

Final Report
Joint Study on Article 43



Prepared for:
The United States Postal Service
The United States Department of State
The Postal Rate Commission

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Executive Summary

1.0 Preface

The United States Postal Service is an agency of the United States Government. Its statutory obligation is to provide universal postal service at affordable prices. Various private sector firms have advocated the elimination of Article 43 of the Universal Postal Union (UPU) Convention and alignment of terminal dues with domestic postage, asserting that Article 43 constitutes a market allocation scheme and is anti-competitive. The USPS believes that elimination of Article 43 would threaten its domestic revenue base and its ability to continue to provide domestic rate stability. The difference in these two perspectives gave rise to studying the relevant issues and the determination that the risk to domestic revenues would range between a 0.7 and 4.7 billion dollar loss.

2.0 Introduction

An interagency group on postal policy related to the UPU, led by the State Department, the United States Postal Service (USPS) and the Postal Rate Commission, sponsored a joint study to assess the risks of eliminating Article 43 of the Universal Postal Convention adopted in Beijing in 1999. Article 43 permits a postal administration to charge domestic postage rates for mailings of a customer resident in its territory that have been posted in another country for delivery to addressees within its national territory. Article 43 provides the basis for minimizing the impact to the USPS (and other postal administrations) of handling remail in the course of honoring the legally mandated universal service obligation. Inbound international remail is the diversion of mail from the domestic mail stream or from its conventional route to one that benefits from lower compensation paid by foreign postal administrations to the USPS for delivery of that mail. Article 43 protects against remail by authorizing adjustments to the delivery compensation rates in an attempt to simultaneously make the compensation for it more equitable while reducing the incentive for remail to occur. Article 49 of the UPU also has an impact on the regulation of remail and will be included as appropriate in this study.

Remail occurs when a customer resident in country A posts mail in country B (either directly or through an agent) for delivery back into country A (ABA remail) or country C (ABC remail). ABA remail becomes potentially attractive when a gap exists between the revenue that country A receives for domestic postage versus the revenue received under terminal dues from country B. ABC remail becomes potentially attractive when differences in terminal dues payment levels between country A and B for mail destinating in country C exist (i.e., UPU industrialized versus developing country terminal dues rates).

This study evaluates the economic impact and non-financial qualitative factors impacting ABA remail, both under the current UPU Convention and under the hypothetical elimination of Article 43. This study estimates the financial impact on USPS. Non-financial qualitative factors include such items as international service performance, use of a foreign postal indicia, loss of drop ship options, reduction in the number of entry points, decrease in quality of the mail piece, address correction, and undeliverable-as-addressed for remail. The primary focus of this study is the following task areas:

- Estimate the current level of ABA remail activity into the US
- Evaluate the potential for ABA remail with the elimination of Article 43 and Article 49
- Effects of Article 43 and Article 49 on remail
- Estimate the financial and non-financial impact on the USPS of the elimination of Article 43
- Estimate of the impact on stakeholders of the elimination of Article 43

3.0 Background

A brief overview of the UPU, terminal dues, and the provisions of Article 43 and Article 49 are needed for the understanding of this study.

3.1 The Universal Postal Union

The Universal Postal Union (UPU) is a specialized agency of the United Nations and defines its mission:

*“... to develop social, cultural and commercial communications between all peoples throughout the single postal territory by the efficient operation of the postal services described in the Acts.” **

One of the overarching goals of the UPU is to provide universal and affordable service to send and receive letter post to and from every citizen of every country, including developing countries or unprofitable, hard-to-service locations. Because of this commitment of service to every citizen, the UPU has designed delivery policies, compensation agreements, and corrective mechanisms to bolster the ability of postal administrations to provide universal service at affordable prices. The mechanism for calculating and administering payments for the delivery of inbound letter post received from other member administrations is called terminal dues.

* Council of Administration Resolution 10, 1998.

3.2 The Current Terminal Dues System – Beijing 1999

In 1999, the UPU adopted a two-tiered system for determining terminal dues paid to UPU Postal Administrations that became effective January 1, 2001. The tiers are distinguished based on whether a country is classified as industrialized or developing. The

compensation provisions relevant to this study are the terminal dues applicable to either industrialized or developing countries posting mail for delivery in the US:

- Industrialized countries pay terminal dues to other industrialized countries based on charges specific to the destinating country with per item and per kilogram components.
- Developing countries continue to pay the prior UPU flat rate per kilogram for mail between each other and to industrialized countries except as provided under special criteria.

3.3 Articles of the Universal Postal Convention, Beijing 1999

Article 43 is the primary focus of this study, but Article 49 is also considered.

3.3.1 Article 43

Article 43 is the primary mechanism for protecting postal administrations from the potential erosion of their domestic and international revenue streams under the current UPU terminal dues system. It specifically provides corrective postage adjustments for situations involving “uneconomic remail,” ABA and ABC. ABA remail siphons mail from the domestic system and posts it overseas as inbound international mail for delivery in the domestic First-Class mail stream. This activity has the potential to erode a postal administration’s net revenue base when the domestic rates for letter post are higher than terminal dues, creating an arbitrage situation that is often the case for mail destinating in industrialized countries.

ABC remail becomes attractive to remailers due to arbitrage opportunities caused by the two-tier nature of the current terminal dues system. This activity has the potential to erode a postal administration’s international revenue base by reducing terminal dues receipts. The focus of this study, however, is ABA remail.

Recognizing the potential loss of revenues to postal administrations, Article 43 allows the collection of additional postage for the delivery of items deemed to be ABA or ABC remail. If payment of the required additional postage is refused, an administration can deny delivery of the mail, return it to the posting country, and collect redirection costs.

For ABA remail, Article 43 allows domestic postage rates be assessed for similar mail receiving similar handling and service. In the case of the USPS, the appropriate rate is that of First-Class Single Piece mail. For ABC remail, Article 43 permits an adjustment equal to the maximum of either 1) 80% of domestic postage rates or 2) an amount based on the same parameter values as the bulk mail option, but applied only to the particular remailing.

3.3.2 Article 49

Article 49 governs the terminal dues charges for a developing country posting mail for delivery by an industrialized country. Article 49 provisions that might affect the compensation for remail include:

- The Revision Mechanism allows an industrialized country to charge developing countries a revised flat rate per kilogram derived from a formula with per piece and per kilogram components for mail flows exceeding 150 metric tons per year and when the number of items per kilogram is over 21.
- The Bulk Mail Option enables an industrialized country to charge developing countries per piece and per kilogram terminal dues rates due to it from other industrialized countries on shipments by single mailers exceeding 1,500 pieces in a day or 5,000 pieces in a two-week period.
- The System Harmonization mechanism enables an industrialized country to charge developing countries the same terminal dues rates due to it from other industrialized countries for mail volumes exceeding calculated thresholds specific to the sending country.

4.0 Study Structure

This study was designed to collect and validate information from sources of data related to the current or future use of remail. Information from internal USPS organizations and data systems, large mailers, external data systems, and organizations developing and/or implementing policies that govern the movement of international mail are the basis for the conclusions and findings in this study. The following steps and data sources were used to gather and validate remail data to satisfy the objectives of this study:

- Analysis of internal USPS data systems
- Interviews with USPS personnel
- Interviews with external organizations including the Universal Postal Union and PostEurop
- Field visits to the International Service Centers in New York City and Dallas, Texas
- In-depth interviews with 12 industry experts
- Hybrid Focus Groups conducted with 25 mailers
- Web based Mailer Survey of 415 high volume mailers
- Development and execution of a sophisticated forecasting model (Remail Impact Model – RIM) that incorporates results of a Conjoint Analysis of the Mailer Survey Data
- Expert Panel composed of 6 senior industry experts and prominent business partners to validate the major study findings
- Final Report capturing and reporting all the pertinent data collected by Battelle and presenting the findings and conclusions supported by the empirical study data

Each step in the study was designed to build on and validate the data collected in the previous study activity. For example, in-depth interviews conducted with mailers

provided data necessary to construct a more precise and targeted mailer survey. Initial data gathering activities provided data for subsequent use in the RIM model and Mailer Survey design activities.

5.0 Summary of Findings

The study findings are summarized as follows.

5.1 Current Level of ABA Remail Activity into the US

Based on the following activities we concluded that there is no significant volume of ABA remail currently entering the US and ABA represents a minimal impact on USPS revenue:

- Interviews with postal personnel (International Business Unit, Postal Inspection Service, Legal Department, and International Service Center acceptance and operations managers) identified some minor occurrences of remail over the past fifteen years.
- Observations of the operations, acceptance, and statistical programs units at the International Service Centers located in New York City and Dallas, Texas, identified some minor incidences of ABA and ABC remail.
- Results of the In Depth Mailer Interviews, the Mailer Survey, Focus Groups and the Expert Panel indicated that there is no significant current ABA remail activity.

5.2 Potential for ABA Remail with the elimination of Article 43 and Article 49

During our mailer surveys and focus groups, a cross section of large mailers were presented scenarios that postulated an international market place where no restrictions exist on ABA remail. The following findings resulted from the Mailer Survey and Focus Groups:

5.2.1 Propensity to Remail

- Roughly one-third of the major mailers surveyed indicated they were likely to engage in remail for one or more classes of mail within 5 years of the removal of remail prohibitions. Propensity to remail was somewhat varied across mail classes, with 23% First-Class, 35% Standard A and 42% Periodicals mailers, characterized as “likely to remail”.
- Mailers that indicated they would be likely to remail (absent restrictions) tend to be higher-volume mailers, with greater numbers of employees. Additionally, companies that operate outside of a local scope, particularly those that have a physical presence in foreign countries, tend to be more favorably disposed to the concept of ABA remail. In comparing likely remailers with those not likely to

remail, there is not a strong difference in the distribution of remailers within profit and non-profit organizations.

- In general, First-Class and Standard A mailers that send advertising mail appear to be more likely to consider ABA remail than those sending their mail for other purposes. Companies that currently engage in worksharing (particularly Standard A and Periodicals mailers) are also more prone to consider remailing. Additionally, companies that send Standard A or Periodicals mail outside of their state have a greater tendency toward remail.

5.2.2 Time Frame for Remail

Mailers that are likely to remail expressed a degree of caution with respect to the timeframe within which they would engage in the practice (absent restrictions). Only 14% indicated they would begin remail within the first six months. Over one-half (62%) indicated they would initiate remail within the first year and virtually the entire group indicated they would engage in remail by the end of the second year.

However, it should be noted that the Expert Panel expressed reservations regarding the two-year timeframe. Rather, they felt that it would take longer for mailers to adopt the practice of remail. They indicated that the first two years would probably be a period of experimentation and mailers would adopt a wait-and-see attitude carefully gauging the reaction of the USPS to remail.

5.3 Effects of Article 43 and Article 49 on the Propensity to Remail

The effects of Article 43 and Article 49 on the propensity to remail were determined by data obtained from the Mailer Survey and Focus Groups.

Table 1 indicates Article 43 provisions are perceived to be the most effective deterrent to ABA remail; 69% of the mailers that indicated they would be likely to remail perceived this restriction to be a “strong deterrent, that hardly any mailers would attempt to circumvent.”

Table 1 Perceived Effectiveness of UPU Provisions Among Likely Remailers

UPU Provision	Perceived As A Strong Deterrent (% of Likely Remailers)
Article 43 Only	69 (±9)
System Harmonization Mechanism Only	30 (±10)
Revision Mechanism Only	26 (±9)
Bulk Mailing Option Only	39 (±9)

Of the three provisions of Article 49, the Bulk Mail Option is perceived to be the strongest. However, each of these three UPU provisions are perceived to function as

strong deterrents by less than half of mailers; the majority of mailers believe that some companies would attempt to circumvent them. More importantly, as indicated in the qualitative interviews, they wonder how these restrictions could be enforced. The harmonization mechanism and revision mechanism are viewed as being particularly ineffective. Between one-third and one-half of likely remailers indicated that they would still be highly likely to engage in remail, even with these prohibitions in place and strictly enforced.

While Article 43 and the Bulk Mail Option are perceived by mailers to be the most effective deterrents to remail, they are difficult and costly to implement. Our field observations indicated that the System Harmonization Mechanism would be relatively easy to implement at a reasonable cost, and has the potential to significantly dampen remail activity. Section 7 provides an in-depth assessment of the effectiveness of these three mechanisms.

5.4 *Estimate of the financial impact on the USPS of the elimination of Article 43*

The financial impacts of the elimination of Article 43 were determined by combining data from the mailer survey conjoint analysis with financial data contained in the RIM simulation model. A series of financial scenarios were produced revolving around such factors as the level of domestic USPS postage, the SDR (Special Drawing Rights) conversion rate, the likelihood of bulk mail detection, the cost of processing mail in the domestic USPS system, UPU terminal dues and other costs. These scenarios, and the assumptions they are based, can be reviewed in depth in Section 6 and Appendix 13.

The results of four core remail scenarios are presented in Table 2. These four scenarios represent Battelle's best estimates of the impact of remail in an unrestricted environment (no Article 43 or 49), and an environment where Article 43 has been eliminated but the Article 49 System Harmonization Mechanism is fully enforced. These scenarios are varied to take into consideration the use of domestic costs (CRA) of processing and delivery of inbound ABA remail versus the use of international costs (ICRA) for the processing and delivery of the same volume of ABA remail.

Alternative scenarios varying the costs of handling ABA remail are presented because cost estimates specific to remail are not available historically (because remail is not widely observed to occur) and because the available proxies for such costs have strengths and weaknesses.

ICRA costs are for aggregate inbound air letter-post, but letter-post includes all shapes of mail as well as non-business-generated mail. Presumably, remail would be business-generated and thus tend to have better address hygiene than the average mix of inbound letter-post. Furthermore, since the arbitrage opportunities for ABA remail are greatest for light weight mail tendered by developing countries, the shape mix for such remail might be skewed toward letter and card shaped mail rather than flats and packets. For these reasons, ICRA costs may overstate the handling costs of ABA remail.

The alternative cost assumption uses CRA metered First-Class letter costs as a proxy for ABA remail. This choice is consistent with the treatment of mail migrating from workshared categories to non-workshared categories in R2000-1. The marginal costs are lower than the ICRA costs, but may not include all of the processing steps and costs required for inbound Foreign Origin mail and does not account for potentially different productivity levels for ISCs relative to domestic-only facilities. Therefore, the CRA costs may understate the handling costs of ABA remail.

Thus, the two alternatives are likely upper and lower bounds for costs of handling remail and present a balanced view of the costs associated with processing remail.

The Core Remail Scenarios in Table 2 yield the following results:

- The impact on USPS domestic revenue for the unrestricted scenarios ranges from a low of \$3.0 billion to a high of \$4.7 billion in lost revenue.
- The impact on USPS domestic revenue for the scenarios with full execution of the System Harmonization Mechanism ranges from a low of \$.7 billion to a high \$1.5 billion in lost revenue.

Table 2 Summarization of Core Remail Scenarios (billions)

Baseline using ICRA Costs		Alternative using ICRA Costs	
System Harmonization (SH)	\$0.9	System Harmonization	\$1.5
Unrestricted (UR)	\$4.1	Unrestricted	\$4.7
Baseline using CRA Costs		Alternative using CRA Costs	
System Harmonization	\$0.7	System Harmonization	\$1.1
Unrestricted	\$3.0	Unrestricted	\$3.5

5.5 Impact of Non-Financial Factors

The potential for remail under several scenarios, each highlighting a particular non-financial remail characteristic, was estimated by applying the Remail Impact Model (RIM). Each RIM scenario had an appropriate and specific set of assumptions. Most of these scenarios were developed using characteristics of remail that were identified in the Mailer Survey conjoint models.

Two remail features, service levels and the use of foreign postal indicia, are viewed as having the largest effects among the alternatives. The net revenue effects on the USPS range from approximately 30% more than baseline losses for comparable service levels to 10% more for US indicia.

5.6 Estimate of Impact on Stakeholders on the elimination of Article 43

The proposed elimination of Article 43 will have differing financial, service and other impacts on a variety of stakeholders. These impacts were validated by members of the Expert Panel and are presented in Table 3.

Table 3 indicates that the USPS and its business partners would stand to lose substantially, as would single-piece (and other) mailers who would need to bear the cost of commensurate rate increases. Business mailers, privatized foreign posts, developing countries' postal administrations, and other USPS competitors would stand to gain the most: all at the expense of the USPS and those mailers not taking advantage of remail opportunities. The elimination of Article 43 and/or Article 49 were of concern to members of the Expert Panel because of the potentially adverse effect on the ability of the USPS to continue to provide the full range of mailing and delivery services that the Expert Panel members currently expect and heavily rely upon. It was reasoned that losses in domestic revenues due to remail would force increases in domestic postage rates in order to meet the Service's revenue requirement.

Table 3: Effect on Stakeholders of Removing UPU Provisions

Stakeholders	If Only Article 43 were Removed	If Both Article 43 & 49 were Removed
Large Business Mailers	Minimal effect	Gain (F*)
Small Business Mailers	Small gain (F)	Gain (F)
Single-Piece Mailers/Mail Recipients	Small loss (F, S*)	Loss (F, S)
US Postal Service	Loss (F, S)	Loss (F, S)
US Postal Service Business Partners	Small loss (F, S)	Loss (F, S)
Foreign Postal Administrations – Developing Countries	Small gain (F)	Gain (F)
Foreign Postal Administrations – Canada	Gain (F)	Small gain (F)
Foreign Postal Administrations – Other Industrialized Countries	Loss (F)	Loss (F)
Foreign Postal Service Business Partners	Gain (F)	Gain (F)
Foreign Privatized Posts	Gain (F)	Gain (F)
Universal Postal Union (UPU)	Small loss (O*)	Loss (O)
US Postal Service Competitors	Gain (F)	Gain (F)

* F = Financial Impact, S = Service Impact, O = Other Impacts

Table of Contents

Section 1. Introduction.....	1
1.1. Purpose of this Study	1
1.2. Background.....	2
1.2.1. The Universal Postal Union.....	2
1.2.2. The Current Terminal Dues System	4
1.2.3. The Remail Decision Process	5
1.3. Study Structure and Structure of the Final Report.....	11
1.3.1. Methods and Data Sources.....	11
1.3.2. Structure of the Final Report.....	12
1.4. Summary of Findings.....	13
1.4.1. Current Level of ABA Remail Activity.....	13
1.4.2. Potential for ABA Remail.....	14
1.4.3. Effects of Article 43 and Article 49 on the Propensity to Remail	15
1.4.4. Impact of the Elimination of Article 43	16
Section 2. The Relative Importance of Remail Decision Factors.....	21
2.1. Introduction.....	21
2.2. Financial Considerations.....	21
2.2.1. Focus Groups	22
2.2.2. Expert Panel.....	22
2.3. Non-Financial Considerations	23
Section 3. Economic Incentives for Remail.....	26
3.1. Introduction.....	26
3.2. ABA Rate Based Arbitrage Opportunities.....	26
3.2.1. Summary of ABA Arbitrage Opportunities.....	27
3.2.2. ABA Rate Arbitrage	28
3.3. ABC Arbitrage Opportunities.....	31
3.3.1. Summary of ABC Arbitrage Opportunities	31
3.3.2. ABC Arbitrage.....	32
3.4. Other Costs.....	35
3.4.1. Access Fees for Foreign Posting.....	35
3.4.2. Preparation and Printing Costs.....	36
3.4.3. International Transportation Costs.....	36
3.4.4. Risk-Adjusted Detection Costs.....	36
3.5. Summary	38
Section 4. Remail Non-Financial Considerations.....	39
4.1. Introduction.....	39
4.2. Non-Financial Considerations	39
4.2.1. Comparable Service Levels	39
4.2.2. Foreign Indicia.....	45
4.2.3. Loss of Domestic Drop Ship Options	46
4.2.4. Reduction in the Number of Domestic Entry Points	46
4.2.5. Reduction in Mailpiece Quality.....	46
4.2.6. Loss of Address Correction and Undeliverable-As-Addressed Capabilities....	47
4.3. Effect of Non-Financial Considerations on ABA Remail	48

Section 5. Financial Impacts - RIM Remail Scenarios	52
5.1. Remail Impact Model (RIM) Rationale	52
5.2. Scenario Assumptions	52
5.2.1. Core Remail Scenario Assumptions and Variations	52
5.3.2 Other Scenario Assumptions	55
5.3. Remail Financial Scenarios	55
Section 6. Limiting Remail	60
6.1. Introduction and Background	60
6.1.1. Article 43 Background	60
6.1.2. Article 49 Background	60
6.2. Enforcement of Articles 43 and 49	61
6.2.1. Article 43 Enforcement	61
6.2.2. Article 49 Enforcement	62
6.2.3. Summary of Field Visits	62
6.3. Ease of Enforcement	62
6.3.1. Article 43 Ease of Enforcement	62
6.3.2. Article 49 Ease of Enforcement	62
6.4. Mailers' Perception of the Effectiveness of Articles 43 and 49	63
6.4.1. Mailer Survey	63
6.4.2. Focus Group Results	66
6.4.3. Expert Panel Review	67
6.5. Financial Impact of Enforcement of the Provisions of Article 49	67
Section 7. The Stakeholders	74
7.1. Introduction	74
7.2. Impacts on the Stakeholders	74
7.2.1. Financial Gains	75
7.2.2. Financial and Service Losses	76
7.2.3. Other Impacts	76
7.2.4. Summary	76
7.3. Quantification of Financial Impacts	77

List of Tables

Table 1-1	Perceived Effectiveness of UPU Provisions Among Likely Remailers	15
Table 1-2	Effect of UPU Provisions on Remail Propensity Among Likely Remailers...	15
Table 1-3	Summarization of Core Remail Scenarios	17
Table 1-4	Effect on Key Stakeholders of Removing UPU Provisions	18
Table 2-1	Impact of Remail Considerations on Estimated Remail Volumes	23
Table 2-2	Relative Importance of Each Factor	25
Table 3-1	Average Weight Per Piece in ounces.....	33
Table 4-1	Summary of Current Service Standards	41
Table 4-2	Impact of Remail Considerations on Estimated Remail Volumes	43
Table 5-1	Summarization of Core Remail Scenarios	56
Table 6-1	Perceived Effectiveness of UPU Provisions Among Likely Remailers	65
Table 6-2	Effect of UPU Provisions on Remail Propensity Among Likely Remailers...	65
Table 6-3	Unrestricted Scenario – Article 43 Eliminated and No Article 49 Remedies Applied.....	69
Table 6-4	Article 43 Eliminated, Bulk Mail Detection and Enforcement Risk = 10% ...	70
Table 6-5	Article 43 Eliminated with System Harmonization Enforcement.....	71
Table 6-6	Article 43 Eliminated with System Harmonization Enforcement, Bulk Mail Detection and Enforcement Risk = 10%.....	72
Table 7-1	Article 43 Stakeholders	74
Table 7-2	Effect on Key Stakeholders of Removing UPU Provisions	75
Table 7-3	Stakeholder Financial Impacts (Millions of Dollars)	78

List of Figures

Figure 1-1	Flowchart of the ABA Remail Decision Process	7
Figure 1-2	Flowchart of the ABC Remail Decision Process	10
Figure 1-3	Changes from Unrestricted Scenario	19
Figure 1-4	Changes from Baseline under System Harmonization.....	20
Figure 2-1	Changes from Unrestricted Scenario	24
Figure 3-1	The Ratio of Selected US Domestic Rates to the Minimum of DC and IC ...	29
Figure 3-2	The Ratio of First-Class Automation Basic Letter Rates to DC and IC Terminal Dues Rates.....	30
Figure 3-3	The Ratio of Standard A Automation Basic Letter Domestic Postage Rates to the Minimum of DC and IC Terminal Dues Rates	31
Figure 3-4	Developing Country vs. Industrialized Country ABC Arbitrage Opportunities.....	33
Figure 3-5	The ABC Arbitrage Gap	34
Figure 4-1	Changes from Unrestricted Scenario	50
Figure 4-2	Changes from Baseline under System Harmonization.....	51
Figure 5-1	Remail Financial Scenarios.....	57
Figure 6-1	USPS Net Revenue Impact versus Bulk Mail Detection Success.....	73

Article 43 - Appendices

- Appendix 1 – Definitions of ABA, ABC and ABB Remail
- Appendix 2 – Field Visit Reports – Redacted
- Appendix 3 – In Depth Interviews – Summary of Findings
- Appendix 4 – Hybrid Focus Groups/Mailer Survey – Summary of Findings
- Appendix 5 – Mailer Survey – Technical Documentation
- Appendix 6 – RIM Model and Conjoint Analysis
- Appendix 7 – Expert Panel - Summary of Findings
- Appendix 8 – UPU Membership
- Appendix 9 – Summary of the Provisions of Article 49
- Appendix 10 – ABA and ABC Remail Decision Processes
- Appendix 11 – US Domestic Rate Categories at Risk from Remail versus Terminal Dues Received From Developing and Industrialized Countries
- Appendix 12 – Developing Country Mail Flows and System Harmonization Thresholds - Redacted
- Appendix 13 – Detailed Remail Financial Scenarios – Redacted ICRA data

Section 1. Introduction

The United States Postal Service is an agency of the United States Government. Its statutory obligation is to provide universal postal service at affordable prices. Various private sector firms have advocated the elimination of Article 43 of the Universal Postal Union (UPU) Convention, and alignment of terminal dues with domestic postage, asserting that Article 43 constitutes a market allocation scheme and is anti-competitive. The USPS believes that elimination of Article 43 would threaten its domestic revenue base and its ability to continue to provide domestic rate stability. The difference in these two perspectives gave rise to studying the relevant issues, and the determination that the risk to domestic revenues would range between a 0.7 and 4.7 billion-dollar loss.

Section 1 introduces key concepts and provides the background that allows the reader to understand the purpose of the study, overall structure of the study, and the data sources that contribute to the findings.

1.1. Purpose of this Study

Article 43 of the Universal Postal Union (UPU) Convention permits a postal administration to charge domestic postage rates to a customer resident in its national territory for mailings that have been posted in another country for delivery to addressees within its national territory. The purpose of Article 43 is to protect the domestic revenue base of a postal administration in order to provide the financial support of that postal administration's legally mandated universal service obligations.

The incentives for a sender to post items abroad—a practice referred to as remailing—are varied, ranging from taking advantage of lower postage rates abroad to centralizing mailing operations in one country for distribution to addressees in a number of countries. Postal administrations refer to such mailings as uneconomic remail. Uneconomic remail is the diversion of mail from the domestic mail stream or from its conventional route to one that benefits from lower compensation paid by foreign postal administrations to the USPS for delivery of that mail. ABA remail occurs when a customer resident in country A posts mail in country B for delivery back into country A. ABC remail occurs when a customer resident in country A posts mail in country B for delivery into country C. Appendix 1 contains more detailed definitions of types of remail.

Remail has arisen at least in part because of the gap between revenues a postal administration would receive under domestic postage rates and the revenues it receives from terminal dues payments from other countries. Remail has also arisen due to arbitrage differences in terminal dues payment between industrialized and developing postal administrations.

Private sector service providers have recommended to the Department of State that the US Government seek the elimination of Article 43 from the UPU Convention and alignment of terminal dues with domestic postage. The Postal Service has asserted that elimination of Article 43 provisions would threaten its domestic revenue base and its

ability to offer consumers affordable rates for a universal service. The private sector providers, on the other hand, contend that Article 43 is anti-competitive and constitutes a market allocation scheme.

An interagency group on postal policy, led by the Department of State, the United States Postal Service and Postal Rate Commission, has agreed to joint sponsorship of this study to analyze the benefits and risks of eliminating Article 43 protection. This study evaluates the economic incentives and non-financial qualitative factors impacting remail, both under the current UPU Convention and under the hypothetical elimination of Article 43. Central to this evaluation are the following task areas:

- Estimate the current level of ABA remail activity into the US
- Evaluate the potential for additional ABA remail if the current provisions under Article 43 and Article 49 were eliminated without changes to the current terminal dues system
- Estimate the potential impact on stakeholders that may result from Article 43's elimination, including:
 - Effects on domestic and international revenues, mailing volumes, and costs to the USPS
 - Financial consequences to the US mailing public and competitors of the USPS in the international arena
 - Consequences for the existing international system of providing affordable, universal international mail service
- Determine the effectiveness of Articles 43 and 49 on remail

1.2. Background

This section describes the UPU and the current system of terminal dues that protects postal services from losses due to uneconomic remail.

1.2.1. The Universal Postal Union

The Universal Postal Union (UPU) is a specialized agency of the United Nations whose constitution defines its mission:

"... to develop social, cultural and commercial communications between all peoples throughout the single postal territory by the efficient operation of the postal services described in the Acts."¹

1.2.1.1. Commitment to Universal Service

One of the overarching goals of the UPU is to provide universal and affordable service to send and receive letter post to and from every citizen of every country, including

¹ Source: Universal Postal Union – Constitution, General Regulations, Resolutions and Decisions – Berne 2000 – Part II, Section 1, Chapter 1, Commentary Paragraph 1.2, Page A.5.

developing countries or unprofitable, hard-to-service locations. Article 1, Paragraph 1 of the Universal Postal Convention, 1999, describes the commitment to universal service:

“In order to support the concept of the single postal territory of the Union, member countries shall ensure that all users/customers enjoy the right to a universal postal service involving the permanent provision of quality basic postal services at all points in their territory, at affordable prices.”

Because of this commitment of service to every citizen, the UPU has designed delivery policies, compensation agreements, and corrective mechanisms to bolster the ability of postal administrations to provide universal service at affordable prices. The mechanisms for calculating and administering payments for the delivery of inbound letter post received from other member administrations is called terminal dues.² Other compensation arrangements exist for the delivery of parcels and Express Mail. However, only letter post items are considered in this study of Article 43 since the Article applies only to terminal dues.

1.2.1.2. UPU History

The Universal Postal Union (UPU) was founded on October 9, 1874 by the Treaty of Berne. With 189 member countries, the UPU is the primary forum for cooperation between postal services and helps to ensure a truly universal network of up-to-date products and services. In this way, the organization fulfills an advisory, mediating and liaison role, and renders technical assistance where necessary. It sets the rules for international mail exchanges and makes recommendations to stimulate growth in mail volumes and to improve the quality of service to customers.

The UPU became a specialized agency of the United Nations on July 1, 1948. Since then its relations and active cooperation with other international bodies have grown.

1.2.1.3. Membership and Voting Rights

With 189 member countries, the UPU embraces almost every country in the world. UPU membership is divided into two categories, industrialized countries and developing countries. Currently the UPU membership includes 29 industrialized countries and 160 developing countries (See Appendix 8 – UPU Membership).

Articles 43 and 47–51 are part of the UPU Convention, which can only be changed by a vote of the member countries every five years. Given that developing countries represent a clear voting majority, changes to Article 43 or the terminal dues structure defined in Articles 47–51 will occur only if those changes are agreeable to the UPU developing country membership.

² Letter post items include letters and postcards (LC) and other articles including printed papers, small packets and literature for the blind (AO). Letter post items generally weigh up to 2 kilograms, although optionally, countries may accept items up to 5 kilograms for M-Bags, and up to seven kilograms for literature for the blind.

1.2.2. The Current Terminal Dues System

Terminal dues is the remuneration paid among postal administrations for the cost of delivery of inbound international letter mail.

1.2.2.1. The Beijing Congress and General Terminal Dues Provisions Under the Universal Postal Convention, 1999

The UPU Congress convened in Beijing in September of 1999 to consider, among other issues, proposals for new terminal dues compensation formulas. The Beijing Congress adopted a new, two-tier system detailed in Articles 47 through 51. This system created separate terminal dues structures for industrialized and developing countries, with dependencies on the direction of mail flow.

Under the new system terminal dues between industrialized countries are derived by formula using domestic postage rates. Domestic postage rates are used because it is assumed they are a reasonable proxy for costs. Terminal dues rates between industrialized countries are assessed on a per item and per kilogram basis.

- Subject to both minimum and maximum rates, compensation may not be higher than 60% of domestic postage rate for a “standard” 20-gram priority letter item in the destination country.
- The maximum rate will rise over a three-year period to a yet undetermined level based on costs and percentages of domestic postage rates.

For inbound international mail to the US the minimum rate of 0.147 SDR per item plus 1.491 SDR per kilogram³ is the applicable terminal dues rate. For letter post flows from developing countries to industrialized countries, developing countries pay a flat rate per kilogram of 3.427 SDR unless special provisions of Article 49 apply.⁴ The same flat rate applies to exchanges between developing countries. For incoming mail from industrialized countries, developing countries will be compensated at a rate 7.5% higher than the outgoing rate in order to fund quality of service improvements.

³For industrialized countries, terminal dues charges are subject to minimum and maximum levels. The minimum charge is 0.147 SDR per item, plus 1.491 SDR per kilogram. If 60% of an industrialized country’s rate in SDR for a 20-gram priority letter is higher than the minimum charge, then rates can be increased up to the following ceilings:

- 2001 -- 0.158 SDR per item plus 1.684 SDR per kilogram
- 2002 -- 0.172 SDR per item plus 1.684 SDR per kilogram
- 2003 -- 0.215 SDR per item plus 1.684 SDR per kilogram
- 2004 and 2005 charges are yet to be determined.

The USPS rate for a 20-gram First-Class letter is less than the minimum rate. Thus the US receives the minimum for mail from industrialized countries into the US, which is 0.147 SDR per item and 1.491 SDR per kilogram.

⁴This rate is 3.427 SDR per kilogram. There are three provisions allowing adjustments to this rate under special circumstances designed to limit “unfair competition and dislocation of mail” (UPU News Release No. 12, 27 September 1999). These provisions are the System Harmonization Mechanism, Revision Mechanism and the Bulk Mail Option and are contained in Article 49. See Section 6 for a complete description of Article 49 and its provisions.

1.2.2.2. Articles 43 of the Universal Postal Convention, 1999 – Posting Abroad of Letter Post Items

Article 43 is the primary mechanism for protecting postal administrations from the potential erosion of their domestic and international revenue streams under the current UPU terminal dues system. It specifically provides corrective postage adjustments for situations involving two kinds of uneconomic remail, ABA and ABC.

ABA remail occurs when a customer resident in country A posts mail in country B (either directly or through an agent) for delivery back into country A. ABA remail siphons mail from the domestic system and posts it overseas as inbound international mail for delivery in the domestic First-Class mail stream. This activity has the potential to erode a postal administration's net revenue base when the domestic rates for letter post are higher than terminal dues.

ABC remail occurs when a customer resident in Country A reroutes mail for delivery in Country C through an intermediary postal administration, Country B. ABC remail becomes attractive due to arbitrage opportunities caused by the two-tier nature of the current terminal dues system.⁵ This activity has the potential to erode a postal administration's international revenue base by reducing terminal dues receipts.

1.2.2.3. Article 49 – Provisions of Mail Flows from Developing to Industrialized Countries

Article 49 applies to terminal dues for mail flows from developing countries to industrialized countries. It includes three provisions that could affect the compensation for remail in the event that it is not detected or treated under the provisions of Article 43. Since the 1989 UPU Washington Congress two provisions that can affect terminal dues compensation are the revision mechanism and the bulk mail option. Their current structure under Article 49 is described in Appendix 9. Also, a new provision adopted at the 1999 Beijing Congress is the system harmonization mechanism effective as of January 1, 2001. The effects of these three adjustment options on developing country arbitrage gaps is discussed in Section 6. A summary of their provisions is given in Appendix 9.

1.2.3. The Remail Decision Process

Before this study could evaluate the potential for an increase in the practice of remail and estimate the impact of an increase, researchers first needed to analyze what factors, and in what sequence, go into a mailer's decision to engage in, or not engage in, ABA or ABC remail.

⁵ ABA remail can also be viewed as a two-tiered system, one tier being rates for domestic customers, the other tier being the rates for the foreign customers.

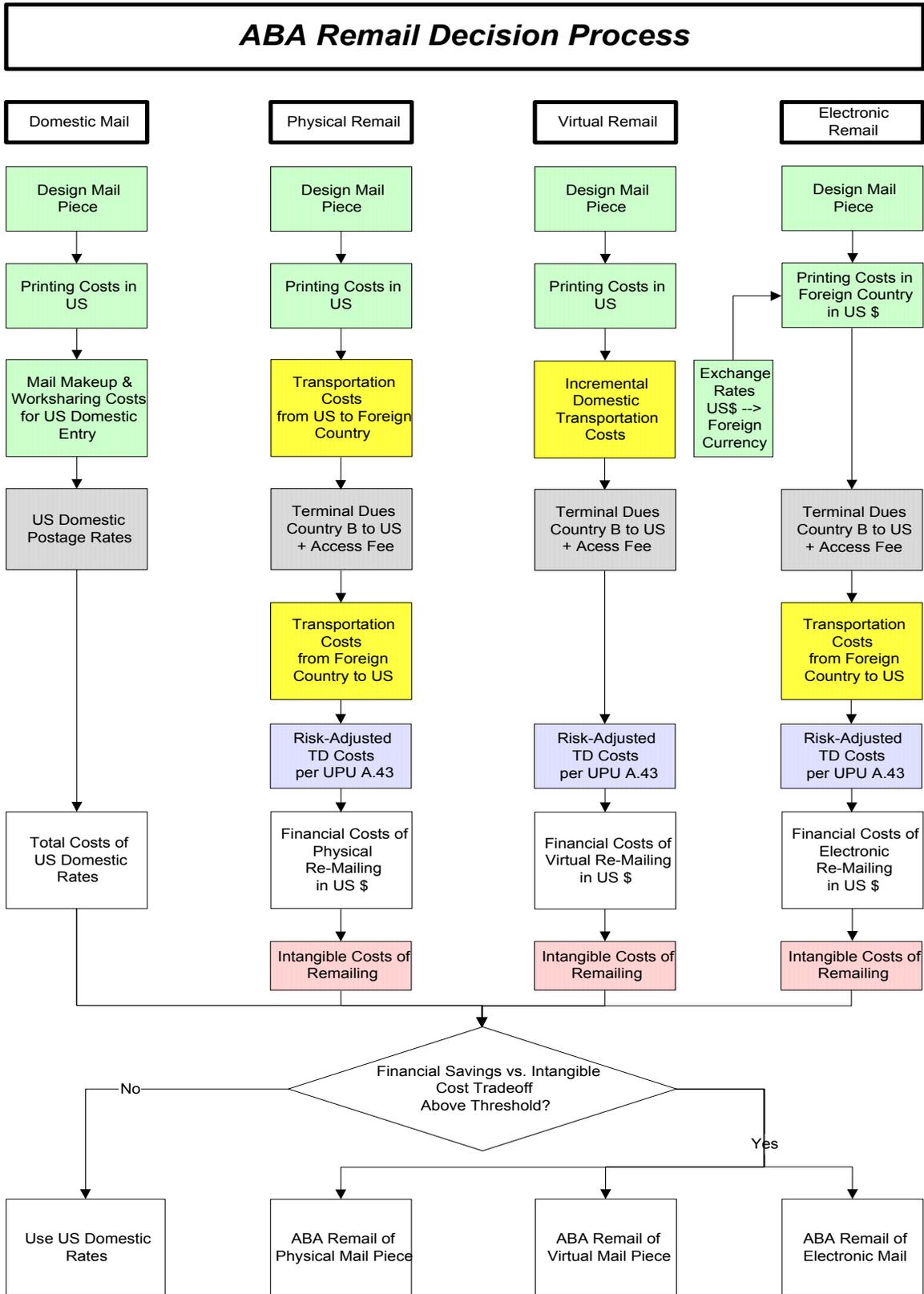
1.2.3.1. ABA Remail Decision Process

In order for ABA remail to be an attractive option for domestic mailers there needs to be a sufficient rate differential to offset the following problems:

- Added logistical complications
- Potentially degraded service
- Questionable legality, and the financial consequences and risk of detection
- Possible negative perceptions by recipient.

Figure 1-1 provides a flowchart that is the basis for a more detailed discussion of the ABA remailing alternatives in sections that follow. This flowchart focuses on the financial elements of the decision process, and includes the various non-financial considerations under the “intangible” category.

Figure 1-1 Flowchart of the ABA Remail Decision Process



The ABA flowchart illustrates four possible mail flows relevant to this discussion:

1. Conventional domestic mail entered under an appropriate domestic rate schedule
2. ABA physical remail – mail produced in the US, transported out of country and then re-entered as inbound international letter post under foreign (“B” country) indicia
3. ABA virtual remail – mail produced in the US and entered into the USPS mailstream as inbound international mail
4. ABA electronic remail (also called non-physical remail) – mail not printed in the US, but instead possibly prepared (designed and stored in electronic format) in the US, printed in a foreign country, and posted to the US as inbound foreign origin mail

The flowchart classifies various aspects of mailing costs and non-financial considerations into categories represented by a color-coding scheme.

Financial considerations for mailers include:

- Postage rates, either domestic or terminal dues – a function of the average weight for the given type of mailing (e.g., catalogs versus letters, gray-shaded)
- An “access fee” for accessing the terminal dues system through a foreign country (included in the terminal dues boxes, gray-shaded)
- Redirecting, preparation and printing costs for the mailing including any mail makeup costs for accessing US domestic worksharing mail discounts (green-shaded)
- International transportation costs from (physical and electronic remail) and possibly to (physical remail only) the foreign posting location (yellow-shaded)
- Risk-adjusted detection cost liability requiring domestic postage payment under Article 43 (blue-shaded)

Intangible considerations (red- shaded) include:

- Mail characteristics (e.g., average weight per piece, value of message, urgency)
- Change in delivery time
- Degree of uncertainty or variability in delivery time
- Perception of foreign indicia as indicative of inferior or suspicious products
- Loss of domestic drop shipping options
- Loss of address correction and undeliverable-as-addressed capabilities
- Reduction in the number of designated entry points
- Reduction in mailpiece quality

These considerations are discussed in greater detail in Appendix 10.

1.2.3.2. ABC Remail Decision Process

ABC remail arbitrage opportunities are created based on the differential between an industrialized country’s terminal dues rates and a developing country’s terminal dues. Rates for the industrialized countries are more expensive for light items, because of the item-based component of the rate. The opposite is true for developing countries since only a single flat rate per kilogram applies. For a mailer residing in an industrialized

country, lighter weight mailings are potential candidates for ABC remail through a developing country. Conversely, for a mailer residing in a developing country, heavier weight items become attractive for remailing through an industrialized country. Unlike ABA remail, there is no longer a direct comparison with domestic postage. The use of foreign indicia is not an issue. Regardless of routing, the mail will carry a foreign indicia.

The ABC flowchart (Figure 1-2) illustrates four possible mail flows relevant to the discussion of this type of remail:

1. Conventional international mail entered via a direct flow from the sender's country of residence to the US
2. ABC virtual remail
 - a) Mail produced in Country A with the international indicia of Country B and then routed from Country A to Country C, or
 - b) Mail produced in Country C with the international indicia of Country B, but entered into Country C's international mail stream without ever crossing the border
3. ABC physical remail – mail produced in Country A and transported abroad (to Country B) and then re-entered as international mail to the US under Country B's indicia
4. ABC electronic remail (also called non-physical remail) – mail not printed in Country A, but instead possibly prepared (designed and stored in electronic format) in Country A, then printed in Country B and posted to the US under Country B's indicia

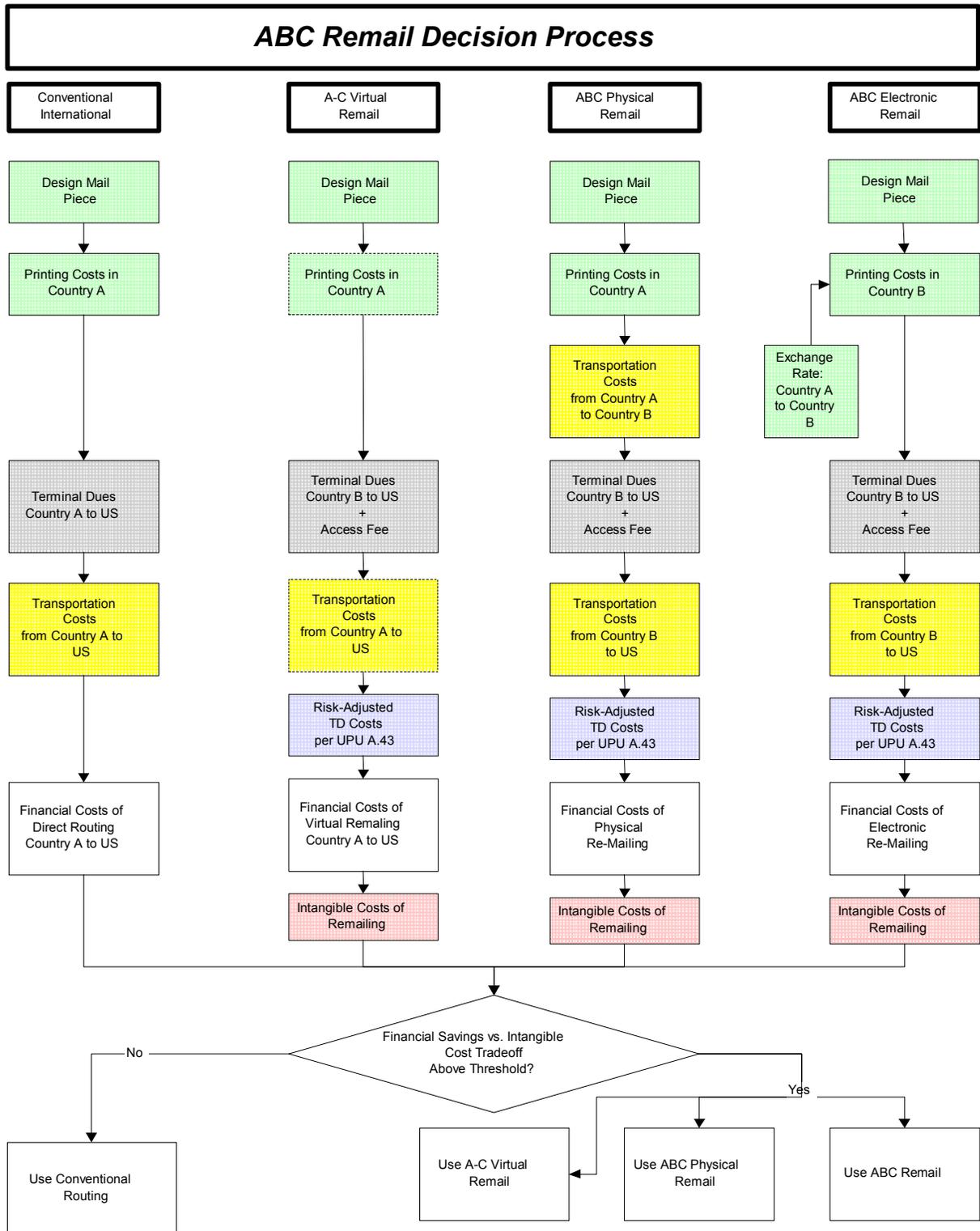
Note in the ABC flowchart all costs are assumed to be unitized in “country A” costs for ease of exposition. As for ABA remail the flowchart highlights the components comprising the financial considerations that include:

- Terminal dues differentials between developing and industrialized countries (gray-shaded)
- Access fee for accessing terminal dues system through a foreign country (gray-shaded)
- Possibly increased international transportation costs due to altered routing (yellow-shaded)
- For electronic remail printing costs in foreign posting country versus resident country (green-shaded), and risk-adjusted liability for 80% of domestic postage, or revision mechanism-based payments, whichever is greater (blue-shaded).

The intangible costs and considerations (red-shaded) include:

- Mail characteristics
- Increased delivery time depending on printing location
- Increased variance in delivery time depending on printing location
- Greater risk of mail loss / inconsistent routing of mail.

Figure 1-2 Flowchart of the ABC Remail Decision Process



ABC considerations are discussed in detail in Appendix 10.

1.3. Study Structure and Structure of the Final Report

This study was designed to collect and validate information from all possible sources of data related to the current or future use of remail. Information from internal USPS organizations and data systems, large mailers, external data systems and organizations developing and/or implementing policies that govern the movement of international mail became the basis for the conclusions and findings in this report.

1.3.1. Methods and Data Sources

The following methods and data sources were used to gather and validate remail data to satisfy the objectives of this study:

- Analysis of internal Postal Service data systems including:
 - SIRV/I
 - USPS Cost and Revenue Analysis Report (CRA)
 - USPS International Cost and Revenue Analysis Report (ICRA)
 - RPW
 - CBCSI
 - Household Diary Study
 - MIDAS
 - International ODIS
 - IBU weight data
 - Mail Flow Data from the International Accounting Branch (IAB).
- Structured interviews with USPS organizations including:
 - International Business
 - Postal Inspection Service
 - The Law Department
 - Operations and Transportation personnel
 - The operations, statistical programs, and international accounting staff at the International Service Centers (ISCs) (JFK and Dallas)
 - International Accounting Branch
 - Statistical Programs staff in Headquarters
- Structured interviews with external organizations including:
 - Universal Postal Union
 - PostEurop
- Field visits to the International Service Centers located at JFK New York and Dallas Texas – See Appendix 2 for summaries.
- Structured and scripted in-depth interviews with twelve industry experts. The key objectives of these interviews were to understand the current awareness of remail and to identify concerns and evaluation criteria regarding potential remail use - See Appendix 3 for summary of findings.
- Hybrid Focus Groups/Mailer Survey that included:
 - Five structured and scripted Focus Groups with twenty-five (25) mailers
 - A statistically valid, at a ninety per-cent confidence level, survey of 415 mailers to determine current ABA remail volume, remail

mailer characteristics and the remail propensity if Article 43 were removed, including the impact of price differential and service factors. – See Appendix 4 for a summary of findings and Appendix 5 for a discussion of the statistical accuracy of the Mailer Survey.

- Developed and executed a sophisticated forecasting model (Remail Impact Model – RIM) that incorporates results of a Conjoint Analysis of the Mailer Survey Data. This model identifies arbitrage and cost differentials for each mail class and generates remail volume and revenue estimates for each mail class. See Appendix 6 for a detailed discussion of the RIM Model and Conjoint Analysis.
- Conducted an Expert Panel composed of six (6) senior industry experts and prominent business partners to validate the major study findings, to calibrate the RIM results, identify likely Stakeholders/participants and to surface and discuss options for addressing remail concerns. See Appendix 7 for a summary of findings.
- Prepared a Final Report capturing and reporting all the data collected by Battelle, and presenting the findings and conclusions supported by the empirical study data.

Each step in the study was designed to build on and validate the data collected in the previous study activity. For example, in-depth interviews conducted with mailers provided data necessary to construct a more precise and targeted mailer survey. Initial data gathering activities provided data for subsequent use in the RIM model and Mailer Survey design activities. Careful attention was given to ensuring the accuracy and validation of the data collected.

1.3.2. Structure of the Final Report

Section 1 provides all the necessary history and background data to allow the reader to understand the remail process, Article 43, Article 49, remail decision factors, and the implications of eliminating Article 43. In addition, this section includes a summary of the primary study findings.

Section 2 identifies and charts the relative importance of each remail decision factor. Subsequent sections present detailed study findings associated with each remail decision factor.

Section 3 explores remail financial considerations. This section first identifies the apparent arbitrage gap for ABA and ABC remail, namely the difference between domestic postage and terminal dues rates. The results of these calculations form ABA and ABC total cost opportunities.

Section 4 addresses non-financial considerations and their impact on remail.

Section 5 presents the results of the RIM Model financial simulations and the impact on USPS domestic revenues.

Section 6 discusses the Article 49 provisions dealing with limiting remail and the effectiveness of those provisions.

Section 7 identifies the Stakeholders and the impact of the elimination of Article 43 on each stakeholder.

1.4. Summary of Findings

The Article 43 study was designed to evaluate the economic incentives and non-financial qualitative factors impacting remail, both under the current UPU Convention and under the hypothetical elimination of Article 43. Central to this evaluation is the satisfaction of the following requirements:

- Estimate the current level of ABA remail activity into the US
- Evaluate the potential for additional ABA remail if the current provisions under Article 43 were eliminated without changes to the current terminal dues system
- Evaluate the effects of Article 43 and Article 49 on remail
- Estimate the potential impacts that may result from the elimination of Article 43 including:
 - Impacts on the domestic volumes and revenues of the USPS
 - Impacts on the affected Stakeholders
- Identify and quantify the non-financial factors affecting the volume of remail.

1.4.1. Current Level of ABA Remail Activity

Based on the following activities we concluded that there is no significant volume of ABA remail currently entering the US:

- Interviews with postal personnel (International Business Unit, Postal Inspection Service, Legal Department and International Service Center (ISC) acceptance and operations managers) identified some minor occurrences of remail over the past fifteen years.
- Observations of the operations, acceptance and statistical programs units at the International Service Centers (ISC's), located at JFK, New York and Dallas, Texas, identified some minor occurrences of ABA and ABC remail.
- The occurrences of remail identified above did not impact the Postal Service's revenue to any appreciable degree.
- Results of the In Depth Mailer Interviews, the Mailer Survey, Focus Groups and the Expert Panel indicate that there is no significant current ABA remail activity.

1.4.2. Potential for ABA Remail

During our mailer surveys and focus groups a cross section of large mailers were presented scenarios that postulated an international market place where no restrictions exist on ABA remail. The following findings resulted from the Mailer Survey and Focus Groups (See Appendix 4 for more detail):

1.4.2.1. Propensity to Remail

- Roughly one-third of the major mailers surveyed indicated they were likely to engage in remail for one or more classes of mail within a 5-year time horizon. Propensity to remail was somewhat varied across mail classes, with 23%, 35% and 42% of First-Class, Standard A, and Periodicals mailers, respectively, characterized as “likely to remail.”
- Mailers that indicated they would be likely to remail (absent restrictions) tend to be higher-volume mailers, with greater numbers of employees. Additionally, companies that operate outside of a local scope, particularly those that have a physical presence in foreign countries, tend to be more favorably disposed to the concept of ABA remail. In comparing likely remailers with those not likely to remail, there is not a strong difference in the distribution of mailers between profit and non-profit organizations.

In general, First-Class and Standard A mailers that send advertising mail appear to be more likely to consider ABA remail than those sending their mail for other purposes. Companies that currently engage in worksharing (particularly Standard A and Periodicals mailers) are also more prone to consider remailing. Additionally, companies that send Standard A or Periodicals mail outside of their state have a greater tendency toward remail.

1.4.2.2. Time Frame for Remail

Mailers that are likely to remail expressed a degree of caution with respect to the timeframe with which they would engage in the practice (absent restrictions). Only 14% indicated they would begin remail within the first six months. Over one-half (62%), however, indicated they would initiate remail within the first year and virtually the entire group indicated they would engage in remail by the end of the second year.

However, it should be noted that the Expert Panel expressed reservations regarding the two-year timeframe; they felt that it would take longer for mailers to adopt remail. They indicated that the first two years would probably be a period of experimentation and that mailers would adopt a wait-and-see attitude carefully gauging the reaction of the USPS to remail.

1.4.3. Effects of Article 43 and Article 49 on the Propensity to Remail

The effects of Article 43 and Article 49 on the propensity to remail were determined by data obtained from the Mailer Survey and Focus Groups (See Appendix 4 for more detail):

As Table 1-1 indicates, the Article 43 provisions are perceived to be the most effective deterrent to ABA remail; 69% of the mailers indicating they would be likely to remail perceive this restriction to be a “strong deterrent that hardly any mailers would attempt to circumvent.”

Table 1-1 Perceived Effectiveness of UPU Provisions Among Likely Remailers

UPU Provision	Perceived As A Strong Deterrent (% of Likely Remailers)
Article 43 Only	69 (±9)
System Harmonization Mechanism Only	30 (±10)
Revision Mechanism Only	26 (±9)
Bulk Mailing Option Only	39 (±9)

Further, as Table 1-2 indicates, the number of mailers indicating that they would be “highly likely” to remail with Article 43 in place (and strictly enforced) is substantially reduced. Mailers indicated that they would be less likely to remail with the strict enforcement of Article 43 due to the potential negative impacts on their costs, service times and the reputations of their companies.

Table 1-2 Effect of UPU Provisions on Remail Propensity Among Likely Remailers

UPU Provision	Portion of Likely Remailers that would Remain Highly Likely to Engage in Remail in 5-Year Time Horizon with the Indicated Provisions in Place (%)		
	First-Class	Standard A	Periodicals
Article 43 Only	21	12	7
System Harmonization Mechanism Only	47	27	41
Revision Mechanism Only	45	39	28
Bulk Mailing Option Only	33	15	12
Combined Harmonization Provision, Revision Mechanism, and Bulk Mailing Option	34	14	11

Of the three other provisions, the Bulk Mail Option is perceived to be the strongest; however, each of these three UPU provisions are perceived to function as strong deterrents by less than half of mailers. The majority of mailers believe that some companies would attempt to circumvent them. More importantly, as indicated in the qualitative interviews, they wonder how these restrictions could be enforced. The harmonization mechanism and revision mechanism are viewed as being particularly ineffective. Between one-third and one-half of likely remailers indicated that they would

still be highly likely to engage in remail, even with these prohibitions in place and strictly enforced.

While Article 43 and the Bulk Mail Option are perceived by mailers to be the most effective deterrents to remail, they are difficult and costly to implement. Both Article 43 and the Bulk Mail Option require the identification of the mailer and/or the origin of the mail. Identification of the mailer and/or origin of the mail would require a close inspection of the mail as it passes through the ISCs. This type of inspection is not currently performed and would require additional manpower to implement. Further the identification of the mailer and/or the origin of the mail could be easily disguised making mail violating Article 43 or the Bulk Mail Option difficult to detect. Our field observations indicated that the System Harmonization Mechanism would be relatively easy to implement at a reasonable cost, and as will be demonstrated below the System Harmonization Mechanism has the potential to significantly dampen remail activity. See Section 5 for an in depth discussion of the enforcement of the provisions of both Articles 43 and 49.

1.4.4. Impact of the Elimination of Article 43

Eliminating Article 43 would have financial impacts USPS as well as a variety of impacts on the various Stakeholders.

1.4.4.1. Financial

The financial impacts of the elimination of Article 43 were determined by combining data from the mailer survey conjoint analysis with financial data contained in the RIM simulation model. A series of financial scenarios were produced revolving around the sensitivity of the results to such factors as the level of domestic USPS postage, the SDR conversion rate, the likelihood of bulk mail detection, the cost of processing mail in the domestic USPS system, UPU settlement costs and others. These scenarios, and the assumptions they are based on, can be reviewed in depth in Section 5 and Appendix 13.

The results of four Core Remail Scenarios are presented again in Table 1-3. These Core Remail Scenarios represent our best estimates of the impact of remail in an unrestricted environment (No Article 43 or 49) and an environment where Article 43 does not exist but the Article 49 System Harmonization Mechanism is fully enforced.

The Core Remail Scenarios in Table 1-3 yield the following results:

- The impact on USPS domestic revenue for the unrestricted scenarios ranges from a low of \$3.0 billion to a high of \$4.7 billion.
- The impact on USPS domestic revenue for the scenarios with full execution of the System Harmonization Mechanism ranges from a low of \$.7 billion to a high of \$1.5 billion.
- The average revenue loss (yellow shaded box in center) across all Core Scenarios is \$3.825 billion with unrestricted remail and \$1.048 billion with the System Harmonization Mechanism in place.

Table 1-3 Summarization of Core Remail Scenarios

Baseline using ICRA Costs		Alternative using ICRA Costs	
System Harmonization (SH)	\$0.9	System Harmonization	\$1.5
Unrestricted (UR)	\$4.1	Unrestricted	\$4.7
Baseline using CRA Costs		Alternative using CRA Costs	
System Harmonization	\$0.7	System Harmonization	\$1.1
Unrestricted	\$3.0	Unrestricted	\$3.5

1.4.4.2. Impact on Stakeholders

The proposed elimination of Article 43 will have differing financial, service and other impacts on a variety of Stakeholders. These impacts were validated by members of the Expert Panel and are presented in Table 1-4.

Table 1-4 demonstrates that the USPS and its business partners would stand to lose substantially, as would single-piece (and other) mailers who would need to bear the cost of commensurate rate increases. Business mailers, privatized foreign posts, and developing countries' postal administrations would stand to gain the most (at the expense of the USPS and those mailers not taking advantage of remail opportunities), as would other USPS competitors. The list of projected winners and losers concerned the Expert Panel members because of its potentially adverse effect on the ability of the USPS to continue to provide the full range of mailing and delivery services at affordable prices.

Table 1-4 Effect on Key Stakeholders of Removing UPU Provisions

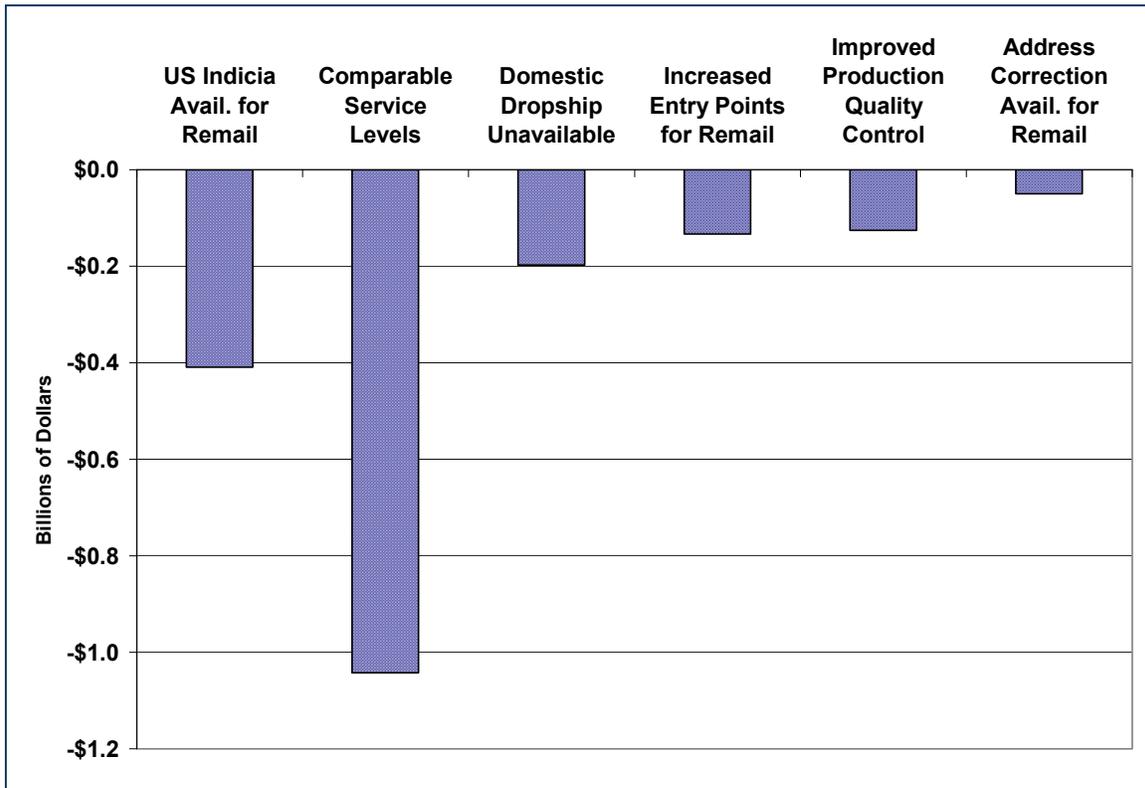
Stakeholders	If Only Article 43 were Removed	If Both Article 43 & 49 were Removed
Large Business Mailers	Minimal effect	Gain (F) ⁶
Small Business Mailers	Small gain (F)	Gain (F)
Single-Piece Mailers/Mail Recipients	Small loss (F, S)	Loss (F, S)
USPS	Loss (F, S,)	Loss (F, S)
USPS Business Partners	Small loss (F, S)	Loss (F, S)
Foreign Postal Administrations – Developing Countries	Small gain (F)	Gain (F)
Foreign Postal Administrations – Canada	Gain (F)	Small gain (F)
Foreign Postal Administrations – Other Industrialized Countries	Loss (F)	Loss (F)
Foreign Postal Service Business Partners	Gain (F)	Gain (F)
Foreign Privatized Posts	Gain (F)	Gain (F)
Universal Postal Union (UPU)	Small loss (O*)	Loss (O)
USPS Competitors	Gain (F)	Gain (F)

1.4.4.3. Impact of Non-Financial Factors

The potential for remail under several scenarios, each highlighting a particular non-financial remail characteristic, was estimated by employing the Remail Impact Model loaded with appropriate assumptions. Most of these scenarios were developed by manipulating the characteristics of remail that are specified in the Mailer Survey conjoint models. The estimates in Figure 1-3 and Figure 1-4 are given in terms of the additional amount of net revenue loss that would occur if a particular negative aspect of remail were to be removed. Thus an estimate of -\$1.0 billion indicates that the estimated net revenue loss to the USPS would be \$1.0 billion greater than the baseline estimate. Since all scenarios involve mitigating negative remail characteristics, all potential impacts are expected to be negative dollar amounts. The estimates presented in Figure 1-3 and Figure 1-4 place upper bounds on the additional net revenue losses if the characteristics could at least be partially resolved.

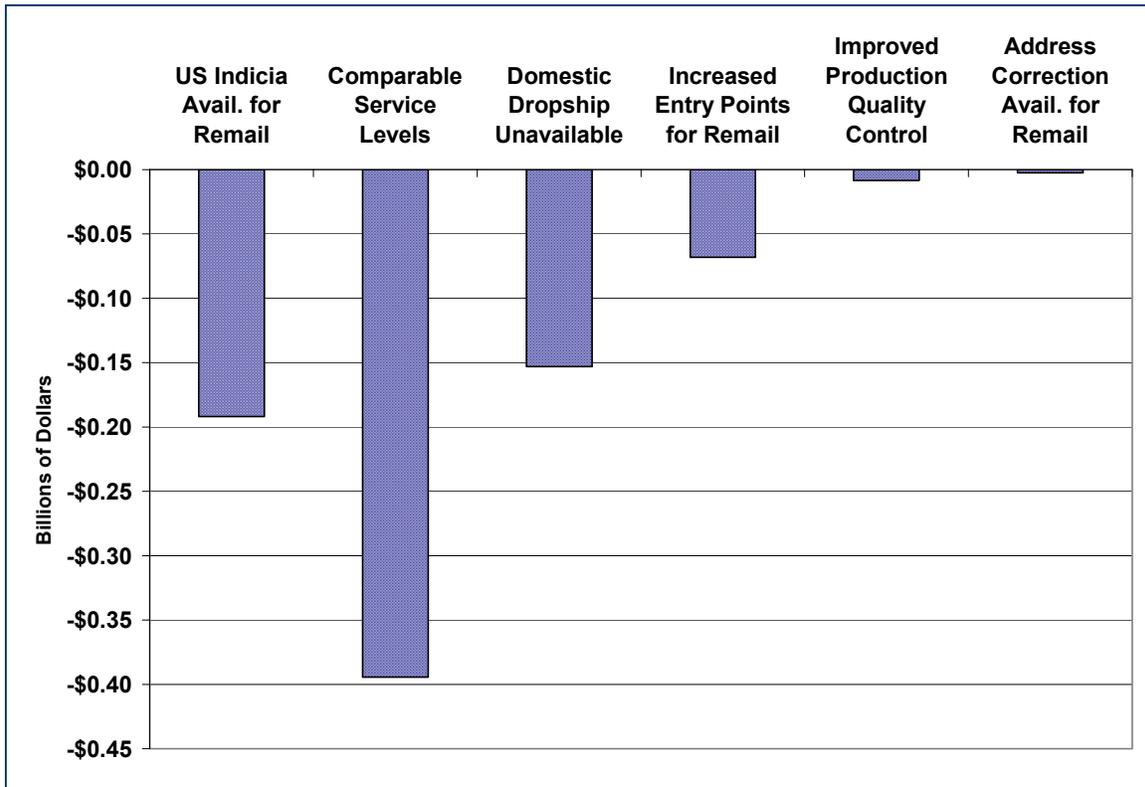
⁶ F = Financial Impact, S = Service Impact, O = Other Impacts

Figure 1-3 Changes from Unrestricted Scenario



- Figure 1-3 depicts the unrestricted scenario and is defined as the elimination of both Article 43 and Article 49
- These scenarios are relative net revenue effects in addition to the estimated baseline loss of \$4.1 billion. (Baseline using ICRA costs)
- Two remail features, service levels and the use of foreign indicia, are viewed as having the largest effects among the alternatives. In terms of stimulating additional remail, the net revenue effects on the USPS are from approximately 30% more than baseline losses for comparable service levels to 10% more for US indicia.

Figure 1-4 Changes from Baseline under System Harmonization



- The Figure 1-4 scenarios assume that Article 43 has been eliminated and that the System Harmonization Mechanism is fully enforced.
- These scenarios are relative net revenue effects in addition to the estimated baseline loss of \$.9 billion.
- Service levels and foreign indicia again are estimated to have the largest effects among the alternatives.

The findings enumerated above clearly indicate that ABA and ABC remail do not currently represent a problem for the USPS. However, these same finding reveal that the elimination of Article 43 and a move toward an unrestricted international remail environment would have serious financial consequences for both the USPS and its Stakeholders, threatening the ability of the USPS to meet its universal service obligation.

The financial consequences with enforcement of Article 49 provisions mitigating the elimination of Article 43 are still significant and must be dealt with either from the perspective of domestic rate increases, decreases in service levels, or increases in international rate.

Section 2. The Relative Importance of Remail Decision Factors

One purpose of this study is to evaluate the potential for ABA remail if the current provisions of Article 43 were eliminated. The accomplishment of this objective requires a determination of the relative importance of each financial and non-financial factor in deciding whether to remail.

2.1. Introduction

A number of factors affect a mailer's propensity to engage in uneconomic ABA or ABC remail. These factors include both financial and non-financial considerations, and the impact of these factors varies by the type mailer or the type mail being remailed.

Financial factors include:

- The pure arbitrage gap between postage rates and terminal dues rates, or in the case of ABC remail terminal dues differentials between developing and industrialized countries
- Access fees for foreign posting
- Preparation and printing costs
- International transportation costs
- Risk-adjusted detection costs

Non-financial considerations include:

- Foreign indicia
- Comparative service levels – delivery time and variability
- Loss of domestic drop ship options
- Reduction in the number of designated entry points
- Reduction in mailpiece quality
- Loss of address correction and undeliverable-as-addressed capabilities

Each of these factors is defined and discussed in detail in Appendix 10.

A determination of the importance of each factor and its impact on remail was accomplished by employing a structured methodology that included in-depth interviews, hybrid focus groups, mailer survey, expert panel, conjoint analysis and simulation modeling.

2.2. Financial Considerations

The results of our investigations indicate that by far the most important factor affecting the likelihood to remail is the financial savings created by the arbitrage gap between US domestic postage rates and by terminal dues rates in developing and even, in some cases, industrialized countries. These savings were adjusted by additional costs such as access

fees, preparation and printing costs, and international transportation costs to yield the net cost savings associated with remail.

Results of our mailer survey and resulting conjoint and RIM analysis clearly support the proposition that cost savings is the primary factor in the remailing decision. Findings from the Focus Groups and Expert Panel to a large degree support this contention.

2.2.1. Focus Groups

The excerpts below from the Focus Group Summary Report (See Appendix 4) discuss cost-savings factors.

Generally, mailers in the groups were quite interested in the concept of ABA remail, because they recognized the potential to realize substantial cost savings relatively quickly by taking advantage of it.

Overall, mailers in the focus groups indicated they would need savings ranging from 10% to 50% to consider remail, depending, primarily, on the volume of mail in question. Remail alternatives that offer smaller savings for the mailer are only appealing to those with especially high volumes. For non-profit mailers particularly, who often use volunteer labor for their printing/production activities, postage cost savings would need to be quite substantial for them to consider remail options.

Mailers indicated that they would adopt a wait and see attitude voicing a strong concern about the USPS reaction to large volumes of remail. This concern focused on possible increases of domestic rate levels by the USPS, and the narrowing of the arbitrage differences that give rise to the remail incentive cost savings. Given that substantial start-up costs could be associated with switching to ABA remail, mailers were concerned that a strong USPS response to mitigate against a revenue loss would make remail economically less attractive and cause a loss of all or part of their investment. Further, there was also a concern voiced that foreign posts or mail consolidators would not provide them with assurances of sustained savings.

2.2.2. Expert Panel

Members of the Expert Panel were given an information module that contained preliminary study findings on the impact of eliminating Article 43 and 49 provisions. The excerpt below from the Expert Panel Review of Preliminary Study Findings (Appendix 7) supports the conclusion that, in the long run, cost savings is a key factor.

The assertion that up to 17.1 billion pieces of mail and \$4.3 billion in revenue could be lost to ABA remail annually (if all Article 43 and 49 provisions were eliminated) was viewed with some skepticism. Some

panel members felt this represented an "upper limit" for ABA remail volume in the initial years, a level that would only be achieved if experiences with remail were extremely positive and concerns about other factors, such as indicia, time-in-stream, and production quality were addressed. In practice, they felt that the real number could be much lower due to a slow adoption curve by mailers, difficulties associated with the logistics of ABA remail, and a reticence by many high-volume mailers to engage in a practice that might undermine the USPS's infrastructure and daily operations.

In the long term, however, panel members believed that the practice could become even more widespread than the 17.1 billion pieces reported if mailers derived a sustainable financial benefit from remail.

2.3. Non-Financial Considerations

It has been postulated that several key non-financial factors (or risks) associated with remail might mitigate the degree to which mailers would engage in ABA remail if Article 43 were removed. These non-financial considerations are listed in Section 2.1.

Based on our mailer survey responses, each of these factors would have a relatively minor impact in curbing remail demand, as shown in Table 2-1. Foreign indicia presents the greatest concern to mailers, potentially curbing remail volume by 1.5% (absolute) below what it might be if a US indicia were allowed. Poorer comparative service levels (e.g., slower time-in-stream) for First-Class Mail and the availability of drop ship for domestic (Standard A and Periodicals) mail, which can reduce net mailing costs by roughly 5%, could each mitigate potential remail by roughly an additional 1%. Each of the other factors has a less pronounced impact on remail volumes, as shown in Table 2-1.

Table 2-1 Impact of Remail Considerations on Estimated Remail Volumes¹

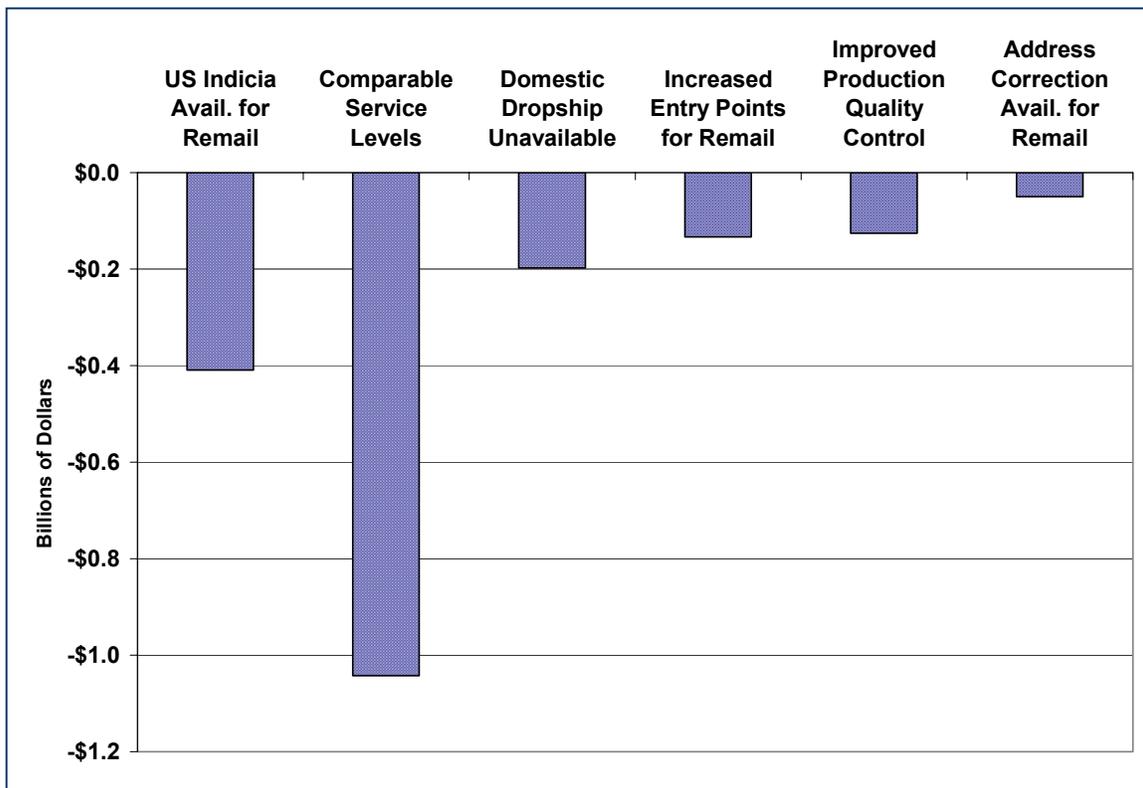
Remail Risk	Net Change in Remail Volume (as a % of Current USPS Volume)
Foreign Indicia	-1.5% (± 1.0%)
Poorer Comparative Service Levels (increased time-in-stream and delivery variability)	-1.0% (± 0.8%)
Domestic Dropship Availability (i.e., reduced remail cost savings)	-0.6% (± 0.5%)
Limited Entry Points (increased time-in-stream and delivery variability)	-0.5% (± 0.2%)
Quality Control (if US-based production/preparation quality unavailable)	-0.3% (± 0.2%)
Address Correction and Undeliverable Mail Handling (no address correction)	-0.2% (± 0.1%)

¹ Reported uncertainty (±) is based on a 90% confidence interval

When this mailer survey data is modeled in the RIM simulation model the impact of each of the above non-financial factors is displayed in Figure 2-1. These estimates are given in terms of the additional amount of net revenue loss that would occur if a particular negative aspect of remail were to be removed. Thus an estimate of -\$1.0 billion indicates that the estimated net revenue loss to the USPS would be \$1.0 billion greater than the baseline estimate.

Since all scenarios involve mitigating negative remail characteristics, all potential impacts are expected to be negative dollar amounts (which the estimates bear out). It should be noted that most of these characteristics are inherent to remail and their complete alleviation would be unlikely in the real world. However, these estimates place upper bounds on the additional net revenue losses if the characteristics could be at least partially resolved.

Figure 2-1 Changes from Unrestricted Scenario



Two remail features, service levels and the use of foreign indicia, are viewed as having the largest effects among the alternatives. In terms of stimulating additional remail, the net revenue effects on the USPS are from approximately 30% more than baseline losses for comparable service levels to 10% more for US indicia. Service times may be controllable to a degree, especially under a maturing remail market. This might close the service gap between remail and domestic mail, but comparability to domestic service times may not be achieved.

The relative importance of each factor (from most important to least important) based on the unconstrained scenario is presented in Table 2-2. As can be determined from Figure 2-1 and Table 2-2 the financial impact of each of these factors is relatively insignificant with the exception of comparable service levels and foreign indicia.

Table 2-2 Relative Importance of Each Factor

Factor	Approximate Impact on Remail Revenue Loss
Comparable Service Levels	30%
US Indicia Available for Remail	11%
Domestic Drop Ship Unavailable	6%
Increased Entry Points Available for Remail	6%
Improved Production and Quality Control	3%
Address Correction	1%

Section 3. Economic Incentives for Remail

The purpose of this section is to assess the economic incentives for remail. For ABC remail, execution of this objective required an analysis of developing and industrialized country terminal dues rates. For ABA remail, the relationship between terminal dues and USPS domestic tariffs needed to be analyzed. These analyses focused on features that result in potential arbitrage opportunities that could give rise to uneconomic ABA and ABC remail.

3.1. Introduction

Appendix 10 provides flowcharts and a detailed discussion of the ABA and ABC remail decision processes. These flowcharts focus on the financial elements of the decision process, as well as the various non-financial considerations under the “intangible” category.

The economic incentives identified are based on comparisons of US domestic rates, effective January 7, 2001, with UPU terminal dues rates as of January 1, 2001. The comparisons contained in this section also address the other non-postage costs associated with remail: international transportation, mail preparation, access fees, and offshore printing costs. However, the comparisons do not include non-financial considerations such as:

- Added logistical complications
- Potentially degraded service
- Questionable legality, and associated risk of detection
- Quality of printing in developing countries
- Negative perceptions by recipients.

The non-financial aspects identified above will be discussed in Section 4 of this report. This section is the foundation upon which will be layered additional qualitative information, ultimately presenting a complete view of the current remail environment and the potential impacts if Article 43 is eliminated.

3.2. ABA Rate Based Arbitrage Opportunities

There exist substantial differences between the revenues the USPS receives for various domestic mailings and the revenues that would be received as terminal dues from foreign postal administrations. (See Appendix 11) These differences represent the arbitrage gaps that provide incentives for domestic mailers to post their domestic mail as foreign origin mail. These arbitrage opportunities vary greatly depending on sending country classification, domestic mail class, and mail weight.

Mailers who might take advantage of these arbitrage opportunities include the full spectrum of mailers and cover a wide range of mail classes and types. Among such mailers are retailers, utilities, financial institutions, lotteries, associations, and foreign

governments. They could participate in remail activities directly or through the services of consolidators, wholesalers, or foreign postal administrations and their affiliates.

3.2.1. Summary of ABA Arbitrage Opportunities

Domestic mailers are found to have rate-related incentives to bypass the USPS by posting their mail abroad, thus converting domestic mail to inbound international mail. The financial incentive can be quite large, especially for lighter weight mailings as illustrated in Figures 3-1, 3-2, and 3-3. The examination of ABA arbitrage opportunities shows that:

- Arbitrage opportunities for lightweight mail are greatest for developing countries, since their terminal dues structure is a flat per-kilogram rate. Industrialized countries posting mail to the US have a minimum per-item charge of approximately 19.7 cents, which limits their arbitrage opportunities for lightweight mail. For example, the arbitrage gap between US domestic postage rates and developing country terminal dues for Regular Standard A mail is -10.3 cents or -61%, while industrialized country terminal dues are 5.8 cents higher (34% higher—see page 10 of Appendix 11).
- For First-Class mail, both developing and industrialized terminal dues are less than domestic postage (Figure 3-1). First-Class Single Piece/Priority mail is roughly twice as costly for domestic mailers as the same mail entered as international mail by either developing or industrialized countries (with the exception of First-Class post cards mailed from industrialized countries into the US). For example, for a 4-ounce First-Class Single Piece item, domestic postage is 97 cents, industrialized country terminal dues are 39.6 cents, and developing country terminal dues are 45.6 cents (see page 1 of Appendix 11).
- For Standard A and Periodical mail, arbitrage opportunities generally exist only for lightweight mail (less than 2 ounces) posted in developing countries. Industrialized countries have very limited arbitrage opportunities for these classes. Standard A and Periodical domestic rates become less costly than terminal dues as mail weight increases. For example, after 1.9 ounces, the Standard A Regular rate becomes less costly than developing country terminal dues (Figure 3-1). After 1.5 ounces, the Standard A Automation Basic Letters rate is less costly than terminal dues (Figure 3-3). Above these weights, the postage-related arbitrage opportunities are eliminated.
- For lightweight mail between 0.25 and 0.50 ounce, domestic rates for all categories of First-Class, Standard A and Periodical mail are up to several times greater than developing country terminal dues. For ultra-light mail weighing under $\frac{1}{4}$ ounce, domestic postage can be 15 to 20 times greater than developing country terminal dues (see Figure 3-2 and Figure 3-3 for high resolution views for First-Class Automation Basic Letters and Standard A Automation Basic Letters).

3.2.2. ABA Rate Arbitrage

A series of highly detailed tables that systematically illustrate ABA arbitrage gaps is provided in Appendix 11. The tables review all of the relevant domestic mail classes subject to arbitrage over the range of relevant mail weights. These tables are based on current USPS rates¹ and current UPU terminal dues payments² due the US for inbound foreign origin mail. Also included on the tables are estimated amounts of revenue generated under each category (revenue estimates for some mail shapes were not available) to provide a comparison of the current revenue to the arbitrage gaps.³

A series of selected US products will be graphically compared with terminal dues to provide a summary of the detailed information from the appendix.

Figure 3-1 highlights two classes of mail, First-Class Single Piece merged with Priority Mail above 13 ounces, and Standard A Presorted Basic mail. The graph shows the ratio of domestic rates to the minimum of DC and IC terminal dues. Due to the “crossover,” DC terminal dues are most attractive for lighter weight mail, and IC terminal dues for heavier weight mail. This crossover is indicated on the graph by the vertical red line. Note that Standard A ends at its maximum weight limit of up to 16 ounces. First-Class/Priority continues though 70 ounces (roughly 2 kilograms).

For example, for First-Class single piece mail weighing less than 1 ounce, the current postage rate is 34 cents. For a 1/2-ounce letter post item, the terminal dues owed by a developing country in SDRs are:

$$\frac{1/2\text{ounce}}{16\text{oz}/\text{lb}} \div 2.2046\text{lb}/\text{kg} * 3.427\text{SDR}/\text{kg} = 0.049\text{SDR}$$

At the prevailing SDR rate, this amount is 6.5 cents in US dollars.⁴ The ratio of US First-Class postage to this is 34/6.5 or 5.2. This is the starting point for the solid blue line on Figure 3-1.

For an industrialized country, the ratio is calculated as follows:

$$\frac{1/2\text{ounce}}{16\text{oz}/\text{lb}} \div 2.2046\text{lb}/\text{kg} * 1.491\text{SDR}/\text{kg} + 0.147\text{SDR}/\text{item} = 0.168\text{SDR}$$

Converted to US currency, this equates to 22.6 cents. The ratio of domestic postage to this value is 34/22.6 or 1.5. In Figure 3-1, this is the location of the first “x” for industrialized countries mailing into the US. The percentage of savings relative to US domestic postage is computed as $1 - 22.6/34$, or 34%.⁵

¹ Effective January 7, 2001.

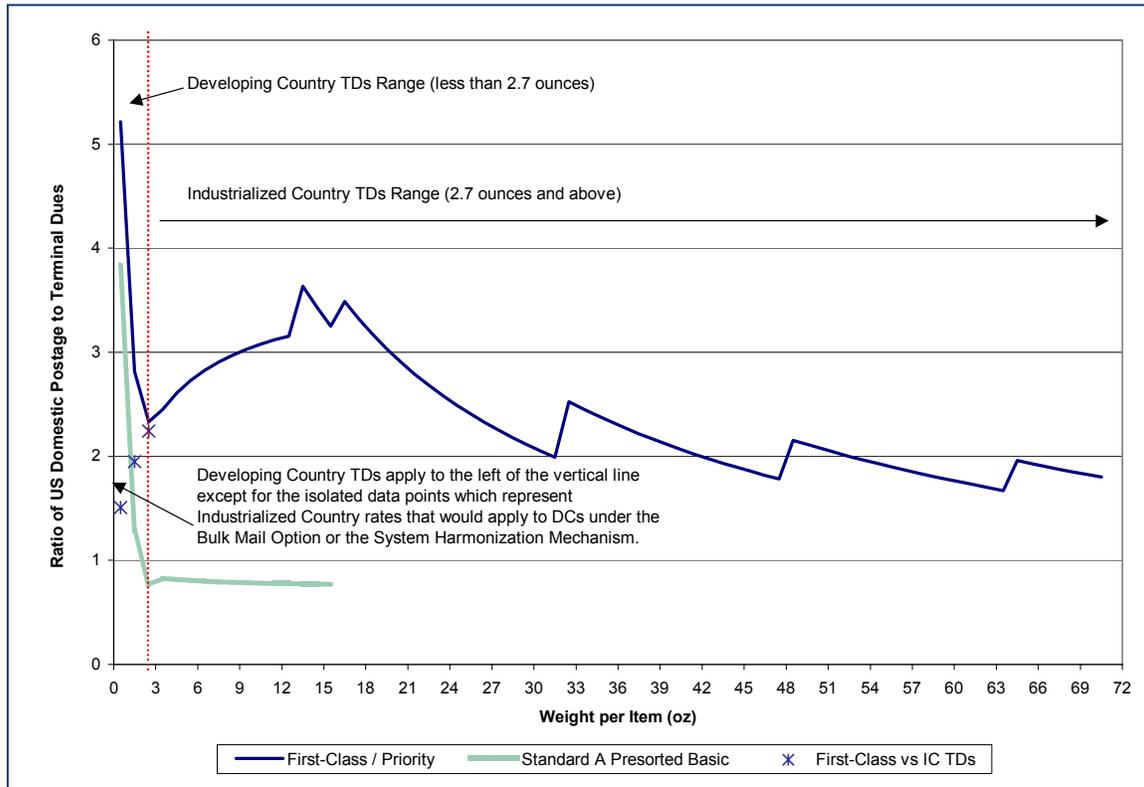
² Effective January 1, 2001.

³ The revenue estimates are based mainly on FY 1999 Revenue, Pieces and Weight Report (RPW) for the government fiscal year. In cases where sufficient detail was not available from RPW, FY 2000 billing determinant data have been used and noted.

⁴ The official SDR rate for FY 2001 is \$1.3416 per SDR.

⁵ This calculation duplicates the calculation on the first page of Appendix 11 under the first ounce of the single piece calculation (see shaded data line). Note that mid-step weights are used in Appendix 11, so for the 0 to 1 ounce weight step, 0.5 ounces is used as in the above example and in Appendix 11.

Figure 3-1 The Ratio of Selected US Domestic Rates to the Minimum of DC and IC

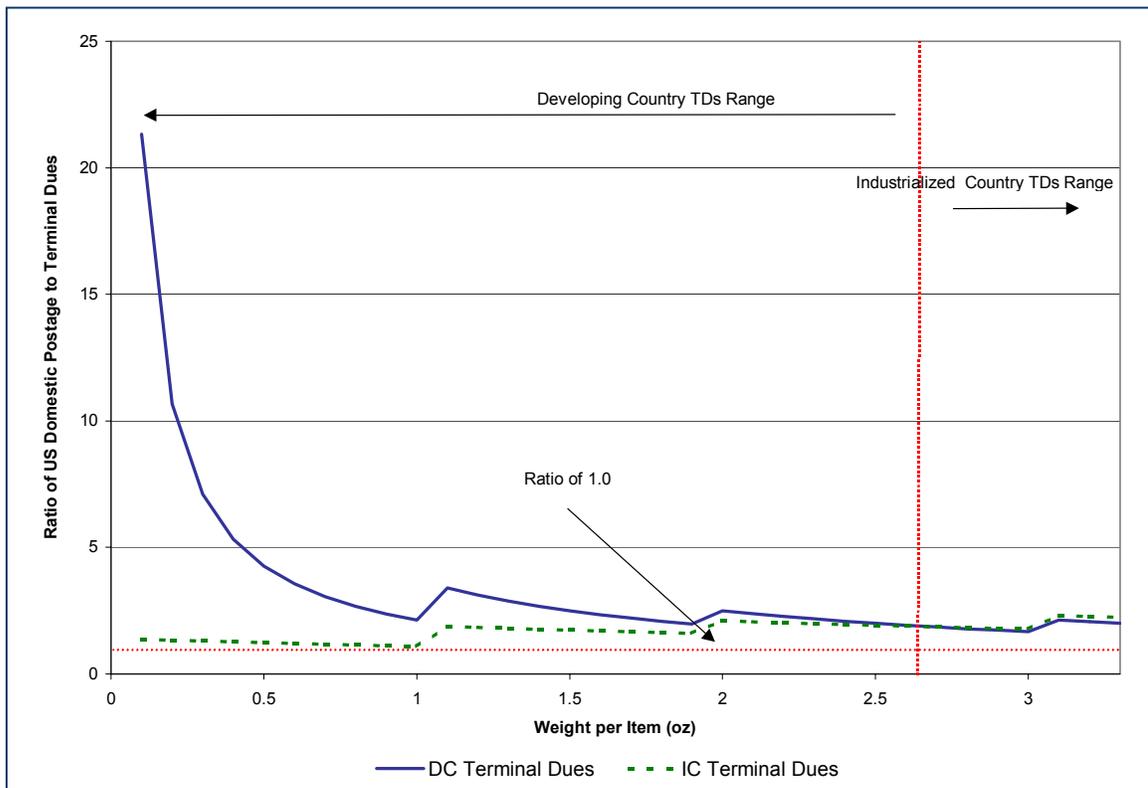


Terminal Dues Rates

Note that for very light mail, domestic rates for both First-Class and Standard A are approximately 4 to 5 times greater than terminal dues. This is potentially an attractive arbitrage gap for the remail decision process. After 1.9 ounces, rates for Standard A mail become lower than terminal dues, eliminating the financial incentive for remailing. Rates for First-Class / Priority mail are always at least roughly twice as great as the same mail entered under the lowest cost terminal dues system.

Figure 3-2 is a high-resolution view of First-Class Automation Basic, focusing on the first 3.3 ounces only. Here the weight steps are in increments of 0.1 ounces. Arbitrage gaps for both developing countries and industrialized countries are shown. Note that for very light mail the US domestic postage is over 20 times higher than terminal dues from developing countries. Industrialized country terminal dues are fairly close to domestic postage through the first ounce (the ratio is very close to 1.0 as indicated by the dotted horizontal red line).

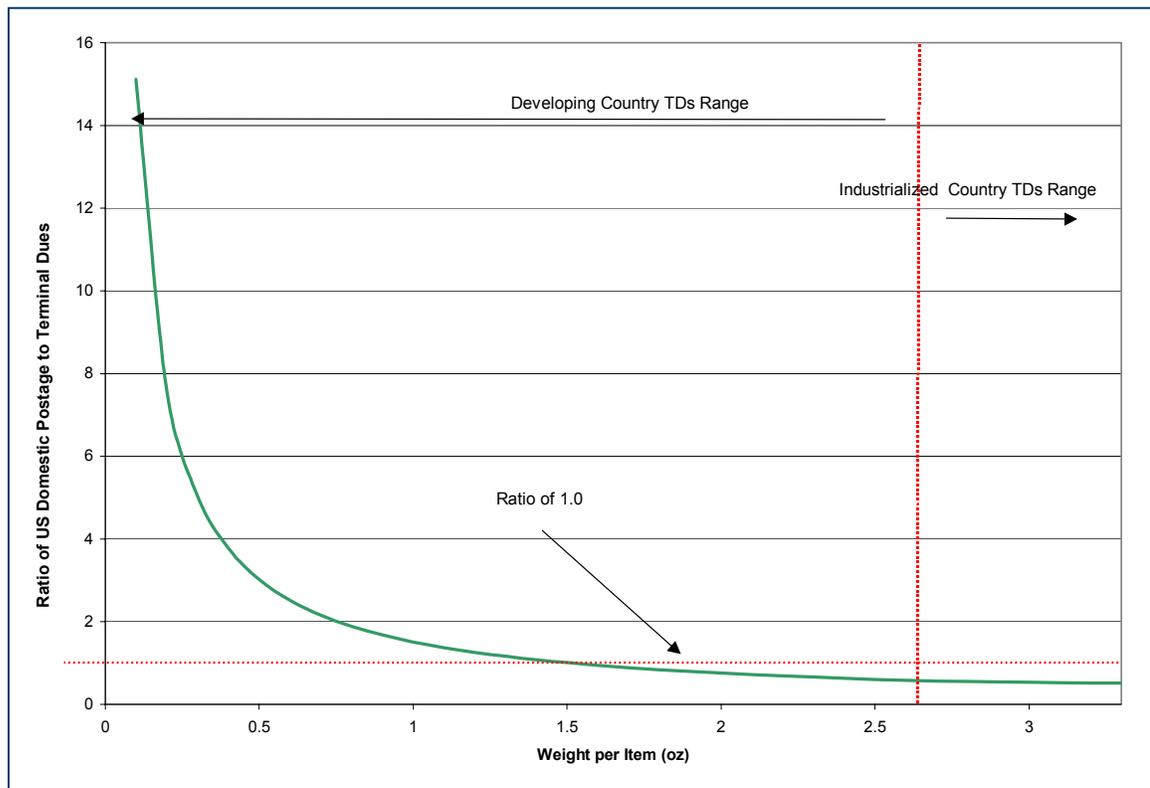
Figure 3-2 The Ratio of First-Class Automation Basic Letter Rates to DC and IC Terminal Dues Rates



Continuing the ratio example from Figure 3-1, the terminal dues for developing and industrialized countries for 0.50 ounce mail are 6.5 and 22.6 cents, respectively. The 0.50 ounce rate for First-Class Automation Basic Letters is 27.8 cents. The ratio of US postage to DC terminal dues is $27.8/6.5$ or 4.4. The corresponding ratio to IC terminal dues is $27.8/22.6$ or 1.2. These results can be visually compared to the values in Figure 3-2 and also verified on the second page of Appendix 11, under the first weight step for Automation Basic Letters (shaded data).

Figure 3-3 shows ratios of US postage for Standard A Automation Basic Letter mail to terminal dues up to 3.3 ounces. After 1.5 ounces, domestic postage is lower than either developing country or industrialized country terminal dues. Thus, only relatively light Standard A automation mail is a potential candidate for remail.

Figure 3-3 The Ratio of Standard A Automation Basic Letter Domestic Postage Rates to the Minimum of DC and IC Terminal Dues Rates



3.3. ABC Arbitrage Opportunities

There exist substantial differences between the revenues the USPS receives as terminal dues from foreign postal administrations for delivery of identical mailings, depending on whether the foreign postal administration is defined by the United Nations as an industrialized or developing country. These differences represent the arbitrage gaps that provide incentives for foreign postal customers or administrations to post their US-bound mail from administrations having lower terminal dues rates to the US, resulting in reduced revenues to the USPS. The arbitrage opportunities vary depending on sending country classification, domestic mail class and mail weight.

3.3.1. Summary of ABC Arbitrage Opportunities

A comparison of developing and industrialized country terminal dues structures for mail to the US (Figure 3-4 and

Figure 3-5) shows that for lighter weights the developing country terminal dues are lower, while for higher weights the industrialized country terminal dues are lower.

The crossover point occurs for mail to the USPS at mail weights over 2.7 ounces (See Figure 3-4 and .

Figure 3-5). For example:

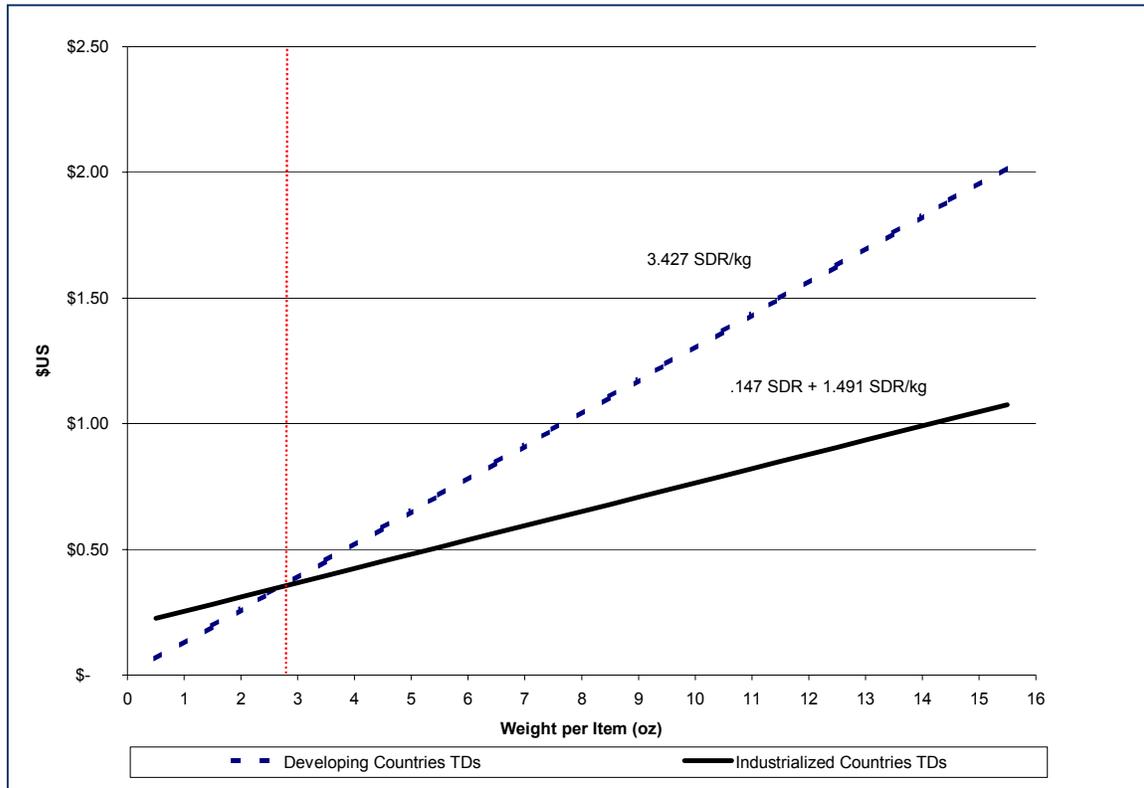
- A mailer from an industrialized country sending mail to the US with an average per piece weight of 1 ounce could achieve terminal dues savings of 49% by remailing it through a developing country. For pieces weighing 0.5 ounce, a 71% savings in terminal dues would be realized (a developing country would pay terminal dues of 0.05 SDR versus 0.17 SDR for an industrialized country).
- A mailer from a developing country sending a piece weighing 9 ounces to the US would realize terminal dues savings of 40% by remailing through an industrialized country (a developing country would pay terminal dues of 0.87 SDR versus 0.53 SDR for an industrialized country). The greatest possible terminal dues savings for developing country mailers routing heavy mail through industrialized countries in this way does not exceed 55% (for a 2-kilogram item, a developing country would pay terminal dues of 6.85 SDR versus 3.13 SDR for an industrialized country).

3.3.2. ABC Arbitrage

A comparison of developing and industrialized country terminal dues structures for mail to the US shows that for lighter weights the developing country terminal dues are lower, while for higher weights the industrialized country terminal dues are lower. Figure 3-4 illustrates the relationship between developing country and industrialized country terminal dues payments to the US currently in effect, as per UPU International Bureau Circular 533.⁶

⁶ Mail weights for Figures 3-1, 3-2 and 3-4 are in ounces and are computed at mid-step half-ounce weights. Figures 3-3, and 3-5 are in 0.1-ounce increments. All weights are for “not over” ounces.

Figure 3-4 Developing Country vs. Industrialized Country ABC Arbitrage Opportunities



The notable feature is that no one payment system dominates the other across the weight range for letter post. The crossover point occurs for average mail weights between 2.6 and 2.7 ounces.

The following chart identifies the inbound foreign mail average weight per piece for industrialized and developing countries as well as the average weight per piece for domestic First-Class, Standard A and Periodicals.

Table 3-1 Average Weight Per Piece in ounces

	Inbound Foreign	First Class**	Standard A**	Periodicals**
Industrialized	Redacted			
Developing	Redacted			
Domestic		0.7	2.0	7.3

Another way to view the relative terminal dues is in arbitrage gap format as in the following chart.

** RPW for FY2000 (Priority Mail is 30.8)

Figure 3-5 The ABC Arbitrage Gap

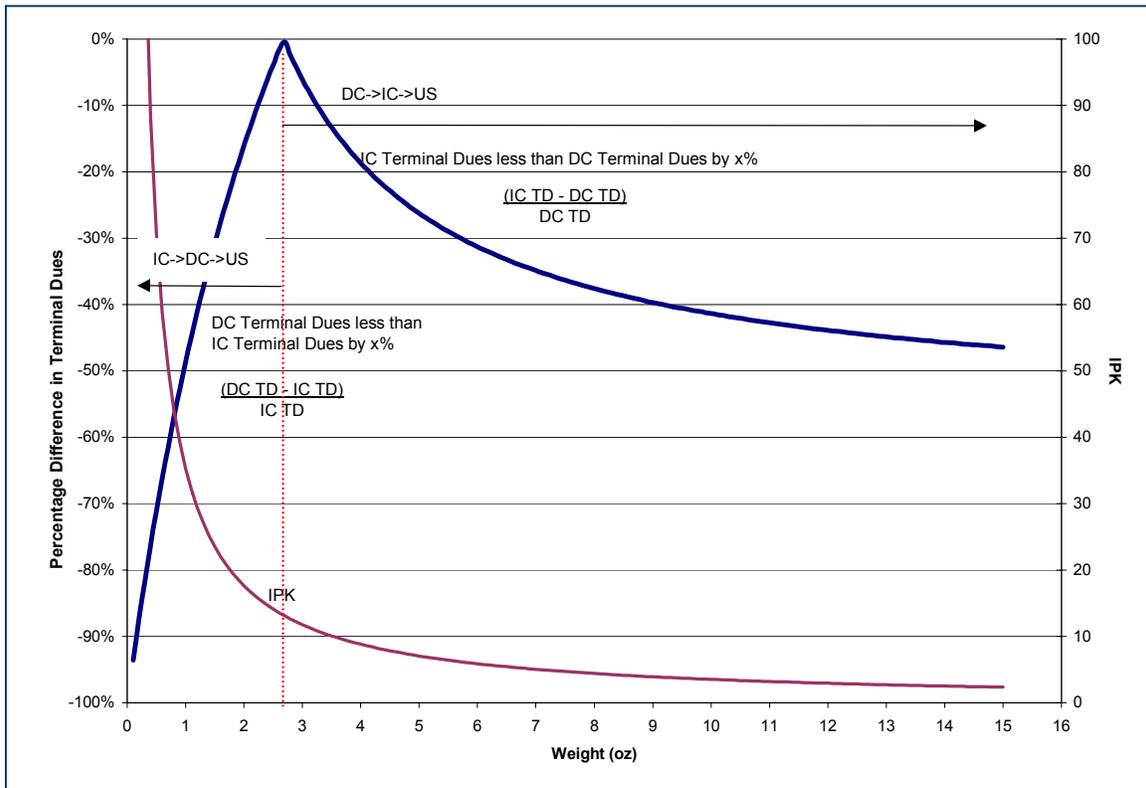


Figure 3-5 shows the percentage difference (negative percentages represent terminal dues savings) between terminal dues paid to the US by DCs relative to those paid by ICs left of the inflection point, and the percentage difference of IC terminal dues relative to DC terminal dues right of the inflection point. For example, the chart shows that a mailer from an industrialized country sending mail to the US having an average per piece weight of 1 ounce could achieve a terminal dues savings of 50% by remailing it instead from a developing country. For pieces weighing 0.5 ounces, a 71% savings in terminal dues would be realized.

On the other hand, a DC mailer of a piece weighing 9 oz would realize a terminal dues savings of 40% by remailing from an industrialized country. However, the greatest possible terminal dues savings for developing country mailers routing heavy mail through industrialized countries in this way does not exceed 55% for the heaviest letter post items (this is outside of the range of Figure 3-5).

The upshot of the terminal dues design for the two country classifications is that an ABC remail arbitrage gap exists for light weight mail routed through a developing country from an industrialized country. After 2.7 ounces, the situation reverses and remail from a developing country through an industrialized country becomes attractive.

3.4. Other Costs

The driving financial factor behind ABA or ABC remailing is the arbitrage gap between domestic rates and terminal dues (ABA remail) or the arbitrage gap created by the difference between an industrialized country's terminal dues rates and a developing country's terminal dues rates (ABC remail). This is only one of the dimensions to consider, but in the absence of such a gap, remailing is not financially attractive. However, there are other remailing costs that can either increase or decrease these arbitrage gaps thereby impacting the propensity to engage in remailing. These costs vary based on whether the mailer is engaged in ABA or ABC remail.

Other costs include:

- An “access fee” (described below) for accessing the terminal dues system through a foreign country
- Preparation and printing costs for the mailing including any mail makeup costs for accessing us domestic worksharing mail discounts
- International transportation costs from (physical and electronic remail) and possibly to (physical remail only) the foreign posting location
- Risk-adjusted detection cost liability (described below) requiring domestic postage payment under article 43.

3.4.1. Access Fees for Foreign Posting

The access fee serves as an inducement for the foreign administration to post remail for the sender and applies to both ABA and ABC remail. The access fee concept merely refers to the costs over and above terminal dues that would be assessed by developing countries (DC) postal administrations. This is not assumed to be the same as foreign postage rates in Country B, but instead represents a payment that allows the remailer direct access to terminal dues rates. The access fee could either be a fixed charge, a percentage markup term or some other combination of charges and fees.

The cost to the DCs of offering remail would be the terminal dues rates for the mailing, administrative costs of processing the mail, and international transportation costs depending on the arrangements with the remailer. There could also be a revenue “float” benefit from remail to the DC postal administration since terminal dues may be paid with a considerable lag time. The lapsed time can approximate up to two years after the mailing occurs.

Since remail could generate additional revenue for DC postal administrations at little added cost, competitive forces would likely keep the access fees close to administrative costs. If the DC postal administration also provides international transportation services these costs would also be included in the charges for remail. In this discussion access fees and transportation costs are considered separately.

3.4.2. Preparation and Printing Costs

ABA Remail can either be prepared in the US and shipped abroad to be returned via the international mail stream (physical remail) or printed abroad and then posted to the US (electronic remail).⁷ The extent that foreign printing costs differ from domestic printing costs is another element of the financial impact of remailing. If foreign printing costs are lower than in the US, then an enhanced incentive to this category of remail exists.⁸

ABC Remail can either be prepared in the resident country (A) and shipped abroad (to country B) to be posted to the US (physical remail) or ABC remail can be printed in country B and then posted directly to the US (electronic remail). The extent that country B printing costs differ from domestic (country A) printing costs is as before another component of the financial impact of remailing. For virtual remail, printing may also occur in Country C.

3.4.3. International Transportation Costs

The necessity to transport ABA remail from an international location adds expense to remail (with the exception of virtual remail, which never leaves the US). Depending on the location of the foreign administration and the mode of transportation, these costs can range from small to significant and are an important component of the financial aspects of the remailing decision. The provider of international transportation services could be either the postal administration through which the remailing occurs, or an international freight transporter.

The necessity for indirect routing is one of the features of ABC physical remail. The cost impact of any rerouting depends upon the geographic locations of the three countries. In general, routing distances increase and terminal transfer fees apply. ABC electronic remail may actually incur reduced transportation costs depending again on the locations of Countries A and B relative to Country C. For virtual remail, transportation costs to Country A would be avoided if the mail were prepared in Country C instead of Country A.

3.4.4. Risk-Adjusted Detection Costs

Article 43 provides postage adjustments for detected ABA remail. This article allows the USPS to assess First-Class rates for any remail that is identified by screening systems in the US. Given the extra costs of international transportation, detected remail will be more costly to the sender than domestically entered mail (ignoring changes in mail production costs). High rates of detection would likely serve to eliminate the attractiveness of this option, especially if the mail would have readily qualified for USPS worksharing discounts.

⁷ Equivalent to electronic remail would be the case where a US company had a foreign printing operation in Country B.

⁸ Even if part of the remailing incentive were driven by lower printing costs in the posting country, they may be insufficient to justify foreign posting because of print quality. Printing could be accomplished in Mexico facilitated by NAFTA and ready access to Mexico is available with border operations in close proximity to US entry locations for domestic mail (e.g., San Diego, El Paso).

A highly simplified illustration can be made by assuming that international transportation costs for a 1-ounce item are 2.8 cents per piece and that the access fee (assumed to be 5% of terminal dues) is 0.7 cents. From a developing country, terminal dues cost for a piece weighing 1 ounce is 13 cents. The total costs for this hypothetical item entered as international mail are 16.5 cents. USPS First-Class single piece postage is 34 cents, and it is assumed that this is the rate that would be assessed if detected as remail (since this is the service provided by the USPS). Thus, with the access fee and transportation costs, detected remail cost would be 37.5 cents.⁹ If the remailed piece had qualified for the First-Class Automation Basic rate, the US domestic postage would have been 27.8 cents. Thus, if detected, the remail would be liable for increased postage of 9.7 cents. If undetected, the savings are 11.3 cents (27.8 – 16.5).

If the probability of detection is zero, remail entails a savings of 11.3 cents per item for the above example, nearly half of the domestic postage of 27.8. If the probability of detection is 50%, the expected postage cost is $50\% * 16.5 + 50\% * 37.5 = 27.0$ cents, for a per item savings of only 0.8 cents. If detection risks are 54%, the risk-adjusted savings are zero. For higher detection rates, the risk adjusted “savings” become a loss to the mailer (i.e., the expected costs are greater than domestic postage).

In addition, Article 43 provides for cost adjustments to terminal dues for ABC remail. It allows the US to assess the higher of the following two calculations:

- 80% of the domestic rates for equivalent items (i.e., First-Class rates)
- A charge of 0.14 SDR per piece plus 1.0 SDR per kilogram

It should be noted that the latter charge is lower than industrialized countries (IC) terminal dues payable to the US across all weight steps. For lighter-weight ABC remail posted through a developing country, the revision mechanism provides higher rates through approximately the first two ounces than under unadjusted DC terminal dues.

However, the 80% provision will provide the highest compensation and represent a severe financial disincentive to ABC remail.¹⁰ Given the extra costs of international transportation, detected ABC remail will be more costly to the sender than conventional international mail. So for lighter weight remail through developing countries, as for the ABA case, high rates of detection would likely serve to eliminate the attractiveness of this mode of remail under the provisions of Article 43.

⁹ Under Article 43, the remailer has the option of “abandoning” the mail. Under this option, the domestic postage charges would be avoided, but there may be an additional fee for redirection or disposal.

¹⁰ For ABA remail, the financial adjustment is merely the rate that it would have paid had it been posted in accordance with Article 43 (ignoring worksharing discounts that the remailer might have otherwise qualified for if prepared for domestic entry). For light weight ABC remail, the 80% compensation adjustment is higher than the industrialized country terminal dues rate for the US – presumably the rate that it would have been posted under had it not been ABC remail.

3.5. Summary

This section lays the groundwork for the remail financial projections to follow. It summarizes the financial characteristics of the remail environment in which the USPS operates. It identifies the various financial components of the remail decision process and also documents that arbitrage gaps exist for both ABA and ABC remail. Highly detailed calculations of ABA arbitrage opportunities for all relevant US domestic rates are provided in Appendix 11. ABC arbitrage opportunities are described using Figure 3-4 and .

Figure 3-5.

Each of the non-postage related remail costs and the non-financial components of the remailing decision making process received further investigation in one or more of the following ways:

- Through focus groups or mailer surveys developed as part of this Joint Study
- By inspecting billing determinant and settlement data
- By further research into specific areas (e.g., transportation costs).

Focus groups and mailer survey results were used to further characterize the important Stakeholders and additional aspects of the remail environment. The other financial costs were incorporated into complete calculations of arbitrage opportunities and revised arbitrage estimates developed.

The revised arbitrage estimates were then incorporated into a remail impact model and estimates prepared of the propensity to remail based on the arbitrage gap as well as other characteristics of remail (e.g., potentially degraded delivery service times, foreign instead of domestic indicia). The propensity to remail relationships were developed based on quantitative survey mail share allocation exercises wherein mailers were offered hypothetical alternatives under varying characteristics for remail and mail shares were allocated to US domestic products as well as remail alternatives.

The results of these investigations are portrayed as a series of remail scenarios depicting the impact of remail on USPS domestic revenue and the impact on remail Stakeholders. Section 5 of this report presents these scenarios and stakeholder impacts.

Section 4. Remail Non-Financial Considerations

As discussed in Section 2 it has been postulated that several key non-financial factors (or “risks”) associated with remail might mitigate the degree to which mailers would engage in ABA remail if Article 43 were removed. These considerations are:

- Foreign indicia
- Comparative service levels – delivery time and variability
- Loss of domestic drop ship options
- Reduction in the number of designated entry points
- Reduction in mailpiece quality
- Loss of address correction and undeliverable-as-addressed capabilities.

4.1. Introduction

These non-financial components of the remailing decision making process received further investigation either through focus groups, mailer surveys or the expert panel developed as part of this Joint Study, or by further research into specific areas.

These non-financial factors along with arbitrage estimates were incorporated into the Remail Impact Model (RIM) and estimates prepared of the propensity to remail based on the arbitrage gap as well as these other risk factors. The propensity to remail relationships were developed based on quantitative survey mail share allocation exercises wherein mailers were offered hypothetical alternatives under varying financial and non-financial characteristics for remail and mail shares were allocated to domestic US domestic products as well as remail alternatives.

Each non-financial remail factor is investigated in some depth in the remainder of this Section. These factors are presented in order of their relative importance as displayed in Table 2-2, Section 2.

4.2. Non-Financial Considerations

This section presents the study team’s findings related to recent or current service levels for inbound international mail from points of entry in a foreign country to local, regional, and national delivery areas in the USA. It also compares these service levels with actual service levels for similar domestic mail and the Postal Service’s benchmark service standards for the same mail.

4.2.1. Comparable Service Levels

End-to-end service for inbound international letter post can be separated into several components, inbound international mail to the US must be:

- Either collected (e.g., from drop boxes) or tendered to the originating foreign postal administration

- Processed by the foreign administration and identified as mail with a us destination
- Routed to the appropriate international transportation
- Transported to the US by the international carrier and delivered to an appropriate international exchange office of the USPS.

Once in the USPS system, the mail must clear customs. Once cleared, the mail, regardless of class—Standard A or First-Class—is processed as if it were raw First-Class collection mail with no worksharing of any kind.

4.2.1.1. International Service Measurement Systems

There are various systems that the USPS uses for measuring international service performance achievements. One system (UNEX) involves the use of “seeded” mail with a known time of entry into the foreign postal system and a known time of delivery to the customer.

Unipost External Diagnostic Monitoring (UNEX)

The USPS has participated in this quality of service monitoring program since 1994. It is designed to measure service performance among 21 International Post Corporation member countries. Each country identifies “droppers” and “receivers” to measure actual service performance from collection to delivery. The country seeding the mail is the “owner” of the data. The US seeds in 10 cities for outbound service performance measurement to Canada and Europe. Thus, the data for the service performance of inbound international mail (relevant to remailers) is that from the European or Canadian seedings, owned by the sending countries and not releasable due to confidentiality requirements.

Origin Destination Information System (ODIS)

Another system (ODIS) is based on a statistical sample of mail at selected destinations and involves examining cancellation dates on mail pieces on the day the piece is scheduled for delivery (i.e., assumed delivery date).

The ODIS is the only source for actual data on foreign origin delivery times collected for this report. It is based on statistical sampling and the sampling procedures are designed to minimize interference with mail delivery. The issues for measuring delivery time for domestic mail, discussed below, are similar to those for foreign origin mail.

By inspecting mail cancellation times and origin ZIP codes of domestic mail, the number of days from cancellation to delivery for mail from a particular ZIP Code can be accurately determined. Lack of coverage occurs for mail that is not canceled or has a missing or illegible cancellation date, like metered mail (which will have a date, but may not be tendered to the USPS on a timely basis) or permit imprint mail (no usable date information). For example, metered mail that is not over-canceled during processing can only be assumed to have entered the mailstream on the day of the meter imprint. First-

Class permit imprint mail has no date associated with the imprint, and thus its date of entry is indeterminate. Other types of mail, particularly Standard A, receive no cancellation with a date stamp. Standard A may contain data on the originating ZIP code, but often the point of entry will even be unknown.

4.2.1.2. Domestic Service Measurement Systems

The USPS supports two domestic service performance measurement systems that publish service scores on a routine basis and that do not require direct participation by mailers. These are externally managed systems for First-Class and Priority mail (External First-Class Measurement System (EXFC) and Priority Mail End-to-End (Pete)).

In addition, the USPS maintains two systems for internal use in tracking mail delivery performance based on ODIS and its international counterpart. These systems derive estimated service times from cancellation information on pieces statistically sampled near the end of the delivery stream (or processing stream for outbound international mail) in the US.

4.2.1.3. Current USPS Domestic Service Standards

Table 4-1 presents a summary of current USPS service standards. These standards create the expectations of mailers regarding service performance. Our study data indicates that significant deviation from or wide variability around these standards can have a dampening effect on ABA remail.

Table 4-1 Summary of Current Service Standards

First-Class	1-3 days
Priority	1-3 days
Standard A	3-10 days
Periodicals	1-7 days

4.2.1.4. Hybrid Focus Group/Mailer Survey Findings

Hybrid Focus Group/Mailer Survey

Selected excerpts from our mailer survey and focus groups demonstrate current mailer perceptions regarding domestic service performance and their expectations for remail service performance and variability.

Mailer Survey

These, and similar statements, may be found in the Mailer Survey Summary Report (See Appendix 4.)

“Perceived domestic delivery times average between three and four days for First-Class Mail, and between six and seven days for Standard A and Periodicals Mail. Mailers report that they experience between two and four days variability, on average, around these typical delivery times.”

“For air delivery into the US, mailers expect that ABA remail would take, on average, between 5 and 6 days from the time the mail was ready for introduction into the mail stream in the (B) country until final delivery to US-based recipients. Surface entry (via truck from Mexico or Canada, or via ship, would be expected to take 8 to 10 days, on average. Variability around these average levels is expected to be roughly ± 3 to 4 days. If the mail were first produced in the US, and subsequently transported to the foreign (B) country for introduction into that country's mail stream, mailers believe that this step would add roughly one additional week to the process.”

Based on mailers' responses to the scenarios presented in our survey poorer comparative service levels (i.e., slower time-in-stream) for First-Class Mail could mitigate potential remail by roughly 1.0% as depicted in Table 4-2 below:

Table 4-2 Impact of Remail Considerations on Estimated Remail Volumes

Remail Risk	Net Change in Remail Volume (as a % of Current USPS Volume) ¹
Foreign Indicia	-1.5% (± 1.0%)
Poorer Comparative Service Levels (increased time-in-stream and delivery variability) ²	-1.0% (± 0.8%)
Domestic Dropship Availability (i.e., reduced remail cost savings) ³	-0.6% (± 0.5%)
Limited Entry Points (increased time-in-stream and delivery variability)	-0.5% (± 0.2%)
Quality Control (if US-based production/preparation quality unavailable)	-0.3% (± 0.2%)
No Address Correction or Undeliverable Mail Handling	-0.2% (± 0.1%)

Focus Groups

The Focus Group Summary Report (See Appendix 4) provides additional insight.

“Generally, mailers in the groups were quite interested in the concept of ABA remail, because they recognized the potential to realize substantial cost savings relatively quickly by taking advantage of it. Although some mailers indicated it would be very difficult to design a remail alternative that would be acceptable to their companies or organizations, there appears to be considerable interest provided particular service and delivery requirements can be met.”

“Generally, the most common mail pieces that would be considered for remailing are non-time-sensitive pieces. There are concerns around putting faith in the time-in-stream estimates of foreign countries, and, therefore, selected participants would rather not risk delays or delivery failures for their time-sensitive or very important mail pieces. Given that many such pieces are sent First-Class, the expectation is that remail alternatives would be used primarily for non-time-sensitive Standard A and Periodicals mail, such as general bulk advertising mail and periodic mail (financial reports, membership directories, etc.).”

“In general, mailers are reluctant to send time-sensitive mail pieces via a remail option. For example, insurance firms are legally required to respond to individual claims within a certain time frame and it could be more risky to send their responses via remail. Commercial client-based companies, as noted earlier, are particularly adamant about their need for

¹ Change in remail volume (percent of total USPS First-Class, Standard A, and Periodicals volume, excluding First-Class single-piece mail) relative to an assumed base remail volume of 15.9% (assuming a 25% net cost savings and 6-day time-in-stream [from completed production]). Uncertainty estimates (±) at 90% confidence interval.

² Realized on First-Class mail only.

³ Estimated among mailers using drop ship on 50% or more of their pieces.

relatively quick delivery times. Many distinguish themselves on the basis of the timeliness of their responses to clients' requests for service and/or products.

This issue aside, Commercial Advertisers, who face fewer time constraints, would be willing to adjust their production schedules to allow for potential extensions of time-in-stream associated with the use of remail. Here, the more important issue concerns the reliability of delivery time. As long as foreign countries can guarantee a delivery time range, whatever it is, these companies are prepared to factor this additional time into their planning and implementation schedules."

4.2.1.5. Summary

As a summary of the findings related to international service performance, the following statements can be made regarding service standards and service achievements for inbound international and domestic mail:

- Recent estimated delivery time for inbound international mail measured from the date of posting abroad exceeds 7 days.⁴ This is 4 to 6 days longer than the domestic First-Class benchmark service times.
- Domestic service standards for Standard A are from 3 to 10 days. Thus, compared to Standard A that is to be distributed beyond local areas throughout the US, inbound international mail service times could be faster than the domestic Standard A service standard. The service standard for Standard A that is drop shipped at destinating BMCs is 4 days.
- Customs inspection times for inbound international letters and flats in trays cause modest additions to the delivery service time. For international mail received in sacks (i.e., small packages and parcels) customs inspection can add time before the mail enters the First-Class processing stream.⁵
- Regardless of actual service achievements, mailer expectations will be crucial to the remail decision process. The value that mailers place on service performance is evident based on our mailer survey and focus group information.
- Regardless of service times for existing inbound international mail, ABA remailers might be able to reduce the amount of time spent outside of the USPS system by collaborating with remail service providers and foreign postal administrations.

⁴ Source: ODIS, Postal Quarter II, 2001.

⁵ An exception to these statements is that mail from certain targeted countries may be held in customs for an extended period in order to detect fraudulent mail or the shipping of prohibited or illegal items. Also, agricultural inspections sometimes delay mail for longer periods.

4.2.2. Foreign Indicia

Another attribute of ABA remail is that mail that would normally travel under a USPS indicia would travel under foreign indicia. This feature may be taken as a quality or credibility signal by the recipient and affect his or her response to such mail, and in turn the viability of certain remailing operations.

The application of a foreign indicia to domestic remail was addressed in the mailer survey and during the focus groups and expert panel. The reaction of mailers during these forums is summarized below:

Mailer Survey

Foreign indicia presents one of the greatest concern to mailers, potentially curbing remail volume by 1.5% (absolute) below what it might be if a US indicia were allowed (See Table 4-2, Section 4.2.1.4).

Focus Groups

Focus group participants expressed significant concern regarding the application of a foreign indicia to their domestic mail as demonstrated by the following Focus Group Summary Report extract:

“Primarily for reasons associated with maintaining their companies' reputations, some First-Class and Standard A mailers would object to the use of a foreign indicia and return address. Some mailers expressed fear over potential objections that American jobs are being given away. In addition, Non-Commercial Mailers believe that part of their reputation as a respected community-orientated organization results from the fact that all of their production and preparation processing takes place within their community. In addition, some non-profit organizations anticipate an objection by their constituents that donations should be kept completely within the city in which the non-profit organization is located.”

Expert Panel

Expert Panel members did not address the use of a foreign indicia in a direct manner. However, their comments indicate that they view its use as a deterrent to remail.

“The assertion that up to 17.1 billion pieces of mail and \$4.7 billion in revenue could be lost to ABA remail annually (if all Article 43 and 49 provisions were eliminated) was viewed with some skepticism. Some panel members felt this represented an ‘upper limit’ for ABA remail volume in the initial years, a level that would only be achieved if experiences with remail were extremely positive and concerns about other

factors, such as indicia, time-in-stream, and production quality were addressed.”

4.2.3. Loss of Domestic Drop Ship Options

Domestic drop ship alternatives have a positive impact on delivery times and in some cases may accrue cost savings to the mailer. The use of ABA remail precludes the use of domestic drop ship options and thereby may have a negative impact on delivery times, the variability of delivery times and costs.

The loss of the availability of drop ship for remail (Standard A and Periodicals) , which can reduce net mailing costs by roughly 5%, could mitigate potential remail by roughly 0.6%, as presented in Table 4-2, Section 4.2.1.4.

4.2.4. Reduction in the Number of Domestic Entry Points

ABA remail enters the US as part of the international mailstream; therefore the entry points into the US mailstream are restricted to a total of 14.⁶ In contrast domestic mail can be rated and entered at hundreds of acceptance points based on its make-up and level of sortation. The loss of a large number of domestic entry points may have a significant impact on delivery times and therefore may negatively impact a mailer’s propensity to engage in ABA remail.

The reduction in the number of domestic entry points could mitigate potential remail by roughly 0.5%, as evidenced in Table 4-2, Section 4.2.1.4.

4.2.5. Reduction in Mailpiece Quality

Remail can either be prepared in the US and shipped abroad to be returned via the international mail stream (physical remail) or sent electronically for printing abroad and then posted to the US (electronic remail).⁷ The extent that foreign printing costs differ from domestic printing costs is an element of the financial impact of remailing. However, even if the costs of preparation and printing were lower in a foreign country there may be problems with: the quality of the printing technology and paper used in foreign printing operations the dimensions of the address area and the lack of automation compatibility standards. Further, there may be general quality control and management control issues that reduce the impact of printing cost savings.

During our focus group discussions several mailers expressed concerns regarding the quality of the mail produced in foreign countries as depicted in the following excerpt:

⁶ Fourteen international entry points process sufficient international mail volumes to be candidates for remail activities. These entry points are: New York - JFK ISC, Chicago ISC, San Francisco ISC, Dallas ISC, Los Angeles ISC, Detroit BMC, New Jersey BMC, Dulles Virginia P & D, Honolulu P & D, San Juan Puerto Rico P & D, Buffalo P & D, Oakland ISF, Seattle AMC and the Miami AMC.

⁷ Equivalent to electronic remail would be the case where a US company had a foreign printing operation in Country B.

“Finally, several mailers of each class of mail are concerned about quality and reliability issues surrounding the use of remail, especially when printing and/or production in a foreign facility is taken into consideration. Commercial client-based companies, in particular, demand a high standard of paper and print quality.

The expectation is that with certain developing countries, quality control would suffer and additional costs could be associated with traveling overseas to handle quality concerns in person. Mailers express a greater willingness to deal with ‘more reputable’ countries to which their company already sends mail, or that are close in proximity, in the event an in-person appearance is necessary. The use of mail consolidators to oversee the quality of foreign production could mitigate these concerns for a sizable group, however.”

Expert panel members also expressed concerns related to the management oversight required to manage the quality of printing and production in foreign countries:

“While several of the panel members’ organizations currently operate foreign mail production facilities (and affirm that these facilities often enjoy lower operating costs), they pointed to the fact that the additional cost of managing these operations, dealing with production quality issues, and transporting materials essentially offset any production cost savings.”

The reduction in the quality of the mailpiece could mitigate potential remail volume by roughly 0.3%, as evidenced in Table 4-2, Section 4.2.1.4. Several expert panel participants indicated that they already print in Canada due to lower production costs, ease of transportation, and paper and print quality comparable to what is available in the United States.

4.2.6. Loss of Address Correction and Undeliverable-As-Addressed Capabilities

ABA remail is not accorded the same treatment as domestic mail in terms of address correction and mail that is undeliverable-as-addressed. The loss of these services may have a negative impact on service levels and cost and as a result dampen the use of ABA remail as an alternative for domestic mail.

During our focus group discussions several mailers expressed concerns regarding the loss of address correction and undeliverable-as-addressed services:

“Both commercial client-based companies and Non-Commercial Mailers indicate that the provision of address correction, mail forwarding, and return of undeliverable mail services are critical factors affecting their willingness to engage in ABA remail. Such services substantially reduce

costs associated with the production of the mail by allowing companies to update their mailing lists and successfully reach their customers (i.e., deliver products to the correct recipient). Mailers did volunteer, however, that address correction services could be purchased through third-party companies using the USPS' national change of address database. Accordingly, if the total savings associated with remail outweighed the added cost of using third-party address correction systems, remail would be considered."

The loss of address correction and undeliverable-as-addressed services could reduce potential remail volume by roughly 0.2%, as evidenced in Table 4-2, Section 4.2.1.4.

4.3. Effect of Non-Financial Considerations on ABA Remail

As discussed above, remail has several associated characteristics that are less attractive than are those for US origin domestic mail. These characteristics can be viewed as disincentives to enter the remail market and serve to offset any postage-related and cost-related arbitrage that may be available. The potential for remail under several scenarios, each highlighting a particular remail characteristic, was estimated by employing the Remail Impact Model loaded with appropriate assumptions. Most of these scenarios were developed by altering the characteristics of remail that are specified in the conjoint models.⁸ The estimates are given in terms of the additional amount of net revenue loss that would occur if a particular negative aspect of remail were to be removed. Thus an estimate of -\$1.0 billion indicates that the estimated net revenue loss to the USPS would be \$1.0 billion greater than the baseline estimate. Since all scenarios involve mitigating negative remail characteristics, all potential impacts are expected to be negative dollar amounts (which the estimates bear out). It should be noted that most of these characteristics are inherent to remail and their complete alleviation would be unlikely in the real world. However, these estimates place upper bounds on the additional net revenue losses if the characteristics could at least be partially resolved. Six scenarios were investigated:

- **US Indicia Available for Remail:** The effect of losing US indicia for remail. The scenario estimates the additional amount of remail revenue loss that would occur if remail could have a US indicia. This scenario was estimated via adjustment to the conjoint specification for the indicia for remail.
- **Comparable Service Levels:** The effect of longer delivery times and greater variances in delivery times. This scenario makes service levels for remail comparable to USPS service. Even though it is not likely that this could be achieved, some narrowing of the service level gap might be expected under the elimination of Article 43. This scenario was estimated by resetting service times and variances equal to domestic service.
- **Domestic Dropship Unavailable:** When a mailer dropships their mail this mail bypasses a number of USPS processing operations thereby avoiding

⁸ The conjoint models were developed by National Analysts and incorporated into RIM. The conjoint methodology derives marginal valuations for several features associated with remail and allows RIM to specify which features are present or absent.

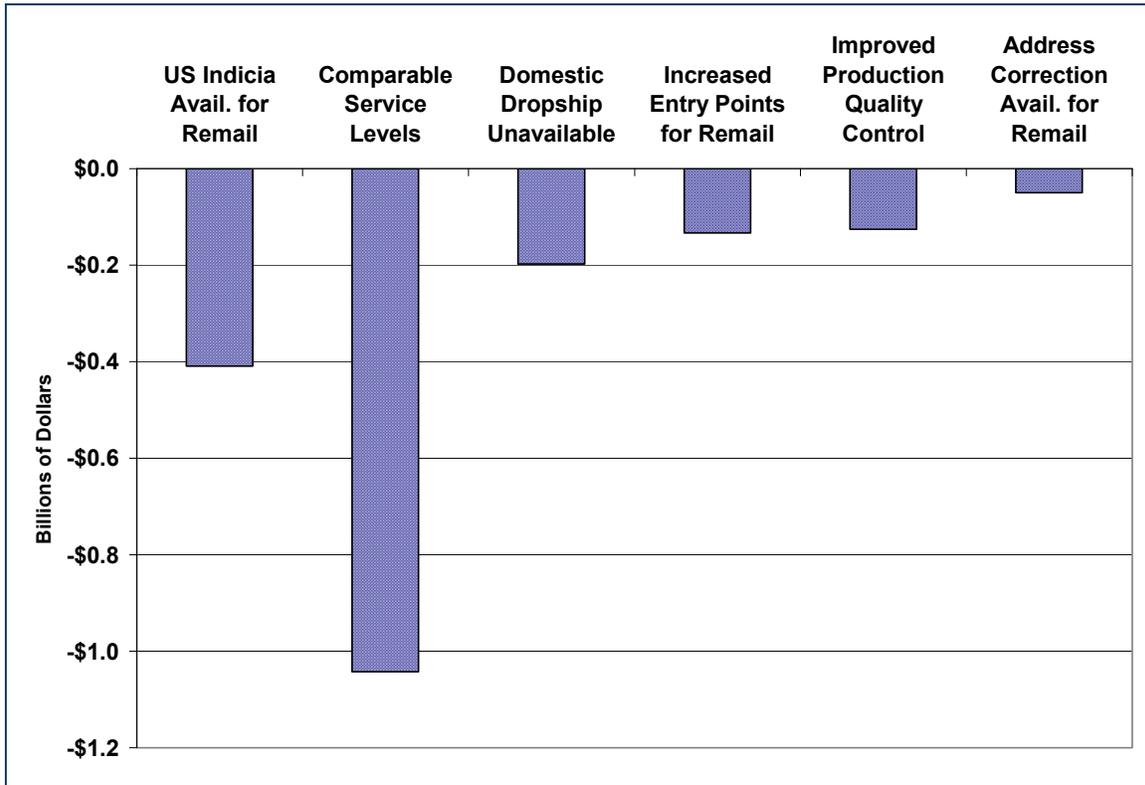
USPS processing costs and accruing savings. In order to encourage mailers to engage in dropshipping the USPS shares the processing cost savings, in the form of dropshipping discounts, with the mailer. Remail cannot access domestic worksharing programs such as dropshipping; therefore dropshipping discounts are not available for ABA remail. The absence of these discounts denies dropshipping worksharing savings to both the mailer and the USPS further exacerbating the bottom line impact of remail. This scenario was modeled by replacing all dropshipping rates with rates for similar non-destination entry mail.

- **Increased Entry Points for Remail:** This scenario was run by assuming that both the time in stream and the variability in stream would be reduced under a wider distribution of entry points for remail. The estimated change in time in stream and variability is 0.3 days for both.⁹
- **Improved Production Quality Control:** Production quality control for remail is viewed as having lower achievements than for domestic mail. This scenario was run by adjusting the conjoint model specification of facility ownership in the foreign country. For this case, it was assumed that company-owned facilities were available in the foreign country.
- **Address Correction Available for Remail:** This scenario estimates the value of address correction for domestic mail and probes the effects were the same service to be available for remail. The scenario was estimated by directly manipulating the remail characteristics specified in the conjoint model.

The results of these scenarios are presented in Figure 4-1 and Figure 4-2 below:

⁹ Source: National Analysts, “Article 43 Quantitative Survey — Preliminary Data Tabulations,” October 1, 2001, Table 14.

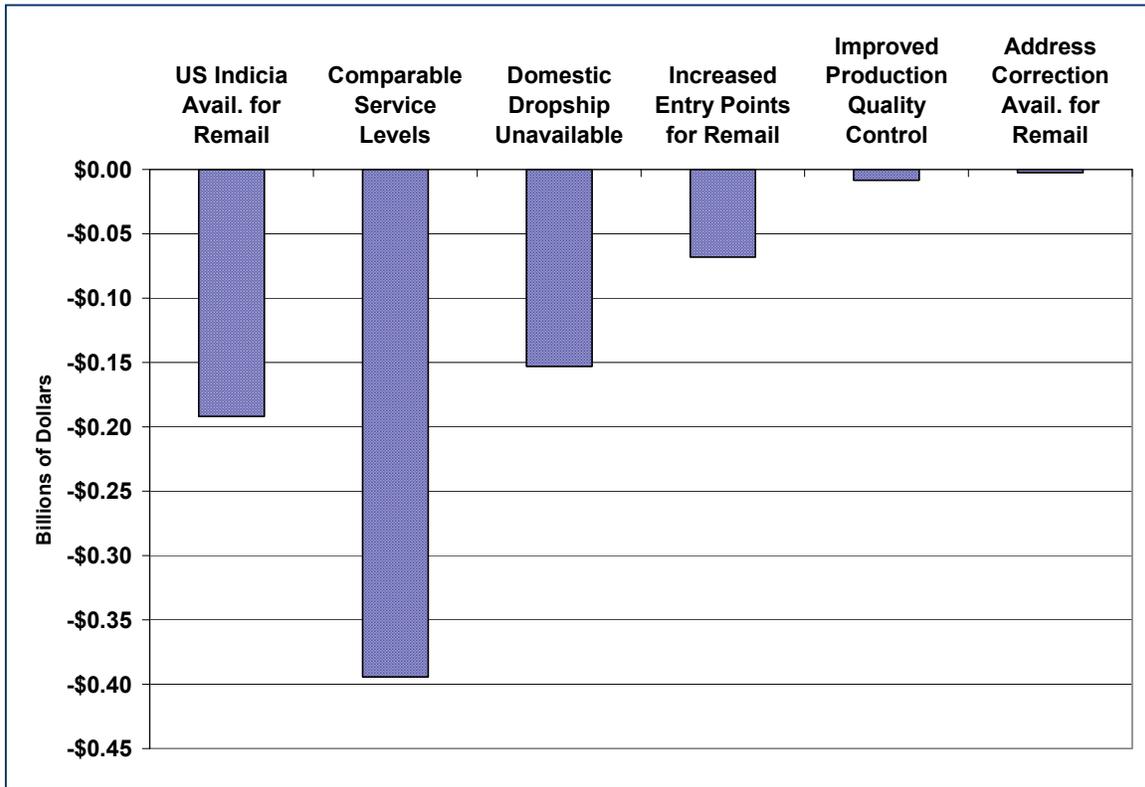
Figure 4-1 Changes from Unrestricted Scenario



- Figure 4-1 depicts the unrestricted scenario and is defined as the elimination of both Article 43 and Article 49
- These scenarios are relative net revenue effects in addition to the estimated baseline loss of \$4.1 billion.¹⁰
- Two remail features, service levels and the use of foreign indicia, are viewed as having the largest effects among the alternatives. In terms of stimulating additional remail, the net revenue effects on the USPS are from approximately 30% more than baseline losses for comparable service levels to 10% more for US indicia. Service times may be controllable to a degree, especially under a maturing remail market. This might close the service gap between remail and domestic mail, but comparability to domestic service times may not be achieved.

¹⁰ The baseline-unrestricted estimate assumes ICRA costs and that remailer preparations cost savings are equal to 20% of the revenue difference for workshared mail categories. This estimated amount is saved because remailers no longer have to engage (or can engage) in worksharing.

Figure 4-2 Changes from Baseline under System Harmonization



- The Figure 4-2 scenarios assume that Article 43 has been eliminated and that the System Harmonization Mechanism is fully enforced.
- These scenarios are relative net revenue effects in addition to the estimated baseline loss of \$.9 billion.¹¹
- Service levels and foreign indicia again are estimated to have the largest effects among the alternatives. In percentage terms relative to the baseline net revenue these net revenue impacts represent larger amounts. This is because under system harmonization enforcement, the developing countries all attain remail amounts up to their system harmonization capacities. The system harmonization limits lower the base to such a great degree relative to the unconstrained case that additional mail tendered through Canada or at industrialized country rates becomes a relatively high percentage of the base.

¹¹ As for the unconstrained scenario, ICRA costs and preparation cost savings of 20% of the rate differential is assumed for workshared mail categories.

Section 5. Financial Impacts - RIM Remail Scenarios

The Remail Impact Model (RIM) was developed to simulate a range of financial scenarios and to model variations sensitive to several financial aspects of the remail phenomenon.

5.1. Remail Impact Model (RIM) Rationale

RIM was developed to merge mailers' propensity to remail and the influence of the non-financial factors developed from the Mailer Survey conjoint analysis with a wide range of financial factors to produce a set of scenarios depicting the financial impacts of remail. Appendix 6 (RIM Model and Conjoint Analysis) and Appendix 10 (ABA and ABC Remail Decision Processes) present a very detailed view of the RIM model and conjoint analysis and the remail decision process for both ABA and ABC remail.

5.2. Scenario Assumptions

As indicated above, a number of factors can influence the financial impacts of remail; therefore it is not reasonable to produce a single financial impact estimate. To ensure a full view of ABA remail financial impacts, the RIM model was exercised to produce a range of scenarios, each with a variation in one or more of the major factors affecting remail volume.

5.2.1. Core Remail Scenario Assumptions and Variations

Some of the more important assumptions and variations are presented below.

5.2.1.1. Baseline Scenario Assumptions

- The year 2005 was used as the year of estimation because it generally provides the maximum opportunity for developing countries arbitrage.
- A domestic postage rate of 37 cents for the First Class Stamp (effective June 2002) was used in these scenarios. In addition, the scenarios assume a proportional adjustment of all postage rates using the factor 37/34 as the status quo rates for 2005.
- A value of \$1.2775 per SDR (official SDR value for 2002 based on IMF data) was incorporated in these scenarios. This official SDR value was applied in concert with domestic rates, effective June 2002, as the baseline scenario.
- The mid-point of the weight step is assumed for these scenarios. The weight assumptions are: For cards the assumption is 0.1 ounce, for automation mail which cannot exceed 3.3 ounces, the assumption is 3.2 ounces.
- No distribution of volume within a weight increment is available, however, remail will favor lighter weight mail because of the weight-based components of terminal dues.
- The UPU settlement rates for 2005 were estimated at .19 SDR/item and 1.684 SDR/kg. These estimates were based on a 37 cent stamp, an SDR rate of

1.2775 and coverage just over 75% (UPU may increase coverage from 60% to the 70–80% range).

- Worksharing savings were estimated to be 20% of the USPS rate differential.
- Remailers will avoid the costs of preparing mail up to workshare standards in that international has no worksharing. The Expert Panel members estimated that these cost savings would be around 20%.
- These scenarios include an access fee charged by foreign postal administrations for the entry of remail into their systems. This access fee was estimated as a percentage of terminal dues and is 5%. A small fee was assumed due to limited remail cost to the foreign administration coupled with large number of potential countries involved with remail.
- The access fee charged by the Canadian Postal Administration was assumed to be an additional 5%. This increased fee results from and is justified by additional preparation of mail for the US plus relative “advantage” to other ICs.
- A remail fee (7%), paid to intermediaries, was calculated as a percentage of transportation and terminal dues costs. This percentage is based on the assumption that there should be plenty of service providers and that the competition for remail will keep the intermediary fees from becoming too high.
- The bulk proportion of non-bulk categories was assumed to be 0.001%
- This percentage merely defines the potential for mail to be migrated to remail and it still must pass the arbitrage and conjoint tests. There should be some small amount of non-bulk mail that might be potentially shifted to the remail stream.
- Priority Air transportation costs were calculated by using the Department of Transportation formula that applies the USPS international air transportation rates to US carriers for determining upper end range for air costs. The scenarios assume the same priority service as USPS receives.
- The economy transportation rate was calculated as a percentage (50%) of the priority rate. This assumption is based on ISAL air transportation rate relationships to DOT rates. The additional 1-way days for Economy Air was assumed to be 1 day.
- Surface transportation costs were assumed to be 5.6 cents per kilogram and were derived from truck capacity, haul length and cost per mile assumptions.
- Production and preparation costs were derived from the October 1 Mailer Survey data tabulations (See Appendix 4) compiled by National Analysts.
- Cost Estimates for Foreign Origin Inbound ICRA, average LC/AO cost, represents costs of foreign origin letterpost, and may be on the high side because bulk mail could be easier on average to process.
- Cost estimates for domestic mail are from the CRA Report for specific classes and subclasses of mail.
- Service times for remail are based on Group Averages Times from ODIS.
- Domestic service times are based on mailer perceptions and are:
 - First-Class Letters and Cards Domestic Service (days) — 3.6

- First-Class Flats and Packets Domestic Service (days) — 3.6
- Standard A Letters and Cards Domestic Service (days) — 6.71
- Standard A Flats and Packets Domestic Service (days) — 6.71
- Periodicals Domestic Service (days) — 6.21
- DDU Entry Domestic Service Time Reduction (days) — 1
- DBMC Entry Domestic Service Time Reduction (days) — 1
- DSCF Entry Domestic Service Time Reduction (days) — 1
- A System Harmonization adjustment factor of 40% was applied and is used only if the harmonization mechanism is enforced. This factor adjusts for non-covered African countries—approximately 35%, plus slack adjustment for SH implementation lag—approximately 5%.
- Foreign indicia was assumed for all remail
- There was no address correction, mail forwarding, or undeliverable mail returned assumed for these scenarios.
- The entry points into the domestic mail system were restricted to the 14 international entry points.
- There were no drop ship options available.

5.2.1.2. Alternative Core Remail Scenario Assumptions

(Note – All parameters and assumptions same as baseline unless otherwise stated)

- This scenario assumes a 40 cent First Class Stamp for domestic postage. In addition it assumes a proportional adjustment of all postage rates using the factor 40/34 as an outcome with higher rates for 2005. This adjustment has two purposes, it demonstrates sensitivity to domestic rates and it gives a range of uncertainty for future costs. The overall effect is to increase the arbitrage gap.
- This scenario assumes \$1.2000 per SDR, which is a continuation of the current downward trend. This estimate is not intended to be a forecast of SDR rate, just a rough trending to a lower conversion rate. The effect of this trend is to make remail less costly.
- The estimated settlement rates for the UPU in 2005 are, .215 SDR/item and 1.684 SDR/kg (est'd) This estimate is based on a 40 cent domestic First-Class stamp and an SDR rate of 1.2000 and anticipates coverage of roughly 75% (UPU may increase coverage from 60% to the 70-80% range).

5.3.1.2 Core CRA Cost Scenarios

- This scenario uses estimates for First-Class metered mail costs from the FY2000 CRA Report as a proxy for Foreign Origin Inbound mail processing costs.
- These costs are possibly more representative of non-workshare bulk mail, but may possibly miss some of the ISC costs.

5.3.2 Other Scenario Assumptions

(Note – all parameters and assumptions same as baseline unless otherwise stated)

- The weights of remail are varied as follows: Weights of remail are 0.1, 0.3, 0.7 or 0.9 ounces into weight steps. This variation demonstrates the sensitivity of weight variations on net revenue.
- This scenario assumes the risk of bulk mail detection to be 10%. Bulk mail detection requires identifying the mailer, something that is not required for normal settlement process and is hard to do. Some larger mailings might be easy to spot (low hanging fruit idea) and spot-enforcement could be attempted to keep operations generally smooth, but to provide uncertainty to remailers.

5.3. Remail Financial Scenarios

Four Core Remail Scenarios were developed to be representative of the best estimates for ABA remail. These scenarios are presented in Figure 5-1 and represent both an unrestricted remail environment (elimination of Article 43 and no enforcement of Article 49) as well as an environment with the full implementation of the System Harmonization Mechanism. Baseline scenarios are varied to take into consideration the use of domestic costs (CRA) of processing and delivery of inbound ABA remail versus the use of international costs (ICRA) for the processing and delivery of the same volume of ABA remail.

Alternative Core Remail Scenarios contain variations on US domestic postage, SDR conversion rates and UPU settlements costs.

Variations of the Core Remail Scenarios are presented in Figure 5-1 for varying remail weights, worksharing savings, and differing levels of bulk mail detection.

Additional detail related to the scenarios presented in Figure 5-1 a series of additional scenarios is contained in Appendix 13, Detailed Remail Financial Scenarios.

Results summarized in Table 5-1 are expressed in billions of dollars of revenue lost by USPS, showing different combinations of three variables:

- Scenario – Baseline vs. Alternative
- Costs – International (ICRA) vs. Domestic (CRA)
- Type of remail control – Unrestricted (UR) vs. System Harmonization (SH)

The Core Remail Scenarios in Figure 5-1 yield the following conclusions and are summarized in Table 5-1:

- The impact on USPS domestic revenue for the unrestricted scenarios ranges from a low of \$2.992 billion to a high of \$4.703 billion.
- The impact on USPS domestic revenue for the scenarios with full execution of the System Harmonization Mechanism ranges from a low of \$.698 billion to a high of \$1.492 billion.

Table 5-1 Summarization of Core Remail Scenarios

Baseline using ICRA Costs		Alternative using ICRA Costs	
System Harmonization (SH)	\$0.9	System Harmonization	\$1.5
Unrestricted (UR)	\$4.1	Unrestricted	\$4.7
Baseline using CRA Costs		Alternative using CRA Costs	
System Harmonization	\$0.7	System Harmonization	\$1.1
Unrestricted	\$3.0	Unrestricted	\$3.5

May 9, 2002

Figure 5-1 Remail Financial Scenarios

Scenario Assumptions and Results		
o	Scenarios are developed for estimates of potential remail activity in 2005	
	x	2005 is chosen because arbitrage opportunities under the UPU System Harmonization Mechanism are maximized
o	Key 2005 Uncertainties	
	x	Rate Arbitrage -- USPS domestic rates and UPU terminal dues settlements for the US
	x	USPS Costs -- estimates are based on FY 2000 costs
		- ICRA costs for inbound vs CRA costs for inbound -- sensitivities provided
	x	Weight of remailed domestic items
	-	assume mid-step values for most products (i.e., 0.5 oz over minimum weight)
	-	alternative scenarios investigated for 0.1, 0.3, 0.7 and 0.9 ounces
o	Core Scenario Assumptions Designed to Highlight Key Uncertainties of Rate Arbitrage and USPS Costs	
	x	Baseline Assumptions -- Use proposed domestic rates (\$.37) and current SDR Dollar Conversion Rate, Settlement Costs
	x	Alternative Assumptions -- Use 40c First-Class Rate (with proportional adjustments), Lower SDR Conversion Rate, and Estimated Settlement Costs
	x	Vary Cost Assumptions
	x	Without Article 43, but with or without enforcement of System Harmonization.
o	Four Core Scenarios (see Appendix 13 for additional assumptions and individual scenario results)	
	x	Baseline with CRA costs for foreign origin inbound mail
	-	Unrestricted
	-	System Harmonization Enforced
	x	Baseline with ICRA costs for foreign origin inbound mail
	-	Unrestricted
	-	System Harmonization Enforced
	x	Alternative with CRA costs for foreign origin inbound mail
	-	Unrestricted
	-	System Harmonization Enforced
	x	Alternative with ICRA costs for foreign origin inbound mail
	-	Unrestricted
	-	System Harmonization Enforced
	x	Range of Net Revenue Impacts
	-	Unrestricted -- \$2.992 to \$4.703 billion, average \$3.825
	-	System Harmonization Enforced -- \$0.698 to \$1.492 billion, average \$1.048
o	Other Scenarios	
	x	Sensitivity to Weight of Rемаiled Items
	x	Sensitivity to Bulk Mail Option Enforcement
	x	Sensitivity to Cost Savings Assumption for Workshare Mail Categories

May 9, 2002

Scenario Assumptions and Results

 Note On Cost Alternatives:

o	Two USPS Estimates for Costs of Handling Inbound Remail:		
x	-	ICRA Air LC/AO costs for inbound remail	
	-	Based on USPS estimated costs for handling LC/AO inbound mail	
x	An alternative estimate bases inbound remail costs on First-Class metered letters		
	-	Consistent with treatment of worksharing mail that migrates to non-workshared category in R2000-1	
Non-transportation costs redacted			
o	Comments		
x	ICRA cost estimates for Air LC/AO include hand-written letters, which should be more expensive to process than bulk business mail		
x	First-Class metered letters may not include all of the processing steps required for inbound foreign origin mail, also may not reflect processing costs and productivities at the ISCs		
x	None of the cost estimates presented include estimates for increased costs of enforcing Article 49 provisions		
	-	System Harmonization Mechanism enforcement would require expanding IPK sampling to small developing countries	
	-	Bulk Mail Option enforcement would require additional screening and data collection for inbound mail.	

May 9, 2002

Scenario Assumptions and Results (\$ Billions)

<ul style="list-style-type: none"> With 0.1 Weight Steps 				<ul style="list-style-type: none"> Worksharing savings 0% of rate differential 				<ul style="list-style-type: none"> Bulk Mail Detection Rate at 10% 			
System Harmonization	\$	2.696		System Harmonization	\$	0.692		System Harmonization	\$	0.885	
Unrestricted	\$	5.950		Unrestricted	\$	3.869		Unrestricted	\$	3.552	
<ul style="list-style-type: none"> With 0.3 Weight Steps 				<ul style="list-style-type: none"> Worksharing savings 40% of rate difference 				<ul style="list-style-type: none"> Bulk Mail Detection Rate at 20% 			
System Harmonization	\$	1.338		System Harmonization	\$	1.084		System Harmonization	\$	0.850	
Unrestricted	\$	5.104		Unrestricted	\$	4.289		Unrestricted	\$	2.987	
<ul style="list-style-type: none"> With 0.7 Weight Steps 								Alternative With Bulk Mail Detection			
System Harmonization	\$	0.489						<ul style="list-style-type: none"> Bulk Mail Detection Rate at 10% 			
Unrestricted	\$	3.193						System Harmonization \$ 1.034			
<ul style="list-style-type: none"> With 0.9 Weight Steps 								Unrestricted \$ 4.100			
System Harmonization	\$	0.368									
Unrestricted	\$	2.535									
Baseline 2005 Scenario Assumptions -- ICRA						Alternative 2005 Scenario Assumptions -- ICRA					
<ul style="list-style-type: none"> 37 cent First Class Stamp (proposed) 						<ul style="list-style-type: none"> 40 cent First Class Stamp (estimated) 					
<ul style="list-style-type: none"> \$1.2775 per SDR (current) 						<ul style="list-style-type: none"> \$1.20 per SDR (projection) 					
<ul style="list-style-type: none"> 0.5 ounces into weight steps 						<ul style="list-style-type: none"> 0.5 ounces into weight steps 					
<ul style="list-style-type: none"> UPU for 2005 -- .19 SDR/item and 1.684 SDR/kg (estimated) 						<ul style="list-style-type: none"> UPU for 2005 -- .215 SDR/item and 1.684 SDR/kg (estimated) 					
<ul style="list-style-type: none"> ICRA costs for inbound foreign origin 						<ul style="list-style-type: none"> ICRA costs for inbound foreign origin 					
<ul style="list-style-type: none"> Worksharing savings 20% of revenue differential 						<ul style="list-style-type: none"> Worksharing savings 20% of revenue differential 					
<ul style="list-style-type: none"> Canada access fee additional 5 percentage points 						<ul style="list-style-type: none"> Canada access fee additional 5 percentage points 					
System Harmonization			\$	0.923		System Harmonization	\$	1.492			
Unrestricted			\$	4.113		Unrestricted	\$	4.703			
Baseline 2005 Scenario Assumptions -- CRA						Alternative 2005 Scenario Assumptions -- CRA					
<ul style="list-style-type: none"> CRA First Class Metered Presort costs for inbound foreign origin 						<ul style="list-style-type: none"> CRA First Class Metered Presort costs for inbound foreign origin 					
<ul style="list-style-type: none"> 37 cent First Class Stamp (proposed) 						<ul style="list-style-type: none"> 40 cent First Class Stamp (estimated) 					
<ul style="list-style-type: none"> \$1.2775 per SDR (current) 						<ul style="list-style-type: none"> \$1.20 per SDR (projection) 					
<ul style="list-style-type: none"> 0.5 ounces into weight steps 						<ul style="list-style-type: none"> 0.5 ounces into weight steps 					
<ul style="list-style-type: none"> UPU for 2005 -- .19 SDR/item and 1.684 SDR/kg (estimated) 						<ul style="list-style-type: none"> UPU for 2005 -- .215 SDR/item and 1.684 SDR/kg (estimated) 					
<ul style="list-style-type: none"> Worksharing savings 20% of revenue differential 						<ul style="list-style-type: none"> Worksharing savings 20% of revenue differential 					
<ul style="list-style-type: none"> Canada access fee additional 5 percentage points 						<ul style="list-style-type: none"> Canada access fee additional 5 percentage points 					
System Harmonization			\$	0.698		System Harmonization	\$	1.078			
Unrestricted			\$	2.992		Unrestricted	\$	3.492			

Section 6. Limiting Remail

To ensure the protection of postal administrations from the potential erosion of their domestic and international revenue streams the UPU member countries adopted a series of protective mechanisms designed to stem the flow of ABA and ABC remail.

6.1. Introduction and Background

The primary goal of the UPU is to provide universal and affordable service to send and receive letter post to and from every citizen of every country, including developing countries or unprofitable, hard-to-service locations.

There are two articles of the UPU Universal Postal Convention that contain four mechanisms designed to inhibit uneconomic ABA and ABC remail:

- Article 43
- Article 49
 - Revision Mechanism
 - Bulk Mail Option
 - System Harmonization Mechanism

6.1.1. Article 43 Background

Recognizing the potential loss of revenues to postal administrations, Article 43 allows the collection of additional postage for the delivery of items deemed to be ABA or ABC remail. If payment of the required additional postage is refused, an administration can deny delivery of the mail, return it to the posting country, and collect redirection costs. For ABA remail, Article 43 allows domestic postage rates for similar mail receiving similar handling and service to be assessed. In the case of the USPS, the appropriate rate is that of First-Class Single Piece mail. For ABC remail, Article 43 permits an adjustment equal to the maximum of either 1) 80% of domestic postage rates or 2) the revision mechanism rate of 0.14 SDR per item plus 1.0 SDR per kilogram (described below). These two criteria apply only to a specific mailing that is identified as remail.

6.1.2. Article 49 Background

Article 49 governs the terminal dues charges for a developing country posting mail for delivery by an industrialized country. Article 49 provisions that might affect the compensation for remail (in the event that it is not detected as remail and adjusted per Article 43) include:

- The revision mechanism which allows an industrialized country to charge developing countries a revised flat rate derived from a formula with per-piece and per kilogram components for mail flows exceeding 150 metric tons per year and when the number of items per kilogram is over 21.¹

¹ The revision mechanism formula is 0.14 SDR per item plus 1.000 SDR per kilogram. Note that this formula is similar in structure to industrialized country terminal dues, but that the rate is below the minimum rate (0.147 SDR per item and 1.491 SDR per kilogram) for flows between industrialized countries.

May 9, 2002

- The bulk mail option which enables an industrialized country to charge developing countries per piece and per kilogram terminal dues rates due to it from other industrialized countries on shipments by single mailers exceeding 1,500 pieces in a day or 5,000 pieces in a two-week period.
- The system harmonization mechanism permits an industrialized country to charge industrialized country terminal dues rates on mail volumes from developing countries that exceed calculated thresholds specific to the sending country.²

The remaining portions of this section will discuss the current enforcement of these mechanisms, ease of enforcement, mailer perception of their effectiveness and, the financial impacts of enforcement.

6.2. Enforcement of Articles 43 and 49

Currently there is little need to apply either Article 43 or the provisions of Article 49. Results of the focus groups, mailer survey, and the expert panel confirmed that the existence of Article 43 serves as a strong deterrent to ABA remail.

6.2.1. Article 43 Enforcement

Interviews with postal personnel regarding enforcement of Article 43 provided limited information with the exception of discussions with the Postal Inspection Service and IBU personnel. Discussions with these two organizations are summarized below:

Inspection Service investigations of alleged ABA and other remail incidents have been conducted primarily in response to “tips” rather than as a result of any internal studies or investigations of the remail issue in general. The most recent investigations occurred about 4–5 years ago and included 3 major cases and 10 that were relatively minor (involving single or very few mail pieces). One of the major cases was decided in the courts, which ruled that because the mail in question had been delivered by the Postal Service before it was discovered as remail, penalties under USPS regulation IMM 790 (now 780) were not applicable. The following examples illustrate the potential magnitude of some of the cases investigated by the Inspection Service:

- ABA Remail from Barbados: 1,252,000 pieces, \$0.007 revenue per piece
- ABC Remail from Barbados: 12,000 pieces, \$0.07 revenue per piece
- ABC Remail from Curacao: 77,000 pieces, \$0.045 revenue per piece

USPS International Business maintains files of alleged remail cases discovered over a period covering about the last 15 years. The information provided by International Business indicates that consistent with Inspection Service experience, few instances of potential remail have been reported since 1995.

² For the system harmonization mechanism to apply, annual mail flows from the developing country must first exceed 50 metric tons.

May 9, 2002

As discussed above, our analysis of International Business case files and interviews with the Postal Inspection service yielded very few cases of Article 43 violations during the past fifteen years. Over the past five years we could only identify two cases of the invocation of Article 43 with very little revenue recovery. Over the past fifteen years there have been sporadic attempts to invoke Article 43 with little tangible result. In addition, observations and interviews were conducted with field personnel at the JFK, New York and Dallas ISC's to determine the invocation of Articles 43 and 49 and the procedures in place to identify and capture both ABA and ABC remail. These observations and discussions are summarized below.

6.2.2. Article 49 Enforcement

Redacted

6.2.3. Summary of Field Visits

The mailers that participated in the Mailer Survey and Focus Groups as well as the Expert Panel members indicated that the Bulk Mail Option is the strongest deterrent to remail other than Article 43. While mailer perception is that Article 43 is the strongest deterrent to remail and the Bulk Mail Option is the second strongest, we concluded that the enforcement of Article 43 and the Article 49 Bulk Mail Option would be extremely costly and difficult to enforce from an operational perspective. Further, our field observations confirmed that the IT systems are in place to strictly enforce the Article 49 System Harmonization and Revision Mechanisms at little or no additional cost or operational disruption. If the System Harmonization or Revision Mechanisms were strictly enforced they could potentially be a significant deterrent to ABA or ABC remail.

6.3. *Ease of Enforcement*

While Article 43 is quite difficult to enforce, the Systems Harmonization Mechanism could be implemented with relative ease to cut off potential ABA or ABC remail.

6.3.1. Article 43 Ease of Enforcement

Redacted

6.3.2. Article 49 Ease of Enforcement

Enforcement of the Bulk Mail Option requires the identification of bulk mail shipments by individual mailers exceeding 1,500 pieces in a day or 5,000 pieces in a two-week period. Bulk mailers attempting to avoid detection could conceivably segment their mailing and send it to multiple ISCs or split the mailings over multiple dispatches to a single or multiple ISCs.

Enforcement of the System Harmonization or Revision Mechanisms can be achieved more easily and at a lower cost than either Article 43 or the Bulk Mail Option. Execution of both of these enforcement mechanisms relies on the cumulative weight and the Items

May 9, 2002

Per Kilogram (IPKs) of the mail entering the US from developing countries. Currently very accurate cumulative weights are captured for all dispatches entering the US from developing countries and are maintained electronically by the Records Units at the ISCs. If a country exceeds the System Harmonization weight thresholds, a sample of that country's mail will have to be taken to determine IPKs for billing purposes. Additional costs will be incurred to conduct the IPK sampling; however, these costs should not be onerous and would only occur if the weight caps were violated.

The provisions of Article 49 dictate that the execution of either the Revision or System Harmonization Mechanism precludes the use of the other enforcement mechanism. In that these mechanisms cannot be used simultaneously we investigated the implementation of both mechanisms to determine which one would have the greatest impact on remail. Our review indicated that the ease of execution and associated costs are equivalent for both, and that the System Harmonization Mechanism would cutoff remail earlier at the 50 metric tonne level as opposed to the Revision Mechanisms 150 metric tonne limit. Based on these factors we concluded that the System Harmonization would appear to be the best enforcement mechanism.

System Harmonization would cut off the flow of ABA or ABC remail for the majority of developing countries that have annual flows greater than 50 metric tonnes. Appendix 12 indicates that very few developing countries send between 50 and 150 metric tonnes or exceed 150 metric tonnes of mail sent to the US. Therefore execution of the System Harmonization mechanism would cut-off potential ABA or ABC remail at a much lower level, 50 metric tonnes, for the majority of developing countries versus 150 metric tonnes for the Revision Mechanism. The Revision mechanism could be executed only for those countries that are currently sending more than 150 metric tonnes of mail into the US, thus closing down another potential source of remail.

6.4. *Mailers' Perception of the Effectiveness of Articles 43 and 49*

Mailers' perception of the effectiveness of Articles 43 and 49 were investigated during the Hybrid Focus Groups/Mailer Survey and Expert Panel. The results of these activities clearly indicated that Article 43 was the most effective deterrent to remail and that the next most effective deterrent was the Bulk Mail Option. The results of the Mailer Survey, Focus Groups and Expert Panel are summarized below (See Appendices 4 and 7 for more detailed information).

6.4.1. Mailer Survey

The survey covered a wide range of topics related to remail potential. Information on current mail volumes, mailing practices, and mailing costs was obtained. Additionally, mailers' awareness of remail restrictions was measured, as well as their perceptions of the impact of these restrictions on curbing remail behavior. The mailers' perceptions regarding the impact of Article 43 and Article 49 are summarized below.

May 9, 2002

6.4.1.1. Awareness of Restrictions on Remail

The vast majority of the mailing decision-makers indicated that they are not aware of any current restrictions on ABA remail. Only 8% ($\pm 3\%$) of mailers claimed awareness, and of these roughly one-half were not aware of the specific nature of the restrictions.

6.4.1.2. Perceived Effectiveness of Existing UPU Provisions Governing Remail

In addition to Article 43, the other three specific UPU provisions of Article 49 were addressed during the survey. These UPU provisions include:

- System Harmonization Mechanism
- Revision Mechanism
- Bulk Mailing Option

A portion of mailers indicated that each of these provisions would curb their propensity to engage in ABA remail. The perceived effectiveness of each provision, and the degree to which they would curb remail intent, is shown in Table 6-1 and Table 6-2.

Table 6-1
Perceived Effectiveness of UPU Provisions Among Likely Remailers³

UPU Provision	Perceived As A Strong Deterrent (% of Mailers)
Article 43 Only	69 (±9)
System Harmonization Mechanism Only	30 (±10)
Revision Mechanism Only	26 (±9)
Bulk Mailing Option Only	39 (±9)

As Table 6-1 indicates, the Article 43 provisions are perceived to be the most effective deterrent to ABA remail; 69% of the mailers indicating they would be likely to remail perceive this restriction to be a “strong deterrent that hardly any mailers would attempt to circumvent.” Further, as Table 6-2 indicates, the number of mailers indicating that they would be “highly likely” to remail with Article 43 in place (and strictly enforced) is substantially reduced.⁴

Table 6-2
Effect of UPU Provisions on Remail Propensity Among Likely Remailers⁵

UPU Provision	Portion of Likely Remailers that would Remain Highly Likely to Engage in Remail in 5-Year Time Horizon with the Indicated Provisions in Place (%)		
	First-Class	Standard A	Periodicals
Article 43 Only	21	12	7
System Harmonization Mechanism Only	47	27	41
Revision Mechanism Only	45	39	28
Bulk Mailing Option Only	33	15	12
Combined Harmonization Provision, Revision Mechanism, and Bulk Mailing Option	34	14	11

Of the three other provisions, the Bulk Mail Option is perceived to be the strongest; however, each of these three UPU provisions are perceived to function as strong deterrents by less than half of mailers; the majority of mailers believe that some companies would attempt to circumvent them. More importantly, as indicated in the qualitative interviews, they wonder how these restrictions could be enforced. The harmonization mechanism and revision mechanisms are viewed as being particularly ineffective. Between one-third and one-half of likely remailers indicated that they would still be highly likely to engage in remail, even with these prohibitions in place and strictly enforced.

³ Among mailers indicating they would be at least 50% likely to send remail for that specific class of mail in the 5-year time horizon.

⁴ Because mailers are unaware of current offenders and assume that the U.S. Postal Service does or is capable of detecting such offenders, they would be dissuaded from engaging in remail. Fear of public exposure and being an example are powerful deterrents, according to several group participants.

⁵ Based on the brief description of the statute provided in the survey.

May 9, 2002

6.4.2. Focus Group Results

Very few mailers who participated in the focus groups had any prior awareness of either the existence of ABA remail or any restrictions prohibiting it. A small contingent knew of the general prohibitions on remail; however, they did not know of the restriction or article by name or number. After a summary of Article 43 and the related Article 49 provisions was provided, mailers generally agreed that Article 43 was the most effective restriction for ABA remail. This restriction is seen as highly penalizing to the mailer and the potential savings that might be garnered would not be worth the financial consequences or the risk of negative publicity associated with its effective enforcement. In further discussions, it became clear that the risks associated with ignoring Article 43 could be so significant that even in the absence of strict enforcement a sizable group would refrain.⁶ In summary, mailers believe that very few companies would be willing to engage in remail with Article 43 in place.

"My company prides itself on its reputation as a AAA company and wouldn't want to jeopardize their reputation by being involved in some fraudulent illegal entry scheme."

Mailers view Systems Harmonization and the Revision Mechanism as similar to one another and much less powerful than Article 43, suggesting that these restrictions might make the use of remail somewhat difficult, but not impossible or even unattractive. Because these provisions are aimed at the foreign countries as opposed to the individual mailer, the focus for mailers would be on strategies that would minimize the risk associated with the enforcement of these restrictions.⁷ Mailers believe it would be possible for their companies or their mail consolidators to monitor the mail volume or weight coming from various countries and avoid sending remail through countries approaching their limit.

"Deutsche Post right now knows how much mail is coming or going. Some mailing companies are government subsidized, so you can get access to the information and find out what the balance is. You can get it through the post office... I mean, that's public information... And I would see people like World Distribution, TNT, making these decisions for me and other mailers. And they carry enough mail – they know how much is going."

Of course, a specific concern associated with these restrictions is whether foreign countries would be able to retroactively impose fees on companies once the weight limit is reached. Because unanticipated costs cannot be tolerated, some mailers say they would

⁶ Because mailers are unaware of offenders and assume that the USPS does or is capable of detecting such offenders, they would be dissuaded from engaging in remail. Fear of public exposure and being a made an example are powerful deterrents, according to several group participants.

⁷ In particular, high volume mailers feel less vulnerable to these restrictions, suggesting that foreign countries might be willing to absorb imposed fees in an attempt to maintain their major clientele.

May 9, 2002

go so far as to require binding contracts with third-party mailers that would prohibit the imposition of retroactive fees.

Mailers view the Bulk Mail Option as an extremely effective deterrent for remail, assuming it can be enforced. At least among the mailers interviewed, this restriction is considered to be just as effective as Article 43 in preventing the use of remail. Most mailers view reaching the volume limit as unavoidable and, therefore, the use of remail in this situation might be especially risky. In addition, there seems to be some confusion about who would levy the penalty or fine. Needless to say, mailers recognize that their identities would be immediately known, but were unsure whether the USPS or the foreign post would impose a fine on them. Just as with Systems Harmonization and the Revision Mechanism, however, the ability of countries to impose fees retroactively is an important consideration for respondents. If countries could not impose retroactive fees, some mailers would be more willing to consider remail under the Bulk Mailing Option, until they get caught.

6.4.3. Expert Panel Review

A total of six industry experts and prominent mailers/business partners participated in the five-hour panel discussion held in Philadelphia on October 30, 2001. Participants included officers of mailing trade organizations as well as high volume mailers. Because these senior officials were well versed in industry issues, they were able to provide an assessment of the likely behavior of other mailers as well as their own organizations.

When queried regarding the effectiveness of Article 43 and Article 49 enforcement mechanisms, the Panel members believed that elimination of Article 43 alone would likely not precipitate major remail activity. If Article 49 provisions (particularly the Systems Harmonization Mechanism) could be enforced, they would effectively cap potential ABA remail revenue losses at around \$1 billion. Furthermore, with the Article 49 provisions in place, panel members thought it would be unlikely that any major mailers or consolidators would become involved in the practice, given the limited volume of mail that could be absorbed by eligible countries before Systems Harmonization caps were met. Under these conditions, they argued that ABA remail would be undertaken only by a "fringe" element, bent on finding a least cost alternative. If their assertions were true, the Postal Service's possible revenue loss would be minimal.

6.5. *Financial Impact of Enforcement of the Provisions of Article 49*

Contrary to the perceptions of the mailer community Battelle believes System Harmonization to be the best enforcement mechanism to limit remail. System Harmonization would cut off the flow of ABA or ABC remail for the majority of developing countries that have annual flows greater than 50 metric tonnes. Therefore, this analysis will not address the Revision Mechanism and will focus on the financial impacts associated with the Systems Harmonization Mechanism and the Bulk Mail Option.

May 9, 2002

Two scenarios are presented, one with no enforcement of the System Harmonization Mechanism, and the other assuming that it is enforced. For each scenario two variations are presented, one variation including the Bulk Mail Option enforcement, the other not including it. The Bulk Mail Option involves detecting remail as bulk mail and charging industrialized country rates for such mail. Bulk mail is difficult to detect as such and if detection rates are high enough easy countermeasures by remailers could be employed. In the Remail Impact Model, the Bulk Mail Option is modeled as a detection and enforcement risk parameter. Costs over and above developing country rates are incorporated in an additional fee to insulate intermediaries against the cost of bulk mail detection. Our scenarios assume that all remail will pay this fee to an intermediary. Thus, if bulk mail is detected and the Article 49 remedies applied, no additional impact on an individual remailer occurs, the intermediary merely pays the fee out of the funds that have been collected for this purpose. For the scenarios presented in the tables below, bulk mail detection and enforcement rates are assumed to be 10%. That is, a particular remailing has a 10% risk of being detected as bulk mail and this 10% is charged higher rates. A low level of risk (10%) was chosen because bulk mail is difficult to detect and if it is detected mailers can take countermeasures such as splitting mailing into multiple dispatches, sending bulk mail to different international entry points and varying the return address to disguise the identity of the mailer. In the scenarios that apply the bulk mail option, the operational costs to the USPS are unknown; thus the net revenue impacts do not include them.

In the “unrestricted” scenario that assumes no Article 43 or Article 49 provisions are enforced, the net revenue impact to the USPS is -\$4.113 billion as shown in Table 6-3. Under a 10% Bulk Mail Option detection risk, this net revenue impact is reduced to -\$3.552 billion (Table 6-4). With System Harmonization Enforcement, the net revenue impact is only -\$0.923 billion, reflecting the effects of harmonization limits that greatly restrict remail at developing country rates (Table 6-5). Under the combined effects of the System Harmonization Mechanism and the Bulk Mail Option at the 10% detection risk, the net revenue impact is -\$0.885 billion (Table 6-6).

May 9, 2002

Table 6-3 Unrestricted Scenario – Article 43 Eliminated and No Article 49 Remedies Applied

	First-Class Mail	Regular Standard Mail	Enhanced Carrier Rte Standard Mail	Priority Mail	Nonprofit Standard Mail	Periodicals Regular Rate	Grand Totals
USPS Impacts (Millions of \$)							
Net Revenue Impact -- Canada	(\$196)	(\$0.6)				(\$0.2)	(\$197)
UPU Country Related Net Revenue Impact							\$(3,916)
Total Net Revenue Impact	(\$1,343.9)	(\$1,772.2)	(\$596.3)		(\$392.2)	(\$8.6)	(\$4,113)
Remail Characteristics							
Weight (Thousands of Metric Tons)	60.9	117.7	34.3		30.3	2.9	246.0
Volume (Millions)	3,866.2	6,971.4	2,306.3		2,131.0	76.3	15,351.3
Ounces Per Item	0.6	0.6	0.5	27.4	0.5	1.3	0.6

May 9, 2002

Table 6-4 Article 43 Eliminated, Bulk Mail Detection and Enforcement Risk = 10%

	First-Class Mail	Regular Standard Mail	Enhanced Carrier Rte Standard Mail	Priority Mail	Nonprofit Standard Mail	Periodicals Regular Rate	Grand Totals
USPS Impacts (Millions of \$)							
Net Revenue Impact -- Canada	(\$196.2)	(\$0.6)				(\$0.2)	\$(197)
UPU Country Related Net Revenue Impact							(\$3,355)
Total Net Revenue Impact	(\$1,231.2)	(\$1,515.1)	(\$499.8)		(\$298.7)	(\$7.1)	(\$3,552)
Remail Characteristics							
Weight (Thousands of Metric Tons)	59.1	107.5	30.6		26.0	2.8	225.9
Volume (Millions)	3,730.1	6,455.9	2,094.9		1,831.6	72.5	14,185.0
Ounces Per Item	0.6	0.6	0.5	27.4	0.5	1.3	0.6

May 9, 2002

Table 6-5 Article 43 Eliminated with System Harmonization Enforcement

	First-Class Mail	Regular Standard Mail	Enhanced Carrier Rte Standard Mail	Priority Mail	Nonprofit Standard Mail	Periodicals Regular Rate	Grand Totals
USPS Impacts (Millions of \$)							
Net Revenue Impact -- Canada	(\$431.1)	(\$45.1)				(\$1.0)	(\$477)
UPU Country Related Net Revenue Impact							
Total Net Revenue Impact	(\$875.3)	(\$46.9)				(\$1.1)	(\$923)
Remail Characteristics							
Weight (Thousands of Metric Tons)	49.2	6.3				0.4	55.9
Volume (Millions)	3,064.1	437.2				10.6	3,511.9
Ounces Per Item	0.6	0.5		27.4		1.2	0.6

May 9, 2002

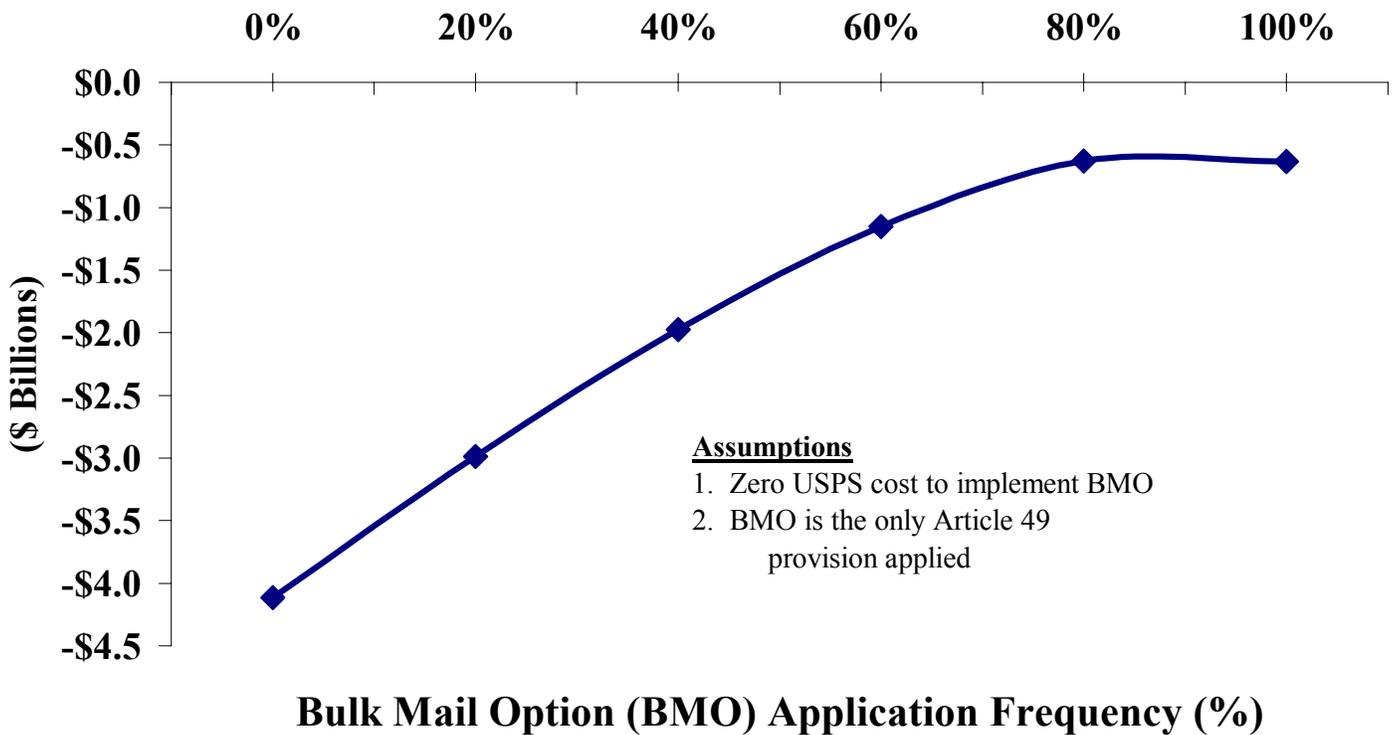
**Table 6-6 Article 43 Eliminated with System Harmonization Enforcement,
Bulk Mail Detection and Enforcement Risk = 10%**

	First-Class Mail	Regular Standard Mail	Enhanced Carrier Rte Standard Mail	Priority Mail	Nonprofit Standard Mail	Periodicals Regular Rate	Grand Totals
USPS Impacts (Millions of \$)							
Net Revenue Impact -- Canada	(\$432.4)	(\$45.9)				(\$1.0)	(\$479)
UPU Country Related Net Revenue Impact							
Total Net Revenue Impact	(\$836.7)	(\$47.0)				(\$1.1)	(\$885)
Remail Characteristics							
Weight (Thousands of Metric Tons)	48.5	6.3				.4	55.2
Volume (Millions)	3,003.9	437.0				10.6	3,451.4
Ounces Per Item	0.6	0.5		27.4		1.2	0.6

Since the Bulk Mail Option detection level is merely an assumption, Figure 6 -1 was prepared to show the effects of various detection rates. At lower detection levels, developing countries represent significant net revenue impact to the USPS. As detection levels rise, eventually Canadian remail displaces the developing country remail. This occurs around the 60% detection level. Note that the net revenue impacts do not include any costs of implementation or enforcement.

Figure 6-1 USPS Net Revenue Impact versus Bulk Mail Detection Success

USPS Net Revenue Impact versus Bulk Mail Detection Success in the Absence of Article 43



Section 7. The Stakeholders

The proposed elimination of Article 43 will have differing financial, service and other impacts on a variety of Stakeholders.

7.1. Introduction

A list of the Stakeholders is presented in Table 7-1. This list was developed through discussions with mailers and Postal Rate Commission and USPS representatives and presented to the Expert Panel for evaluation. Expert Panel members expanded the list and refined the impacts in Table 7-2.

Table 7-1 Article 43 Stakeholders

Stakeholders
Large Business Mailers
Small Business Mailers
Single-Piece Mailers/Mail Recipients
USPS
USPS Business Partners
Foreign Postal Administrations – Developing Countries
Foreign Postal Administrations – Canada
Foreign Postal Administrations – Other Industrialized Countries
Foreign Postal Service Business Partners
Foreign Privatized Posts
Universal Postal Union (UPU)
USPS Competitors

7.2. Impacts on the Stakeholders

The Stakeholders identified in Table 7-1 will experience gains or losses in the financial, service or other impacts areas as identified in Table 7-2. A brief description of these gains or losses follows:

Table 7-2 Effect on Key Stakeholders of Removing UPU Provisions

Stakeholders	If Only Article 43 were Removed	If Both Article 43 & 49 were Removed
Large Business Mailers	Minimal effect	Gain (F ¹)
Small Business Mailers	Small gain (F)	Gain (F)
Single-Piece Mailers/Mail Recipients	Small loss (F, S)	Loss (F, S)
USPS	Loss (F, S,)	Loss (F, S)
USPS Business Partners	Small loss (F, S)	Loss (F, S)
Foreign Postal Administrations – Developing Countries	Small gain (F)	Gain (F)
Foreign Postal Administrations – Canada	Gain (F)	Small gain (F)
Foreign Postal Administrations – Other Industrialized Countries	Loss (F)	Loss (F)
Foreign Postal Service Business Partners	Gain (F)	Gain (F)
Foreign Privatized Posts	Gain (F)	Gain (F)
Universal Postal Union (UPU)	Small loss (O)	Loss (O)
USPS Competitors	Gain (F)	Gain (F)

7.2.1. Financial Gains

- Large Business Mailers and Small Business Mailers will gain financially if they take advantage of the elimination of Article 43 only or elimination of both Articles 43 and 49. These financial gains result from the reduction in costs associated with domestic mail that is remailed as either ABA or ABC remail.
- Foreign Postal Administrations – Developing Countries and Foreign Postal Administration – Canada, benefit financially from the access fees that they collect for allowing the entry of either ABA or ABC remail through their postal systems.
- Foreign Postal Service Business Partners gain financially through the fees that they collect for providing either ABA or ABC remailing services.
- Foreign Privatized Posts have been very aggressive in providing remail services and benefit financially through fees for these remailing services. In some cases these posts either own or have arrangements with transportation companies and benefit from the collection of transportation revenues.

¹ F = Financial Impact, S = Service Impact, O = Other Impacts

May 9, 2002

- USPS Competitors could potentially gain financially from the elimination of any controls over remail and the move toward a free market environment for international mail. This elimination of restrictions would improve the competitiveness of their international pricing and provide opportunities for expansion of their businesses into the processing and shipment of international mail.

7.2.2. Financial and Service Losses

- Single-Piece Mailers/Mail Recipients, the USPS and Foreign Postal Administrations – Other Industrialized Countries could experience both financial losses and declines in service levels/performance. Any significant diversion of domestic mail into the international remail stream would have the effect of reducing postage revenues for the affected postal administrations thereby placing pressure on their domestic rates. This pressure on domestic rates might have the result of increasing those rates, and/or reducing service levels/performance to accommodate the revenue losses. Any significant diversion of domestic mail and the associated revenue loss could potentially impact the ability of the US Postal to satisfy its universal service obligation.
- Business mailers might be able to avoid or mitigate the impact of these rate increases by continuing to or increasing remailing.
- USPS Business Partners could experience financial losses resulting from the decline in revenue from the production and transportation of domestic mail diverted to foreign production and transportation operations as a result of the remail process.

7.2.3. Other Impacts

Universal Postal Union (UPU) – Elimination of Article 43 or both Articles 43 and 49 would weaken the foundation for providing universal service at an affordable cost which is the primary goal of the UPU. This impact could have the effect of weakening the UPU and the international mail system.

7.2.4. Summary

The proposed elimination of Article 43 will have differing financial, service and other impacts on a variety of stakeholders. These impacts were validated by members of the Expert Panel and are presented in Table 7-2.

Table 7-2 indicates that the USPS and its business partners would stand to lose substantially, as would single-piece (and other) mailers who would need to bear the cost of commensurate rate increases. Business mailers, privatized foreign posts, developing countries' postal administrations, and other USPS competitors would stand to gain the most: all at the expense of the USPS and those mailers not taking advantage of remail opportunities. The elimination of Article 43 and/or Article 49 were of concern to members of the Expert Panel because of its potentially adverse effect on the ability of the

May 9, 2002

USPS to continue to provide the full range of mailing and delivery services the Expert Panel members currently expect and now heavily rely. It was reasoned that losses in domestic revenues due to remail would force increases in domestic postage rates in order to meet the Service's revenue requirement.

7.3. Quantification of Financial Impacts

Certain remail financial impacts were calculated as part of the RIM remail scenario simulations. These impacts included the net revenue impact of remail on the USPS, the revenue gains (access fees) for developing countries postal administrations, the cost saving for US domestic remailers, the fees obtained by remail intermediaries and the international transportation revenues generated by remail. These impacts are summarized in Table 7-3 for the four Core Remail Scenarios identified in Section 5, Table 5-1.

May 9, 2002

Table 7-3 Stakeholder Financial Impacts (Millions of Dollars)

Scenario	USPS	Developing Countries Postal Administrations	Remail Intermediaries	US Domestic Remailers	Transportation Revenues
Baseline – ICRA Costs					
Unrestricted	(\$4,113)	\$66.1	\$96	\$2,195.6	\$141.5
System Harmonization	(\$923)	\$50.8	\$46.8	\$433.7	\$51
Baseline – CRA Costs					
Unrestricted	(\$2,992)	\$66.1	\$96	\$2,195.6	\$141.5
System Harmonization	(\$698)	\$50.8	\$46.8	\$433.7	\$51
Alternative – ICRA Costs					
Unrestricted	(\$4,703)	\$72.8	\$102.9	\$2,647.1	\$160.7
System Harmonization	(\$1,492)	\$95	\$83.1	\$628.9	\$69.7
Alternative – CRA Costs					
Unrestricted	(\$3,492)	\$72.7	\$102.9	\$2,634.9	\$160.5
System Harmonization	(\$1,078)	\$92	\$83.2	\$632	\$71.5