



Testimony Of

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On Behalf Of The

Postal Rate Commission

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Subcommittee On The Postal Service

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Testimony

Chairman McHugh, members of the Committee on Government Reform, Subcommittee on the Postal Service, I am pleased to testify here today on behalf of the Postal Rate Commission. I am the Director of the Commission's Office of Rates, Analysis and Planning. For a number years I have prepared studies for international mail conferences and worked with members of foreign postal administrations. Consequently, the chairman gave me the responsibility of working with the State Department when it became responsible for dealing with the Universal Postal Union (UPU). For this reason he also asked me to testify here today.

First I intend to discuss briefly the Commission's international mail report. Because Chairman McHugh's letter of invitation indicated that this hearing will concentrate on U.S. policies concerning the international exchange of documents and parcels, most of my testimony will deal with the recent transfer of authority for UPU policy and representation to the State Department.

The Commission's Report to the Congress

As you know, legislation amended Title 39 of the U.S. Code in November, 1998, and required the Commission to provide Congress with a comprehensive report on International mail costs, volumes and revenues. The Commission completed its first report and transmitted it to Congress on June 30, 1999.

In order to carry out its new responsibilities, the Commission first asked interested parties for their views on 1) the scope of the report, and 2) on what data the Commission should require from the Postal Service in order to prepare the report. The Commission sent a number of requests for data and information to the Postal Service. The Service provided the data requested by the Commission, but it also pointed out that under existing law, Postal Service business information which a private firm would not

normally disclose must be kept confidential. For that reason, the Commission has not made its entire report public. Instead it has provided the public with a version from which a small amount of sensitive information has been redacted. The highlights of the report are contained in the Attachment to this testimony.

After our report was issued, the Commission provided additional analyses in response to a request from Chairman McHugh. One of the more difficult questions still outstanding is the extent to which inbound and outbound mail flow data can, or should, be combined. The Commission has tried to accommodate interested members by providing data in disaggregated form so that it can be combined as the user sees fit.

Since the preparation of the report did not involve a section 3624 proceeding, members of the Commission's Consumer Advocate's staff worked with the advisory staff on the study. In preparation for its second report the Commission has just completed a formal rulemaking on the scope of the report and the data to be supplied by the Postal Service. The Service will be submitting the data by March 15, and the Commission will commence work on its second report.

A PRC Perspective on the Activities Resulting from the Transfer of Authority to the State Department

In November 1998, at the same time the Commission was given its new international responsibility, Congress also transferred responsibility for UPU policy and representation from the Postal Service to the State Department. Soon after the legislation was enacted, the State Department formed an interagency advisory group consisting of the Justice (Antitrust Division) and Commerce departments, the U.S. Trade Representative, the Postal Service and the Postal Rate Commission. State also held public meetings and sought the views of individuals from the Postal Service and other groups with an interest in UPU policy. Representatives of the State Department met with officials of several European governments and posts and with officials of the UPU. The State Department officials quickly grasped the complex issues of international mail and formulated policy for the quinquennial UPU Congress. The

interagency group approved the policy by consensus. This all happened relatively quickly, beginning in January and culminating with the Congress in August.

At the request of Chairman Gleiman, Commissioner Ruth Goldway and I participated in virtually every interagency advisory group and public meeting. Legal and technical staff of the Commission also attended these meetings. We met informally with other interagency advisory group members to provide background on postal matters and to consider policy issues. The Commission sponsored a presentation for the advisory group on the remail industry by a knowledgeable person from that industry. When the State Department expressed an interest in our providing support at the Beijing Conference, the chairman arranged for my attendance and that of Commissioner Goldway.

Commission support of the State Department effort continued in December 1999 when I attended the first meeting of the High Level Group set up to consider reform of the UPU. In addition, Commission staff and I have worked with Postal Service staff in drafting a schedule of work (SOW) for a joint study on remail and terminal dues. The SOW was circulated to the interagency advisory group and other stakeholders on March 2. Our intention is to revise the SOW taking into account the comments we receive. The SOW will be included in a formal request for proposals in preparation of awarding a contract for the study.

Rationale for transferring authority to the State Department

The Universal Postal Union (UPU) was organized in 1874 to facilitate the international exchange of documents (including letters and cards) and parcels. The goal of the UPU was the creation of a single postal territory composed of all member states. That goal is facilitated by the universal service obligation (USO) imposed on the postal administrations of the member states by their governments. Under this arrangement, mail sent from any member country is accepted for delivery in any other member country and receives the same universal service as domestic mail.

For a century the UPU quietly succeeded in its purpose. Since there were no alternative means for the regular exchange of documents and parcels, it was only natural that governments (i.e., the members of the UPU) were represented at the UPU by their national postal administrations. The 1970s, however, gave rise to the express and remail industries that competed with the posts by providing more rapid and reliable delivery of documents and parcels. Two domestic express companies, Federal Express and United Parcel Service, became important suppliers to the international market. As private operators siphoned off much of the high end of the market, the UPU began to concentrate on assisting postal administrations now in competition with private operators that had no legally binding universal service obligation.

Meanwhile, Australia, New Zealand, and the European Commission began to question the scope of the mail monopolies enjoyed by their posts and to encourage competition in traditional postal markets. Distinctions were made between governments and postal administrations. Countries began sending representatives of both to the UPU beginning in the early 1990s. This distinction is becoming increasingly important as the scope of mail monopolies is being reduced around the world and as posts are becoming commercialized, incorporated under ordinary commercial law, and privatized.

The International express industry is growing in importance with the globalization of the economy. Indeed, as others have said, the industry makes globalization possible. There is, however, an asymmetry in the way these companies' interests are represented at the UPU. The Dutch Post, which participates in the UPU, owns an important international express company, TNT. Similarly, the German Post also participates in the UPU and has a substantial minority stake in the international express company DHL. Thus, these express companies at least, are indirectly represented at the UPU.

Given the competition in the international exchange of documents and parcels, it became increasingly clear that the U.S. Postal Service could not in fairness represent

the divergent interests within the United States at the UPU. Recognizing this, Congress transferred responsibility for UPU policy and representation to the State Department.

State Department's UPU Policy and the Universal Service Obligation

In response to the diverse interests of the Postal Service, private operators and international mailers, State's main policy theme developed for the Beijing Conference was that the UPU itself should be reformed to take into account the changes in the international mail market and to be more open to the interests of the private sector. For the first time representatives of the U.S. express industry and mailing industry were included in the U.S. delegation to the UPU.

Many countries, however, opposed giving recognition to the interests of private operators in Beijing. These countries felt that increased competition from private operators could subvert the ability of national postal administrations to fulfill their universal service obligations at affordable prices, and consequently, endanger the single postal territory.

Thus, the question before policy makers is: "How much deference should national postal administrations receive in international mail policy because they have a USO?" In particular, should the U.S. Postal Service be given commercial advantages in international mail because of its USO?

We should first note that international mail volume and revenue are small portions of total volumes and revenues for the U.S. Postal Service (and for the other industrial nations' posts). In the United States, international mail accounts for one half of 1 percent of the volume and 3 percent of the revenue. International mail on the whole makes a smaller than average contribution to institutional costs but is not cross-subsidized.

The cost of the universal service obligation is the cost of providing services which would not be performed by a profit-making competitive firm. This cost has not been

calculated for the U.S. Postal Service or, as far as I know, for any other postal administration. The Government grants the U.S. Postal Service a letter mail monopoly to enable it to provide universal service. The monopoly is tantamount to the ability to tax mail users, because it allows rates to be set higher than they could be set in a competitive environment. The domestic letter mail monopoly accounts for more than 80 percent of the Postal Service's revenue and nearly 90 percent of the contribution to its institutional costs. If all international mail volume were lost, it would not affect the ability of the Postal Service to pay for its universal service obligation. Thus, no commercial advantage needs to be given to international mail in the United States in order to maintain our Postal Service's USO. I believe this same analysis would apply to all other postal administrations of industrial countries.

This does not mean that the Postal Service does not have a universal service obligation with respect to international mail. Data supplied to the Rate Commission by the Postal Service and displayed at page 39 of our report to the Congress on International Mail Volumes, Costs and Revenues shows that the preponderance of the largest and most lucrative portion of outward international mail (air letters and cards), were sent by households. Household mail is also an important constituent of air AO (other objects) and air parcels. Additionally, households account for about 90 percent of all surface parcels. The data we received from the Postal Service does not separately break out small volume non-household mailers. A fair inference would be that they are also important users of the air services which households use. Small volume commercial mailers and household mailers do not have sufficient volumes to interest consolidators and so have no affordable alternatives to the Postal Service. Their mail is *de facto* monopoly mail. Therein lies the Service's obligation to these mailers.

The Beijing Congress and its Aftermath

The Beijing Congress took two important steps from a U.S. policy standpoint. One was the creation of a High Level Group to consider reform of the UPU. As I mentioned, I attended the first meeting of this group in Bern in December. I must say that I was surprised at the receptiveness of most of the delegations to the concept of

reform. This was reinforced by remarks of the Secretary General, Mr. Thomas Leavey. While some delegations were silent about the desirability of reform and one nation was actively opposed, at this time I am guardedly optimistic about a successful outcome from the High Level Group.

The Beijing Congress also ratified a new terminal dues agreement to take effect in 2001. Terminal dues are the rates that the posts of UPU member nations charge each other for letters, cards and *autre objets* (other objects). Because terminal dues are set below domestic postage rates for comparable mail in industrial countries, and because terminal dues rates are available only to postal administrations, terminal dues have competitive implications. The new terminal dues agreement was supported by the State Department because the new rates would be more cost-based than the current terminal dues. State believes the new agreement begins the process of having terminal dues based on costs, which would make them more competitively neutral.

State Department Defers to the Postal Service in Other Areas

The UPU is important to the U.S. Postal Service in dealing with its international mail. The UPU is the means by which products, prices, means of payment, rules of exchange, security and technical assistance for less developed nations are established. The Postal Service has an excellent and dedicated staff that deals with these important matters at the UPU. It is my observation that, except for terminal dues, the State Department defers to the Postal Service on those issues, which are akin to commercial arrangements.

Suggestions for the Policy Development Process

The Rate Commission agrees with the recommendation of the GAO that the State Department set up an advisory committee under the Federal Advisory Committee Act. Such a committee would institutionalize a consultative process which could not be easily discarded. It would also guarantee the participation of interested parties. While the Commission believes the *ad hoc* procedures adopted by the State Department served it well in the hurried atmosphere of preparing for the Beijing Conference, more

formal procedures would be helpful at this juncture. The Congress may wish to consider mandating the establishment of such an advisory committee.

The Commission also suggests that when appropriate, State should issue and publish in the Federal Register a formal statement of policy in which it explains the basis for the policy and deals with all stated objections to that policy. We are contemplating a process as similar to notice and comment rulemaking, in that the State Department should solicit comments prior to issuing a final version. Statements of Policy would memorialize decisions and explain why they were made. They would prevent arbitrary changes in policy and ensure considered policymaking.

Finally, although the Commission reiterates the view that the State Department has exercised its new authority in an extremely competent and skillful manner, it believes that there is still a lack of expertise on international mail within the State Department. The Postal Service has this expertise, but it is not disinterested in these matters. While the Commission is prepared to continue to provide its support, we believe the State Department may wish to take steps to supplement the knowledge base of its staff so as to better ensure balanced decision-making, in the ongoing representation of the interest of the United States.

MAJOR FINDINGS OF PRC REPORT ON INTERNATIONAL MAIL

- ◆ International mail as a whole is compensatory. It is not cross-subsidized by domestic mail.
- ◆ The overall cost coverage for International mail is 113 percent compared to the systemwide cost coverage of 158 percent.
- ◆ Four outbound services fail to cover their costs: (1) Surface AO, (2) Surface periodicals, (3) Global Package Link, and (4) Global Priority Mail. New rates that became effective 5/30/99 may alleviate the problem.
- ◆ Two inbound categories are not compensatory: (1) Air LC/AO and (2) Surface LC/AO.
 - Compensation in these categories is based on UPU terminal dues for 42 percent of inbound mail. Bilateral agreements with 14 countries in Europe and Canada account for the rest.
 - Presumably the loss comes from UPU countries but because USPS doesn't have inbound regime-specific costs, we cannot analyze the revenue-cost relationship.
- ◆ Settlement costs (terminal dues, inward land charges, and imbalance charges) directly affect outbound rates because the Postal Service includes them in the cost base used to set rates.
 - Rate = (mail processing cost + domestic transportation cost + other domestic cost + international transportation cost + **settlement cost**) x cost coverage.
- ◆ The volume, revenue, and cost data are generally reliable and the cost coverages are statistically significant except for inbound air LC/AO and Inbound EMS.