AN ANALYSIS OF THE POTENTIAL BUDGETARY IMPACTS OF CERTAIN PROPOSALS RECOMMENDED BY THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL: TASK FORCE REPORT ON FEDERAL PERSONNEL MANAGEMENT

Special Study

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I. REDUCE CIVIL SERVICE RETIREMENT BENEFITS

BACKGROUND. The Civil Service Retirement (CSR) system now covers 2.7 million active federal workers (including some 600 million employees of the U.S. Postal Service) and 1.8 million beneficiaries. Participation in CSR is mandatory--regardless of contributions to the Social Security system--for most federal employees and requires a payroll withholding fixed by law at 7 percent of salary. The size of an individual's CSR annuity depends on his or her average final salary (three years of highest earnings) and total years of government service, including military service, if certain conditions are satisfied, and unused sick leave. The annuity, as a percentage of final salary, increases with the length of government service--in general, 16.25 percent after the first 10 years of service and an additional two percentage points per year thereafter. Under current law, CSR enrollees may draw an unreduced pension at age 55, if they have at least 30 years of service, and their benefits will be adjusted for inflation through annual cost-of-living increases.

The recently enacted Social Security Amendments of 1983 extend Social Security coverage to new federal employees hired on or after January 1, 1984; however, the amendments did not affect mandatory participation in CSR or the benefits it provides. Consequently, newly hired workers will contribute 13.7 percent of their federal salaries to deferred benefit programs--7 percent to CSR and the remainder to Social Security. The 2.7 million workers currently covered by the CSR system were not affected. They may, of course, eventually qualify for a Social Security annuity through nonfederal employment.

The report of the Federal Personnel Management Task Force of the President's Private Sector Survey on Cost Control (referred to as the Grace Report) recommended several changes in the CSR system based on practices typical of private-sector employers. All of the recommendations would require legislation to implement; most have been identified in prior reports considered by the Congress.

ESTIMATED BUDGETARY EFFECT. The outlay projections in the following table assume an October 1, 1983, effective date and were estimated by measuring the potential impact of the Grace recommendations against CBO's current policy baseline. More detail concerning the assumptions and methods used by the CBO are provided in the next section.

POTENTIAL OUTLAY IMPACTS OF THE GRACE RECOMMENDATIONS
FOR THE CIVIL SERVICE RETIREMENT SYSTEM

	1984	1985	1986	1987	1988
	(By fiscal year, in millions of dollars)				
Increase Normal Retirement to Age 62 a/	--	--	--	--	--
Base CSR Benefits on Average Salary for Five Years	-40	-110	-180	-260	-340
Discontinue Crediting Unused Sick-Leave	-10	-40	-60	-90	-110
Increase Early Retirement Reduction	b/	-10	-20	-20	-30
Modify Disability Criteria and Benefits	+60	+190	+240	+220	+190
Require Actuarial Survivor Benefit Reductions	-30	-70	-130	-180	-240
Eliminate Certain Student Benefits	-40	-60	-70	-80	-80
Reduce Inflation Protection	-100	-370	-820	-1,230	-1,630
Broaden Social Security Coverage	-450	-480	-500	-520	-560
Total c/	-600	-930	-1,520	-2,140	-2,800

a/ In accordance with the Grace Report, CBO assumed employees age 45 or more would not be affected by this proposal. (See page 28 of the April 15, 1983, Personnel Management Report.)

b/ Under $5 million.

c/ Details may not add to column totals because of the cost interaction among the proposed changes and rounding.

BASIS OF ESTIMATE. The CBO estimates assume that the behavior of federal employees projected to retire during the next five years would not change appreciably if the Grace proposals were enacted. To the extent that large numbers of workers accelerate their retirement plans to avoid benefit reductions, CSR costs would increase accordingly. The proposals to reduce annual cost-of-living adjustments (COLAs) and to eliminate student survivor benefits are the only changes that would affect individuals currently receiving benefits. In general, the estimates utilize data on CSR annuitants contained in the Office of Personnel Management's Fringe Benefit Facts for Fiscal Year 1981; more recent data were used wherever possible. The critical assumptions for each provision are detailed below.

Increase the Normal Retirement Age to 62 Years. If implemented as recommended in the Grace Report, this proposal would have no significant budgetary impact during the next five years because nearly all employees retiring in this period are currently over age 45 and, therefore, would not be affected.

Base CSR Benefits on Average Salary for Five Years. Under current law, CSR annuities are based on the average of the highest three years of earnings. The CBO estimate assumes the Grace proposal would reduce initial benefits for employees retiring during the next five years by approximately 6 percent.

Discontinue Crediting Unused Sick Leave Toward CSR Benefits. Under current law, unused sick leave is included in the calculation of length of service for determining CSR annuities. On average, federal workers retire with one-half year of creditable sick leave.

The CBO estimate assumes that enactment of the Grace proposal would reduce initial benefits for new retirees by approximately 2 percent. On the other hand, the proposal would also encourage employees to increase their use of sick leave during active employment. Savings from this proposal, therefore, might be offset to the extent additional staff or paid overtime was required. These effects are difficult to quantify and have not been included in the CBO estimate.

Increase Reduction for Early Retirement. Beginning in fiscal year 1984, this proposal would require a 4 percent per year reduction in CSR benefits for certain employees retiring under involuntary provisions before age 55. According to the Office of Personnel Management (OPM) data, approximately 4,000 employees per year could be affected. These employees would retire at an average age of 51 and, in 1984, would have an average monthly annuity of approximately $1,200 rather than $1,300 under the current system.

Tighten Disability Criteria and Increase the Guaranteed Benefit Level. Long-term disability payments would be independent from the CSR system, would increase from a minimum of 40 percent of the average of the highest three years of earnings to 60 percent of final salary, and would not be indexed for price increases due to inflation. After the first 24 months, however, an annuitant would not be able to receive disability payments unless he or she could not perform any job. Under the current definition of disability, and the one that would continue for the first 24 months, an individual is disabled if he or she cannot perform all the critical functions of his or her incumbent position or an equivalent position (same grade and level).

Under current law, each year some 15,800 federal employees would begin to receive disability annuities averaging approximately $950 per month in 1984. Under the Grace Report's proposal, these monthly payments would increase to an average level of $1,640 in 1984. The higher benefits would continue for a 24-month period. At that time, the estimate assumes one-third of the disability payments would continue; one-third would continue as optional retirement benefits but at a reduced level--based on age and length of service; and the remaining one-third would be discontinued because the recipients would neither qualify for disability under the Grace definition nor satisfy CSR age and service criteria for early retirement.

Require Actuarial Survivor Benefit Reduction. This proposal, if enacted, would base annuity reductions for survivor coverage on actuarial factors consistent with the actual ages of the retirees and their spouses. This would result in an additional benefit reduction of about 8 percent for the average federal retiree. Consequently, some individuals may not purchase survivor protection. Such a change in behavior would reduce long-run costs but require higher benefit payments until the former employee dies. Because these effects are difficult to project, they are not reflected in the CBO estimates.

Eliminate Certain Student Benefits. This proposal would phase out, over four years, survivor benefits for students between the ages of 18 and 22. Specifically, current benefits would be reduced by 25 percent per year, no benefits would be received during the summer months, benefits would not be increased for cost-of-living adjustments, and no new payments would begin.

Under current law, about 23,000 survivors of CSR participants are eligible for benefits because they are between the ages of 18 and 22 and enrolled in post-secondary education on a full-time basis. These benefits are paid monthly throughout the year and are increased for annual COLAs. In 1984, the average monthly benefit is estimated at approximately $250 per person. The savings estimate assumes that approximately 3,000 student survivors would be dropped from the rolls each year and some 1,000 new claims per year would not be processed.

Reduce Inflation Protection. This proposal would reduce annual cost-of-living adjustments for civil service retirees. Annuitants under age 62 would receive COLAs equal to 33 percent of either the change in the Consumer Price Index or the annual federal pay raise--whichever is less. Annuitants age 62 and over would receive COLAs equal to 70 percent of the applicable salary or price increase. All CSR annuitants, regardless of when they retired, would be affected by this proposal.

Over the next five years, cumulative COLAs are projected to reach 20.6 percent for retirees under age 62 and 22.2 percent for those age 62 and over. This proposal would reduce cumulative COLAs to 6.9 percent for retirees under age 62 and 15.2 percent for those age 62 and over.

Broaden Social Security Coverage. The Grace proposal would require all federal employees under age 45 to contribute to the Social Security system. Federal agencies would be required to match their employees contributions. Although contributions from employees generate budget revenues, only contributions from off-budget federal agencies, mainly the U. S. Postal Service, generate outlay savings. Approximately 336,000 Postal Service employees, with average salaries in 1984 of $24,400, would be affected. The outlay reductions represent the Postal Service's contribution to Social Security for these employees.

II. MODIFY THE ANNUAL PROCESS FOR DETERMINING COMPARABILITY PAY ADJUSTMENTS FOR FEDERAL WHITE-COLLAR EMPLOYEES

BACKGROUND. Under the comparability principle, pay adjustments received each October should keep federal white-collar employees' salaries at levels equivalent to those paid in the private sector for similar work. The Federal Pay Comparability Act of 1970 requires that a proposed comparability adjustment go through several steps before it is put into effect. First, information concerning private-sector salary levels is collected each March by the Bureau of Labor Statistics (BLS). Next, staff of the Office of Personnel Management formulate a proposed comparability adjustment by comparing federal pay rates with the BLS data. But the President, after reviewing the proposed comparability increase, may submit an alternate plan to the Congress calling for a lower pay adjustment in order to achieve budgetary and economic objectives and to set an example of wage restraint for the nonfederal sector. Even though the Congress may overturn an alternate plan by a simple majority vote of either House, alternate pay plans have been implemented in each of the last five years.

As currently measured, pay comparability would require an October 1983 adjustment in excess of 20 percent. About 5.5 points of the 20 percent adjustment represents the estimated change from March 1982 through March 1983 in private-sector salary levels. The remaining difference represents the cumulative effect of five successive caps on federal pay adjustments. In light of past practices for restraining October pay increases, CBO baseline projections do not assume implementation of pay comparability during the next five years. Rather, the fiscal year 1984-1988 baseline projections assume that all federal civilian workers, including those now at the pay ceiling, will receive pay rate adjustments equal to the annual rate of change in private-sector pay. These increases are projected to be 5.5 percent in October 1983 and 4.8 percent in each of the next four years.

In recent years, both the definition of what actually constitutes comparability and the method for arriving at a comparability adjustment have been challenged repeatedly. The Grace Report recommended several modifications to improve the reliability of the comparability process; some of these would require legislation to implement, whereas others could be implemented administratively. Many of the recommendations have been identified in prior reports or legislative proposals considered by the Congress; none would preclude the President from proposing an alternate pay adjustment plan.

If enacted, the Grace recommendations concerning federal pay comparability would: establish geographic salary differentials for federal workers in clerical, technical, and support job positions; significantly increase the number of federal job levels; expand the BLS survey to include salary data from state and local governments, nonprofit organizations, and smaller private-sector establishments that, in general, employ 25 to 50 workers; compare salary data for a greater number of jobs; and give serious consideration to a biennial survey cycle.

ESTIMATED BUDGETARY EFFECT. The Grace Report estimates that adoption of its recommended changes in the determination of pay comparability would reduce the size of future "comparability" adjustments by four or five percentage points. This suggests that the October 1983 pay comparability adjustment could be 15 percent rather than the 20 percent projected under current law and procedures.

The federal white-collar payroll now equals about $43 billion on an annual basis. A 15 percent raise would increase 1984 payroll costs by more than $6 billion--some $4 billion above the amount currently provided in the Budget Resolution for Fiscal Year 1984 passed by the House of Representatives, which provides for a 4 percent civilian pay increase.

While the changes proposed in the Grace Report might add credibility to the calculation of annual pay adjustments based on comparability, they would not alter executive or legislative branch discretion to set pay caps in the future. Because of that discretion, projected payroll costs, as estimated in the CBO baseline, are substantially below the budgetary costs of pay comparability as now determined. The revisions recommended by the Grace study would not affect the methodology used by CBO to determine the size of future federal pay adjustments included in the CBO baseline. Consequently, the Grace recommendations would neither reduce nor increase the baseline budgetary costs of federal workers' salaries. Administrative costs would rise, however, primarily to cover costs incurred by BLS as federal job descriptions change and as the number and type of occupations surveyed increase.

ESTIMATED BUDGETARY EFFECTS

	1984	1985	1986	1987	1988
	(By fiscal year, in millions of dollars)				
Increase in Annual Outlays	6	8	11	12	14

BASIS OF ESTIMATE. The projected outlay effects are based on information provided by staff of the BLS and assume adoption of a biennial survey cycle beginning in March 1984. Fiscal year 1983 program costs for the BLS private-sector survey will total $2.8 million and involve some 65 workyears of effort. Implementation of the Grace recommendations would require an annual increase of some 275 workyears of effort over a four- to five-year implementation period.

Most of the additional expense would result from an expansion of area wage surveys in order to develop geographic salary differentials for certain federal employees. If these differentials were developed without expanding the number of area surveys, some $8 million of the ultimate annual cost increase could be avoided. Many analysts have argued that geographic salary differentials redistribute income rather than reduce payroll costs. From this perspective, the additional $8 million that would be spent on geographic salary differentials would not necessarily reduce government-wide payroll costs.

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