in the economic environment would explain a change of this magnitude in so short a span of time?
- b. What factors in your model would explain a change of this magnitude in so short a span of time?

RESPONSE:

As a minor detail that has no bearing whatsoever on this answer, the demand equations in R2006-1 rely upon three additional quarters of data as compared with R2005-1.

- a. The numbers you cite in your interrogatory are estimates of the own-price elasticity of First-Class workshared letters, based on the econometric equations used in the R2005-1 and R2006-1 cases. The change in the estimated elasticity is not due to a change in the economic environment over the past three quarters, but due to a change in the econometric equation used to estimate the price elasticity.
- b. The key factor which explains the change in the estimated elasticity was the estimation of the impact of the number of Broadband subscribers on the volume of First-Class workshared letter mail. My R2006-1 equation estimates that Broadband had a larger negative impact on volume (more electronic diversion) than was estimated using the R2005-1 specification. With electronic diversion having a greater negative impact, the estimated negative impact from higher First-Class workshared letter rates is reduced. The result is a much better econometric fit for the First-Class workshared letters demand equation (for example, the mean-squared error for my R2006-1 equation is 0.000119 as

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compared to a mean-squared error of 0.000153 using the R2005-1 specification, as shown in Library Reference LR-L-65 at page 9), but, coincidentally, a smaller estimate of the own-price elasticity.

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ABA-NAPM/USPS-T7-2. In Table 10 of your testimony on page 51, you show the effect of the Internet and “electronic diversion” on the volume of First-Class Mail. The effect on single piece mail is notable starting in 1990 and more pronounced after 1995, whereas a significant effect on workshared mail appears only after 2002. With fewer than 0.02 billion pieces of workshared mail “diverted” in 2001, 1.1 billion “diverted” in 2004, and 1.3 billion “diverted” in 2005, please explain fully why you see workshared mail as becoming increasingly inelastic between the R2005-1 and R2006-1 rate cases.

RESPONSE:

I do not believe that First-Class workshared mail has become increasingly inelastic between the R2005-1 and R2006-1 rate cases. Rather, my estimate of the own-price elasticity of First-Class workshared letters has changed for the reasons discussed in my response to ABA/USPS-T7-1. Please see also my response to GCA/USPS-T7-8(e) for some discussion of the expected relationship between increasing electronic diversion and the price elasticity of First-Class Mail.

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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