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## A Brief Overview of the History of the UPU Terminal Dues System

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As the UPU considers changes in its compensation system, it may be useful reflect briefly on how the UPU compensation system has evolved over the years.

Broadly, the compensation system has gone through four periods of development.

The first period was from 1875, when the UPU was founded, to 1964, almost a century that included fifteen Congresses.

In this period, there was no monetary compensation for delivery of inbound mail. Compensation was the product of a barter system. Each post office delivered inbound mail in return for the right to have its outbound mail delivered.

There were two fundamental problems with this barter arrangement. First some post offices received more inbound mail than they sent out. The net exporters benefitted and the net importers lost. As early as 1906, Italy observed that it received 325,000 more letters than it sent out. Italy advocated some sort of compensation system but was unsuccessful. The other problem was that the barter system encouraged remail. Therefore, in the 1924 Stockholm Congress the UPU first adopted a prohibition against ABA remail.

The second period in the development of the UPU compensation system lasted from 1969 to 1984, a span of four Congresses. In this period, the UPU introduced terminal dues payments, but that actual amounts were arbitrary and unrelated to any economic basis.

What brought the end to the pure barter system was an increase in UPU membership. The new members were mostly net importers, and they added to the demand for an explicit payment system. The first terminal dues charge was adopted by the 1969 Tokyo Congress. The amount of compensation was one-half gold franc (SDR 0.163) per kilogram. This was a completely arbitrary amount. Despite five years of study, the Executive Council had been unable to discover an economically reasonable basis for terminal dues.

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<sup>1</sup> This paper expresses the personal views of the author only and should not be construed as the views of any client or other party.

The arbitrary charge of 1969 Convention was arbitrary tripled by the 1974 Congress and then arbitrarily tripled again in the 1979 Congress. In the 1984 Congress, the major industrialized countries joined forces to keep the increase in terminal dues to an equally arbitrary 45 percent.

The third period of compensation development took place in the decade from the 1989 to 1999 and included three Congresses. In this period, the UPU compensation system was shaped by postal concerns about remail and concerns of competition authorities about restrictions on remail.

The rise of remail was due mainly to improvements in air transportation. It became easier and cheaper for large companies to tender international mail directly to a foreign post office instead of the national post office. In 1986, the US liberalized outbound remail, in large part due to the urging of US antitrust authorities. Suddenly, post offices were competing with one another to become hubs for the regional distribution of foreign remail.

Many postal officials felt that competition between post offices was destructive. In April 1987, the British Post Office convened a meeting of sixteen major post offices from Europe and North America to find a way to restrain remail. This group developed a three-part strategy. First, adopt a new terminal dues system that included an item charge as well as a kilogram charge to replace the UPU's kilogram-only charge. The item charge was intended to drive up the cost of letter remail. Second, enforce the anti-remail provision of the UPU Convention. Third, promote a "code of good conduct" among post offices. In practice, this amounted to a pledge not to do business with private carriers tendering large amounts of foreign remail.

The item-kilogram rate developed in these meetings was put into effect in 1988 and became known at the "CEPT agreement" because it was later endorsed by the Conference of European Posts and Telecommunications Administrations.

The CEPT agreement applied only to intra-European mail. Supporters of the CEPT agreement also urged the UPU to apply these measures globally. As a result, the 1989 Washington Congress of the UPU adopted a new approach towards terminal dues and remail. The new UPU approach was based directly on the CEPT agreement.

The CEPT approach was controversial. Competition authorities in both the United States and Europe objected that it distorted and restrained legitimate competition. In Europe, the post offices were forced to replace the CEPT agreement with a new agreement that aligned terminal dues with domestic postage rates. This was the REIMS 2 agreement, approved by the European Commission in 1999.

The UPU also came under increasing pressure from competition authorities to align terminal dues with the postage rates in the destination countries. The result was the 1999 UPU Convention adopted by the Beijing Congress. The 1999 Convention pledged that the UPU

would adopt a “country-specific” terminal dues system for industrialized countries by 2005, the end of the next cycle. Country-specific terminal dues would also be applied to all other countries as soon as possible. As an interim measure, the 1999 Congress adopted a temporary terminal dues system similar to the CEPT agreement that applied only for the first three years of the five-year cycle. The Postal Operations Council was directed to prepare a plan by 2003 for the transition to country-specific terminal dues.

The fourth period of UPU compensation development has lasted from 2004 to the present and includes the results of four Congresses. This has been a period of increasing elaboration of the temporary terminal dues system adopted by the 1999 Beijing Congress but without progress towards country-specific terminal dues.

This fourth period began with highly contentious meetings of the POC in 2002 and 2003. In these meetings, the POC decided not to develop a plan for transition to country-specific terminal dues. Instead the POC continued the temporary CEPT-like terminal dues system adopted by the Beijing Congress and called upon future Congresses to introduce a country-specific system.

The next four Congresses followed this approach. Each Congress has refined and elaborated the temporary terminal dues system of the 1999 Convention without fundamentally changing it. And each Congress has called upon the following Congress to move towards a true country-specific terminal dues.

Although the current terminal dues system is vastly more sophisticated than the 1988 CEPT agreement, it is fundamentally similar. Uniform caps and floors, defined by per item and per kilogram charges, have replaced the single CEPT formula, but they have the same effect. The anti-remail measures of 1988 have been strengthened by anti-ETOE rules. The code of good conduct has been transformed into a prohibition against the use of UPU documentation by private carriers and limits on the assignment of IMPC codes. As a result, twenty years after the Beijing Congress, virtually no country charges terminal dues that are truly aligned with domestic postage rates and restraints on competition have been reinforced.

If we now look back over these four periods of compensation development in the UPU, it seems to me that three points stand out.

First, this is not so much a history of evolution as of continuity. The UPU compensation system today has the same fundamental weaknesses as it did in 1875. Compensation is uniform across countries with very different postage rates and costs of delivery. As a result, the compensation system benefits net exporters at the expense of net importers. This is unfair and economically distortive. In many cases the compensation rates are too low compared domestic postage. This creates strong incentives for inefficient arbitrage and remail. The flaws in the UPU compensation system are more than mere technical issues amenable to technical solutions. They are encoded into the DNA of the UPU. If governments of the UPU wish to adapt the UPU compensation system to the twenty-first century, they

must first appreciate how fundamental is the link between compensation and the original concept of UPU and the single postal territory.

Second, when all of the mathematical elaborations are stripped away, the current UPU terminal dues system is essentially a more sophisticated version of 1988 CEPT system. There is no doubt that the current UPU compensation system, like the 1988 CEPT system, is inconsistent with the principles of the competition laws in the major countries. This is not so much a legal issue as a policy issue. For these countries, the competition laws are designed to serve fundamental economic and public purposes. The underlying policies of the competition laws are at least as fundamental to society as the benefits of international postal services. To preserve the public benefits of the UPU in the future, the UPU needs to find a way to reform its compensation system so that it is consistent with the fundamental economic policies of the major countries.

Third, the UPU compensation system has never been based on sound economic considerations. It has always been based on a political process in which the most powerful countries are able to benefit at the expense of other countries.