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LEGISLATIVE COUNCIL BRIEF

Post Office Ordinance (Chapter 98)

REVISION OF POSTAGE RATES

INTRODUCTION

At the meeting of the Executive Council on 3 July 2001, Members noted that the Postmaster General (PMG) had, in accordance with section 4(1) of the Post Office Ordinance, decided to revise some postage rates with effect from 1 April 2002.

BACKGROUND

2. Postage rates were last increased in September 1996 and the weighted average net increase then was 8.7%. The Post Office (PO) subsequently restructured postage rates, and reduced the rates for local mail and bulk airmail service by 4% and 17% in 1997 and 1998 respectively.

The postage revision

3. The postage revision includes both increases and reductions, and will result in a weighted average net increase of 6.5%. Briefly, for **local mail**, the postage rate for letters up to 50g in weight will be increased by 10 cents per letter, and for letters over 50g but below 250g in weight by 20 cents per letter. In addition, local printed papers rates will be abolished, i.e. printed papers will be subject to the same rates as letters either as first class or bulk economy items. As for international mail, in respect of **surface mail**, postage rates for bulk posted bags will be increased by \$4/kg, while the rates for all other items will be increased by about 10% on average. For **airmail**, postage rates for all non-bulk items will be reduced by 10 cents. Details of the revision plan are set out at Annexes A to D.

4. The PO expects the planned revision to bring about additional revenue of \$118 million in a full year. PMG's original plan was to implement the postage revision in October 2001, so as to reduce the PO's operating deficit in 2001-02 from \$103 million to \$44 million and that in 2002-03 from \$164 million to \$46 million. In deferring the revision to 1 April 2002, the operating deficit in 2001-02 will remain at \$103 million. There will also be a roll-on effect, which would delay possible revisions for inflation adjustments in subsequent years. As a result, the operating deficit in 2002-03 is projected to become \$67 million.

Factors taken into account in postage revision

5. In determining the level of adjustment in postage rates referred to in paragraph 3 above, PMG has taken into account the following factors.

(A) Increase in operating costs

6. Since the last postage rate increase in September 1996, the PO's operating costs have increased by about 8.6%, from \$3,341 million in 1996-97 to \$3,627 million in 2000-01. Overall increase in mail traffic of 14% over the last five years has led to increase in operating costs, but corresponding revenue does not match operating costs because some of the mail services do not achieve full cost recovery.

(B) Decrease in revenue

7. While operating costs have increased, revenue for the PO has decreased by about 19.6% from \$4,470 million in 1996-97 to \$3,596 million in 2000-01. In particular, revenue from airmail and philatelic services, which have been the two major sources of revenue subsidizing losses incurred by other mail services, has been drastically reduced in recent years.

8. In respect of airmail, due mainly to widespread e-substitution and diversion of international mail from the normal international mail exchange, revenue has dropped by over 35.9% from \$905 million in 1996-97 to \$580 million in 2000-01.

9. As regards philatelic services, although there were exceptional windfall profits in 1996-97 and 1997-98 which amounted to

about \$913 million and \$1,454 million respectively, revenue has returned to a much lower level since then: \$303 million in 1998-99, \$287 million in 1999-2000 and \$127 million in 2000-01.

10. To better utilise its asset and manpower, the PO has, since April 2000, introduced the PayThruPost service to accept counter bill payment for utility companies. This has increased revenue by \$5 million. When the service is extended to accept payment for government bills by the end of the year, the estimated annual revenue will be around \$30 million depending on patronage.

(C) Cross-subsidization among postal services

11. Cross-subsidization has become increasingly untenable and needs to be phased out for the reasons set out below.

12. At present, local mail, surface mail and miscellaneous postal services are subsidized by revenue generated by airmail, Speedpost and philatelic services. For example, the existing postage rates for surface mail bulk posted bags, at \$26 and \$27 per kilogram for the two postal zones, are insufficient to cover the delivery rate charged by destination administrations (\$35 per kilogram), not to mention the conveyancing and local handling costs for these items. As revenue from the profitable services decreases, continuation of cross-subsidization has become untenable.

13. Recent changes in the payment system for the delivery of international mail have also accentuated the need to remove cross-subsidization. At the Universal Postal Union Congress held in 1999, postal administrations agreed that, with effect from 1 January 2001, the despatching postal administration may request the postal administration at destination to link the rate of payment for mail delivery to the latter's domestic tariff. In the case of Hong Kong, implementation of such an arrangement would mean subsidizing overseas mailers. Although at present Hong Kong has not yet acceded to such requests, the PO expects that it will be under increasing pressure to do so.

14. It has also emerged that some overseas mail is already being diverted from the normal international mail exchange the PO has with other postal administrations. Companies associated with overseas postal administration and other delivery companies are bringing in international mail by non-postal means for direct posting at our local post offices, to take advantage of the lower domestic tariff.

15. In the light of the above, there is a need to reduce cross-subsidization to maintain the overall viability of postal services and to avoid Hong Kong users subsidizing overseas mailers. The PMG aims to gradually achieve full cost recovery for the loss-making mail services in phases.

(D) Operating deficits since 1998-99

16. The Post Office Trading Fund (POTF) has recorded operating deficits since 1998-99. Total operating loss for 1998-99 and 1999-2000 amounted to \$150 million and \$77 million respectively. For 2000-01, the amount of operating deficit was reduced to a projected amount of about \$32 million as a result of increase in productivity and additional profits from election postings (\$42 million) and the Hong Kong 2001 Stamp Exhibition (\$33 million). However, the PO expects that the trend of operating deficit will continue and deteriorate if the present postage rates remain unchanged. With the existing postage rates, PMG estimates that the POTF will incur operating loss of \$103 million in 2001-02, and \$164 million in 2002-03.

(E) Inflation

17. In moving the resolution for establishing the POTF in July 1995, the Administration undertook that future postage rate increases would be broadly in line with inflation.

18. The revision will result in a weighted average net increase in postage rates of 6.5% over existing postage rates, and is not out of line with inflation applicable to Government spending. Compared to the postage rates immediately after the last increase in September 1996, the weighted average net increase would be around 3%. The revision is estimated to increase the Composite Consumer Price Index only by about 0.002%.

(F) Abolition of local printed papers service

19. Historically, printed papers, such as advertisements, newspapers and periodicals etc, enjoy a discount off the letter postage rates, on the assumption that they are to be posted in bulk and processed at a lower cost with longer delivery time. However, a review by the PO has revealed that more than 45% of the local printed papers are not posted in bulk and no operational savings can be achieved. The Director of

Audit queried the price differential between letters and printed papers in 1993, as both services enjoy the same service standard. The Public Accounts Committee also recommended a review of the price structure and service standard of the printed papers service. The PO has decided that it would be more equitable to give discounts only where operational savings are achievable (e.g. when the mail items are standard, pre-sorted, posted in bulk, or require lower delivery standards etc.), and that the local printed papers rates should be abolished. In June 1997, in briefing the Legislative Council on the plan to restructure local postage rates, PMG indicated that the local printed papers category would be phased out in due course.

20. At present, there are printed papers rates for standard and non-standard services. Following the abolition of local printed papers rates, the same rates for local letters using first class and bulk economy services will apply to local printed papers. For items using the bulk economy service, there will only be very small increases or even reductions in postage rates, depending on the weight of the individual items. There will be increase for items using the non-bulk first class service. Businesses which rely heavily on postal service such as publishing, advertising and mail ordering could choose the service quality optimal to their requirement. The PO will also continue to provide the same discount levels currently available for pre-sorted mail and bulk postings of first class and “economy” items.

Effective date of the postage revision

21. Our original plan was to implement the postage revision in October this year. The LegCo Panel on Economic Services was briefed on the planned postage revision on 28 May 2001. Taking into account the economic situation and views of members of the Panel, the public and major users, PMG has decided to revise the postage rates as set out in paragraph 3 above on 1 April 2002.

FINANCIAL AND STAFFING IMPLICATIONS

22. Based on existing mail traffic, the postage revision will bring about additional annual revenue of some \$118 million for the PO. Deferral of the postage revision to 1 April 2002 will increase PO's operating deficit and overall deficit to \$103 million and \$75 million respectively for the current fiscal year 2001-02. With the postage revision effective from 1 April 2002, PO will still have projected

operating deficit and overall deficit of \$67 million and \$39 million respectively in 2002-03.

23. The PO is a trading fund established under the Trading Funds Ordinance (Cap.430). It is required to operate on a self-financing basis and achieve reasonable return. The current target of return is 10.5%. In the light of its projected adverse financial performance, PO will need to achieve substantial cost savings, or generate new sources of revenue, or implement higher rates of postage increases, or a combination of these measures in the years to come.

ECONOMIC IMPLICATIONS

24. Given that postage constitutes only a small proportion of overall household expenditure, the postage revision is estimated to increase the Composite Consumer Price Index by about 0.002%. Also, postage constitutes only a small proportion of business costs in general. Thus the impact on inflation will not be significant. For businesses which rely heavily on the postal service, such as publishing, advertising and mail ordering, the impact of the planned increase in postage on them could be larger. However, the choice of service quality available to these businesses as detailed in paragraph 20 above would help to minimise any adverse impact.

PUBLIC CONSULTATION

25. Members of the Legislative Council Panel on Economic Services and industry associations of major users were briefed on the planned postage revision. Their views were taken into account in the current decision to defer postage revision to April 2002.

PUBLICITY

26. A press release will be issued and a spokesman will be available to answer public enquiries.

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Economic Services Bureau

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(Chapter 98)**

REVISION OF POSTAGE RATES : ANNEXES

- Annex A - Local mail - first class and bulk economy letters and cards
- Annex B - Local mail - options available to users after abolition of printed papers rates
- Annex C - International mail - bulk bag and surface mail
- Annex D - International mail - airmail