OFFICE OF
INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

International Terminal Dues White Paper

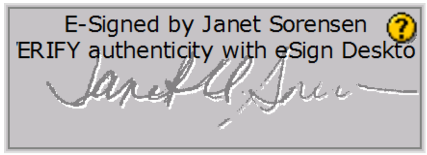
March 7, 2014

Prepared by: Office of Audit
Report Number: MS-WP-14-002

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

March 7, 2014

MEMORANDUM FOR: GISELLE E. VALERA
VICE PRESIDENT & MANAGING DIRECTOR,
GLOBAL BUSINESS



FROM: Janet M. Sorensen
Deputy Assistant Inspector General
for Revenue and Business

SUBJECT: International Terminal Dues
(Report Number MS-WP-14-002)

Attached are the results of our self-initiated review of International Terminal Dues rates and their impact on the U.S. Postal Service (Project Number 13RG034MS000). In this paper, we discuss the impact on the Postal Service of terminal dues rates set by the Universal Postal Union (UPU) and the effects of changes to terminal dues made at the September 2012 UPU Congress.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Joshua Bartzen, acting director, Sales & Marketing, or me at 703-248-2100.

Thank you in advance for your time and consideration.

Attachment

cc: Corporate Audit and Response Management

International Terminal Dues

Executive Summary

The U.S. Postal Service is the largest postal operator in the world and exchanges mail services with over 200 countries and territories. The Postal Service earns revenue when domestic customers send mail to foreign destinations and when foreign postal operators deliver mail from their countries to the U.S. In fiscal year (FY) 2013, the Postal Service earned over $3 billion from dispatching and delivering about 902 million international mailpieces. Each postal operator that receives mail[1] has the right to collect payment from the originating post to compensate for costs incurred to deliver that mail; these charges are called *terminal dues*.

The Universal Postal Union (UPU) oversees the exchange of mail between foreign countries. The UPU is an agency of the United Nations whose primary functions include setting policy and establishing rates every 4 years for mail products. These rates can vary by country classification as determined by the member countries at the UPU Congress. In addition, terminal dues rates are based on whether a country is a target country or a transition[2] country. For example, presently the U.S. and Germany are target countries and China and India are transition countries. The U.S. receives the lowest terminal dues rates among the target countries; that is, it receives the lowest fees from target countries sending mail to it. While China and India have a significant impact on the global economy, they are still considered transition countries and pay the lowest terminal dues rates, especially for lightweight mailpieces.

To offset the impact of low terminal dues rates, the Postal Service can negotiate separate (bilateral) agreements with countries to exchange international mail at higher rates. Currently, the Postal Service has many different types of bilateral agreements with multiple countries, ranging from comprehensive (multiple mail products) to product-specific.

Even with these international bilateral agreements, it is difficult for the Postal Service to cover the costs of delivering inbound market-dominant international mail subject to terminal dues.[3] For example, the loss for Inbound Single-Piece Letter Post was $79 million in FY 2013; however, outbound market-dominant international products made a positive contribution to the Postal Service's institutional costs (after U.S. domestic costs). In addition to the low terminal dues rates, there are several other factors that contribute to the losses for inbound international market-dominant products such as the overall decrease in letter volume and increases in cost per piece.

[1] International mail subject to payment for receipt from a foreign post (terminal dues) is defined as letter post that is a letter, flat, or parcel under 4 pounds, or 2 kilograms.
[2] Not all countries are at the same stage of development and there are significant variations in their mail volumes, postal rates, and cost absorption. The goal of the target system is to progressively incorporate all countries into a target system that already applies a more cost-based terminal dues system.
[3] International market-dominant products subject to terminal dues contain one outbound product and one inbound product: Outbound First-Class Mail International and Inbound International Single-Piece Letter Post.

In an effort to make terminal dues more equitable and cost-effective for all countries, UPU member countries agreed to make significant changes at the UPU Congress in September 2012. Specifically:

- Inbound terminal dues rates for the U.S. will increase by an average of 13 percent[4] each year from 2014 through 2017 due to the low U.S. inbound terminal dues rates in prior years. Other target countries, such as Germany and France — that already had the highest inbound terminal dues rate — will be subject to a 3 percent cap increase each year. Inbound terminal dues rates for new target countries and transition countries will increase by 6 percent[5] and 2.8 percent each year, respectively.

- The increase in foreign countries' inbound terminal dues rates also means the U.S. will pay higher terminal dues for its outbound mail to target countries, averaging a 3 percent increase each year from 2014 through 2017.

The Postal Service will enjoy a $[redacted] net gain over the next 4 years as a result of these changes in terminal dues rates. Therefore, the Postal Service should move closer to covering the cost of inbound international mail by 2017 and continue to contribute to institutional costs for outbound international mail.

[4] The 13 percent increase in terminal dues is calculated based on per kilogram and per item rates and items per kilogram for mail flow between target countries.
[5] The 6 percent increase is for terminal dues cap rates for mail flow to, from, and between new target countries.

TABLE OF CONTENTS

Introduction 1

Prior Terminal Dues System (2010 – 2013) 4

Current and Future Terminal Dues System (2014 – 2017)... 5

Conclusion 7

Appendix A: Country Classification List.. 8

Introduction

The U.S. Postal Service is the largest postal operator in the world and exchanges mail services with over 200 countries and territories. The Postal Service earns revenue when domestic customers send mail to foreign destinations and when foreign postal operators deliver mail from their countries to the U.S. The Postal Service earned over $3 billion in revenue in fiscal year (FY) 2013 from dispatching and delivering about 902 million international mailpieces. The Universal Postal Union (UPU) oversees the exchange of mail between foreign countries. Under the acts of the UPU, each postal operator that receives mail has the right to collect payment from the originating post to compensate for costs incurred to deliver that mail; these charges are called terminal dues.

THE UPU AND TERMINAL DUES

The UPU is a body of the United Nations and is the international organization that oversees the exchange of mail between countries. Its primary functions include setting policy and establishing rates for international mail products between postal operators. These rates, known as terminal dues, are intended to compensate the destination country for the transportation, handling, and delivery costs of letter post items from abroad.

There are five bodies within the UPU: the Congress, the Council of Administration, the Postal Operations Council, the Consultative Committee, and the International Bureau. Each has different functions and responsibilities. For example, the UPU Congress primarily focuses on broad policy issues. The Council of Administration has the power to approve proposals from the Postal Operations Council. The Postal Operations Council deals with the operational, economic, and commercial aspects of international postal service.

Without the UPU, each postal operator would have to negotiate separate agreements with every other foreign postal operator with which it wanted to exchange international mail. More importantly, without the UPU, countries could not be guaranteed mail service to and from nearly every signatory nation around the globe.

The terminal dues system was introduced in the 1969 UPU Congress in Tokyo as a simple way to compensate developing/transition countries for imbalances of mail volume. There has been a significant amount of work aimed at improving the system by moving toward covering the actual costs of each country’s individual mail flow.

Terminal dues have policy and regulatory aspects, which the Council of Administration oversees, and operational and financial aspects, which the Postal Operations Council handles. As a result, these two bodies jointly prepared a single UPU congressional proposal in 2012. To become effective, a proposal must be approved by a majority of the member countries represented at Congress and having the right to vote.[6] Each member country is entitled to one vote.[7]

The UPU member countries establish terminal dues rates based on a country's designation as a target or a transition country. Countries are classified into five major groups[8] with Group 1.1 consisting of the most developed countries. Further, the terminal dues rate a country charges can vary based on which countries it exchanges mail with. For example, the U.S. charged different terminal dues rates for inbound letter post sent from Germany (target country), Singapore (new target country), and China (transition country) in 2013.

Currently, there are 41 target countries, 36 new target countries, and 144 transition countries.[9] The UPU has established detailed and complex criteria to determine whether a country is a target or a transition country. One key factor in country classification is the Gross National Income (GNI) per capita.[10] Table 1 ranks the 10 countries with the highest GNIs in the world; however, four are classified as transition countries due to their low GNI per capita. Generally, transition countries are subject to lower terminal dues rates for lightweight mail items than target countries. See Appendix A for a detailed listing of target and transition countries.

Table 1: GNI in U.S. Dollars

Country	2012 GNI (in billions)	2012 GNI per capita ($)	Current Country Classification
U.S.	$16,430	$52,340	Target
China	$7,731	$5,720	Transition
Japan	$6,107	$47,880	Target
Germany	$3,625	$44,260	Target
France	$2,743	$41,750	Target
United Kingdom	$2,445	$38,670	Target
Brazil	$2,311	$11,630	Transition
Italy	$2,063	$33,860	Target
India	$1,955	$1,580	Transition
Russian Federation	$1,823	$12,700	Transition

Source: The World Bank and UPU documentation.

Additionally, the UPU has established floor and cap rates for terminal dues for mail exchanged between target countries. Floor rates apply to countries with low domestic postage rates and cap rates limit countries with high domestic postage rates to

[6] UPU Act, Article 21, Conditions of Approval of Proposals.
[7] UPU Act, Article 101.3, Organization and Convening of Congresses and Extraordinary Congresses.
[8] Group 1.1 contains countries that joined the target system prior to 2010, also known as target countries; Groups 1.2 and 2 contain countries that joined the target system in 2010 and 2012, also known as new target countries; and Groups 3, 4, and 5 contain transition countries.
[9] A country may contain multiple territories, which may be subject to different classification and terminal dues.
[10] The GNI per capita is an indicator of the average annual income available to an inhabitant of a country.

moderate the impact on terminal dues. For example, among most of the target countries,[11] the U.S. had the lowest rates of both 2012 domestic postage and 2013 terminal dues. Other countries constrained by the cap rates include Belgium and Denmark. Without the floor and cap mechanism, terminal dues rates would be less equitable.

Although the Postal Service, working with the Department of State (DOS) and the Postal Regulatory Commission (PRC), has one of the 192 votes in UPU actions, it also currently has a leadership role in the Letter Post Remuneration Group, which manages the operational and financial dimensions of the terminal dues system development process.

The Postal Accountability and Enhancement Act (PAEA) of 2006[12] identified U.S. agencies' roles with regard to international mail. Specifically, the DOS has the responsibility to formulate, coordinate, and oversee foreign policy related to international postal and delivery services. The PRC has the responsibility to provide advice on international agreements governing rates and classifications for market-dominant products and their consistency with statutory criteria for rate setting. The PAEA also requires the PRC to consult with the DOS on international postal policies.[13]

The Postal Service can increase revenue by seeking opportunities for new international competitive products. Unlike market-dominant products, which are restricted to UPU rates and often do not cover costs, competitive products must be priced to cover at least their attributable costs. The Postal Service may also enter into agreements with countries to govern the exchange of international products and services. Rates set forth in these agreements often exceed UPU rates because they provide additional services not mandated under UPU rules. Therefore, these agreements can increase revenue and also foster collaboration between two postal operators to provide additional products and services to meet customers' needs.

Even with these international bilateral agreements, it is difficult for the Postal Service to cover the cost of delivering inbound market-dominant international mail subject to terminal dues.[14] For example, the loss for inbound market-dominant international mail products was $79 million; however, outbound market-dominant international products made a positive contribution to institutional costs. In addition to the low terminal dues rates, there are several other factors that contribute to losses of inbound international market-dominant products, such as the overall decrease in letter volume and increases in mail processing costs (see Table 2).

[11] In 2013 terminal dues were based on the 2012 domestic postage rate for a 20 gram letter. Falkland and Pitcairn Islands were the only two target countries that had lower domestic postage rates than the U.S. in 2012.
[12] Public Law 109-435, December 20, 2006.
[13] To perform this responsibility, the DOS formed an advisory committee on international postal and delivery services. Committee members include representatives from the Postal Service, various government agencies, and companies in the mailing industry.
[14] International market dominant products subject to terminal dues contain one outbound product and one inbound product: Outbound First-Class Mail International and Inbound International Single-Piece Letter Post.

Table 2: Inbound and Outbound Market-Dominant Products Revenue/Loss Comparison in Millions

Market-Dominant Products Subject to Terminal Dues	FY 2013	FY 2012	FY 2011	FY 2010
Inbound International Single-Piece Letter Post	$(79)	$(65)	$(36)	$(53)
Outbound First-Class Mail International	136	227	209	327
Net Results for Inbound and Outbound	**$57**	**$162**	**$173**	**$274**

Source: Postal Service *Cost and Revenue Analysis* reports.

Prior Terminal Dues System (2010–2013)

The UPU's past formula for setting international terminal dues hurt the financial performance of U.S. international inbound mail. The UPU based its prior formula on the domestic postage rate for a 20 gram letter, a product for which the U.S. has the lowest postage rates among all target countries. As a result, the UPU-established inbound mail rates do not allow some international products to cover their costs as required. In addition, the UPU has established floor and cap rates to moderate the impact on terminal dues. See Table 3 for a terminal dues rates comparison between target countries.

HOW ARE TERMINAL DUES DETERMINED?

Terminal dues are determined by the UPU member countries, based on how a country is categorized. Country categories range from "transition" to "target" depending on factors such as GNI per capita and domestic postal rate. The U.S. is a target country and has the lowest rates among all target countries. China and India are examples of transition countries, and pay the lowest terminal dues rates.

Table 3: 2013 Terminal Dues Comparison

Country	2013 Terminal Dues Per Item	Floor or Cap
Belgium	$[redacted]	[redacted]
Canada	$[redacted]	[redacted]
Denmark	$[redacted]	[redacted]
Germany	$[redacted]	[redacted]
U.S.	$[redacted]	[redacted]

Source: UPU document and U.S. Postal Service Office of inspector General (OIG) calculation.
Note: The terminal dues in this chart are calculated based on items per kilogram of 12.16 and the currency exchange rate as of December 30, 2013.

Terminal dues are based on a country's classification as a target country or a transition country; however, this system creates some inequities. For example, the U.S. and Germany are target countries and China and India are transition countries. The U.S. has the lowest terminal dues rates among the target countries, which means it was the least expensive country for foreign target countries to mail to. In contrast, China and

India, which have a significant impact on the global economy, are still considered transition countries, and subject to the lowest terminal dues rates, especially for lightweight mailpieces.

Current and Future Terminal Dues System (2014–2017)

> ***THE 2012 DOHA CONGRESS***
>
> *At its quadrennial Congress in Doha, Qatar in 2012, the UPU approved a new formula for setting rates for international products and services that are closer to actual costs. These new rates began to be phased in starting in January 2014 and will be finalized by 2017. For the U.S., this 4-year period will result in an increase of over 50 percent for international inbound letter post rates from target countries.*

At the September 2012 UPU Congress, member countries established new business rules for a new formula to produce terminal dues that are closer to actual costs.

Rates will increase for both target and transition system countries through 2017 as the result of the revised formula. Specifically, the new formula included domestic postage rates for both 20 gram and 175 gram letters. While the U.S. still has the lowest domestic postage rate for a 20 gram letter among all the target countries, the domestic postage rate for a 175 gram letter is relatively high. Therefore, on balance, the revised formula benefits the U.S. See Table 4 for a terminal dues rates comparison among target countries.

Table 4: 2014 Terminal Dues Rates Comparison

Country	2014 Terminal Dues Per Item	Cap or Floor
Belgium	$[redacted]	[redacted]
Canada	$[redacted]	[redacted]
Denmark	$[redacted]	[redacted]
Germany	$[redacted]	[redacted]
U.S.	$[redacted]	[redacted]

Source: UPU documentation and OIG calculation.
Note: The terminal dues in this chart are calculated based on items per kilogram of 12.16 and the currency exchange rate as of December 30, 2013.

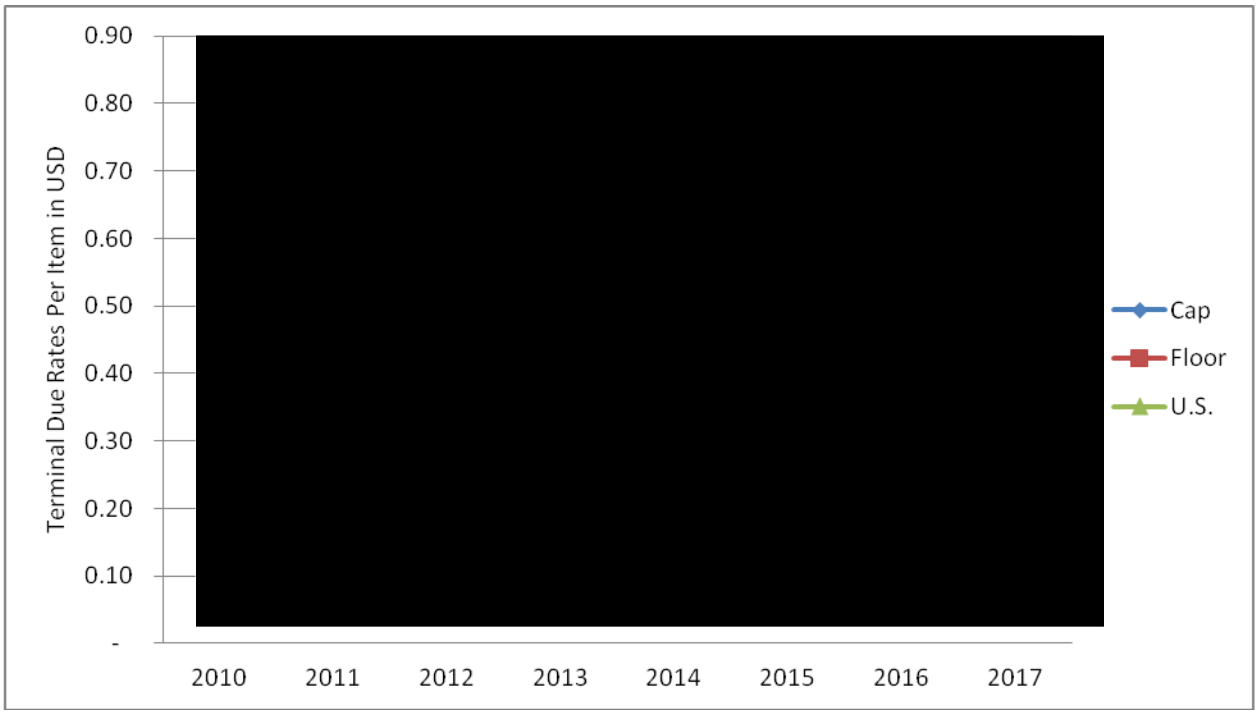
The percentage of rate increase varies by country. For example, inbound terminal dues rates for the U.S. will increase by an average of 13 percent[15] each year from 2014 through 2017, due to the low U.S inbound terminal dues rates in prior years. Other target countries, such as Germany and France, which already have the highest inbound terminal dues rate, will be subject to a 3 percent cap increase each year. Inbound terminal dues rates for new target and transition countries will also increase by an average of 6 percent[16] and 2.8 percent each year, respectively. Foreign countries'

[15] The 13 percent increase in terminal dues is calculated based on per kilogram and per item rates and items per kilogram for mail flow between target countries.
[16] The 6 percent increase is for terminal dues cap rates for mail flow to, from, and between new target countries.

terminal dues rates increases also mean the U.S. will pay higher terminal dues to target countries for its outbound mail, averaging a 3 percent increase each year from 2014 through 2017. While these recent changes will likely increase net revenue for the Postal Service, they will take more than 4 years to fully implemented.

Figure 1 compares the UPU terminal dues floor and cap rates as a result of recent UPU congressional revisions. U.S. terminal dues rates were at the floor level during the prior cycle; however, these rates will move closer to the cap rates by 2017.

Figure 1: Terminal Dues Rates for Mail Flows between Target Countries



Source: UPU documentation.
Note: The terminal dues rates in this graph are calculated based on items per kilogram of 12.16 and the currency exchange rate as of December 30, 2013.

Other changes approved during the most recent UPU Congress will result in certain countries moving from the transition system to the target system. Countries that do not agree with the migration schedule will need to follow the UPU appeals process. This migration could ultimately provide increased revenue for the Postal Service as these countries begin paying the higher target system terminal dues rates.

However, migration to the target system will take years to fully implement. For example, some transition countries (such as China and Russia) are scheduled to move from the transition system to the target system in 2016. Other countries that have a major impact on the global economy (such as India and the Philippines) will continue to be identified as transition countries, paying the lowest UPU rates, especially for lightweight mail items.

Conclusion

In an effort to make terminal dues more equitable and cost-effective for all countries, the UPU member countries agreed to significant changes in September 2012. As a result, both U.S. inbound and outbound terminal dues rates will increase an average of 13 and 3 percent, respectively, each year from 2014 through 2017. The overall impact of these increases for both inbound and outbound international mail will be about $[redacted] in additional revenue for the Postal Service over the next 4 years. Therefore, the Postal Service should move closer to cost coverage for inbound international mail by 2017 and continue to provide a positive contribution to institutional costs for outbound international mail.

Appendix A: Country Classification List

Countries and Territories					
Group 1.1	**Group 1.2**	**Group 2**	**Group 3**	**Group 4**	**Group 5**
Australia	Anguilla	Antigua and Barbuda	Argentina	Albania	Afghanistan
Austria	Aruba	Bahrain (Kingdom)	Belarus	Algeria	Angola
Belgium	Bahamas	Barbados	Bosnia and	Armenia	Bangladesh
Canada	Bermuda	Brunei Darussalam	Herzegovina	Ascension	Benin
Denmark	British Virgin Islands	Cook Islands	Botswana	Azerbaijan	Bhutan
Falkland Islands	Cayman Islands	Croatia	Brazil	Belize	Burkina Faso
Faroe Islands	Hong Kong	Curacao	Bulgaria (Republic)	Bolivia	Burundi
Finland	Kuwait	Cyprus	Chile	Cameroon	Cambodia
France	Qatar	Czech Republic	China (People's	Cape Verde	Central African Republic
French Polynesia	Singapore	Dominica	Republic)	Colombia	Chad
Germany	Slovenia	Estonia	Costa Rica	Congo Republic	Comoros
Gibraltar	Turks and Caicos	Grenada	Cuba	Cote d'Ivoire (Republic)	Congo (Democratic
Greece	Islands	Hungary	Fiji	Korea (Democratic	Republic)
Greenland	United Arab Emirates	Korea (Republic)	Gabon	People's Republic)	Djibouti
Guernsey		Macao, China	Jamaica	Dominican Republic	Equatorial Guinea
Iceland		Malta	Kazakhstan	Ecuador	Eritrea
Ireland		Montserrat	Latvia	Egypt	Ethiopia
Isle of Man		Poland	Lebanon	El Salvador	Gambia
Israel		St. Kitts and Nevis	Libya	Georgia	Guinea
Italy		Saudi Arabia	Lithuania	Ghana	Guinea-Bissau
Japan		Saint Martin	Malaysia	Guatemala	Haiti
Jersey		Slovakia	Mauritius	Guyana	Kiribati
Liechtenstein		Trinidad and Tobago	Mexico	Honduras (Republic)	Lao (People’s
Luxembourg			Montenegro	India	Democratic Republic)
Monaco			Nauru	Indonesia	Lesotho
Netherlands			Niue	Iran (Islamic Republic)	Liberia
New Caledonia			Oman	Iraq	Madagascar
New Zealand			Panama (Republic)	Jordan	Malawi
Norfolk Island			Romania	Kenya	Mali
Norway			Russian Federation	Kyrgyzstan	Mauritania
Pitcairn Islands			Saint Lucia	Maldives	Mozambique
Portugal			Saint Vincent and the	Moldova	Myanmar
San Marino			Grenadines	Mongolia	Nepal
Spain			Serbia	Morocco	Niger
Sweden			Seychelles	Namibia	Palestine

Countries and Territories					
Group 1.1	**Group 1.2**	**Group 2**	**Group 3**	**Group 4**	**Group 5**
Switzerland Tristan Da Cunha United Kingdom U.S. Vatican Wallis and Futuna Islands			South Africa Suriname Thailand Former Yugoslav Republic of Macedonia Turkey Ukraine Uruguay Venezuela (Bolivarian Republic)	Nicaragua Nigeria Pakistan Papua New Guinea Paraguay Peru Philippines Sri Lanka St. Helena Swaziland Syrian Arab Rep. Tajikistan Tokelau Tonga Tunisia Turkmenistan Samoa Uzbekistan Vietnam Zimbabwe	Rwanda Sao Tome and Principe Senegal Sierra Leone Solomon Islands Somalia South Sudan Sudan Tanzania (United Republic) Timor-Leste (Democratic Republic) Togo Tuvalu Uganda Vanuatu Western Samoa Yemen Zambia

Source: UPU.