BEFORE THE
POSTAL RATE COMMISSION

International Mail Report Docket No. IM99-1

COMMENTS OF FEDERAL EXPRESS IN RESPONSE TO ORDER NO. 1226
AND REQUEST FOR LEAVE TO FILE LATE
FEBRUARY 1, 1999

By Order No. 1226 (January 15, 1999), the Commission requested comments on data that should be provided by the Postal Service in compliance with 39 USC 3663. In response, Federal Express is pleased to the offer the following comments.

1. International mail services

a. Types of service

To lend order to the variety of outward international postal services, it is helpful to realize that, for the most part, the Postal Service is selling only three basic delivery services by foreign post offices: letter-post, parcel post, and express mail. Letter-post service is provided under the terms of the Universal Postal Convention and is divided into two main sub-services: letters and cards (LC) and other matter such as printed matter and small packets (AO). There are three rates for LC mail: letters, cards, and aerogrammes. Although AO mail includes both printed matter and small packets, there is no distinction in rates or service, so it appears appropriate to consider AO service as a single Postal Service product. Express and parcel services are similar to their domestic equivalents.

The Postal Service seems to offer a broader range of international services because many of the Postal Service's international mail services represent discounts, marketing

packages, and front-end enhancements built up from these three types of foreign postal service. For example, International Priority Airmail is a discount LC service; the LC mail is treated no differently by foreign post offices than other LC mail. Global Priority Airmail likewise appears to be regular LC service in foreign countries, although this point should be checked. International Surface Airlift (ISAL) is a discount service for AO mail, no different from other AO mail service in other countries.[1]

Two new products should be added to this short list of basic services: direct entry and Global Package Link (GPL). Direct entry is a reselling of the local domestic postal service of a foreign post office, i.e., remail. There is, so far, only one example of direct entry, Mexico Direct. GPL service appears to be a bulk express mail or parcel post service, depending on the "service option" chosen. However, GPL also appears to include such a high level of information handling and customs clearance services that it might be considered a distinctly different service. In addition, GPL offers merchandise return, an important service for direct marketers.

For inward and transit international mail, the situation appears to be correspondingly simplified. Regardless of how foreign post offices may characterize their services to the United States, the Postal Service is essentially providing only three basic inward services: letter-post (LC and AO), parcel post, and express mail. It seems likely that the Postal Service does not distinguish more finely in recording the service characteristics of inward

[1] International Customized Mail Service (ICM)is a special case. ICM is a discount program for all services available to large companies. Since ICM is not associated with any particular underlying service, it may make most sense to distribute ICM data to other products for general purposes. In addition, it may be useful to examine ICM contracts as a group for other purposes..

international mail.[2] One exception to this general rule may be ISAL. ISAL is a well-established international service and USPS may account for inward ISAL shipments separately from AO generally.

b. Definitions of service by destination

International costs of international mail (see below) account for more than half of all international mail costs. These costs vary radically by global region and foreign terminal dues regime. Moreover, mail flows to different destinations can differ substantially in physical attributes. For these reasons, the Commission should not make the mistake of considering international rate categories as the equivalent of rate zones in the domestic mails. Regardless of whether destination specific (e.g., by country or rate group) information is included in public reports, the Commission should consider requiring the production of traffic and revenue figures by country or rate group as appropriate.

c. List of services

In light of the foregoing, a list of international mail services can be developed by consolidating the various tariffed services described in the Postal Service's announcements of international mail services. In Appendix A., we have provided a preliminary list compiled from the International mail Manual, 63 F.R. 67017 (Dec. 4, 1998) (proposed changes in international postal rates); 63 F.R. 65153 (Nov. 25, 1998) (proposed changes in IPA rates); and 63 F.R. 3642 (Jan. 26, 1998) (final rates for ISAL).

2. International mail costs

Attributable costs for International mail may be divided into two groups

[2] However, for each service, USPS will keep separate accounts by originating country to settle terminal dues accounts. See below.

domestic costs mail; and international costs (cost segment 14.2). For reasons stated below, we believe that cost segment 14.2 should be subdivided into three subcategories.

a. Domestic costs

Domestic costs for International mail include costs incurred in the collection (outbound mail), delivery (inbound mail), or domestic transportation (both outbound and inbound mail) of International mail. Domestic costs account for about 42 percent of all International mail costs (in FY 1997, $532 out of $1,265 million).

In general, domestic costs of International mail are developed and accounted for by the same cost systems used for the development of Domestic Mail costs. The cost systems which provide the details for Domestic Mail costs will automatically yield the domestic costs of International mail. For key cost segments 2 and 3, cost data, separated by class and by outbound and inbound mail stream, is reported in the same LIOCATT reports upon which USPS relies for the Domestic Mail rate calculations. For cost segment 14, as well, cost data for the domestic transportation of International mail appears to be developed as part of the same reports that USPS uses Domestic Mail.

b. International costs (cost segment 14.2)

International costs account for about 58 of the costs of international mail. There are three distinct types of international costs which, we believe, should be stated separately, i.e., as cost segments 14.2a, 14.2b, and 14.c. These are described below.

i. International transport (proposed CS-14.2a)

Costs incurred in the purchase of international air, water, and highway (if any) transportation for outward International mail. International transport costs vary by weight

and by regional destination. The major rates are set by the Department of Transportation, although USPS negotiates separate rates for the carriage of ISAL. We do not know if the Postal Service incurs separate costs for the international transportation of express mail and parcel post or whether transportation costs for such items are included with the transportation costs of letter post.

ii. Air conveyance dues and transit fees (proposed CS-14.2b)

If a foreign postal administration provides long distance transportation for outbound International mail either within the destination country (e.g., from Paris, France, to Marseille, France) or to a third country (e.g., from Paris, France, to Tunis, Tunisia), these costs are called "air conveyance dues" and ultimately charged to USPS by the French postal administration. If forwarding charges are incurred in providing surface transportation by water or land, the charges are called "transit charges."

iii. Terminal dues (proposed CS-14.2c)

Terminal dues are payments to foreign postal administrations for local delivery as opposed to long distance transportation of outward International mail. There appear to be three terminal dues schemes currently applied to international letter-post mail: Canada, UPU (high volume) and UPU (low volume). In general, terminal dues are uniform between post offices within a terminal dues regime. That is, for example, the Postal Service and the U.K. Post Office pay each other for the delivery of mail according to a formula (UPU high) that applies to both U.S. origin and U.K. origin mail. Likewise, the United States and Egypt pay each other according to a second formula (UPU low) that applies to both U.S. -origin and Egypt-origin mail. The UPU high rate applies only to mail to and from post offices with whom the Postal Service exchanges 150 metric tonnes of mail per year. In the recent past,

the Postal Service also applied a fourth terminal dues scheme, the CEPT terminal dues system, to exchanges of mail with most European post offices. Finally, it is likely that the Postal Service has agreements with some foreign post offices to waive terminal dues entirely for exchanges of mail.

Terminal dues for parcels and express mail appear to be set on a country specific basis. That is, for example, the U.K. Post Office charges a rate for delivery parcels received from the Postal Service, and the Postal Service charges a different rate for delivery of parcels received from the U.K. Post Office. Each rate is presumably related to the costs incurred by the destination post office.

c. Canada and Mexico

In its cost reports, we strongly urge the Commission to separate international mail services into at least three categories (i) to and from Canada, (ii) to and from Mexico from (iii) to and from the rest of the world. Canadian mail, which accounts for about 25 percent or more of all international mail, differs substantially from other International mail in transport costs, terminal dues costs, and average weight per piece. Aggregating Canadian mail to other International mail will render all international mail data opaque. There will be no way to determine whether large changes in cost are due to changing proportions of Canadian versus other mail or actual changes in costs or errors. This same phenomenon applies to Mexican mail to a lesser extent. The uniqueness of international mail services to Canada and Mexico, compared to the rest of the world, is evident from the fact that international mail tariffs generally provide specific rates for these destinations.

3. Terminal dues for letter-post services

Terminal dues present special problems in the analysis of letter-post data because they are not true charges for delivery services but rather nominal accounting figures which do not correspond to actual costs. Because terminal dues are the same for inward and outward mail flows in any given bilateral exchange, there is an element of barter in the costing of letter-post services. For this reason, outward and inward mail flows cannot be costed separately. An example is provided in table 1.

Table 1. Example of effect of terminal dues rates on nominal profit in an exchange of 100 pounds of mail with another post office (same amount in each direction)

TD/lb	Rev	Outward costs ex TDs	Outward TDs	Outward inst. contrib	Inward costs ex TDs	Inward TD revenue	Inward inst. contrib	Net inst. contrib.
$5.00	$2000	$1000	$500	$500	$400	$500	$100	$600
$2.50	$2000	$1000	$250	$750	$400	$250	-$150	$600
$0.00	$2000	$1000	$0	$1000	$400	$0	-$400	$600

The foregoing example imagines that the Postal Service is sending 100 pounds of mail to another post office and that post office is sending 100 pounds of mail to the Postal Service. As the example shows, the nominal institutional contribution from outward mail is arbitrary. If the terminal dues rate is set at $5 per pound, the Postal Service appears to make an institutional contribution on outward mail of $500 and an institutional contribution on inward mail of $100. If the terminal dues rate is set at $2.50 per pound, the Postal Service appears to make an institutional contribution on outward mail of $750 and a loss on inward mail of $150. If terminal dues are waived, the Postal Service appears to make an institutional contribution on outward mail of $1000 and a loss on inward mail of $400.

Looking at outward mail only, the institutional contribution depends on the terminal dues rate, even though that rate has no effect on the underlying costs incurred by the Postal Service and the foreign post office. Only by taking into account inward as well as outward flows it possible to derive a meaningful figure: i.e., the institutional contribution from the two-way exchange of mail which is, in this example, $600.

Because of this phenomenon, it is necessary to take into account inward and outward mail flows when analyzing the profitability of letter-post services. While it would be possible to aggregate costs and revenues across terminal dues regimes, terminal dues differ so drastically from regime to regime that we suggest a separate analysis should be carried out for each terminal dues regime. Since accounts for air conveyance dues, transit fees, and terminal dues are maintained for each foreign post office, this should not be difficult. Other costs can be allocated by traffic data.

The difficulties presented by uniform terminal dues schemes do not arise where terminal dues are country specific and represent actual charges for delivery. FedEx is under the impression that both parcel post and international express mail are characterized by realistic terminal dues rates, but this should be confirmed by the Commission.

A more detailed discussion of terminal dues may be found in Appendix B.

4. Institutional costs

As we pointed out in R94-1, the Postal Service classifies as institutional costs several types of costs uniquely generated by international mail. These include:

- costs of the international affairs office in headquarters;
- international travel costs;
- costs of participation in Universal Postal Union, regional postal unions, and

the International Post Corporation;

- costs of technical support of post offices in developing countries; and
- international penalty mail costs.

Customs clearance costs may or may not fall into this group as well. Generally, we would urge the Commission to identify and set out in its report all costs that appear to be generated exclusively or primarily in support of international mail, even if classified as "institutional costs" by the Postal Service.

5. Historical data

FedEx notes that a few years of historical data would be most helpful in interpreting current data. It is obvious that, without historical data, anomalies will be difficult to identify.

Request for leave to file late

Comments were due by close of business on Friday, January 29th. These comments are being filed on Monday, February 1. Therefore, Federal Express respectfully requests leave to file these comments one day late. This delay was caused by illness of counsel last week and by the press of business due to extraordinary events at the Department of State relating to the development of international postal policy. Federal Express believes no party will suffer injury due to late acceptance of this document.

Respectfully submitted,

James I. Campbell Jr.
Counsel for Federal Express
1015 18th Street N.W. Ste. 925
Washington, D.C. 20036
Tel: 202-223-7080
Fax: 202-466-4771
Email: jcampbell@jcampbell.com

Sarah Prosser
Managing Attorney
Federal Express
2605 Nonconnah Boulevard Ste. 105
Memphis, Tennessee 38132
Tel: 901-395-5150
Fax: 901-395-5166
Email: ssprosse@fedex.com

February 1, 1999

Certificate of Service

I hereby certify that I have this day served the foregoing document on all participants of record in this proceeding in accordance with section 12 of the rules of practice.

James I. Campbell Jr.

February 1, 1999

Appendix A

List of International Mail Service

Outward

- Letter-post
  - Letters and cards (LC)
    - Individual LC items
      - Letters
        - Canada
        - Mexico
        - Rest of world
      - Cards
        - Canada
        - Mexico
        - Rest of world
      - Aerogrammes
    - International Priority Airmail (IPA)
      - Full service
        - Worldwide
        - Presort
          - Rate group 1
          - Rate group 2
          - Rate group 3
          - Rate group 4
      - Dropship
        - Worldwide
        - Presort
          - Rate group 1
          - Rate group 2
          - Rate group 3
          - Rate group 4
      - Bulk Letter Service to Canada
    - Global Priority Mail
      - Worldwide flat rate
        - Canada
        - Rest of world
      - Worldwide single piece
  - Other matter (AO)
    - Printed matter & small packets
      - Air
      - Surface
        - Regular printed matter
          - Canada (Valuepost)
          - Mexico
          - Rest of world
        - Publishers periodicals
          - Canada (?)
          - Mexico
          - Rest of world

- Books & sheet music
  - Canada (?)
  - Mexico
  - Rest of world
- International Surface Airlift (ISAL)
  - Full service
    - Rate group 1
    - Rate group 2
    - Rate group 3
    - Rate group 4
  - Direct shipment
    - Rate group 1
    - Rate group 2
    - Rate group 3
    - Rate group 4
  - Dropship
    - Rate group 1
    - Rate group 2
    - Rate group 3
    - Rate group 4
- New Market Opportunities

M-bags
- Air
- Surface
  - Regular printed matter, catalogs
  - Books, sheet music

Parcel Post (CP)
- Surface
  - Canada
  - Mexico & Central America
  - Rest of world
- Air
  - Canada
  - Mexico
  - Rate group A
  - Rate group B
  - Rate group C
  - Rate group D
  - Rate group E

Express Mail International Service (EMIS)
- On demand service
  - Canada
  - Mexico
  - United Kingdom
  - China
  - Japan
  - Rate group 1
  - Rate group 2
  - Rate group 3
  - Rate group 4
  - Rate group 5

- Rate group 6
- Custom designed service
  - Mexico
  - United Kingdom
  - China
  - Japan
  - Rate group 1
  - Rate group 2
  - Rate group 3
  - Rate group 4
  - Rate group 5
  - Rate group 6
- Direct Entry
  - Mexico Direct
- Global Package Link (GPL)
  - Preimum service
    - Outbound service
      - Brazil
      - Canada
      - Chile
      - China
      - Germany
      - Great Britain
      - Hong Kong
      - Japan
      - Mexico
      - Singapore
  - Return service
    - Canada
    - Great Britain
    - Japan
  - Standard service
    - Canada
      - Origin Zone A
        - Local
        - Regional
        - National
      - Origin Zone B
        - Local
        - Regional
        - National
      - Origin Zone C
        - Local
        - Regional
        - National
      - Origin Zone D
        - Local
        - Regional
        - National
    - France
    - Great Britain

- Japan
- Mexico
- Singapore
- Economy service
  - Great Britain

International Customized Mail (ICM)
(distribute among other services)
Special services
- Certificate of mailing
- Insurance
- Registered mail
- Return receipt
- Restricted delivery
- Recall/change of address
- Special delivery
- Special handlling
- Recorded delivery
- International money orders
- International reply coupons
- International business reply service

Inward

Letter-post
- Letters and cards (LC)
  - Letters
  - Cards
  - Aerogrammes
- Other matter (AO)
  - Printed matter & small packets
  - ISAL
- M-bags

Parcel Post (CP)
- Air
- Surface

International Express Mail Service (IEMS)
Special services
- Storage
- Customs presentation
- Returned mail charges

Transit

Letter-post
Parcel Post (CP)
International Express Mail Service (IEMS)

Appendix B

Terminal Dues

1. Brief history

Despite the importance of delivery costs in establishing the overall cost of end-to-end postal service, when the Universal Postal Union was founded in 1874, it adopted the principle that post offices would not charge each other the cost of delivering cross-border mail. Each post office therefore had to subsidize the cost of delivering inward cross-border mail by increasing the rates for outward cross-border mail or domestic mail. When the UPU consisted of a small group of post offices with relatively similar unit costs exchanging more or less equal numbers of individually prepared letters, this highly simplified scheme may have been economically defensible. However, with industrialization of postal operations and a shift in the traffic base of post offices from individual letters to mass produced mail and printed matter, the non-compensation principle has become ever more inappropriate.

As early as 1906, post offices which received more international mail than they sent out urged the Universal Postal Union to provide explicit compensation for the delivery of the additional international mail. It was not until 1969 that the UPU finally did so. In that year, the UPU adopted a compensation rate of SDR 0.16[1] for each kilogram by which the weight of international mail sent from post office A to post office B exceeded the weight of

[1] Originally terminal dues were defined in terms of gold francs, an archaic monetary unit. In 1979, the UPU effectively replaced the gold franc by linking it to a fixed number of Special Drawing Rights (SDRs). The SDR is a monetary unit defined by reference to a basket of major national currencies used by the International Monetary Fund. The UPU set 3.061 gold francs equal to 1 SDR. See 2 Acts of the Universal Postal Union [1984], Conv. Art. 8, note 1 (1985). By now, the UPU has eliminated all references to the gold franc. In the text, all gold franc charges have been converted to SDR equivalents for simplicity.

international mail sent from B to A. This "terminal dues" charge was the same for all post offices worldwide; it was not related to the actual costs incurred by a specific destination post office. In 1974, the terminal dues charge was increased to SDR 0.49 per kilogram; in 1979, it was increased to SDR 1.90 per kilogram; in 1984 it was raised to SDR 2.614 per kilogram. In 1989, the UPU introduced a two-tiered system: one rate for major exchanges of mail, i.e, more than 150 metric tonnes per year (LC, 8.115 SDR; AO, 2.058 SDR) and another rate for minor exchanges (LC/AO, 2.940 SDR). In 1994, the two -tiered system was retained but the rules for major exchanges were rendered much more complicated.

2. Distortions caused by terminal dues

It is self-evident that this terminal dues system does not provide a sound economic basis for developing costs for cross-border postal services. Rather, the terminal dues approach adopted by the UPU piles one source of economic distortion on top of others.

The first and most important source of economic distortion arises from the uniformity of the terminal dues system. Suppose two post offices with substantially different unit costs exchange equal amounts of mail. If the post offices agree to pay each other a uniform rate for the delivery of cross-border mail, each will owe the other the same amount and neither will receive a net payment. Yet the economic value of delivery services provided is, in fact, very different in the two countries.

The distortion derived from the uniformity of the terminal dues scheme does not depend upon the actual level of terminal dues. For equivalent exchanges of mail, it makes no difference whether post offices agree to pay each other 1 SDR per kilogram or 100 SDR per kilogram. In neither case is any liability incurred; the terminal dues rate is simply an accounting device. In short, uniformity of terminal dues preserves the distortions of the

non-compensation principle for exchanges of mail that are in balance according to the units of measure giving rise to terminal dues obligations. The distortion arises from the difference in the economic value of the services rendered. Even within the European Union, the unit costs of postal service vary by a factor of three or more among the post offices.

A second source of economic distortion is due to the misalignment between the terminal dues rate and the actual delivery costs incurred by the destination post office. If terminal dues rates are uniform between countries, liabilities still arise if there are imbalances in mail exchanges. Yet the terminal dues scheme does not result in correct charges for the delivery of imbalance mail either. Since actual postal costs vary widely among post offices and the level of terminal dues does not vary, it is obvious that terminal dues payments cannot reflect the actual cost of delivery for imbalance mail (except for those few post offices that happen to have average costs). For imbalance mail, the amount of distortion will correspond to the difference between the terminal dues and the actual cost of delivery.

A third source of economic distortion arises because the UPU approach to terminal dues traditionally failed to recognize that the cost of postal delivery depends more upon the number of items to be delivered than upon the weight of individual items. For this reason, post offices charge their domestic customers by weight step, not by gram. An irreducible basic charge applies to the lowest weight step, a weight step which in fact includes most letters and cards. In contrast, under the 1984 UPU terminal dues scheme, a post office would charge half as much to deliver a 10 gram international letter as to deliver a 20 gram letter. Beginning with the 1989 UPU terminal dues scheme, the post

offices have begun to base terminal dues on weight and piece data if the volume exchanged exceed 150 tonnes annually.

Distortions caused by the terminal dues approach are today recognized by post offices. As the U.K. post office has explained:

> It is widely recognized that the UPU terminal dues system needs major reform. . . . The UPU system depends on a national world average cost, which has no basis in economic reality. This produces distortions in the international postal market which can have serious effects on the traffic flows and income of both developed countries and developing countries, which in turn has adverse effects on the customer.

Nonetheless, the Postal Service continues to exchange mail based on terminal dues principles so an understanding of terminal dues is necessary to understand the Postal Service's international accounts.

3. An example of applying terminal dues to a postal exchange

In order to understand how terminal dues creates a relationship between outbound and inbound mail, it is necessary to consider carefully the costs and benefits. The following example was developed for the purpose of litigation in Europe. Although it is based on an exchange of one pair of letters under the 1984 UPU terminal dues, the lessons drawn are applicable to any uniform terminal dues regime.

The example begins with the exchange of a pair of letters between the U.K. Post Office and the German postal service, Postdienst. After the exchange of a single pair of letters (one in each direction), each postal administration has paid the other 0.06 in terminal dues and used up their credits for inward delivery by the other administration. Economically, the U.K. Post Office is 0.15 better off than the Postdienst, because the terminal dues payments cancel out and the economic value of what the U.K. Post Office

has received (delivery of a letter in Germany worth 0.34) is worth 0.15 more than what the Bundespost has received (delivery of a letter in the U.K. worth 0.19). In short, the U.K. Post Office has been overcompensated by 0.15 and the German Postdienst has been undercompensated by the same amount. These figures are summarized in the table above.

Table 1. 1984 terminal dues: costs per letter in a bilateral exchange

	U.K. Post	Postdienst
Actual fully allocated cost of letter delivery	-0.19	-0.34
Direct compensation for delivery of letter from other post office: terminal dues	0.06	0.06
Indirect compensation for delivery of letter from other post office: economic value of right to delivery by other post office at terminal dues rate.	0.28	0.13
Overcompensation (undercompensation) after exchange of one letter in each direction	+0.15	-0.15
Undercompensation after delivery of one letter for which there is no return letter (imbalance situation)	-0.13	-0.28

The above analysis contrasts with the traditional postal description of terminal dues payments: "In view of the extremely low compensation of inbound mail, the postal administrations traditionally compensated these losses through high profit margins on outward traffic." This traditional postal explanation, however, obscures the economics underlying balanced exchanges of mail, which constitutes the majority of letter mail. According to this traditional explanation, if two postal administrations with similar cost structures exchanged equal quantities of identical mail, it would be concluded that all inbound mail is undercharged and all outward mailers are overcharged. *Both the amount of the undercharge and overcharge would be completely arbitrary*, depending upon the

level of terminal dues. Such an analytical approach is unhelpful.

It is submitted that the approach used above is more correct because it places an economic value on the right of reciprocal "low cost" delivery. Under this approach, if two postal administrations with similar cost structures exchanged equal quantities of identical mail, it would be concluded that each post office has charged the other the correct amount for inward delivery, when one considers both the terminal dues paid and reciprocal rights of delivery. Neither post office would be overcompensated or undercompensated. This conclusion does not depend upon the level of terminal dues. This appears to be a more correct and helpful manner of describing the situation than declaring each post office undercompensated, a determination that is based on an entirely arbitrary "terminal dues" that does not correspond to any actual charge.

The foregoing situation is clear enough if the same number of letters is sent in both directions. What happens if the U.K. Post Office receives one more letter from Germany than it sends? Again, the U.K. Post Office incurs a cost of 0.19 and it receives a payment of 0.06 (terminal dues) and a credit worth 0.28 for the next letter sent to Germany. But the U.K. Post Office has no more letters to send to Germany so the credit is worthless. In this case, the U.K. Post Office suffers a net loss of 0.13 on the "imbalance" letter. If the extra letter were delivered by the German Postdienst instead of the U.K. Post Office, the loss to the German Postdienst would be 0.28.

As this discussion shows, so long as the postal administrations pay each other a uniform terminal dues charge for delivery, the only practical effect of the terminal dues rate is the profit or loss made in the delivery of any imbalance letters. To the extent the mail flows are balanced, the U.K. Post Office will always be 0.15 better off after each pair of

letters is exchanged, regardless of whether, in nominal terms, the post offices pay each other 0.01 per letter or 100 per letter.

To obtain a sense of relative distortion, let us imagine that the U.K. Post Office sent the German Postdienst 1.3 million letters and received 1 million letters in return, a 30 percent inward imbalance for the German Postdienst. The German Postdienst would lose 150,000 due to the distorting effect of the uniform rate structure and another 84,000 due to undercompensation for delivering the imbalance.[2] The total loss of Postdienst would be 234,000, about one-third of which would be due to the imbalance. For this pair of post offices, it may be seen that, as long as the imbalance is a minor percentage of the total mail flow, the primary source of trade distortion inherent in the 1984 terminal dues agreement was the uniformity of terminal dues rates—i.e., the fact that terminal dues are not adjusted to the actual costs of delivery experienced by each post office—not the fact that the terminal dues was below the actual cost of inward delivery. These calculations are summarized in table 2.

[2] The calculation is 300,000 (imbalance letters) *times* [0.34 (cost of German Postdienst inward delivery) *minus* 0.06 (terminal dues payment)]. These numbers are intended to be illustrative only; the IECC does not have data on bilateral mail traffic. Moreover, in actual calculations, the relative economic costs and benefits experienced in a bilateral exchange of mail would depend upon additional factors as well, such as differences in the average weight per letter and differences in the degree of sorting performed by each post office on outgoing mail.

Table 2. 1984 terminal dues: a sample bilateral exchange with imbalance

	U.K. Post	Postdienst
Number of letters exchanged in balance	1,000,000	1,000,000
Actual fully allocated cost of delivery	(190,000)	(340,000)
Direct compensation for delivery, terminal dues	60,000	60,000
Indirect compensation: economic value of right to delivery by other post office at terminal dues rate.	280,000	130,000
Overcompensation (undercompensation) after exchange letters in balance	150,000	(150,000)
Number of imbalance letters delivered by U.K. Post office	-300,000	300,000
Overcompensation (undercompensation) for delivery of imbalance letters	84,000	(84,000)
Net profit (loss) on exchange of letters	234,000	(234,000)
Imbalance as % of total over- or under- compensation	36%	36%

It should be noted that the distortion due to the uniformity of terminal dues charges depends upon the magnitude of the difference between the actual delivery costs of the post offices concerned. For two post offices with more nearly equal costs than the U.K. and German post offices, the distortion due to a uniform terminal dues scheme would be correspondingly less. The distortion in the handling of imbalance mail would remain the same, however, because it is due to the difference between the level of the terminal dues rate and the actual cost of delivery for the post office with the inward imbalance.[3] Therefore, for a pair of post offices with more nearly equal costs, the distortion due to an incorrect level of terminal dues becomes relatively more important compared to the distortion due to the uniformity of terminal dues charges. However, the differences between

[3] If the French Post Office, whose delivery cost is 0.24, is substituted for the U.K. Post Office in the above example, the German Postdienst would lose 100,000 in an equal exchange of 1 million letters and a further 84,000 on an inward imbalance of 300,000 letters.

the costs of postal delivery within the EU are substantial, so that it seems likely that the effects of uniformity greatly outweigh the effects of imbalance for the EU as a whole.

It is plain from this analysis that all postal administrations were not "grossly undercompensated" by the 1984 UPU terminal dues scheme. Overall, as a result of the uniform terminal dues rate, low cost postal administrations, such as the U.K. Post Office, were overcompensated and high cost postal administrations were undercompensated. Collectively, the overcompensation and undercompensation balanced for the mail exchanged among a given set of postal administrations. This basic pattern is complicated, but not fundamentally altered, by imbalances that were paid for at the terminal dues rate. A postal administration with an inward imbalance would be underpaid for the cost of inward delivery if the terminal dues rate was less than actual cost, as was generally true for the EU postal administrations. By the same token, postal administrations with a net outward imbalance were benefitted by the system.

In general, these distortions are passed on to consumers. The U.K. Post Office, for example, does not charge British mailers to Germany the full value of inward delivery into Germany. Rather, the U.K. Post Office charges U.K. domestic postage on letters to Germany. In this manner, the U.K. Post Office earns enough on an outward letter to Germany to pay for the cost of delivering an inward letter from Germany. The British mailer thereby pays less for delivery in Germany than a German mailer. Similarly, the undercompensation of the German Postdienst is made up by charging domestic postage rates to German mailers sending mail to the U.K. The German mailer is paying much more than the actual cost of delivery in the U.K. and more than U.K. mailers pay for the same service.

4. Interrelationship between outbound and inbound traffic

The foregoing example illustrates the incorrectness of using terminal dues "charges" as a measure of costs. Terminal dues charges are largely arbitrary accounting entries that can be set high or low by agreement between post offices. In fact, there is no way to determine whether the Postal Service made a profit or loss on, say, LC service to Germany. Likewise, there is no way to say that the Postal Service lost money on delivering LC mail from Germany. The only thing that one can say is that the Postal Service made or lost money on the exchange of LC mail with Germany. This may be calculated by subtracting all costs associated outbound and inbound mail to and from with Germany (including domestic costs, international transport costs, air conveyance and transit charges, terminal dues costs) from all revenues (outbound postage and air conveyance, transit, and terminal dues receipts). The correctness of this analysis is most obvious in those cases in which the Postal Service has agreed to waive terminal dues payments with a given foreign post office.

5. Economically correct international postage rates

Finally, it may be noted that the foregoing analysis shows that the question of "whether or not the Postal Service covered its costs for a given international mail service" is different from the question of "whether the Postal Service charged a correct price for an international mail service." As shown in the example, if one accepts the proposition that U.S. mailers should, ceteris paribus, pay the same as a German mailer for the delivery of the same letter, then it is possible to construct a "correct" terminal dues rate for U.S. mail to Germany (roughly, 60 to 80 percent of domestic postage). The Postal Service’s postage

rate to Germany should then cover actual outward domestic costs, international transport, and the "correct" terminal dues charge. The same situation applies for mail sent from Germany to the United States.

Actual costs and revenues are not necessarily the same as "correct" costs and revenues, even when outbound and inbound data are consolidated. It may be that the Postal Service has created a situation in which it pays less than its share of the total costs of delivering mail in the U.S.-German exchange and the German post offices pays more than its share. In effect, German mailers would be subsidizing the U.S. Postal Service, allowing the Postal Service to maintain rates that are below their true economic cost. In fact, it seems likely that the foregoing situation characterizes the terminal dues relations between the Postal Service and the rest of the world. That is, it seems likely that the world's mailers are subsidizing U.S. international mail rates. Whether this surmise is correct requires an analysis of data which the Postal Service has so far keep secret. The ultimate explanation for this phenomenon, however, is simply that the Postal Service is a low cost provider of postal services relative to the post offices in other developed countries.[4]

6. Major terminal dues regimes

Tables of the major terminal dues regimes from 1984 to present follow.

[4] The U.K. Post Office is in a similar position. A recent analysis of terminal dues relations in the European Union by the European Express Organisation strongly suggests that the most important net effect of terminal dues relations among EU post offices is, primarily, to create a subsidy from German mailers to U.K. mailers. European Express Organisation, "Comments on Renewed Notification of an Agreement on Terminal Dues (REIMS II) between postal operators, Case No IV/36.748 -- REIMS II, 12 March 1998," available from www.jcampbell.com/rowland.

TERMINAL DUES FORMULAE

	1984 UPU LC/AO	1988 CEPT LC/AO	1989 UPU Correction	1989 UPU High LC	1989 UPU High AO	1989 UPU Low LC/AO	1991 CEPT LC/AO	1992 CEPT LC/AO	1993 CEPT LC/AO	1994 UPU Bulk	1994 UPU Revision	1994 UPU High LC/AO	1994 UPU Low LC/AO
Charge per piece	0.000	0.121	0.143	0.000	0.000	0.000	0.133	0.140	0.147	0.175	0.140	0.000	0.000
Charge per kg.	2.614	1.225	1.258	8.115	2.058	2.940	1.350	1.420	1.491	1.250	1.000	3.427	3.427
Max. items per kg.				55.00	7.00							21.000	
Min. grams per item				18.18	142.86							47.619	
Min. items per kg												14.000	
Max grams per item												71.429	
Effective dates													
Begin	01/01/86	01/01/88	01/01/91	01/01/91	01/01/91	01/01/91	01/01/91	01/01/92	01/01/93	01/01/96	01/01/96	01/01/96	01/01/96
End	12/31/90	12/31/90	12/31/95	12/31/95	12/31/95	12/31/95	12/31/91	12/31/92	12/31/95				12/31/00

Notes

1 In 1989, in Art. 73 of the Convention, the UPU adopted High and Low rates for exchanges of more than or less than 150 tonnes per year. The Low rate was based on weight only and was the same for LC and AO. The High rate differred for LC and AO. The LC High rate was replaced by a "correction" formula if the weight of an LC item was less than 18.18 g per item. The AO High rate was replaced by the same formula if the AO item weighed less than 142.86 g.

2 In 1994, in Art. 47 of the Convention (Draft Acts), the UPU adopted a single rate, 3.427 SDR/kg, for LC and AO except that (i) for flows of more than 150 tonnes per year, other than for flows to developing countries, a Revision rate applies if the weight per item is less than 47.619 g or more than 71.429 g. The Revision rate was set by the Postal Operations Council at 0.14 SDR/piece + 1 SDR/kg.

For Bulk Mail, as defined by the POC, going to countries other than developing countries, the destination country may charge (i) a percentage of domestic postage defined by the POC or (ii) 0.14 SDR/piece + 1 SDR/kg or any other formula approved by the POC. In 1996, the bulk rate was set at (i) 60 percent of domestic rates or (ii) 0.175 SDR/piece + 1.25 SDR/kg. in 1996. Rates set by the POC after 1996 are apparently higher but not known.

Article 26 of the 1994 Convention (Art. 25 of the 1989 Conv.) was amended to add a rate for ABC remail which, if not paid by origin post office, would authorize the destination post office to turn back the mail to origin post office. The Turnback rate is the lower of (i) 80 of domestic postage or (ii) 0.14 SDR/piece + 1 SDR/kg. The Turnback is not calculated separately since it is, for now, equal to the Revision rate.

TERMINAL DUES, SDR PER ITEM

Notes: *" indicates charge is determined by "correction" or "revision" formula.

Grams	1984 UPU LC/AO	1988 CEPT LC/AO	1989 UPU Correction	1989 UPU High LC	1989 UPU High AO	1989 UPU Low LC/AO	1991 CEPT LC/AO	1992 CEPT LC/AO	1993 CEPT LC/AO	1994 UPU Bulk	1994 UPU Revision	1994 UPU High LC/AO	1994 UPU Low LC/AO
0	0.000	0.121	0.143	0.143 *	0.143 *	0.000	0.133	0.140	0.147	0.175	0.140	0.140 *	0.000
5	0.013	0.127	0.149	0.149 *	0.149 *	0.015	0.140	0.147	0.154	0.181	0.145	0.145 *	0.017
10	0.026	0.133	0.156	0.156 *	0.156 *	0.029	0.147	0.154	0.162	0.188	0.150	0.150 *	0.034
15	0.039	0.139	0.162	0.162 *	0.162 *	0.044	0.153	0.161	0.169	0.194	0.155	0.155 *	0.051
20	0.052	0.146	0.168	0.162	0.168 *	0.059	0.160	0.168	0.177	0.200	0.160	0.160 *	0.069
25	0.065	0.152	0.174	0.203	0.174 *	0.074	0.167	0.176	0.184	0.206	0.165	0.165 *	0.086
30	0.078	0.158	0.181	0.243	0.181 *	0.088	0.174	0.183	0.192	0.213	0.170	0.170 *	0.103
35	0.091	0.164	0.187	0.284	0.187 *	0.103	0.180	0.190	0.199	0.219	0.175	0.175 *	0.120
40	0.105	0.170	0.193	0.325	0.193 *	0.118	0.187	0.197	0.207	0.225	0.180	0.180 *	0.137
45	0.118	0.176	0.200	0.365	0.200 *	0.132	0.194	0.204	0.214	0.231	0.185	0.185 *	0.154
50	0.131	0.182	0.206	0.406	0.206 *	0.147	0.201	0.211	0.222	0.238	0.190	0.171	0.171
55	0.144	0.188	0.212	0.446	0.212 *	0.162	0.207	0.218	0.229	0.244	0.195	0.188	0.188
60	0.157	0.195	0.219	0.487	0.219 *	0.176	0.214	0.225	0.236	0.250	0.200	0.206	0.206
65	0.170	0.201	0.225	0.527	0.225 *	0.191	0.221	0.232	0.244	0.256	0.205	0.223	0.223
70	0.183	0.207	0.231	0.568	0.231 *	0.206	0.228	0.239	0.251	0.263	0.210	0.240	0.240
75	0.196	0.213	0.237	0.609	0.237 *	0.221	0.234	0.247	0.259	0.269	0.215	0.215 *	0.257
80	0.209	0.219	0.244	0.649	0.244 *	0.235	0.241	0.254	0.266	0.275	0.220	0.220 *	0.274
85	0.222	0.225	0.250	0.690	0.250 *	0.250	0.248	0.261	0.274	0.281	0.225	0.225 *	0.291
90	0.235	0.231	0.256	0.730	0.256 *	0.265	0.255	0.268	0.281	0.288	0.230	0.230 *	0.308
95	0.248	0.237	0.263	0.771	0.263 *	0.279	0.261	0.275	0.289	0.294	0.235	0.235 *	0.326
100	0.261	0.244	0.269	0.812	0.269 *	0.294	0.268	0.282	0.296	0.300	0.240	0.240 *	0.343
105	0.274	0.250	0.275	0.852	0.275 *	0.309	0.275	0.289	0.304	0.306	0.245	0.245 *	0.360
110	0.288	0.256	0.281	0.893	0.281 *	0.323	0.282	0.296	0.311	0.313	0.250	0.250 *	0.377
115	0.301	0.262	0.288	0.933	0.288 *	0.338	0.288	0.303	0.318	0.319	0.255	0.255 *	0.394
120	0.314	0.268	0.294	0.974	0.294 *	0.353	0.295	0.310	0.326	0.325	0.260	0.260 *	0.411
125	0.327	0.274	0.300	1.014	0.300 *	0.368	0.302	0.318	0.333	0.331	0.265	0.265 *	0.428
130	0.340	0.280	0.307	1.055	0.307 *	0.382	0.309	0.325	0.341	0.338	0.270	0.270 *	0.446
135	0.353	0.286	0.313	1.096	0.313 *	0.397	0.315	0.332	0.348	0.344	0.275	0.275 *	0.463
140	0.366	0.293	0.319	1.136	0.319 *	0.412	0.322	0.339	0.356	0.350	0.280	0.280 *	0.480
145	0.379	0.299	0.325	1.177	0.298	0.426	0.329	0.346	0.363	0.356	0.285	0.285 *	0.497
150	0.392	0.305	0.332	1.217	0.309	0.441	0.336	0.353	0.371	0.363	0.290	0.290 *	0.514
155	0.405	0.311	0.338	1.258	0.319	0.456	0.342	0.360	0.378	0.369	0.295	0.295 *	0.531
160	0.418	0.317	0.344	1.298	0.329	0.470	0.349	0.367	0.386	0.375	0.300	0.300 *	0.548
165	0.431	0.323	0.351	1.339	0.340	0.485	0.356	0.374	0.393	0.381	0.305	0.305 *	0.565
170	0.444	0.329	0.357	1.380	0.350	0.500	0.363	0.381	0.400	0.388	0.310	0.310 *	0.583
175	0.457	0.335	0.363	1.420	0.360	0.515	0.369	0.389	0.408	0.394	0.315	0.315 *	0.600

TERMINAL DUES, SDR PER KG

Notes: *" indicates charge is determined by "correction" or "revision" formula.

Grams	1984 UPU LC/AO	1988 CEPT LC/AO	1989 UPU Correction	1989 UPU High LC	1989 UPU High AO	1989 UPU Low LC/AO	1991 CEPT LC/AO	1992 CEPT LC/AO	1993 CEPT LC/AO	1994 UPU Bulk	1994 UPU Revision	1994 UPU High LC/AO	1994 UPU Low LC/AO
0													
5	2.614	25.425	29.858	29.858 *	29.858 *	2.940	27.950	29.420	30.891	36.250	29.000	29.000 *	3.427
10	2.614	13.325	15.558	15.558 *	15.558 *	2.940	14.650	15.420	16.191	18.750	15.000	15.000 *	3.427
15	2.614	9.292	10.792	10.792 *	10.792 *	2.940	10.217	10.753	11.291	12.917	10.333	10.333 *	3.427
20	2.614	7.275	8.408	8.115	8.408 *	2.940	8.000	8.420	8.841	10.000	8.000	8.000 *	3.427
25	2.614	6.065	6.978	8.115	6.978 *	2.940	6.670	7.020	7.371	8.250	6.600	6.600 *	3.427
30	2.614	5.258	6.025	8.115	6.025 *	2.940	5.783	6.087	6.391	7.083	5.667	5.667 *	3.427
35	2.614	4.682	5.344	8.115	5.344 *	2.940	5.150	5.420	5.691	6.250	5.000	5.000 *	3.427
40	2.614	4.250	4.833	8.115	4.833 *	2.940	4.675	4.920	5.166	5.625	4.500	4.500 *	3.427
45	2.614	3.914	4.436	8.115	4.436 *	2.940	4.306	4.531	4.758	5.139	4.111	4.111 *	3.427
50	2.614	3.645	4.118	8.115	4.118 *	2.940	4.010	4.220	4.431	4.750	3.800	3.427	3.427
55	2.614	3.425	3.858	8.115	3.858 *	2.940	3.768	3.965	4.164	4.432	3.545	3.427	3.427
60	2.614	3.242	3.642	8.115	3.642 *	2.940	3.567	3.753	3.941	4.167	3.333	3.427	3.427
65	2.614	3.087	3.458	8.115	3.458 *	2.940	3.396	3.574	3.753	3.942	3.154	3.427	3.427
70	2.614	2.954	3.301	8.115	3.301 *	2.940	3.250	3.420	3.591	3.750	3.000	3.427	3.427
75	2.614	2.838	3.165	8.115	3.165 *	2.940	3.123	3.287	3.451	3.583	2.867	2.867 *	3.427
80	2.614	2.738	3.046	8.115	3.046 *	2.940	3.013	3.170	3.329	3.438	2.750	2.750 *	3.427
85	2.614	2.649	2.941	8.115	2.941 *	2.940	2.915	3.067	3.220	3.309	2.647	2.647 *	3.427
90	2.614	2.569	2.847	8.115	2.847 *	2.940	2.828	2.976	3.124	3.194	2.556	2.556 *	3.427
95	2.614	2.499	2.764	8.115	2.764 *	2.940	2.750	2.894	3.038	3.092	2.474	2.474 *	3.427
100	2.614	2.435	2.688	8.115	2.688 *	2.940	2.680	2.820	2.961	3.000	2.400	2.400 *	3.427
105	2.614	2.377	2.620	8.115	2.620 *	2.940	2.617	2.753	2.891	2.917	2.333	2.333 *	3.427
110	2.614	2.325	2.558	8.115	2.558 *	2.940	2.559	2.693	2.827	2.841	2.273	2.273 *	3.427
115	2.614	2.277	2.502	8.115	2.502 *	2.940	2.507	2.637	2.769	2.772	2.217	2.217 *	3.427
120	2.614	2.233	2.450	8.115	2.450 *	2.940	2.458	2.587	2.716	2.708	2.167	2.167 *	3.427
125	2.614	2.193	2.402	8.115	2.402 *	2.940	2.414	2.540	2.667	2.650	2.120	2.120 *	3.427
130	2.614	2.156	2.358	8.115	2.358 *	2.940	2.373	2.497	2.622	2.596	2.077	2.077 *	3.427
135	2.614	2.121	2.318	8.115	2.318 *	2.940	2.335	2.457	2.580	2.546	2.037	2.037 *	3.427
140	2.614	2.089	2.280	8.115	2.280 *	2.940	2.300	2.420	2.541	2.500	2.000	2.000 *	3.427
145	2.614	2.059	2.245	8.115	2.058	2.940	2.267	2.386	2.505	2.457	1.966	1.966 *	3.427
150	2.614	2.032	2.212	8.115	2.058	2.940	2.237	2.353	2.471	2.417	1.933	1.933 *	3.427
155	2.614	2.006	2.181	8.115	2.058	2.940	2.208	2.323	2.439	2.379	1.903	1.903 *	3.427
160	2.614	1.981	2.152	8.115	2.058	2.940	2.181	2.295	2.410	2.344	1.875	1.875 *	3.427
165	2.614	1.958	2.125	8.115	2.058	2.940	2.156	2.268	2.382	2.311	1.848	1.848 *	3.427
170	2.614	1.937	2.100	8.115	2.058	2.940	2.132	2.244	2.356	2.279	1.824	1.824 *	3.427
175	2.614	1.916	2.076	8.115	2.058	2.940	2.110	2.220	2.331	2.250	1.800	1.800 *	3.427