**Testimony of**

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**On behalf of the**

**Postal Regulatory Commission**

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**Subcommittee on Government Operations**

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## Introduction

Chairman Meadows, Ranking Member Connolly and members of the Subcommittee on Government Operations, good afternoon. My name is Robert G. Taub. I am the Acting Chairman of the Postal Regulatory Commission (Commission). I am pleased to testify before you today.

## Scope of Testimony

As requested in your letter of invitation, my testimony focuses on the Commission's current responsibilities in international terminal dues treaty negotiations and the current statutory framework for how the United States negotiates international mail rates. The Commission's responsibilities and the broader negotiating framework are codified in section 407 of the U.S. Code, as revised by the Postal Accountability and Enhancement Act (PAEA) of 2006.

The defining feature of the Commission's responsibilities and the current statutory framework is that they exist within the larger context of U.S. membership in the Universal Postal Union (UPU), where terminal dues are negotiated as part of a complex process. I will briefly describe UPU terminology and procedures.

## Terminology

The phrase "terminal dues" refers to the fee a nation's postal operator charges to foreign posts for delivering their letter post items. The UPU generally defines "letter post" as including letters and postcards, printed papers, and small packets weighing up to 2 kilograms (4.4 pounds). Conceptually, letter post can be considered to include three broad products — small letters, large letters (flats), and bulky letters (packets up to 4.4 pounds with a maximum combined dimension of 35.4 inches). Letter post items subject to terminal dues are regulated as Market Dominant products in the United States. For clarity, it is Market Dominant products that are being talked about when we discuss terminal dues, rather than Competitive products and any Competitive NSAs, which are regulated differently, and are required to cover their costs.

For example, when the U.S. Postal Service receives letter post items from China Post for delivery in the United States, the U.S. Postal Service is entitled to a terminal dues payment from China Post as compensation for delivering that mail in the U.S. Likewise, China is entitled to compensation for delivering letter post items within its borders originating in the U.S. From the U.S. Postal Service's perspective, mail subject to terminal dues coming from China is "inbound letter post." Similar mail sent from the U.S. to China is "outbound letter post." The phrase "terminal dues" does not refer to the rate a foreign post charges its customers to send mail to another country. Those rates are determined according to each country's national law.

"Bilateral" and "multilateral" agreements (also referred to as negotiated service agreements) refer to U.S. Postal Service contracts with other countries. Under the PAEA, such Market Dominant agreements must either improve the U.S. Postal Service's net financial position or enhance the performance of operational functions. "Improving the net financial position" of the U.S. Postal Service typically means that UPU terminal dues serve as the benchmark (or "default") rates for applying this test. So while contractual rates under bilateral and multilateral agreements may be higher than the otherwise applicable UPU rates, this does not necessarily mean that costs are fully covered.

## A Brief Look Back

Coincidentally, 15 years ago in March 2000, this Committee held a very similar hearing on international postal policy. The topic was the landmark 1998 legislation that changed more than a century of national policy by transferring the primary responsibility for international mail arrangements, including terminal dues, from the U.S. Postal Service to the Department of State. This transfer reflected the growing recognition that fundamental changes were occurring in the traditional model for providing postal delivery services, including privatization of some posts, as well as in the communications sector more broadly. The conclusion was that the State Department would not have inherent conflicts of interest. The 1998 legislation also made related changes intended to emphasize that the nation's international postal policy supported fair competition.

I attended the March 2000 hearing in my capacity as subcommittee staff director, chaired by former Representative John McHugh. I also was the chief of staff for Representative McHugh when the PAEA was enacted in 2006. The PAEA reinforced the 1998 legislation's emphasis on promoting fairness, competition, and collaboration. I have been at the Postal Regulatory Commission since 2011 and have served as Acting Chairman since December 2014. I know the policies embodied in both pieces of legislation and have seen how they are playing out in practice. My testimony will draw the Subcommittee's attention to successful aspects of the current approach, but also address important factors that hinder efforts to achieve U.S. objectives with respect to terminal dues.

## Current U.S. Negotiating Framework vis a vis the Commission's Section 407(c)(1) Responsibilities

The current negotiating framework, established by the PAEA, retains the State Department as the lead U.S. negotiator for terminal dues, but reinforces and enhances the 1998 legislation's emphasis on extensive collaboration in several significant ways. Most significantly, PAEA established clear policy for the United States to, among other goals, "promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services… ."

State's consultation with other interested parties is now mandatory, not optional, and State must also work with an advisory committee on Postal and Delivery established under the Federal Advisory Committee Act (FACA). Both changes are intended to ensure that State receives ongoing input from others, including industry, on the development of U.S. terminal dues policies. The PAEA also established a new role for the Commission by directing the Secretary of State to request, and the Commission to provide, views on the consistency of terminal dues proposals with modern rate regulation.

Specifically, according to 39 U.S.C. § 407(c)(1), "Before concluding any treaty, convention, or amendment that establishes a rate or classification for a product subject to subchapter I of chapter 36, the Secretary of State shall request the Postal Regulatory Commission to submit its views on whether such rate or classification is consistent with the standards and criteria established by the Commission under section 3622." Section 3622 establishes the objectives and factors for rate setting of Market Dominant mail products.

Section 407(c)(2) provides that the Secretary of State shall ensure that every treaty, convention, or amendment is consistent with the Commission's views. The sole exception is if the Secretary of State does not believe that the views are in the foreign policy or national security interest of the United States. In such case, the Secretary is to provide the Commission with a written determination and explanation.

The Commission's approach to its responsibility for providing the Secretary of State with its views has evolved, due largely to ongoing internal discussions on how to improve transparency and accountability. An important development was the Commission's establishment of a Public Inquiry docket prior to the 2012 UPU Congress to seek public comment on the principles that should guide the development of its views to the Secretary of State. In addition, the Commission has developed an internal analytical framework for evaluating proposals to ensure a consistent, even-handed approach and timely submission to the Secretary of State. The Commission also posts view-related materials on its website.

The next UPU Congress will convene in September 2016. The Commission anticipates continuing its recent practice of establishing a Public Inquiry docket as a forum for public input. The Commission will continue to explore ways of fostering greater transparency.

The Commission actively participates in the formal advisory committee that the State Department has established. I attended the most recent FACA meeting in my new capacity as Acting Chairman of the Commission and to express my interest in and appreciation for the work the Committee does.

The Commission reviews the U.S. Postal Service's international contracts before they take effect. It also conducts post-implementation review, and related analyses of international data, as part of the Commission's ACD.

## The Role of the UPU

The State Department carries out terminal dues negotiations under the umbrella of the UPU. The UPU was founded by international treaty in 1874, when postal systems were the dominant domestic and almost exclusive international communications medium. It has been a United Nation's specialized agency since 1947.

The UPU serves as the primary global forum, among other things, for establishing terminal dues among member countries. The U.S. has been a member of the UPU since its inception and, until the 1998 legislation, the Postmaster General or the U.S. Postal Service (institutionally) negotiated on behalf of the U.S. in all UPU meetings.

The UPU operates on a four-year cycle, which begins with a "Congress" open to all 192 member countries. Congress is the main forum for voting on matters related to terminal dues, which are part of the UPU Acts. However, preparations for a Congress begin well before the meeting convenes, and work continues in follow-up meetings. The main vehicle for revisions to the terminal dues provisions is a document referred to as a "proposal."

## Assessment of the PAEA primarily as it relates to the Commission's Section 407(1) Responsibilities

Since enactment of the PAEA, the Secretary of State has requested — and the Commission has transmitted — views on terminal dues proposals slated for consideration at the 2008 and 2012 UPU Congresses. The Commission's review led to the conclusion that no terminal dues proposals that were adopted by those UPU Congresses were inconsistent with Section 3622. However, the most recent view stated that, “The Commission continues to adhere to the position that the U.S. Government should actively promote terminal dues rates in the UPU that are closely aligned with domestic postage rates and provide sufficient cost coverage to handle, transport and deliver inbound international mail for the Postal Service. Terminal dues rates are available only to designated operators … . The Commission encourages the Department of State to move the UPU to adopt a terminal dues system that is more cost-based, country-specific, and just and reasonable.”

In terms of the U.S. policy of cost-based terminal dues rates, the 2012 terminal dues proposals that were adopted provided for increases in the U.S. Postal Service’s terminal dues rates from most industrialized countries by roughly 13 percent annually from 2014 to 2017. Under the PAEA, the Commission is mandated to conduct an annual review, referred to as an Annual Compliance Determination (ACD), to ensure all U.S. Postal Service rates charged during the previous fiscal year were in compliance with the law. As stated in the Commission's most recent ACD (covering FY 2014), continued terminal dues increases, if accompanied by cost containment, should have a positive effect on Inbound Letter Post revenue and costs coverage during the same period.

The 2012 UPU terminal dues proposals also moved the terminal dues rates paid by developing countries and territories, including Hong Kong, Singapore, and the People's Republic of China, closer to the rates paid among industrialized countries. The Commission recognizes that in the UPU environment, this also represents progress toward cost-based rates.

However, a February 25, 2014, Audit Report issued by the U.S. Postal Service's Office of the Inspector General (OIG) sounds a cautionary note on the U.S. Postal Service's costing methodology for inbound small packets from China sent under a bilateral agreement, mainly as it relates to pricing strategies. The OIG notes that although China Post sorts and dispatches small packets separately, the U.S. Postal Service does not calculate the cost data for these small packets separately from other letter post items or report it separately to the Commission.

## Other Commission Efforts

In each ACD issued since the first in FY 2007, the Commission has recommended that the U.S. Postal Service actively pursue the negotiation of more bilateral or multilateral terminal dues agreements that improve cost coverage. Bilateral or multilateral agreements typically allow the U.S. Postal Service to negotiate rates that are higher than UPU terminal dues.

As the Commission noted in its most recent ACD, "The Commission recognizes that the pricing regime for the Inbound Letter Post product, based upon the current UPU formula, results in noncompensatory terminal dues rates. As a result, domestic mailers continue to subsidize the entry of Inbound Letter Post by foreign mailers who use the same postal infrastructure but bear none of the burden of contributing to its institutional cost."

The Commission also recommended in the FY 2014 ACD that the U.S. Postal Service make concerted efforts to improve service quality for inbound international letter mail. The reason for this recommendation was that due to its performance measurement results for the last several years, the U.S. Postal Service has lost potential terminal dues revenue because terminal dues are based on performance.

In addition, as the Commission's understanding of the UPU terminal dues system grew, it realized that while some work had been done to estimate the potential magnitude of distortions related to insufficient compensation for inbound letter post, no one had analyzed the wider effects of the terminal dues system through the lens of economic theory. Therefore, last year the Commission contracted with Copenhagen Economics to address terminal issues from this perspective. The Commission published the Report on September 30, 2014. The findings were presented at a public briefing the Commission convened on November 17, 2014.

The principal findings of the Copenhagen Economics Report are:

- The application of different terminal dues to designated operators and non-designated operators distorts competition among first-mile delivery operators (service providers who compete for the business of the original senders (or shippers) of mail.

- Terminal dues set at a level below the cost of last-mile activities distort competition among last-mile operators.

- The current terminal dues system increases demand for delivery services covered by the system relative to services outside the system, leading to excessive use of packet delivery services at the expense of parcel delivery services.

- The current terminal dues structure leads to distortions in mail and trade flows by increasing demand for less efficient cross-border delivery of letter post (which includes small packets), especially from certain countries.

- Terminal dues create financial transfers between delivery operators which, in turn, may cause distortionary spillover effects (such as higher taxes to fund the postal operator's loss).

- Alternative systems, such as Remuneration of International Mails (REIMS) and bilateral agreements, create many of the same distortions as the UPU system.

- An optimal and non-distortionary solution would require that terminal dues (the price for last-mile handling of *cross-border* letter post items) are set equal to the price for *domestic* and cross-border letters. To cope with political concerns, this solution should be complemented with an aid program for developing countries.

- To prevent foreclosure of as-efficient non-designated operators, non-distortionary terminal dues must be at least as high as the long-run average incremental cost of last-mile activities.

The Report's bottom line solution is that a postal administration should charge its customers similar prices for similar services, irrespective a mailer's country of origin or its status as private or public operator.

**Broader Perspective**

The 1999 UPU Beijing Congress committed to a goal of achieving a cost-based terminal dues system by 2005. I have re-read the transcript of the March 2000 hearing, where U.S. participation at that Congress was discussed, and have considered post-hearing developments.

The transcript shows that the Commission's testimony at the March 2000 hearing described in positive terms the initial steps the State Department had taken, in anticipation of the 1999 UPU Beijing Congress, to encourage broad reform at the UPU and to promote a collaborative approach to developing U.S positions on terminal dues for the UPU's 1999 Beijing Congress. The Commission observed that the Beijing Congress had taken an important step forward in terms of U.S. policy because the rates in the new terminal dues agreement would be more cost based than the prevailing terminal dues. It also noted that State believed the new agreement would begin the process of having terminal dues based on costs (with domestic rates as a proxy for costs), as this would make them more compensatory. This points to some initial success, on the part of the State Department, in advancing the objectives of the 1998 legislation.

On the other hand, the transcript also shows that Ambassador Southwick, the State Department official negotiating on behalf of the U.S. at the Beijing Congress, reserved the right not to apply the UPU 1999 terminal dues provisions. In addition, some of the witnesses at the March 2000 hearing emphasized that there were fundamental issues with the terminal dues system in which the U.S. participates, especially as it affects fairness and competition. For example, they noted that under the UPU Acts, discounted terminal dues rates are available only to the U.S. Postal Service and other posts, not private operators. This means that the U.S. Postal Service can have outbound mail delivered at substantial discounts by foreign posts. As discounted rates for foreign postal delivery are reflected in the U.S. Postal Service's international mail rates, the U.S. Postal Service enjoys a commercial advantage.

The witnesses also observed that the U.S. efforts in Beijing had not changed the fact that the terminal dues system allows the Postal Service to deliver inbound letter post at a substantial discount compared to rates charged to American mailers for the same domestic product. For U.S. mailers, the implicit cost of the discount to inbound is paid indirectly by domestic mailers, who are captive customers of the U.S. Postal Service, but private operators can’t force domestic customers to cover such costs.

Finally, the witnesses noted that the practice of trading discounts for postal delivery is protected by the UPU, and could otherwise be considered anticompetitive.

The Copenhagen Economics Report shows that the problems those witnesses identified have not been resolved.

In addition, since the March 2000 hearing, the Internet, email, and cell phones have revolutionized patterns of personal and business communication, so conventional personal correspondence and remittance payments have declined as a proportion of the domestic and international mail streams. Moreover, as e-commerce has exploded, small packets are entering the international mail stream because they offer a convenient means of shipping consumer goods, especially relatively low-cost, lightweight items.

The Commission's technical staff has prepared an analysis that shows the impact of these developments in sharp relief. In FY 1999, the average weight per piece was

1.7 ounces for U.S. inbound letter post. In FY 2014, the average weight was 4.7 ounces. This can only mean that the inbound letter post mail stream included very few small packets in FY 1999, but is now dominated by small packets.

There have been three additional UPU Congresses since March 2000, but the goal of the 1999 UPU Congress to achieve cost-based terminal dues has not been realized. In fact, after the State Department reserved the right not to apply the UPU 1999 terminal dues agreement, the UPU revised its rules in 2004 to prevent such action. Instead, member countries dissatisfied with UPU terminal dues rates are prohibited from taking a reservation against the terminal dues provision and instead allowed to attempt to enter into bilateral or multilateral agreements with other countries.

Despite several adjustments, the terminal dues formula still does not generate cost-based rates. Moreover, terminal dues for industrialized countries are subject to a rate cap. This rate cap keeps terminal dues artificially low, thereby preventing them from reaching full cost coverage for most postal operators. It also affects private operators' ability to compete because the terminal dues are lower than domestic rates.

I think the only conclusion that most onlookers unfamiliar with the UPU terminal dues system would come to is that progress on terminal dues has been glacial since the previous subcommittee hearing 15 years ago. Indeed, a decade and a half later, the Commission concluded in its most recent ACD issued less than three months ago, on March 27, 2015: "The Commission recognizes that the pricing regime for the Inbound Letter Post product, based upon the current UPU formula, results in noncompensatory terminal dues rates. As a result, domestic mailers continue to subsidize the entry of Inbound Letter Post by foreign mailers who use the same postal infrastructure but bear none of the burden of contributing to its institutional cost."

## Recommendations on Terminal Dues

In September 2014, the private sector submitted three terminal dues proposals to the State Department's FACA. These proposals would require industrialized countries in the UPU to introduce non-discriminatory, country-specific terminal dues rates based on domestic rates in 2018. These rates would also be available to private delivery operators and customers. The private sector proposals also call for a plan for a global system of country-specific, non-discriminatory terminal dues rates for the 2020 Congress. The Commission suggests that the Advisory Committee's recently-approved subcommittee on terminal dues carefully examine these proposals and the Copenhagen Economics Report.

The Copenhagen Economics Report is a groundbreaking effort, as no one had yet analyzed the wider effects of the terminal dues system through the lens of economic theory. The Copenhagen Economics Report should be closely examined by postal policymakers. Its key solution — *similar prices for similar services regardless of country of origin or status as private or public operator* — shows that terminal dues do not have to remain an intractable problem. The Report engendered much discussion of its findings and recommendations at the Commission's November public briefing.

## Conclusion

Thank you for the opportunity to testify today. I am happy to answer any questions.