

JOHN E. POTTER
POSTMASTER GENERAL, CEO



December 4, 2001

Honorable George A. Omas
Chairman
Postal Rate Commission
1333 H Street, NW, Suite 300
Washington, DC 20268-0001

Dear Mr. Chairman:

We understand that Congressman John McHugh requested that the Postal Rate Commission (PRC) undertake a study on the financial impact for the U.S. Postal Service of using domestic postage rates as a basis for establishing terminal dues. On October 1 Congressman McHugh provided us with a copy of the Commission's report on this subject.

We have reviewed the study. We appreciate the Commission's efforts to apply its expertise on this important topic. We have, however, identified several assumptions in the study that cause us to question its results. Thus, on October 18 we sent the enclosed letter to Congressman McHugh requesting that the study be accompanied by comments from the Postal Service before it is made available to the public through the PRC's Web site or other means. The comments that the Postal Service has prepared are enclosed. We would be grateful if our comments could be made available with the redacted version of the study on your Web site and with any other public distribution of this study.

Thank you for your cooperation.

Sincerely,

A handwritten signature in black ink that reads "John E. Potter".

John E. Potter

cc: Congressman John McHugh
House of Representatives
Washington, DC 20515-3224

JOHN E. POTTER
POSTMASTER GENERAL, CEO



October 18, 2001

Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform
House of Representatives
Washington, DC 20515-6246

Dear Congressman McHugh:

This replies to your letter of October 1 asking for the U.S. Postal Service's comments on the Postal Rate Commission's study on applying domestic postage rates as terminal dues for the exchange of international mail. Specifically, you asked for our comments on the redacted version of the study that you would like to see posted on the Commission's Web site.

Our review of the redacted version of the study indicates that it contains no data that the Postal Service would consider commercially sensitive. We have no objection to posting the study on that account.

We do, however, have a different perspective on the Commission's conclusions with respect to the impact of such a terminal dues structure on international rates. For this reason, we request the opportunity to prepare substantive comments on the study for your consideration and to have those comments included with the study on the Commission's Web site, so that both our perspectives would be equally available.

Sincerely,


John E. Potter

**U.S. Postal Service Comments on September 2001
Terminal Dues Study by the Postal Rate Commission**

The U.S. Postal Service offers the following comments on the September 2001 study by the Postal Rate Commission (PRC) analyzing the financial consequences for the Postal Service of replacing current terminal dues rates with domestic postage rates. This study was conducted at the request of Congressman John McHugh pursuant to his letter to Acting Chairman of the PRC, the Honorable George Omas, on July 17, 2001.

1. Full domestic rate referencing is impractical.

It should be noted that no postal administration in the world charges the actual domestic rate for each piece of inbound international mail, as this approach entails substantial operational, statistical, and accounting requirements that are infeasible given the nature and volume of universal service traffic. The PRC study did not address the potential operational implications of, and administrative expense related to, domestic rate referencing to full first class rates, which would involve assigning rates by weight step.

Additionally, the PRC study uses 100% of domestic rates when calculating terminal dues rates. Within the Universal Postal Union industrialized countries are currently working towards a system of domestic rate referencing at 60% of domestic rates. Even within Europe, where postal operators have more commercial freedoms, national postal operators are only considering alignment of terminal dues within a range of 70% to 80% of domestic rates. European postal operators have already reached consensus that the costs of international mail delivery do not include some costs that are specific to domestic mail only, such as sales, advertising, acceptance, collection and other processing costs.

An attempt to negotiate bilateral terminal dues rates based on 100% of domestic rates would result in substantially higher payments than are currently being contemplated in any postal arena. An effort to negotiate terminal dues based on 100% of domestic rates with Europe, for example, would likely be met with incredulity as the Europeans are not even contemplating 100% domestic rate referencing amongst each other. In any event, such agreement would create an environment where other foreign postal operators competing with the Postal Service for outbound traffic from the United States to Europe would be in a position to offer U.S. customers far lower rates than the Postal Service and make the Postal Service unable to compete.

2. Costs for inbound and outbound international mail should be considered separately.

The PRC study identifies a net \$59.1 million cost increase for the Postal Service. This figure of \$59.1 million is derived by offsetting potential terminal dues increases for outbound international mail with potential increases in terminal dues revenue from inbound international mail. This figure represents a net across all countries, industrialized and developing, except for Canada.

The focus on a \$59.1 million net cost increase may justify a more modest impact on international costs and rates than is likely to be the case. In setting international postage rates, however, the Postal Service does not offset the terminal dues costs of outbound international mail with revenues from terminal dues payments for the delivery of inbound international mail. The financial effects on inbound and outbound mail need to be considered separately.

Thus, the additional terminal dues expense attributable to outbound mail would be substantially higher than \$59.1 million. The PRC report indicates an increase in outbound payment of 118% to industrialized countries and 8% to developing countries. The Postal Service would have to consider what impact these increases in terminal dues would have on rates.

3. The possibility of domestic rate referencing for industrialized and developing countries must be examined separately.

Currently, developing countries access postal networks in developing and industrialized countries at worldwide average rates, which are generally lower than the rates currently paid by industrialized countries to each other. The Universal Postal Union (UPU) already faces a challenging task in working with developing countries to establish a transitional arrangement towards a system of terminal dues in which they will agree to pay higher rates to industrialized countries. It would be even more challenging to persuade developing countries to move towards a terminal dues system in which they would pay industrialized countries 100% of their domestic rates. In the case of the United States, for example, the PRC study indicates that developing countries would pay the Postal Service a 170% increase in terminal dues. Developing countries constitute the vast majority of the UPU membership.

Even if the Postal Service were to move outside of the UPU framework to negotiate terminal dues rates with developing countries on a bilateral basis, they will not agree to give the United States access to their domestic network at their domestic rates, which are often subsidized for the benefit of their own citizens. If the United States were to seek to unilaterally impose its domestic rates on other countries, the developing countries might, in response, apply our own domestic rates or other, higher rates to the mail that we send to them, thus preserving their revenue margins. In any event, we would face increases in terminal dues costs to developing countries significantly higher than the 8% suggested in the PRC study. In order to avoid extreme positions, the UPU is seeking agreement on transitional arrangements to a more cost-based terminal dues system.

4. Price elasticities and impact on volumes.

Finally, while the Postal Service fully understands that the PRC was working under both time and information constraints, the significance of price elasticities should not be ignored, particularly in consideration of a potential 118% cost increase for mail to industrialized countries. The offsetting increase in international rates would have severe impacts on our mailers. Large-volume mailers would pursue alternatives as much as possible to reduce their costs, but small business mailers and single-piece household mailers would bear the brunt of the increase. Examining the volume loss and its impact on universal service and commerce should be carefully considered.

5. The way forward.

The Postal Service recognizes the importance of maintaining adequate cost coverage for delivery of international mail, while remaining mindful of the potential impacts on our mailers. With this in mind, the U.S. Government is working to advance a more cost-based terminal dues system within the UPU. In the case of industrialized countries, the U.S. Government has already agreed to a form of domestic rate referencing for the Postal Service through the UPU. The UPU is now seeking a way to transition developing countries to this system.

The Postal Service continues to work closely with the Department of State, which now has responsibility to oversee U.S. Government policy in the UPU. The Department of State leads an inter-agency process, which includes the PRC, to develop a balanced approach on the position of the United States in these matters.