

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BOZZO  
(USPS-T-12) TO INTERROGATORIES OF VALPAK DIRECT MARKETING  
SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC.  
(VP/USPS-T12-19-20)  
(July 24, 2006)**

The United States Postal Service hereby provides the responses of Witness Bozzo (USPS-T-12) to the following interrogatories of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.: VP/USPS-T12-19-20, filed on July 10, 2006.

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 24, 2006

Response of United States Postal Service Witness A. Thomas Bozzo  
(USPS-T-12) To Interrogatories of Valpak Direct Marketing Systems, Inc., and  
Valpak Dealers' Association, Inc.

**VP/USPS-T12-19.**

Please provide a citation to all references of which you are aware in the published literature on Efficient Component Pricing ("ECP") that advocate basing Efficient Component Prices (or "discounts") on:

- a. Marginal cost;
- b. Volume variable cost; and/or
- c. Attributable cost.

Response.

Since "volume-variable cost" and "attributable cost" are Postal Service costing terms of art, I would not expect them to appear in the general economics literature. However, note that volume-variable cost is defined such that unit volume-variable cost is conceptually equivalent to marginal cost. A reference in the postal economics literature using ECP and volume-variable cost is: "Access Pricing in the Postal Sector: Complexities and Practicalities of the United States Experience," by John Pickett, David Treworgy, and Allison Conrad, in *Current Directions in Postal Reform*, edited by Michael Crew and Paul Kleindorfer, Kluwer Academic Publishers, 2000, 353-372. The role of "attributable cost" in ECP depends on how "attributable cost is defined in relationship to marginal and/or incremental cost." Please see also the response to VP/USPS-T12-20.

Response of United States Postal Service Witness A. Thomas Bozzo  
(USPS-T-12) To Interrogatories of Valpak Direct Marketing Systems, Inc., and  
Valpak Dealers' Association, Inc.

**VP/USPS-T12-20.**

- a. Are you familiar with the article, "The Pricing of Inputs Sold to Competitors," by William J. Baumol and Gregory Sidak?
- b. Would you agree that the above-referenced article by Baumol-Sidak states that ECP should reflect incremental cost? If you do not agree, please explain fully why not.
- c. Please provide a citation to all references of which you are aware in the published literature on ECP that advocate basing Efficient Component Prices on any economic cost concept other than incremental cost.

Response.

- a. Yes.
- b.-c. In the referenced paper, Baumol and Sidak state that the ECP should reflect the average incremental cost of the "bottleneck" services and the opportunity cost of providing "downstream" access. This implies that ECP discounts should be based on the economic costs avoided as a result of providing access. As a shorthand term of general applicability, the economic cost avoidance can be termed an average incremental cost avoidance—as is done, e.g., in Baumol, Ordovery, and Willig's "Parity Pricing and Its Critics: A Necessary Condition for Efficiency in the Provision of Bottleneck Services to Competitors." However, the relevant practical issue is the nature of the cost avoidance. In cases where the cost avoidance does not include product-specific "fixed" or other inframarginal costs, average incremental cost reduces to marginal cost. Therefore, it would be incorrect to take Baumol and Sidak as advocating the use of average incremental cost to the exclusion of the marginal cost concept.

Response of United States Postal Service Witness A. Thomas Bozzo  
(USPS-T-12) To Interrogatories of Valpak Direct Marketing Systems, Inc., and  
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Also, as Kahn and Taylor note in "The Pricing of Inputs Sold to Competitors:  
A Comment," marginal costs also play an important role in understanding  
the allocative efficiency of prices under ECP. This is consistent with the  
roles for unit volume-variable (marginal) and incremental costs described in  
Prof. Baumol's Docket No. R87-1 testimony, USPS-T-3.

## 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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