



January 11, 2006

Letter to the Editor
PostCom Bulletin
1901 N. Fort Myer Drive Suite 401
Arlington, VA 22209-1609

To the Editor:

Rick Merritt would like the world to be very simple. In a recent PostCom commentary, Merritt charged that the Postal Service's productivity numbers are a sham and that postal management is not taking costs out of the system. You would think an astute observer of the Postal Service would know better, but in his opinion piece last month he seems to have lost his way.

He says don't believe postal managers when they say they have increased productivity and taken \$5 billion in costs out the nation's mail system.

The reason he cites are that we use "a homegrown" economic formula for determining productivity instead of a "more generally accepted measurement of productivity" which divides revenues by compensation expenses, which would show productivity has decreased by 2.3 percent since august of 2004. As for cost cutting, he claims expenses were up in 2005 despite the "windfall" of \$3.1 billion from reform of the Civil Service Retirement System contribution methodology.

We are not sure where he gets his economic formula for determining productivity, but the formula we use, Total Factor Productivity (TFP), is conceptually the same as the Department of Labor's Bureau of Labor Statistics Multi Factor Productivity (MFP) formula that measures productivity of the U.S. economy. Each measure is based on a common base of academic research.

What we do no other organization does, because operating the world's largest postal service enterprise is not your local delivery business. How we measure our operations goes beyond just revenues and expenses. TFP includes all factors of production and measures the growth in the ratio of outputs and the inputs, or resources, expended in producing those outputs. By tracking outputs and resource usage, TFP provides a historical measure of efficiency.

The Postal Service's main outputs are mail volumes and servicing an expanding delivery network. To account for variations in resources used to process different types of mail, TFP weights each mail type according to its workload content. The weighting is determined by factors such as size, weight, mailer preparation including barcoding and presorting. In addition to labor, TFP also measures capital and materials inputs, such as mechanized and automated equipment, facilities, transportation, and other non-personnel costs.

Even while we add two million new deliveries every year, we have been able to absorb these increases and hold postage rates steady for more than three years. That has been achieved by improving operational efficiency. In fiscal year 2005, we achieved a record sixth consecutive year of positive TFP resulting in the equivalent of more than \$700 million in cost savings. Yes, Mr.

Merritt, we delivered on a five-year commitment to reduce costs by \$5 billion, a full year ahead of schedule.

While it is true that 2005 expenses were \$2.4 million over the previous year because of higher compensation and energy costs, the \$3.1 billion savings resulting from the changes CSRS law rightly should redound to the benefit of the mailing public since it was generated from postal ratepayers.

Further, were it not for the \$27 billion transfer of military service retirement costs previously paid by the Treasury Department, according to the Congressional Budget Office, there would be more than \$22 billion in the Postal Service Retiree Health Benefit Fund at the end of 2006.

At some point, Congress and the President might approve legislation to have the Postal Service become the only agency of the government to fully pre-fund retiree health benefits. Today, we are the only agency directly funding our employee retirement systems.

But the fact remains that without the need to continue to generate the \$3 billion for an escrow account for as yet undetermined purpose, we still would have been able to maintain steady rates for a fourth year because of sound postal management.

I recommend checking our annual report, where you will find that the primary driver of compensation costs is health benefits. As allowed under law, we applied for Medicare Part D reimbursement for drug benefits provided to our retirees. This would have reduced compensation costs by \$250 million per year.

Despite what Mr. Merritt conjures up to be postal reality, any fair reading of our financial and annual reports will see what the truth is.

As Mr. Merritt should know, sometimes looking at the world in simple terms, may give you simple, but incorrect answers.

Sincerely,



Gerald J. McKiernan
Manager, Media Relations