



# OFFICE OF INSPECTOR GENERAL

## UNITED STATES POSTAL SERVICE

### Terminal Dues in the Age of Ecommerce

LA POSTE

POSTA  
KENYA  
Touching lives

Post Office

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### Executive Summary

Posts pay terminal dues to compensate one another for international deliveries. When someone mails a letter or small package to another country, the postal administration in the sender's country receives the postage and pays terminal dues to the destination post for its share of processing and delivery. Terminal dues rates are painstakingly negotiated at the Universal Postal Union (UPU) among its 192 member countries every 4 years — and implemented about 18 months after that — using the principle of one country, one vote. Because of the complexity and length of the UPU decision-making process, significant changes to the terminal dues system may take many years to unfold.

The terminal dues system was, by design, based upon setting rates by majority agreement rather than reflecting the true economic cost of inbound international mail delivery. The goal was to provide posts with some compensation for international mail while also supporting a single worldwide postal network by subsidizing developing country participation in international universal service. Terminal dues originated at a time when postal traffic was primarily letter based and controlled almost exclusively by posts. Today, however, international letter volume is in decline, and the postal channel is carrying more and more ecommerce package volume, including lightweight packets flowing through the terminal dues stream. This highly competitive market, where postal operators compete with a variety of private sector providers, intensifies existing distortions resulting from the current rate system that does not reflect actual domestic processing and delivery costs and ignores efficient market forces to which private carriers are subject.

The explosive growth in ecommerce traffic, especially from China, has greatly elevated concerns about the system's unfairness. As international ecommerce packages experience rapid growth, destination posts with higher postal rates are protesting that terminal dues do not cover their costs. U.S. online retailers have argued that competitors in China can send packages to the United States through China Post at lower rates than American businesses are required to pay in their own country. Finally, private sector shipping companies maintain that terminal dues are only available to postal operators, providing an unfair competitive advantage. Stakeholders expressed all these concerns in a U.S. House Subcommittee on Government Operations hearing on June 16, 2015.

The U.S. Postal Service Office of Inspector General (OIG) researched terminal dues, with a particular focus on the China to U.S. corridor, to examine concerns and assess the impact of terminal dues distortions in the international small package market. Our research shows that

- The terminal dues received by the U.S. Postal Service do not fully cover costs, leading to a loss on inbound mail and small packages; and
- Terminal dues create winners and losers. In certain instances, low terminal dues benefit China Post and Chinese online retailers in the lightweight, low-value package segment at the expense of the U.S. Postal Service and American retailers.

Our research also found, however, that the advantages to posts and e-merchants in low terminal dues countries only go so far:

- In segments other than lightweight packets, such as heavier, higher-value packages requiring additional services, the rate advantage of low terminal dues posts like China Post decreases.
- Despite the price advantage that low terminal dues afford China Post, other carriers and consolidators operating in Asia still effectively compete in the Chinese market by providing better service and through direct entry into the U.S. mail processing system.
- Evolving innovation in cross-border logistics and the rise of alternatives to the terminal dues channel mean that the competitive impact of lower UPU terminal dues, paid by certain countries like China, is less significant than it may appear. Nevertheless, terminal dues remain distortionary, and reform is a necessity.

In the long term, the terminal dues system should reflect the true cost of inbound delivery. In the interim, the United States should continue to work with the UPU to support the separation of competitive small packages containing merchandise from documents and letters. While letters would continue to fall under terminal dues, small packages would be subject to self-declared rates that reflect cost and are available to all — posts, competitors, and shippers alike.

The bigger issue is the increasing irrelevancy of the international terminal dues channel in an age of ecommerce because it fails to meet customer demands for speed and reliability. Efforts to ensure this channel's responsiveness should not only include fixes to terminal dues remuneration but also, in parallel, measures to improve the service quality of cross-border packages. The Postal Service should champion reform to an increasingly anachronistic terminal dues system. Otherwise, it risks becoming an international ecommerce provider of last resort for a residual product that does not reflect associated costs or provide the speed and quality consumers demand.

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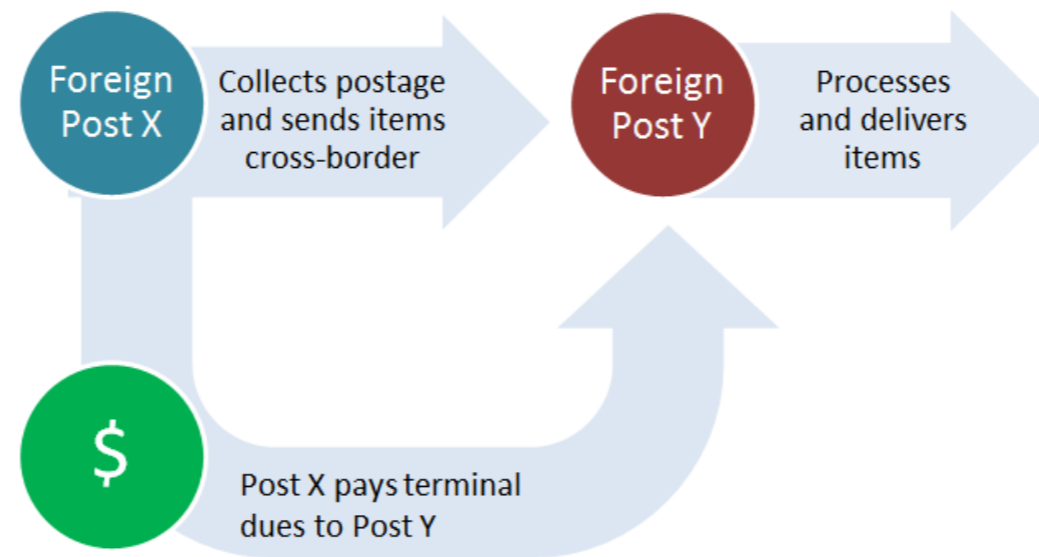
# Observations

## Introduction

### The Terminal Dues Framework

Posts pay terminal dues to compensate one another for the international delivery of letters, flats, or small packages up to 2 kilograms (4.4 pounds).<sup>1</sup> Figure 1 describes the process. Terminal dues are negotiated as an intergovernmental agreement among the 192 member countries of the Universal Postal Union (UPU) every 4 years.<sup>2</sup>

**Figure 1: Terminal Dues Framework**



Source: OIG graphic.

Until 1969, terminal dues did not exist; the receiving post bore the entire cost of sorting, processing, and delivering the foreign customer's item.<sup>3</sup> The terminal dues system's goals were to provide posts with some compensation for their delivery of inbound international mail and to support a single worldwide postal network. As a result, it funded improvements to the postal infrastructure in developing countries. Terminal dues, therefore, by design, were based upon setting rates by majority agreement rather than reflecting true economic costs.

As posts became more commercial, they began taking advantage of the arbitrage opportunities of terminal dues to compete with private sector providers and other posts on outbound mail.<sup>4</sup> Governments and some posts started to discuss UPU remuneration reform to improve the cost coverage for inbound delivery of international mail. In 1999, aligning terminal dues with delivery costs officially became the UPU's long-term goal. To allow a smooth transition, a two-tier structure consisting of developing and industrialized countries (now called "transition" and "target" countries, respectively) emerged. Posts located in lower-income

<sup>1</sup> The formal UPU term for a small package under 2 kilograms (4.4 pounds) is a small packet.

<sup>2</sup> The next UPU Congress will be held in September 2016 in Istanbul.

<sup>3</sup> International mail exchanges, prior to 1969, functioned as a barter system based on a mutual agreement among posts to reciprocally deliver their respective inbound mail for free.

<sup>4</sup> For detailed definitions and analysis of the operational, legal, and financial effects of arbitrage in international mail on the Postal Service at the turn of the century, see Battelle, *Joint Study on Article 43*, study prepared for the U.S. Postal Service, the U.S. Department of State, and the Postal Rate Commission, May 9, 2002, <http://www.state.gov/documents/organization/25206.pdf>.

countries such as India or Morocco generally would pay lower terminal dues than posts in industrialized countries such as the United States or France. In other words, industrialized countries would continue to subsidize developing countries. Although the goal was to improve fairness, the unintended outcome was distortions caused by an artificial compensation system.

### The Distortive Effects of Terminal Dues

As terminal dues rates do not reflect costs and differ for industrialized countries and developing countries, the terminal dues system inherently generates a number of market distortions. At the request of the Postal Regulatory Commission (PRC), Copenhagen Economics defined, analyzed, and quantified some of these distortions.<sup>5</sup> (See [Appendix A](#) for a description of the distortions.)

Copenhagen Economics shows that the system of terminal dues creates winners and losers. First, posts can win or lose according to how terminal dues compare to the cost of delivery and domestic prices. For instance, the U.S. Postal Service “loses” on mail flows from China because the terminal dues it receives do not cover its costs. However, the Postal Service “wins” on flows to Norway, where the terminal dues rates are much lower than domestic rates. Second, terminal dues discriminate between national posts and other operators, which cannot directly access the below-cost rates afforded by terminal dues. Third, terminal dues rates can create distortions in the market for goods by favoring retailers shipping small packages from some countries rather than others, or by favoring online retailers abroad with free or low-price shipping over local brick-and-mortar stores. Finally, terminal dues also create opportunities for arbitrage as when, for example, a shipper chooses to ship through a low terminal dues country to take advantage of favorable international shipping rates.

### The Changing International Mail Market

Today’s competitive shipping environment and international mail and package flows are very different from when the terminal dues framework was originally developed. Until recently, international mail was a slow-growth market of mainly letters and documents. Posts and international consolidators were competing for a share of the international bulk mail market — bank statements, annual reports, or advertising mail. Between fiscal years (FYs) 2009 and 2014, however, the Postal Service’s total international letter mail volume declined 27 percent.<sup>6</sup>

The fast worldwide growth of cross-border ecommerce packages, a segment projected to increase at 27 percent per year, has partially offset the precipitous decline in international letter volume.<sup>7</sup> Much of this growth is in the business-to-consumer segment. PayPal estimates that cross-border purchases by American shoppers, already around \$41 billion in 2013, will double between 2013 and 2018, to \$80 billion.<sup>8</sup>

Ecommerce growth has also intensified competition for UPU member posts, competitors, and integrators in the small package marketplace. In this fast changing environment, delinking rates from cost undermines efficient market forces. The resulting distortions potentially affect not only postal operators, who support the terminal dues system, but also other market participants such as competitors, online retailers, and consumers.

5 Henrik Ballebye Okholm, Anna Möller Boivie, Simon Edkins, and Jimmy Gårdebrink, *Quantification of Financial Transfers Caused by Universal Postal Union Terminal Dues: Final Report*, Copenhagen Economics, November 3, 2015, [http://www.prc.gov/sites/default/files/papers/Quantification%20of%20financial%20transfers%20caused%20by%20Universal%20Postal%20Union%20terminal%20dues\\_final%20report.pdf](http://www.prc.gov/sites/default/files/papers/Quantification%20of%20financial%20transfers%20caused%20by%20Universal%20Postal%20Union%20terminal%20dues_final%20report.pdf) and Henrik Ballebye Okholm, Anna Möller Boivie, Nina Russell, and Jacek Przybyszewski, *The Economics of Terminal Dues: Final Report*, Copenhagen Economics, September 30, 2014, <http://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/6/266/0/The%20Economics%20of%20Terminal%20Dues.pdf>.

6 Postal Service data, inbound and outbound volume combined.

7 “Cross-border Ecommerce to Reach \$1 Trillion in 2020,” *Alizila.com*, June 11, 2015, <http://www.alizila.com/report-cross-border-ecommerce-reach-1-trillion-2020-charts>.

8 PayPal, *Modern Spice Routes – The Cultural Impact and Economic Opportunity of Cross-Border Shopping*, July 2013, [https://www.paypalobjects.com/webstatic/en\\_TW/mktg/pdf/PayPal-ModernSpiceRoutes\\_6markets\\_Eng.pdf](https://www.paypalobjects.com/webstatic/en_TW/mktg/pdf/PayPal-ModernSpiceRoutes_6markets_Eng.pdf).

## Disruptions Are More Acute in the Asia-U.S. Corridor

The growth of cross-border ecommerce and the resulting disruptions from terminal dues distortions are more acute in the Asia to U.S. corridor. First, inbound postal traffic in this corridor has, in recent years, been loss making. Low underlying terminal dues are a vestige of China's developing nation status.

Second, the Asia to U.S. market is large and very competitive: the U.S. Postal Service Office of Inspector General (OIG) has identified at least 18 operators sending small ecommerce packages from China to the United States. The Postal Service has created a special inbound ePacket product with its own rate higher than terminal dues. The ePacket is designed for small lightweight ecommerce packages and includes extra services like basic tracking. As an example of the growth in this corridor, the number of ePackets sent from China Post to the Postal Service has grown more than [REDACTED] percent per year since 2012.<sup>9</sup> As a result of the increasing size of small package traffic, any distortions due to terminal dues will have a larger financial impact on this corridor than on smaller, less strategic flows.

## Terminal Dues: Analysis of Commonly-Held Criticisms

Given these new market dynamics, concerns have increased over the impact of terminal dues on the Postal Service, postal stakeholders, and the U.S. business community.<sup>10</sup> Indeed, many of the concerns about distortions have been an object of debate for several decades. Nonetheless, the lack of publicly available data has often limited the scope and impact of most, if not all, research conducted in this area.

The OIG concentrated on the key criticisms that emerged from the hearing on terminal dues convened by the U.S. House of Representatives' Subcommittee on Government Operations in June 2015. The following assessment discusses each concern to determine its validity and materiality. Overall, the OIG analysis confirms that the terminal dues system indeed creates winners and losers. Moreover, the slow pace of terminal dues reform increasingly causes customers to bypass not only the UPU terminal dues remuneration channel (for instance, through bilateral agreements), but also the international post-to-post supply chain through alternative solutions (for example, third-party logistics providers and integrators). These alternatives unravel the terminal dues system itself, underlining the need for swift and comprehensive reform.

## Terminal Dues Are below Cost, and Some Posts Subsidize Others

Sixteen years into a reform effort, the terminal dues system continues the status quo of some posts subsidizing others. A recent study estimated that in 2014 industrialized posts such as the Postal Service undercharged for inbound letter and small package delivery from both industrialized and developing countries by around \$2.1 billion per year.<sup>11</sup>

These undercharges resulted in the Postal Service losing \$75 million in FY 2014 delivering inbound letters and small packages at UPU terminal dues rates as shown in Table 1.<sup>12</sup> Starting in 2014 through 2017, the Postal Service will receive a 13 percent yearly

9 OIG analysis of Postal Service data on ePacket volumes from China.

10 As part of this study, the OIG interviewed or solicited input from the Postal Service, the PRC, the U.S. Department of State, congressional staffers, the UPU's International Bureau, international postal operators, international consolidators, a market research firm, and U.S.-based online retailers and ecommerce platforms.

11 James I. Campbell, Jr., "A Revised Estimate of the Distortive Effects of UPU Terminal Dues, 2014–2017," (conference paper, 23rd Conference on Postal and Delivery Economics, Center for Research in Regulated Industries, Athens, Greece, May 29, 2015), p. A-30. Campbell's estimates use 70 percent of the equivalent domestic retail rate as a proxy for the cost of processing and delivery. This is based on the UPU's guidelines for setting terminal dues; however, the final terminal dues rates also include other factors. Special Drawing Rights (SDRs) converted at the rate of 1 SDR = 1.400 U.S. dollars.

12 Postal Regulatory Commission, *Annual Compliance Determination Report, Fiscal Year 2014*, March 27, 2015, <http://www.prc.gov/sites/default/files/reports/FY%202014%20ACD.pdf>, p. 53. Table 1 sources include OIG, *International Terminal Dues*, Report No. MS-WP-14-002, March 7, 2014, [http://www.uspsoig.gov/sites/default/files/document-library-files/2015/ms-wp-14-002\\_0.pdf](http://www.uspsoig.gov/sites/default/files/document-library-files/2015/ms-wp-14-002_0.pdf), p. 3, and U.S. Postal Service, *Cost and Revenue Analysis Report, FY 2014*, <http://about.usps.com/who-we-are/financials/cost-revenue-analysis-reports/fy2014.xls>.

increase on inbound remuneration from target (industrialized) countries.<sup>13</sup> This will bring the Postal Service significant additional revenue, but may still fall short of fully compensatory inbound rates.<sup>14</sup> The PRC has recommended continuing to improve the cost coverage.<sup>15</sup>

**Table 1: Postal Service’s Profits and Losses — Inbound and Outbound Mail**

Market-Dominant Products Subject to Terminal Dues*	(\$ millions)					Total
	FY 2010	FY 2011	FY 2012	FY 2013†	FY 2014	
Inbound International Single-Piece Letter Post Loss	(\$53)	(\$36)	(\$65)	(\$79)	(\$75)	(\$308)
Outbound First-Class Mail International Contribution	327	209	227	136	119	\$1,018
<b>Net Results for Inbound and Outbound</b>	<b>\$274</b>	<b>\$173</b>	<b>\$162</b>	<b>\$57</b>	<b>\$44</b>	<b>\$710</b>

\* Includes letters, flats, and small packages. Excludes inbound and outbound mail subject to bilateral agreements and competitive products such as Priority Mail International, International Surface Airlift (ISAL), and International Priority Airmail (IPA).

† International First-Class parcels were shifted to the First-Class Packages International Service competitive category as of January 27, 2013. This accounts for a large part of the decline in contribution from FY 2012-FY 2013.

Source: OIG, *International Terminal Dues White Paper*, and the Postal Service, *Cost and Revenue Analysis Report: FY 2014*.

Several elements affect the level of the subsidies, but three key factors stand out.

### ***Unfairness of the Two-Tier Country System***

The classification of countries in terminal dues into two broad tiers has not kept pace with patterns of economic growth. As of 2015, the lower terminal dues transition country category, established to help developing economies, still includes 140 countries, including the so-called BRICS (Brazil, Russia, India, China, and South Africa). In this way, the Postal Service will have subsidized posts for many years that, in some cases, have not necessarily needed such support.

Forty of these countries, including all of the BRICS except for India, will join the target tier next year. However, moving these countries to the target category may not immediately lead to significant terminal dues payment increases. The UPU Congress will approve new rates, for the period from 2018 to 2021, next year — meaning implementation is 2 to 6 years after a decision. The new target countries may continue to have an advantage during this period.

13 U.S. Postal Service, “Statement of Randy S. Miskanic Before the Subcommittee on Government Operations,” U.S. House of Representatives, June 16, 2015, <https://oversight.house.gov/wp-content/uploads/2015/06/Mr.-Miskanic-Statement-Bio.pdf>, p. 3.

14 One of the factors the PRC is required to take into account in its regulatory system for market dominant products is that each product bear the costs attributable to it. 39 U.S.C. § 3622(c)(2) (2012). The U.S. Department of State has the primary authority to conduct foreign policy with respect to international postal services. 39 U.S.C. §§ 407(b)(1)-(2). The Department is required to take into account the PRC’s views on market dominant rates prior to concluding any international agreement affecting such rates, in order to ensure consistency with Section 3622. 39 U.S.C. §§ 407(c)(1)-(2). The department may conclude such an agreement notwithstanding the PRC’s views, however, if and to the extent that consistency with the PRC’s views is “not in the foreign policy or national security interest” of the United States. (The Department must provide the PRC with a written explanation for its determination.) 39 U.S.C. § 407(c)(2).

15 In the PRC’s most recent Annual Compliance Determination, the PRC recommended that the Postal Service continue to negotiate more compensatory agreements with foreign postal operators in the upcoming fiscal year and that efforts continue to develop a more compensatory UPU terminal dues formula for 2018 to 2021. The PRC notes that “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 costs.” PRC, *Annual Compliance Determination Report*, Fiscal Year 2014, <http://www.prc.gov/sites/default/files/reports/FY%202014%20ACD.pdf>, pp. 2, 53-54.

### ***Bilateral Rates Are Not a Panacea***

The Postal Service has attempted to improve cost coverage and reduce losses on inbound mail by negotiating bilateral agreements with other postal operators and creating special products tailored to ecommerce such as its ePacket product. The agreements provide for per-piece revenue higher than under UPU terminal dues in exchange for a higher level of value-added services such as delivery tracking and confirmation. According to OIG calculations, the net loss per ePacket sent from China to the United States decreased from \$1.10 in FY 2012 to █████ in FY 2014.<sup>16</sup> However, the Postal Service calculates that, according to its methodology newly broken out by shape, ePackets are now actually covering their costs.<sup>17</sup>

The recently renegotiated FY 2016 bilateral agreement between the Postal Service and China Post is aimed at further improving cost coverage for ePackets through higher terminal dues and reduced sorting costs.<sup>18</sup> However, negotiating bilateral agreements takes time and effort, and it is impractical for the Postal Service to negotiate them with every country. Moreover, the existence of UPU terminal dues rates can make it difficult to negotiate bilateral agreements, as postal operators can always choose to revert to these lower default terminal dues rates.

### ***The Problem with Price Caps***

Not all subsidies are from transition to target countries. Terminal dues paid to industrialized countries with higher domestic rates are capped, mitigating the impact of high domestic rates on international mailers. Consequently, the Postal Service and its international mailers benefit when mailing to countries with high domestic postal rates. One example is Norway, where the domestic rate to mail a 20-gram (0.7 ounce) letter will be \$1.32 in 2016.<sup>19</sup> The Postal Service is expected to remit just \$0.39 of the \$1.32 price to Norway Post, potentially creating a loss for Norway Post and benefiting the U.S. Postal Service and U.S. mailers. The OIG estimates that the distortion caused by the cap on this 20-gram mail piece will be \$0.53.<sup>20</sup>

Although removing caps would eliminate another source of distortion caused by terminal dues, it would have consequences for U.S. outbound mailers to countries with high domestic postal rates such as Norway. Net exporters of mail, including the Postal Service, will continue to benefit from the current system as long as terminal dues rates continue to differ substantially from domestic postal rates in destination countries. Net exporter posts win more from being undercharged on outbound mail than they lose by undercharging other posts on inbound mail (see [Table 1](#)). However, the decline of high-contribution outbound mail flows, coupled with the relative stability of inbound volumes, could turn the Postal Service into a net importer of mail. It is therefore more important than ever for the Postal Service to address the profitability of inbound flows.

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16 OIG, *Inbound China ePacket Costing Methodology*, Audit Report No. MS-AR-14-002, February 25, 2014, <https://www.uspsoidg.gov/sites/default/files/document-library-files/2015/ms-ar-14-002.pdf>, pp. 3, 8 and David C. Williams, “Oral Statement, Fair Competition in International Shipping, Hearing before the Subcommittee on Government Operations Committee on Oversight and Government Reform House of Representatives,” June 16, 2015, [https://www.uspsoidg.gov/sites/default/files/document-library-files/2015/06-16-2015\\_williams\\_statement.pdf](https://www.uspsoidg.gov/sites/default/files/document-library-files/2015/06-16-2015_williams_statement.pdf).

17 U.S. Postal Service, e-mail message to the author, October 8, 2015. The Postal Service used this methodology in its request for the PRC to approve its latest bilateral agreement with China, which took effect on October 1, 2015. The PRC approved the agreement.

18 The bilateral agreement also covers postal products not covered by terminal dues, such as packages and express (EMS) items.

19 Posten, *Price List Stamps*, valid from January 1, 2016, [http://www.posten.no/en/products-and-services/letter-services/\\_attachment/660232?\\_ts=150a9457950](http://www.posten.no/en/products-and-services/letter-services/_attachment/660232?_ts=150a9457950).

20 A common assumption of the current terminal dues system and other international postal agreements is that the cost of processing and delivering an international letter is 70 percent of the domestic retail price. Using this assumption, the terminal dues paid to Norway should be 70 percent of \$1.32, or \$0.92, in order to cover costs. Actual terminal dues paid to Norway in 2016 will amount to \$0.337 per item plus \$2.645 per kilogram. For a 20-gram letter, therefore, the Postal Service will pay \$0.39 to Norway. The distortion created by terminal dues will thus amount to \$0.92 minus \$0.39, or \$0.53. Calculations based on provisional quality-of-service-linked terminal dues rates for 2016, from the “UPU Circular 108,” UPU International Bureau, July 13, 2015. SDRs converted at the rate of 1 SDR = 1.400 U.S. dollars. Norwegian krone converted at the rate of 1 NOK = 0.12 U.S. dollars.

## Terminal Dues Rates Exclude Private Carriers, Creating a Clear Postal Advantage in Some Segments

Private sector operators cannot directly access the often lower UPU terminal dues for cross-border shipping, which are accessible only to designated national postal operators.<sup>21</sup> As a result, in countries paying low terminal dues, private sector companies cannot always compete on cross-border prices with the UPU member post.

Postal operators assert that access to terminal dues is a quid pro quo for the costly obligations they incur for providing universal service.<sup>22</sup> They also consider that allowing “non-posts” to access terminal dues would allow them “to select their outbound traffic routes so as to exploit unfairly disparities between nations” in a way posts cannot.<sup>23</sup> On the other hand, various commercial players contend that for competitive small package products, there is no justification economically for having to pay more than foreign posts to have their items delivered by postal operators under like conditions.

Terminal dues, together with the international transportation costs paid by the sending post, are indeed a major component of international postage rates, for not only letters but also small packages. Examining the high growth China-U.S. corridor, the OIG wanted to determine the extent to which lower terminal dues paid by China Post to the Postal Service affected the shipping market for commercial shippers such as U.S. online retailers. We conducted a number of interviews with posts and private sector carriers operating in China and examined comparative pricing data for different segments. (See [Appendix B](#) for pricing details.) The OIG found that

- **China Post’s Air Mail rates face no price-based competition.** Air Mail is underpinned by UPU terminal dues, which do not reflect true operational costs. Consequently, China Post has a price advantage over all other major competitors operating in China for small packages under 1 kilogram (2.2 pounds), especially at very low weights. While Air Mail is not suitable for many customers because it lacks tracking and has delivery standards between 10 and 20 days, some segments of customers still find the product appealing due to its lower price. The posts and carriers the OIG interviewed agreed that given Air Mail’s price advantage, shipping providers outside the UPU system have little market share in the customer segments sending low-value, low-weight, non-time sensitive packages. There is a clear postal advantage in these segments.
- **Speed and service are as important as price.** Commercial competitors are instead focusing their efforts on responding to customer demands for faster, more reliable, and better-tracked service. Our interviews suggest that speed and service are often as important as price. China Post’s generally lower shipping rates in the lightweight package segment have not deterred new players from providing more efficient and better integrated shipping options than the fragmented post-to-post channel. These players successfully compete on a variety of factors like delivery time, value-added services, reliability, bulk air transport, or global brand to provide a total value proposition rather than one based solely on lower shipping prices.<sup>24</sup>
- **The Postal Service’s highly successful ePacket product leverages terminal dues distortions.** Recognizing that the marketplace demands better tracking and speed, the Postal Service and China Post modified the latter’s base Air Mail offering through bilateral negotiations, to create an ePacket product in 2010. ePackets provide better service than Air Mail and include

21 Each UPU member country is responsible for designating their national postal operators who provide universal postal service. Private competitors can work with posts through their Extra-Territorial Offices of Exchange (ETOE) that take advantage of arbitrage opportunities. However, ETOE rates, although based on terminal dues, include a markup.

22 In addition, posts are required to provide additional payments of up to 20 percent of terminal dues for the UPU Quality of Service Fund. This is to help developing countries maintain their networks and to facilitate global exchange.

23 U.S. Postal Service, “U.S. Postal Service comments on terminal dues proposal submitted to the Federal Advisory Committee on International and Postal Delivery Services,” February 13, 2015, <http://www.state.gov/p/io/ipp/237132.htm>.

24 Today, companies willing to ship small packages to the United States can choose from dozens of shipping options. One website alone lists more than 50 different product options from at least 15 carriers: <https://www.pfcexpress.com>.

basic tracking. The OIG found this product lost \$1.10 per piece in 2012, but the Postal Service has been working on negotiating higher rates and estimates that ePackets are now covering their costs according to its methodology.<sup>25</sup> The ePacket rate has been tremendously successful. One package consulting company estimates that nearly half of eBay's sellers in China use this product to ship to the United States.<sup>26</sup> Yet regardless of whether the rate is covering costs, the rate is still negotiated with reference to terminal dues and only available to the postal operator, excluding competitors.

- **With access to terminal dues, competitors could gain share.** Even with the price advantage afforded to the postal channel by terminal dues, competitors are currently competing successfully against the posts in many segments on service and value-added features.<sup>27</sup> If these competitors could access terminal dues or ePacket rates, they could potentially gain an even greater market share.

In the China-U.S. channel, the advantage of terminal dues rates is clear, yet despite this advantage, other providers successfully compete by offering products that better meet the demand of today's consumers.

### U.S. Merchants' Competitiveness Can Be Harmed

In principle, the price advantages enjoyed by China Post can translate into low shipping and handling costs for U.S. shoppers buying from China-based retailers. In the 2014 audit mentioned above, the OIG found the FY 2012 cost of a typical domestic First-Class, single-piece package was \$1.10 higher than the rate China Post was paying under the bilateral agreement, which was based upon terminal dues rates plus costs associated with additional features.<sup>28</sup> Some postal stakeholders and media accounts have expressed a similar concern — that low terminal dues paid by China Post to the Postal Service made it cheaper to ship from China to the United States than *within* the United States. A Washington Post article, noting the OIG study, recounted the lost business of a small American Chinese toy reseller buying from a U.S. importer.<sup>29</sup> An eBay Community online forum, initiated in 2013, includes shippers' comments supporting such claims.<sup>30</sup>

As an small illustration of the issue, the OIG was able to purchase five items from Chinese sites at an average shipping and handling cost of \$1.60 per item (Box 1) — a rate American shippers could hardly match unless they decided to absorb shipping costs and offer free shipping to the consumer.

Nevertheless, the relative competitiveness of U.S. online retailers involves a number of factors beyond differences in shipping charges paid by shoppers. Other drivers include the retailer's brand name and reputation, the perceived reliability of the

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25 OIG, *Inbound China ePacket Costing Methodology*, pp. 3, 8 and David C. Williams, "Oral Statement."

26 "Low Cost Delivery from China to the USA Explained," Jet Worldwide, October 16, 2015, <http://www.jetworldwide.com/blog/low-cost-delivery-from-china-to-the-usa-explained>. See also footnote 17.

27 Interviews conducted have revealed a worrying lack of reliable market share data on the China to U.S. small packages market. OIG research helped identify a number of postal operators other than China Post active in China, including Asendia, bpost, Deutsche Post DHL (Global Mail), Hongkong Post, PostNL, SingPost, and Sweden Post. The China to U.S. small package market is also served by a number of express operators, such as DHL, UPS, FedEx, and SF Express as well as international consolidators such as International Bridge or Jet Worldwide.

28 First-Class Mail package costs excluding Windows Service were used. OIG, *Inbound China ePacket Costing Methodology*, pp. 3, 8 and David C. Williams, "Oral Statement."

29 The merchant explained that remote-controlled boats he first purchased for \$14 and sold online for \$35 could now be obtained for \$18, shipping included, from Chinese sites. Jeff Guo, "The Postal Service is Losing Millions a Year to Help you Buy Cheap Stuff from China," *Washington Post*, September 12, 2014, <http://www.washingtonpost.com/news/storyline/wp/2014/09/12/the-postal-service-is-losing-millions-a-year-to-help-you-buy-cheap-stuff-from-china/> and David Z. Morris, "The United Nations is helping subsidize Chinese shipping. Here's how," *Fortune*, March 11, 2015, <http://fortune.com/2015/03/11/united-nations-subsidy-chinese-shipping/>.

30 "Why is China to U.S. Shipping Cost so much Cheaper than U.S. to China?," <https://community.ebay.com/t5/Shipping>Returns/Why-is-China-to-U.S.-shipping-cost-so-much-cheaper-than-U.S.-to/td-p/2838826>.

Postal Service's domestic service versus China Post's international service, and the availability of return services.<sup>31</sup> It is difficult, therefore, to measure the economic harm, all things being equal.

A comprehensive and representative survey of small U.S. businesses would ultimately be needed to determine how much harm small businesses experience in relation to Chinese competitors benefiting from lower terminal dues. It should also be noted that although inexpensive deliveries from China may potentially penalize domestic retailers, they may benefit U.S. consumers who take advantage of the combination of inexpensive goods and low international shipping rates.

### **Despite the Price Advantage, the Terminal Dues Channel Is Losing Relevance**

As previously noted, competition is not only on rates, but also on speed, reliability, and other services such as tracking. For instance, for small packages of around 1 kilogram, entering the U.S. market at discounted domestic rates may offer a better price-to-delivery time combination than traditional international mail products.

Interviews the OIG conducted show that many international inbound shipments bypass the traditional terminal dues channel — mail pieces subject to UPU terminal dues or alternative bilateral remuneration accords. A significant, but unquantified, proportion of the shipments are entered as domestic items in the Postal Service's domestic facilities.<sup>32</sup> Private package delivery companies also deliver small inbound packages.

These alternative channels have emerged partly in response to the inefficiencies of the fragmented post-to-post supply chains governed by terminal dues.<sup>33</sup> Competitors were able to use integrators to provide seamless, end-to-end solutions at great value and with high service quality. Several factors make this possible: leveraging discounts for securing bulk air transportation, the ability to warehouse in trade-free zones, warehousing inventory in the United States for domestic direct entry, and customizing track and trace to give customers the visibility and speed they expect. A number of other sources corroborated these findings. For example, a foreign postal operator active in China said that a majority of its small packages were first shipped to Europe and then forwarded to the United States to be entered as domestic items.

### **Box 1: Case Study**

In August 2015, an OIG employee purchased five small low-cost items from a Chinese online marketplace and paid \$8.00 total in shipping and handling charges (about \$1.60 per item). Products ranged from 1.4 to 5 ounces. Although the employee submitted the purchase as a single order, the items shipped separately, and all through China Post.

Two shipments came by ePacket with delivery confirmation; three arrived as "small packet by air." Three had Shanghai return addresses while two had Shenzhen addresses; all were delivered to the Washington, DC, metropolitan area 10 to 15 days after the employee placed the order.

In the United States, small online retailers could ship the same items using the First Class Package Service — commercial base packages, single piece product. Rates would vary between \$2.04 (up to 2 ounces) and \$2.22 (4 to 5 ounces) with delivery of 2 to 3 days.

31 A blog entry by David Sasson, President and Co-founder of overstockart.com, a Kansas-based online retailer of oil paintings and frames, illustrates this point. Sasson discusses ePackets from China, and affirms that low shipping charges from Chinese retailers and marketplaces such as Alibaba put pressure on U.S. merchants, especially those dealing in inexpensive lightweight items. However he calls on U.S. merchants to take advantage of what he believes are Chinese merchants' weaknesses: comparatively poor transit times, reliability, customer service (for example, customer service representatives), and return solutions. David Sasson, "China-based merchants ship to U.S. for free," *Practical eCommerce*, April 13, 2015, <http://www.practicalecommerce.com/columns/hand-painted-ecommerce/86294-China-based-merchants-ship-to-U-S-for-free>.

32 These include the Postal Service's Network Distribution Centers (NDC), Sectional Center Facilities (SCF), and Destination Delivery Units (DDU).

33 A representative for a global online platform said his company sent only a very small percentage of small packages and packages to the United States through China Post, a result of what he said was the low reliability of China Post's service. The same interviewee also hinted at the future ability of large Chinese online retailers to bypass posts and other carriers altogether by directly negotiating with airlines and last-mile delivery companies in the destination country.

Another shipment path for cross-border merchandise is warehousing products in the United States prior to American customers placing orders online. Thus, the products are shipped to end customers from the United States, not from China. In fact, as value chains evolve and large online retailers further globalize, distinguishing “Chinese” from “American” merchants is increasingly difficult. One example is the Chinese online platform DH Gates that opened a California warehouse last September to stock “many types of products based on the needs of U.S. business buyers.”<sup>34</sup>

In the end, while some international posts (such as SingPost or Deutsche Post DHL) have been able to combine their terminal dues advantage *and* logistics skills to grow a profitable ecommerce business from China and other Asian countries, others have not yet succeeded. Absent a radical revamping of the terminal dues system, the latter are bound to continue to lose market share and business relevance to more nimble postal and private competitors on key cross-border ecommerce corridors.

### Current UPU Processes Stifle Adaptation to the Changing Market

The UPU system, as it is currently structured, is unable to move fast enough to adapt to the changing market dynamics described above. Similar to other United Nations agencies, the UPU operates on a one country, one vote principle, rooted in equal treatment for all member states. When votes are taken, therefore, no single member country is in theory more powerful than another. For this reason, coming to agreement can prove challenging; this is especially true for sensitive terminal dues issues that have a financial impact and affect countries differently.

In addition, the UPU only makes major decisions at its Congress, which occurs every 4 years. Terminal dues cannot be changed between two Congresses; moreover, the implementation of decisions taken in the Congresses does not occur until about 18 months *after* the Congress. For example, 2016 Congress decisions will apply to the period from 2018 to 2021. Slow decision-making and implementation does not adequately serve UPU members in a rapidly changing postal environment.

The results of interviews the OIG conducted with international posts and consolidators underscore that the UPU cannot afford to wait to move to a cost-based, commercial approach to small package remuneration. If the UPU does not act fast, the international postal network and supply chain model could lose its relevance altogether. This crisis of irrelevance is inevitable.

### The Path Forward

Both terminal dues and the existing UPU governance model need reform to become more agile — and to allow the world’s posts to compete in the present fast-paced cross-border ecommerce market.

Major U.S. stakeholders are aware and agree that the terminal dues system has to be changed. Among the stakeholders, there are different viewpoints about the principles that should guide this reform and the speed of implementation. In particular, while some argue that it should be gradual to allow the market and the U.S. international mailers to adjust to rate increases, others believe that further delaying change will aggravate the distortions as the influx of ecommerce packets into the postal international channel increases.<sup>35</sup> (See [Appendix C](#) for key reform proposals.)

<sup>34</sup> DHgate.com has said that it had “nearly 10 million global buyers from 230 countries and regions, with 1.2 million Chinese sellers offering 33 million products.” “DHgate.com opens new Los Angeles warehouse,” *Post and Parcel*, September 28, 2015, <http://postandparcel.info/68234/news/dhgate-com-opens-new-los-angeles-warehouse/>.

<sup>35</sup> In 2015, the U.S. Department of State’s Advisory Committee on International Postal and Delivery Services developed principles to guide the United States’ UPU policy. The committee’s membership includes representatives of the Postal Service, Postal Service competitors, consolidators, mailers, the PRC, other government agencies, and consultants. It recommended that remuneration for the exchange of international mail items (particularly flats, small packets, and packages) (1) be based on actual costs, country-specific (based on national law), and non-discriminatory; (2) make accommodation, based on need, for developing countries; (3) limit abuse of any preferential rates resulting from this accommodation; and (4) rely on self-declared rates that are subject to national regulation. Committee members also recommended that self-declared rates for small packets and packages apply “as early as practical” and be applied in parity with non-designated operators. For letters and flats, their recommended option was to increase price caps annually, subject to reasonable caps, up to the point where they are equal to domestic rates. Some members, including the Postal Service, opposed these two proposals, and suggested that a full financial impact analysis be conducted.

The OIG supports the view that a comprehensive reform is needed to address the existing market and economic distortions. The reform should lead to a terminal dues system that is based on country-specific, self-declared rates that cover postal operators' costs, are accessible to private sector providers, and have no predetermined caps and floors. Only a system that reflects true costs and is subject to efficient market forces could conceivably fix the imbalances generated by an artificial, non-compensatory mechanism.

However, such a comprehensive reform could take years to implement due to the cumbersome UPU decision-making process. In the short term, the United States should address robust ecommerce growth by continuing to work at the UPU with other countries on the ongoing effort to separate small packages, a highly competitive product area, from letters. While letters containing documents would still be subject to terminal dues, delivery charges for inbound packages containing merchandise up to 2 kilograms (4.4 pounds) should be freely set by each postal operator and accessible to all.

Simultaneously, the United States should support the move to a shorter, more flexible UPU decision-making process to accommodate a fast-changing package market. Finally, fixes to the terminal dues system should occur in parallel with measures to improve posts' quality of international delivery services. The relevance and resiliency of the global postal network depends on the ability to maintain high delivery standards. This imperative is more critical now as the advantage provided by low terminal dues weakens.

## Conclusion

The current terminal dues system facilitates international mail exchanges, but it also generates economic distortions because rates are set based on majority agreement and averages rather than actual country-specific direct costs. In particular, the system fails to cover many postal operators' processing and delivery costs for international inbound mail and hampers competition.

The rapid growth of highly competitive ecommerce packages in the postal terminal dues stream, paired with the decline in letter post volume, has heightened the longstanding debate about distortions from terminal dues. The UPU continues to try to address problems, but progress remains too slow. This slowness reflects the decision-making process of the UPU, which relies on the one country, one vote principle, a 4-year Congress cycle, and an 18-month implementation lag after decisions are made. Failure to act on reform, however, risks tying postal operators to an ineffective system that may offer low prices but cannot effectively meet customers' needs.

Initial reform should focus on separating ecommerce packages from letters in the terminal dues stream, improving cost coverage moving toward a shorter, more flexible UPU decision-making process, and pushing for measures to improve the quality of cross-border delivery. Ultimately, however, the UPU should implement fully compensatory, country-specific, self-declared terminal dues open to all providers. This should be accompanied by the better delivery standards and value-added services that consumers expect. These combined actions will ensure the long-term sustainability and competitiveness of the global cross-border postal network.

# Appendices

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# Appendix A: Distortions, Drivers, and Relevance of the Terminal Dues

The following chart describes six distortions that Copenhagen Economics found could result from the terminal dues system and their applicability to the United States.

Distortion	Driver of the Distortion	Comment	Applicability to the United States
Competition for last-mile handling of cross-border letter post items	Terminal dues below last-mile cost	Efficient delivery operators may not be able to compete with a receiving post charging below cost terminal dues.	Not directly applicable to products covered by U.S. Postal Service last-mile delivery monopoly.
Competition for first-mile handling of cross-border letter post items	Discrimination against operators other than posts	Operators other than the sending post pay more for last-mile activities than the post.	May affect competition on outbound mail from the United States.
Demand for delivery products within and outside the terminal dues system	Terminal dues below price of domestic last-mile activities	Distorted price signals may create inefficient distribution of service products.	Private operators may lose business to posts if low terminal dues create a higher than normal demand for cross-border postal packages, which depresses the demand for more expensive cross-border parcels handled by private operators outside the terminal dues system.
Too much cross-border traffic	Terminal dues below price of domestic last-mile activities	May increase the relative profitability of injecting mail in a foreign country.	There may be too much inbound mail inducted as international mail and paid at terminal dues versus inbound mail injected as domestic mail and paid at domestic bulk rates. This may negatively affect the Postal Service's total revenue and profit. If distortion leads to postage rates from a foreign country being lower than domestic U.S. rates, U.S. online shoppers may prefer to buy from foreign shippers than domestic ones, thereby affecting U.S. businesses.
Too much traffic from transition countries	Discrimination against operators in target system countries	May increase the relative profitability of injecting cross-border mail in a transition country.	The Postal Service may lose revenue if mail originating in a target country is paid at lower transitional system rates.
Transfer between delivery operators	Terminal dues below price of domestic last-mile activities	Non-alignment of compensation to costs creates winners and losers among designated operators.	The Postal Service wins on flows to high-cost (target) countries and loses on flows from low-cost (transition) countries. Overall, the U.S. Postal Service benefits because it is a net exporter of international mail.

Source: OIG analysis and Okholm et al., *Economics of Terminal Dues*, Copenhagen Economics, 2014.

## Appendix B: Competitive Analysis of the China to U.S. Small Package Market

To research the China to U.S. competitive marketplace, the OIG reached out to foreign posts and consolidators active in China. The analysis below is based on publicly available sources that compare commercial rates from a variety of providers. The OIG used the website [pfcexpress.com](http://pfcexpress.com), which allows retailers to enter a small package's weight, dimensions, and destination country. It displays the shipping options available by carrier, delivery time, rate, and features.<sup>36</sup> Wherever possible, this data was cross checked and compared to rates supplied to the OIG by an international consolidator and a market research company. These providers, however, asked that we keep their information confidential.

The commercial rates, summarized below, reflect discounts typically available to China-based retailers. They relate to three segments: basic, basic plus, and express, distinguished according to different delivery times and tracking features.<sup>37</sup>

### Three Main Segments

The basic shipping options available differ in terms of delivery time, features available (for example, tracking), and rates.

**Figure 2: Small Packages, China to the United States– Segmentation**

	Basic	Basic Plus	Express
Typical end-to-end delivery time	7-20 days	7- 20 days	Time definite 2-5 days
Added-value features	No tracking	Registered and/or tracking, delivery confirmation	Advanced tracking + other services
Rates influenced by terminal dues	Yes	Mixed •Yes (e.g., ePacket) •No (direct entry products)	No
Example	China Post Air Mail	China Post ePacket	FedEx, UPS, DHL Express

Source: OIG graphic.

The basic category includes the few products that do not feature any added-value features such as tracking. China Post's Air Mail product, based on UPU terminal dues rates, belongs to this category.

The second segment includes more expensive products with improved service and some form of tracking. This is a crowded market, where China Post's ePacket product, subject to bilateral terminal dues, competes with many postal operators and

<sup>36</sup> Offerings from international consolidators are not shown here. Confidential information gathered separately by the OIG shows they would not differ much from those of the international posts active in China.

<sup>37</sup> Data retrieved from PFC Express website, <http://www.pfcexpress.com/enorderindexNew.aspx>, October 27, 2015. The OIG did not try to collect information on additional services such as consulting, mail preparation, collection, fulfillment that shippers may have to pay on top of shipping rates that directly influence the choice of a carrier.

consolidators. In this segment, international postal operators typically aggregate small packages from disparate shippers in China then fly a bulk shipment to their global or regional hub (for example, Europe or Singapore). Next, packages are entered into the United States using one of two methods:

- **International terminal dues channel.** Packages go through the UPU postal network and are subject to postal customs clearance and terminal dues.
- **Direct entry.** Packages are flown as freight, cleared through commercial customs and entered directly as domestic mail, paid at domestic rates.

Third, the express segment, which is outside the letter mail and terminal dues system, offers a variety of more expensive, time-definite, high-value options.

## Comparison of Commercial Rates

**Table 2: Comparison of Select Commercial Rates — China to the United States**

(rates in U.S. dollars)		Transit time	Weight				
			50 g	100 g	200 g	500 g	1 kg
Basic	China Post Airmail	10-20 days	0.67	1.33	2.67	6.67	13.35
	DP DHL GM Packet	7-15 days	1.43	2.07	3.35	7.20	13.61
	Hongkong Post	7-14 days	0.75	1.49	2.98	7.46	14.92
Basic Plus	China Post Airmail registered*	10-20 days	1.97	2.68	4.10	8.36	15.46
	China Post eBay ePacket†	7-9 days	2.45	2.83	4.08	7.46	13.35
	Hongkong Post	7-14 days	3.02	3.85	5.50	10.44	18.68
	PostNL	7-14 days	4.07	4.60	5.67	8.87	14.21
	bpost	6-9 days	1.83	2.57	4.04	8.44	15.78
	SingPost	7-14 days	2.88	3.57	4.94	9.05	15.90
	Sweden Post	7-15 days	3.29	4.08	5.67	10.43	18.36
	Swiss Post Asendia	7-14 days	3.03	3.55	4.58	7.69	12.87
	U.S. Postal Service Priority – direct entry	5-7 days	5.02	5.02	5.02	9.03	15.70
Express	China Post EMS	5-8 days	19.09	19.09	19.09	19.09	24.86
	FedEx – International Express – Economy	4-7 days	20.06	20.06	20.06	20.06	23.09
	CN DHL	2-4 days	12.25	12.25	12.25	12.25	15.07
	UPS	3-4 days	24.40	24.40	24.40	24.40	28.23

\* Although registered mail is an added-value feature, the Postal Service no longer provides tracking on this product for flows from China.

† The rates of this ePacket product are based on the terminal dues set through bilateral agreement between the U.S. Postal Service and China Post.

Source: PFC Express web site, <http://www.pfcexpress.com/EnorderindexNew.aspx>, as of October 27, 2015.

Table 2 supports the main conclusions presented in this white paper:

- The UPU terminal dues advantage affords a price advantage. China Post Air Mail and Hongkong Post rates face virtually no competition in the basic segment up to 1 kilogram.<sup>38</sup> At 1 kilogram, however, the price advantage in this segment becomes less significant.
- In the “basic plus” segment, many players are able to compete on price or features with China Post’s ePacket product.
- At higher weight steps (for example, 1 kilogram) some express rates are comparable to those of the “basic plus” segment. This may signal that over time, regardless of the development of terminal dues rates, all postal competitors will need to provide faster and more reliable ecommerce shipping options if they are to remain relevant.

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38 Hongkong Post joined the higher-rate target system in 2010, while China Post will do so only next year (2016). This may explain the former’s higher rates.

## Appendix C: Short- and Long- Term UPU Reform Proposals

Several proposals for improving the UPU terminal dues system both short and long term, have been presented at the UPU or at meetings of the U.S. Department of State's Federal Advisory Committee on International Postal and Delivery Services. A description of some of the key proposals follows.<sup>39</sup>

### Proposal to Create Special Rates for Small Packets

For target countries, terminal dues are currently based on a formula that defines a per piece and weight rate based on two domestic rates: a 20-gram letter and a 175-gram flat. In practice, the cost structure of heavier items, which command heftier domestic rates, is under-represented.

One way to improve how terminal dues reflect costs is to develop special terminal dues rates for small packets. As of fall 2015, UPU members were defining parameters of such a pricing formula, as well as discussing the appropriate domestic rate(s) of reference.

### Proposal to Remove Caps

Although based on 70 percent of domestic rates, UPU terminal dues are restricted by the application of

- Caps to limit the impact of rate increases on mailers and sending posts, and
- Floor rates to ensure operators in the poorest countries get minimum revenue.

A number of UPU members, as well as U.S. private sector stakeholders, suggest eliminating the cap on international letters to better reflect domestic costs. Lifting these caps over several years on flows between target countries would be a major step towards ensuring cost coverage. The Postal Regulatory Commission (PRC) has indicated it would conduct a financial impact analysis.<sup>40</sup> On the outbound side, the Postal Service and the International Mailers' Association (IMAG) have maintained that removing caps may lead to significant increases in international postage rates.

There seems to be a broad agreement among stakeholders that floor rates should not be removed. In many developing economies, domestic tariffs are set according to social goals and do not cover costs. These countries need terminal dues higher than rates in support of global interoperability and postal network development.

### Proposal for Postal Operators in Industrialized Countries to Set Their Own Rates for Inbound Items

Governments and the UPU should not set terminal dues for mail and other postal items sent between industrialized countries. Instead, the postal operators in these industrialized countries should set their own rates, terms, and conditions for the delivery of items received from abroad, and these should be open to all carriers including non-UPU members.

### Proposal to Impose Limits on Ecommerce Volume That Would Otherwise Qualify at UPU Rates

Representatives of the U.S. private sector have proposed that each UPU country be able to impose "objectively reasonable limits" on the volume of ecommerce items that would otherwise qualify for delivery at UPU terminal dues rates. It would be up to

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<sup>39</sup> See also [footnote 35](#).

<sup>40</sup> Meeting of the U.S. Department of State Federal Advisory Committee on International Postal and Delivery Services held in Washington, D.C. on September 9, 2015.

the federal government to determine whether “UPU remuneration rates are creating substantial losses for the postal operator or substantial injury to domestic merchants.” If so, higher terminal dues rates would apply.<sup>41</sup>

## Proposal for Product Integration Plan

Postal operators have expressed the need to find an innovative solution to the problem of below-cost terminal dues for small ecommerce packages. “As the growth seems skewed towards lightweight low-value items,” a UPU working group recently argued that posts “should understand that sustainability will not be achieved if they keep handling and delivering [often at a loss] primarily low-weight items that private operators do not want to deliver.”<sup>42</sup>

Ongoing efforts spearheaded by the Belgian and Canadian posts, which lead the key UPU committee overseeing terminal dues and product offerings, aim to outline a new product classification system called the “Integrated Product Plan.”<sup>43</sup> A framework implementation work plan may be submitted to the 2016 UPU Istanbul Congress for approval. The long-standing distinction between “letters” (items up to 2 kilograms subject to terminal dues) and “parcels” (subject to self-declared inbound land rates) would be abolished. It would be replaced by two service categories differentiated by content regardless of weight: (1) documents and (2) goods or merchandise.

For all postal items containing goods instead of documents, new remuneration systems would be developed between 2017 and 2020.<sup>44</sup> For instance, cross-border ecommerce packets might be compensated according to rates set by the receiving post itself, no longer according to terminal dues. This would eliminate one of the main sources of terminal dues distortions. In addition, several levels of remuneration would be put in place to differentiate services according to speed and product attributes (for instance, the level of tracking or delivery confirmation).<sup>45</sup> However, it appears that the new system would not be open to operators other than national posts.

Implementing this plan may require significant changes to the UPU Convention as well as the laws of UPU member countries. These constraints could delay the entire process.

## Proposal to Move Remaining Transition Countries to the Target System

It has not yet been decided when the 100 remaining transition countries, those benefiting from subsidized terminal dues rates, will finally join the target system. The UPU recognized in 2012 that this should take a gradual approach, “in a way that the development opportunities offered therein are ensured and the risks of negative impacts are minimized.”<sup>46</sup> It is likely, therefore, that the transition to the target system, initiated in 1999, will not take place for many years from now.

## Proposal to Uncouple the Quality of Service Fund from Terminal Dues

Created in 1999, the Quality of Service Fund finances postal quality improvement projects from a markup on terminal dues paid to developing countries. Although not related to delivery costs, payments to the fund form an integral part of the terminal dues

41 James I. Campbell, Jr., “Principles the IPoDS Committee Should Recommend to Guide U.S. Policy in the Integration and Modernization Initiative at the UPU,” August 26, 2015.

42 UPU Postal Operations Council, Document No. POC C 3 GSIP 2015.3–Doc 3, 2015.

43 These two countries co-chair the UPU’s Postal Operations Council Committee 3, Physical Services.

44 In parallel, the UPU is introducing as a pilot test among posts that volunteer, a cross-border ecommerce package product called ECOMPRO. Remuneration for this product will be based on self-declared rates.

45 However, the definition of “self-declared rates” may be difficult in countries like the United States where posts typically have a number of domestic package or small package products that involve hundreds of rates based on weight, shape, presorting, barcoding, and distance.

46 UPU Congress Resolution C57/2012 in Universal Postal Union, *Decisions of the 2012 Doha Congress*, 2013, [http://www.upu.int/uploads/tx\\_sbdownloader/actsLastCongressActsEn.pdf](http://www.upu.int/uploads/tx_sbdownloader/actsLastCongressActsEn.pdf).

remittances paid by UPU members. Created to be temporary, the fund's existence has already been extended beyond its original sunset, and it constitutes the UPU's largest development aid mechanism. Although unlikely, a move to other funding sources would eliminate a minor form of terminal dues distortion.

### **Proposal to Modernize UPU Governance**

Many stakeholders the OIG interviewed expressed concerns that effective terminal dues reform also required changes in UPU governance. For instance, it has been suggested the organization's permanent decision-making bodies, the Postal Operations Council and the Council of Administration, be given the authority to adjust terminal dues rates between quadrennial Congresses.<sup>47</sup>

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<sup>47</sup> The UPU has undertaken a broader study on its future governance and the mission of its decision-making bodies.

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# Appendix E: Management's Comments

GISSELLE ELISA VALERA  
MANAGING DIRECTOR, GLOBAL BUSINESS  
AND VICE PRESIDENT



12/9/2015

Renee Sheehy  
Director  
RARC Central  
Risk Analysis Research

SUBJECT: Final Draft – Terminal Dues on the Age of E-Commerce

The United States Postal Service, in collaboration with the State Department and Postal Regulatory Commission, has been actively working within the Universal Postal Union (UPU) on most of the suggested changes to the current terminal dues system. In particular, regarding terminal dues proposals slated to go forward to the Istanbul Congress, the USPS has been an active proponent for the development of separate small packet rates, new caps and floors for these rates that take into consideration the commercial nature of this mail stream, increases to registered mail supplemental rates and the introduction of a tracked packet rate aimed to increase cost coverage on international letter mail.

Through its work with the Product Strategy and Integration Group (PSIG), the USPS has also been actively involved with crafting changes to the current UPU product matrix with a view of streamlining the products and making them more sustainable by eliminating the current silos which cause some of the rate distortions. USPS cannot change this situation unilaterally, and moreover, it is not the lead representative of the United States at the UPU.

A handwritten signature in black ink, appearing to read "Giselle Valera".

Giselle Valera

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