Capping Federal Pay: Alternative Pay Adjustments For Fiscal Year 1979

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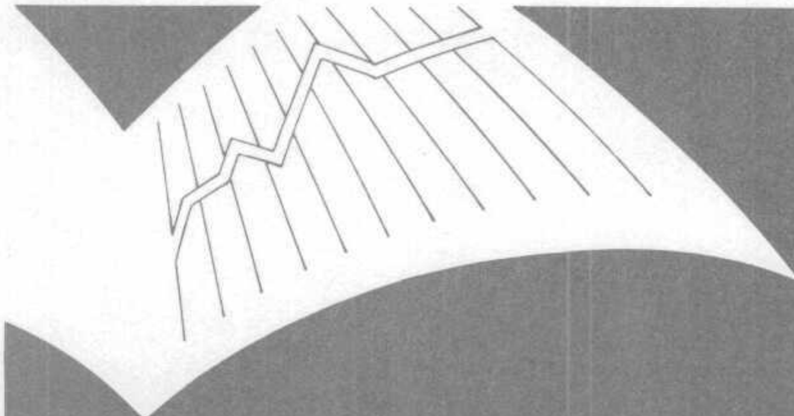

BUDGET ISSUE PAPER FOR FISCAL YEAR 1979

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CAPPING FEDERAL PAY: ALTERNATIVE PAY ADJUSTMENTS FOR FISCAL YEAR 1979

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PREFACE

As part of the President's anti-inflation program, the Administration has proposed a limit of 5.5 percent on the October 1978 pay raise for federal white-collar and military personnel. Before receiving the President's plan, the Senate passed an amendment that would place a statutory cap on pay for white-collar, military, and blue-collar (wage board) employees. This report which was prepared at the request of the House Committee on Post Office and Civil Service, analyzes federal pay adjustments as an anti-inflation measure and provides alternative proposals for consideration by the Congress. In keeping with the Congressional Budget Office's mandate to provide objective and nonpartisan information, the report contains no recommendations.

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Director

August 1978

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SUMMARY

The pay for civilian white-collar and military personnel, who constitute approximately three-quarters of the 4.8 million active federal civilian and military employees, is affected by the October rate adjustments to the General Schedule pay system. The General Schedule is adjusted under a system known as the comparability process.

Broadly defined, "comparability" means equal pay for substantially equal work, both within the federal government and in comparison with equivalent jobs in the private sector. The adjustment process includes four major steps:

- Collection of national salary data by the Bureau of Labor Statistics;
- Development of specific comparability recommendations to bring existing federal salaries into line with those in the private sector;
- The President's pay plan, which either implements a comparability increase or proposes an alternative to the Congress; and
- Congressional veto power over any alternative plan submitted by the President (if an alternative plan is vetoed, the comparability rates take effect).

As a key part of its anti-inflation program, the Administration plans to submit to the Congress an alternative pay plan that will limit or "cap" white-collar and military pay increases at 5.5 percent. In advance of receiving the President's plan, the Senate passed an amendment that would place a statutory cap on white-collar, military, and blue-collar (wage board) employees. Without a cap, the October adjustment is estimated to be 8.4 percent.

CAPPING PAY TO FIGHT INFLATION

Capping federal pay as an anti-inflation measure may be viewed from two perspectives--either as a direct budget and fiscal tool or as an indirect device to set an example for the nonfederal sector. As a direct fiscal tool, the proposed one-time pay cap on 1979 pay increases would reduce inflation by approximately 0.2 percentage points in 1979. The direct impact would decline in subsequent years. The indirect effect of the federal pay cap on the nonfederal sector cannot be determined at this time because it is difficult to know the degree of voluntary restraint that will be exercised in wage increases outside the federal government.

ALTERNATIVE APPROACHES AND THEIR BUDGETARY IMPLICATIONS

A great number of federal pay alternatives could be considered by varying the size, coverage, and duration of a pay cap. The following options are intended to illustrate the possible impact of limiting federal pay:

Option I: Allow federal employees to receive full comparability. This option would provide 3.6 million federal white-collar and military employees with a pay increase of about 8.4 percent, at a cost of $4.5 billion.

Option II: Accept the President's cap. The 5.5 percent cap proposed by the President would cover the same number of employees as Option I; wage board employees would not be affected. It would cost about $1.5 billion less than full comparability (Option I).

Option III: Enact the Senate amendment. This option would go beyond Option II by including some 471,000 wage board workers; it would cost about $1.6 billion less than full comparability.

Option IV: Cap increases for all active and retired federal employees. Under this option, 2.7 million retirees in addition to 4.2 million active federal employees (excluding postal workers) would be affected by the cap. The first-year saving is estimated to be $2.2 billion below full comparability.

Option V: Adopt a one-year moratorium. No pay adjustment or cost-of-living increase would be received by active or retired federal employees, including those of the U.S. Postal Service, in fiscal year 1979. In addition, October pay adjustments for fiscal years 1980 and 1981 would be tied to changes in the Consumer Price Index rather than to salaries in the private sector. Outlays in 1979 would be about $6.3 billion less than full comparability; since a catch-up is not provided until 1982, the fiscal year 1981 costs would be $9.6 billion below full comparability.

Option V would have the greatest impact on inflation in the first few years, reducing the rate by 0.5 percentage points in 1979. By the fifth year (1983), however, the direct budgetary impact of all the alternatives would be about the same--with the rate of inflation about 0.1 percentage point lower than full comparability (Option I) under Option II and 0.2 percentage points lower under Option V.

The main argument for a pay cap is a belief that it would be difficult to expect labor and management in the private sector to hold down wage and price increases if, at the same time, federal employees were allowed the full comparability increase. It is argued that, as a matter of principle, the federal government should set the example.

Opponents to a pay cap maintain that comparability rates should not be considered inflationary since they reflect salary changes that have already occurred in the private sector. Federal employee unions and other advocates of full comparability also argue that a cap would impose wage controls on federal workers while other sectors of the economy would remain unrestrained. In addition, a pay cap could adversely affect the government's ability to recruit qualified personnel into the junior enlisted ranks of the military.

If a reduction in federal pay is desired, it could be achieved through adoption of substantive reforms in the federal government's pay systems that would not compromise the principle of comparability with the private sector. Such reforms would result in permanent cost reductions estimated at $1.3 billion if fully implemented. This would have greater long-run significance than the one-time savings associated with a 1979 pay cap.

CHAPTER I. INTRODUCTION

As a key part of its anti-inflation program, the Administration plans to limit the October 1978 pay increase for federal white-collar and military personnel to about 5.5 percent. This action, which is referred to as a "pay cap," would reduce the average increase below what will be proposed under the annual adjustment system--an estimated 8.4 percent. 1/ Even before receiving the President's plan, the Senate passed an amendment that would impose a 5.5 percent cap on federal blue-collar workers as well as white-collar and military employees.

Without a cap, the increase in federal pay would reflect changes that have already occurred in private sector salaries. These uncapped, proposed changes in federal salaries are referred to as "comparability increases." Contrary to common belief, they are not limited to changes in the cost of living but reflect many factors that affect wage decisions in the private sector.

The President has authority to propose an appropriate alternative to the annual comparability increase in light of "economic conditions affecting the general welfare." The Congress can respond to the President's proposal in three ways:

- Allow federal pay to reflect private sector salaries by disapproving the President's plan;
- Accept the proposed pay cap by taking no action; or
- Enact an alternative of its own.

1/ The estimated increase for October 1978 is based on a comparison of federal salaries with actual private sector salaries as of March 1978. The 8.4 percent estimate is higher than the 6.5 percent increase included in the President's budget for fiscal year 1979.

The federal government has four major pay systems: (1) the General Schedule, (2) the Uniformed Military, (3) the U.S. Postal Service, and (4) the Federal Wage Board (blue-collar employees). Annualized payroll costs for the four major pay systems are estimated to be $70.6 billion for fiscal year 1979. 2/ The basic approaches to adjusting pay in these systems are determinations based on national surveys, collective bargaining, prevailing wages in localities, and linkage of rate changes in one system to those in another. In all cases, the recurring theme is comparability with private sector pay.

General Schedule. The General Schedule (GS) is the basic pay system for 1.4 million federal white-collar employees, or slightly more than one-half of the civilian employees in the federal government. In addition, approximately 113,000 civilian employees are in pay systems that are linked to the General Schedule. Annualized payroll costs for GS employees and civilian employees linked to the General Schedule will total $29.6 billion for fiscal year 1979. Pay adjustments occur on an annual basis and become effective in October, the first month of the fiscal year.

Uniformed Military. The annual pay adjustment for the Uniformed Military System is "linked" to that of the General Schedule; it equals the average percentage adjustment received by GS employees. Thus, 2.1 million active military personnel in all pay grades receive a constant percentage increase--even when GS adjustments vary by grade, as they did in October 1976.

In 1976, the Congress granted the President authority to reduce the increase in basic pay in order to give larger increases in the allowances for quarters and food. As a result, the basic pay increase in October 1977 was reduced from 7.05 percent to 6.2 percent. The remaining portion of the pay adjustment was used to increase the allowances for quarters. The annualized military payroll for active and reserve personnel is $23.6 billion.

2/ Annualized payroll for fiscal year 1979 includes the full-year effect of increases in the previous year. For further discussion see: Congressional Budget Office, The Federal Government Pay Systems: Adjustment Procedures and Impacts on Proposed Changes, Background Paper (February 1977).

U.S. Postal Service. Before 1970, the U.S. Postal Service was linked to the General Schedule for pay setting. Now the pay rates for approximately 80 percent of the 633,000 postal employees are established through collective bargaining between Postal Service management and employee unions. The bargaining is conducted in accordance with the provisions of the Postal Reorganization Act of 1970. This act requires that compensation for all postal employees be maintained on a standard of comparability with the private sector for commensurate levels of work. A new contract was submitted to the postal workers on July 21, 1978, for ratification. The annualized payroll of the Postal Service is approximately $11.3 billion.

Federal Wage Board. The Federal Wage Board, or "Blue-Collar System," represents about 471,000 trade, craft, and labor employees and an annualized fiscal year 1979 payroll of about $8.2 billion. Pay adjustments are based on prevailing local wage norms; each of the approximately 135 local wage areas adjusts pay once a year, but at different times.

Retirement Systems. In addition to the 4.8 million active federal employees, some 2.7 million persons receive federal pensions or survivor benefits. Most of these annuitants are under the civil service and military retirement systems. Both systems provide automatic adjustment for increases in the cost of living. Outlays for retirement and survivor benefits in fiscal year 1979 are estimated to be $21.2 billion, excluding cost-of-living adjustments.

The number of personnel in each pay system in fiscal year 1977 and the total payroll in fiscal year 1979 are summarized in Table 1.

This paper is intended to provide a basis for assessing the President's proposed pay cap and the alternatives to that proposal. The analysis focuses on:

- o The background and significance of the October pay adjustments;
- o The use of a federal pay cap as an anti-inflation measure; and
- o Alternatives for federal pay increases.

TABLE 1. TOTAL EMPLOYMENT AND PAYROLL FOR FEDERAL PAY SYSTEMS

Pay Plan	Total Employment for Fiscal Year 1977 (thousands)	Total Payroll for Fiscal Year 1979 a/ (millions of dollars)	Percent of Total Payroll
Active Employees b/			
General Schedule	1,402	27,390	28.6
Linked to General Schedule	113	2,230	2.3
Subtotal	1,515	29,620	31.0
Uniformed Military	2,111 c/	23,630 d/	24.7
Subtotal	3,626	53.250	55.7
U.S. Postal	633	11,340	11.9
Wage Board	471	8,210	8.6
Miscellaneous e/	110	1,630	1.7
Total, Active	4,840	74,430	77.8
Retired Employees f/			
Civil Service	1,475	11,540	12.1
Military	1,193	9,530	10.0
Other	14	170	0.2
Total, Retired	2,682	21,240	22.2
Grand Total	7,522	95,670	100.0

a/ Payroll estimates prepared by the Congressional Budget Office from data supplied by the Civil Service Commission, the Office of Management and Budget (Object Class Analysis for Fiscal Year 1979), and the U.S. Postal Service. The estimates (rounded to nearest $10 million) do not reflect any pay raises during fiscal year 1979.

b/ Civilian personnel estimates represent work years at basic pay rates as reported to the Civil Service Commission under OMB Circular A-93. Estimates for Uniformed Military are based on data in Department of Defense, Annual Report, for Fiscal Year 1979.

c/ Personnel estimates exclude military reserve forces.

d/ Estimates include the pay for reserve forces and active members of the U.S. Coast Guard.

e/ Estimates include trade and labor employees of the Tennessee Valley Authority.

f/ Estimates prepared by the Congressional Budget Office.

CHAPTER II. OCTOBER PAY ADJUSTMENTS--BACKGROUND AND SIGNIFICANCE

THE COMPARABILITY PROCESS

Approximately three-fourths of the 4.8 million civilian and military employees are affected by the October rate adjustments to the General Schedule. 1/ Those adjustments are made under a system known as the comparability process. Broadly defined, "comparability" means equal pay for substantially equal work, both within the federal government and in comparison with equivalent jobs in the private sector. The adjustment in federal pay reflects the change needed to bring existing federal salaries into line with those in the private sector. The comparison is based on salary levels--not, as is often believed, on percentage increases.

The comparability process includes four major steps:

- The collection of national salary data by the Bureau of Labor Statistics (BLS);
- The development of specific comparability recommendations by the President's Pay Agent (the Secretary of Labor, the Chairman of the Civil Service Commission, and the Director of the Office of Management and Budget);
- The President's pay plan, which either implements a comparability increase or proposes an alternative to the Congress;
- Congressional veto power over any alternative plan submitted by the President (if an alternative plan is vetoed, the Pay Agent's comparability rates take effect).

1/ The October pay adjustment directly affects some 1.4 million white-collar (GS) employees; through linkage, it affects all the military and over one-half of the remaining civilian employees, excluding those under the Wage Board and Postal Service pay systems.

In the October 1977 pay adjustment, the Pay Agent exercised discretion in two areas: the BLS survey of private sector pay was expanded; 2/ and the comparability increase was applied across-the-board rather than on a grade-by-grade basis. If the BLS survey had not been expanded, the increase would have averaged 7.46 percent instead of the 7.05 percent increase that was approved. If the October 1977 adjustment had been based on a grade-by-grade comparability, employees below grade 12 would have had increases averaging 6.44 percent--considerably less than the across-the-board rate. Thus, for three-quarters of the General Schedule employees, the salary increases were greater than they would have been if comparability had been applied on a grade-by-grade basis. For example, a GS 7 employee would have received a 6.26 percent increase instead of the 7.05 percent average rate. The remaining employees (GS 12 through GS 15), however, would have received increases averaging 7.85 percent. Comparability increases for October 1978 would range from 6.14 percent for GS 2 employees to 13.17 percent at the GS 15 level (see Table 2).

PREVIOUS PAY CAPS

Alternatives to comparability pay increases have often been proposed to achieve budgetary and economic objectives and to set an example for wage and price restraint in the private sector. 3/ The General Schedule and Uniformed Military pay systems have become a particular target for Presidential action because alternative pay plans proposed by the President take effect unless vetoed by the Congress. Postal Service and wage board employees have usually been excluded from proposals to cap or defer annual pay increases.

2/ The survey for the October 1977 pay adjustment was expanded by: (a) adding seven industries previously excluded (including broader coverage for transportation); and (b) lowering the establishment size cut-off from 250 to 100 employees in six manufacturing groups. For detailed discussion of changes see Comparability of the Federal Statutory Pay Systems With Private Enterprise Pay Rates, Annual Report of the President's Pay Agent (1977), pp. 2-5.

3/ For example, President Ford's budget message of February 3, 1975, and the President's message to the Congress on August 29, 1975, recommending a 5 percent pay increase.

TABLE 2. GRADE-BY-GRADE COMPARABILITY INCREASES FOR GENERAL SCHEDULE EMPLOYEES, 1977 AND 1978

Selected Grade Levels	Percent Increase 1977	Percent Increase 1978
1	7.08	6.15
2	6.82	6.14
3	6.61	6.18
5	6.34	6.04
7	6.26	6.80
9	6.37	
11	6.67	7.39
12	7.17	8.17
13	7.86	9.14
14	8.76	10.31
15	9.85	13.17

SOURCE: Prepared from data supplied by the Civil Service Commission.

Of the eight pay adjustments between January 1971 and October 1977 (see Table 3), two alternative pay plans were effected:

- o Amendments to the Economic Stabilization Act of 1970 limited the January 1972 increase to 5.5 percent, as compared with the 6.6 percent increase that would have been allowed under comparability; and

- o A Presidential cap of 5 percent was accepted for the October 1975 adjustment in lieu of an 8.66 percent comparability increase.

Under the comparability process, a cap on federal pay amounts to a deferral of the increase for one year rather than a permanent loss in pay. If a pay cap is followed by a full comparability increase in the next year, a "catch-up" would normally be realized since federal salaries would be increased to the level of comparable salaries in the private sector. As a practical matter, however, the catch-up may be nullified to the extent other factors depress the size of the next year's comparability increase. For example, the October 1975 pay cap of 5.5 percent was followed by an October 1976 comparability increase of 5.17 percent. The 1976 increase, however, would have been about 10.3 percent except that the methodology for determining pay comparability was changed. 4/ The practical effect was to nullify the 3.66 percentage point catch-up (implied when the 1975 comparability increase of 8.66 percent was reduced to 5 percent).

TABLE 3. ANNUAL PAY ADJUSTMENTS UNDER GENERAL SCHEDULE, PROPOSED AND ACTUAL PERCENTAGE INCREASES, 1971-1978

Scheduled Increase	Pay Agent	President	Congress (Actual)
Jan. 1971	5.96	5.96	5.96
Jan. 1972	6.60	delay	5.50
Oct. 1972	5.14	5.14 (delay)	5.14
Oct. 1973	4.77	4.77 (delay)	4.77
Oct. 1974	5.20	5.20 (delay)	5.20
Oct. 1975	8.66	5.00	5.00
Oct. 1976	5.17	5.17	5.17
Oct. 1977	7.05	7.05	7.05
Oct. 1978 a/	8.4	5.5	--

a/ Estimates for 1978 are tenative.

4/ The October 1976 pay adjustment included two changes for determining comparability: (a) the secretarial and computer operator occupations were added to the survey of private sector pay; and (b) the results of the entire survey were weighted to reflect the composition of the federal workforce. These changes had the effect of reducing the comparability increase by about 5.1 percentage points below the increase that would otherwise have been proposed.

CHAPTER III. CAPPING PAY TO FIGHT INFLATION

Capping federal pay as an anti-inflation measure may be viewed from two perspectives: either as a direct budget and fiscal tool or as an indirect device to set an example for the nonfederal sector. In truth, however, a cap on federal pay is largely symbolic. Its effectiveness in curbing inflation depends not so much on the direct budget impact of the cap itself as on whether the private sector follows the federal example.

INDIRECT EFFECTS--SETTING AN EXAMPLE

It is virtually impossible to determine the impact of a federal pay cap as an example to the private sector. For example, the last pay cap--when the October 1975 adjustment was limited to 5 percent--was intended to persuade the private sector to minimize wage and price increases. Yet, in the six months following the October 1975 cap, major wage settlements in the private sector averaged (for the first year) 10.4 percent as compared with 9.4 percent in the preceding 6 months.1/ During the six-month period following the cap, significant settlements were negotiated for some 235,000 railroad and garment workers. These multiyear agreements provided annual wage increases that averaged 9.2 percent. The largest settlement was the July 9, 1975, agreement for U.S. Postal Service employees. The three-year contract resulted in an average annual increase of about 7.3 percent, including cost-of-living increases. 2/ Thus, although it is difficult to know what might have occurred in the absence of the cap, the cap did not hold private sector, or even other federal pay, at 5 percent.

The comparison of wage increases under major labor agreements represents a stern test for assessing the impact of the

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1/ U.S. Department of Labor, Bureau of Labor Statistics, Current Wage Developments (April 1978).

2/ Council on Wage and Price Stability, 13th Quarterly Report/ Inflation (April 1978), p. 48.

pay cap. The cap might have some effect on wage increases in industries that are not highly unionized. The dominant influence of increases in the national minimum wage, however, limits the usefulness of comparing changes in average hourly earnings.

DIRECT BUDGETARY AND FISCAL IMPACT

Aside from any indirect effects it might have as an example to the nonfederal sector, a cap on federal pay is often perceived as having a direct anti-inflation impact through its reduction in federal spending. From a budgetary and fiscal perspective, however, a cap on federal pay does not appear to be an effective tool for controlling inflation. The initial change in federal spending would not be large enough to dampen appreciably the demand for goods and services throughout the economy. Pay caps usually result in a one-time budget reduction that defers expenditure for only one year. Thus, the anti-inflation impact is even less than it would be under a permanent reduction in spending.

The limited anti-inflation impact of a federal pay cap can best be measured by the Gross National Product (GNP) deflator. This index reflects changes in the cost of all goods and services--those produced by the private sector as well as those of federal, state, and local governments. 3/ Using the GNP deflator, it is possible to analyze the direct anti-inflation impact of the pay cap that occurred in October 1975. If the October 1975 pay adjustment for white-collar and military personnel had not been capped at 5 percent, a full comparability increase of 8.66 percent would have taken effect. Assuming full comparability and no other changes, it is estimated that the GNP deflator would have increased by only 0.1 percent. In the

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3/ Even though the Consumer Price Index (CPI) is a more popular measure of inflation, it is not used in this analysis. Since the CPI measures the retail price of goods and services produced mainly by the private sector, the impact of changes in federal spending would be less decernible.

following section, the effect of the cap proposed for October 1978 will be analyzed using the GNP deflator. 4/

THE PRESIDENT'S PLAN

The Administration plans to cap the October 1978 pay adjustment for white-collar and military personnel at 5.5 percent. Without the cap, the comparability increase is estimated to be 8.4 percent. If the cap is not extended, the full comparability increase would be deferred until the October 1979 adjustment. Thus, the October 1979 increase would include a 2.9 percent catch-up (10.4 percent in lieu of the projected 7.5 percent).

The President's proposal is intended to set an example. Business and labor are being asked to hold future price and wage increases below the average for the past two years. The program anticipates significant deceleration in every market, although individual circumstances will require different degrees of restraint. 5/ Nationwide, the Administration hopes to hold retail price increases for items other than food and fuel to at least one-half of one percentage point below the 1976-1977 average.

A cap on federal pay would represent a noticeable action by the government to slow the momentum of inflation. The resulting budget reduction would reduce inflation; the direct impact is estimated to be a reduction of 0.2 percentage points in 1979. By the end of the fifth year (1983), the estimated reduction in inflation would be about 0.1 percentage point.

Achievement of the Administration's deceleration objectives will depend on the overall extent of voluntary restraint rather than the presence of the pay cap itself. Although collective

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4/ Estimated changes in the GNP deflator are derived from a model developed by CBO for analyzing alternative economic policies.

5/ For a detailed discussion of the Administration's deceleration program see Annual Report of the Council of Economic Advisors (January 27, 1978), pp. 152-56; and Quarterly Report of the Council on Wage and Price Stability, No. 13 (April 1978).

agreements cover only about 5 percent of the civilian workforce, they are a visible measure of wage movements. Significant upcoming wage settlements in the private sector include railway, retail food, construction, maritime, and airline industries. The largest single settlement is in the public sector for the U.S. Postal Service. The three-year postal contract expired on July 20, 1978, and a new agreement has been submitted to the postal workers for ratification. The tentative agreement is consistent with the Administration's deceleration objectives. It provides an estimated 19.5 percent increase over a three-year period, including cost-of-living increases. This would result in an average annual increase of about 6.1 percent as compared with a 7.3 percent average under the prior contract. In addition, the first-year increase, estimated at 4.4 percent, is well below the 5.5 percent cap proposed for other federal employees. 6/

6/ The tentative postal service agreement provides for scheduled annual increases of 2, 3, and 5 percent as well as cost-of-living adjustments (COLA). The COLA increases amount to 1 cent per hour for each 0.4 percent increase in the Consumer Price Index. In the first year, this formula increases pay by about one-third of the increase in the CPI.

CHAPTER IV. ALTERNATIVE APPROACHES

The President's recommendations for white-collar and military pay will become effective 30 days after being transmitted to the Congress unless otherwise acted on. In advance of receiving the President's plan, the Senate passed an amendment which would enact a 5.5 percent cap for white-collar, military, and blue-collar (wage board) employees. 1/ A legislative alternative to either comparability or the President's proposal could take many forms. Alternatives can address three variables:

- o The size and distribution of the pay increase to be allowed;
- o The groups of workers to be affected (pay systems, occupations, active or retired workers); and
- o The duration of the cap.

Any number of alternatives could be considered by varying the size, coverage, and duration of a proposed cap on federal pay. In order to illustrate the possible impact of limiting federal pay raises, this paper analyzes five options:

Option I: Allow federal employees to receive full comparability (estimated at 8.4 percent for General Schedule employees);

Option II: Accept the President's pay cap (estimated at 5.5 percent) on white-collar and military pay;

Option III: Enact the Senate amendment, which would place a 5.5 percent cap on pay for white collar, military, and wage board (blue-collar) emloyees;

1/ The pay cap amendment is included in the Treasury, Postal Service, and General Government Appropriations Act of 1978 (H.R. 12930), which passed the Senate on June 27, 1978.

Option IV: Cap pay increases at 5.5 percent for all active and retired federal employees;

Option V: Place a one-year moratorium on pay increases for all active and retired federal employees, including those of the U.S. Postal Service, followed by cost-of-living increases for the second and third year.

These options can be considered in terms of their impact on the federal budget and on inflation. Compared with Option I (full comparability), Options II-V produce reductions in the 1979 budget outlays, ranging from $1.5 billion to $6.3 billion (see Table 4). The corresponding reduction in inflation in 1979 would range from 0.2 to 0.5 percentage points. Since all of the options provide a pay cap catch-up (deferred until 1982 under Option V), the impact on inflation is about the same in the fifth year--ranging from a reduction of 0.1 percentage point in Option II to 0.2 percentage points in Option V. Other factors to be noted in considering federal pay alternatives include the example that might be set for the nonfederal sector, the equitable treatment of federal employees, and effects on military recruitment.

OPTION I: ALLOW FEDERAL EMPLOYEES TO RECEIVE FULL COMPARABILITY

Under Option I, 3.6 million federal white-collar and military personnel would receive the comparability pay increase to be recommended by the President's Pay Agent. The increase is estimated to average 8.4 percent, although it is unknown whether it will be applied across-the-board. If the increase is made on a grade-by-grade basis, employees below grade 12 would receive less than a 8.4 percent. The comparability increase would take effect if the President's proposed pay cap is vetoed by either House and no legislative alternatives are enacted. Under full pay comparability, budget outlays for fiscal year 1979 would be about $1.5 billion above the Congressional ceiling established by the First Concurrent Resolution on the Budget.

The federal employee unions and other advocates of full comparability maintain that comparability rates should not be considered inflationary since they reflect salary changes that

TABLE 4. IMPACT OF ALTERNATIVE PAY ADJUSTMENTS ON FISCAL YEAR 1979 BUDGET OUTLAYS: IN BILLIONS OF DOLLARS

	Percent Pay Increase Allowed			Individuals Affected (millions)	1979 Outlay Impact	
	1979	1980	1981		Change from full comparability	Change from 1979 Congressional ceiling
Option I: Full comparability (white-collar and military)	8.4	7.5	7.0	3.6	--	1.5
Option II: President's pay cap (white-collar and military)	5.5	10.4 a/	7.0	3.6	-1.5	--
Option III: Senate amendment (white-collar, military, and wage board)	5.4	10.4 a/	7.0	4.1	-1.6	-0.1
Option IV: Cap on pay for all active and retired employees	5.9	10.4 a/	7.0	6.9	-2.2	-0.6
Option V: One-year moratorium followed by cost-of-living increases (all active and retired employees)	0.0	6.4	6.0	7.5	-6.3 b/	-4.8

a/ Proposed caps on 1979 pay assume that a catch-up is allowed in 1980 when adjustments would again be based on comparable salaries in private industry (Options II, III, and IV).

b/ Outlay reductions in Option V assume that savings in payroll costs for the Postal Service will be reflected in the budget as a reduction in the federal subsidy.

have already occurred in the private sector. 2/ The argument could also be made that, if a reduction in federal pay is desired, it should be achieved through substantive changes in the federal government's pay systems that would not compromise the comparability principle. Specifically, reforms could be enacted in the federal wage board pay system, 3/ the General Schedule could be revised to reflect geographic and occupational differences, 4/ and overgraded jobs could be reclassified. 5/ Such substantive changes would result in permanent cost reductions which, in the long run, would be of far greater significance than the one-time saving associated with a pay cap. If all of these reforms were implemented at the beginning of 1979, the estimated annual saving would be about $1.3 billion. Practical considerations, however, would require such changes to be phased in over a number of years.

OPTION II. ACCEPT THE PRESIDENT'S PAY CAP

The cap proposed by the President would deny the comparability increase to some 3.6 million white-collar civilian employees and military personnel on active duty. The October 1978 cap would defer part of the comparability increase for one year. Unless the cap were extended, the adjustment for October 1979 would include a catch-up of the 2.9 percentage points denied this year. The October 1979 adjustment would thus be 10.4 percent under this option as compared with an estimated 7.5 percent increase if there were no cap in 1978. The direct impact of this option would reduce inflation by 0.2 percentage points in 1979 and 0.1 percentage point in the fifth year, 1983.

2/ The survey conducted by the Bureau of Labor Statistics uses March 30 as the date for measuring salaries in the private sector.

3/ Congressional Budget Office, The Costs of Defense Manpower: Issues for 1977 (January 1977), pp. 108-116.

4/ Congressional Budget Office, The Federal Government's Pay Systems: Adjustment Procedures and Impacts of Proposed Changes, Background Paper (February 1977), pp. 17-24.

5/ A recent study by the Civil Service Commission concluded that a large number of white-collar jobs are overgraded.

Proponents of the proposed cap believe that it would be difficult to expect labor and management in the private sector to hold down wage and price increases if, at the same time, federal employees were allowed the full comparability increase. This is the main argument for a pay cap: if it is in the national interest to pursue a policy of deceleration, then the federal government should, as a matter of principle, set the example. This option recognizes that even with a cap on federal pay, significant reductions in inflation will depend mainly on voluntary efforts in the private sector.

Opponents of the pay cap argue that federal employees are being subjected to wage controls, while other sectors of the economy remain unrestrained. Moreover, it is argued that the cap could have an adverse impact on military recruitment. Even without a cap, there is concern about the ability of the military to attract adequate numbers and quality of persons into the junior enlisted ranks. 6/

OPTION III: ENACT THE SENATE AMENDMENT CAPPING PAY FOR WHITE-COLLAR, MILITARY, AND WAGE BOARD EMPLOYEES

Option III, which is the Senate amendment discussed above, goes beyond Option II by extending the coverage of the pay cap to some 471,000 wage board (blue-collar) employees. This option would enact a statutory pay cap for all three groups of employees and would thus preclude consideration of a Presidential plan.

The Senate amendment reflects a view that a pay cap should apply to white-collar, military, and wage board employees alike. (Postal Service employees would not be covered by the cap.) It is also believed that extending coverage to wage board employees would demonstrate a stronger resolve to fight inflation and hold down federal spending.

6/ See Congressional Budget Office, The Costs of Defense Manpower: Issues for 1977 (January 1977), Chapter III and Appendix; and Congressional Budget Office, Improving the Readiness of the Army Reserve and National Guard (February 1978).

A cap on 1979 pay for blue-collar employees could be considered an appropriate interim measure in light of proposals for changing the present wage board pay system. The General Accounting Office and the President's Panel on Federal Compensation (Rockefeller Commission) both concluded that wage board employees are generally overpaid. If the recommendations of these groups were implemented, wage board payroll costs would decrease about 8 percent. 7/ Opponents of a pay cap for wage board employees would argue, on the other hand, that recommendations for changing the wage board pay system should be considered on their own merits. A statutory pay cap, particularly through an amendment to an appropriations bill, would circumvent the annual pay adjustment processes established by the Congress. 8/

Extending the pay cap to wage board employees would reduce the 1979 federal budget by about $143 million. 9/ In addition to any indirect impact the option might have as an example for private industry, it would have about the same direct impact on inflation as Option II.

7/ For discussion of recommendations to change the current systems for determining pay of blue-collar workers see: Congressional Budget Office, The Costs of Defense Manpower: Issues for 1977, pp. 108-116; General Accounting Office, Improving the Pay Determination Process for Federal Blue Collar Employees (June 3, 1977); and Report to the President of the President's Panel on Federal Compensation, (December 1975).

8/ For discussion of the arguments for and against extending the pay cap to wage board employees, see the debate between Senators Thomas E. Eagleton and Ted Stevens on amendment no. 3080 to the Treasury, Postal Service, and General Government Appropriations Bill, H.R. 12930: Congressional Record S9864-9872, June 27, 1978.

9/ Since wage board increases occur at different dates throughout the year, only about 60 percent of the full-year saving ($238 million) would be realized in fiscal year 1979. During Senate debate, a saving of $250 million was indicated for fiscal year 1979.

OPTION IV: CAP PAY INCREASES FOR ALL ACTIVE AND RETIRED FEDERAL EMPLOYEES

Option IV would go beyond the Senate amendment (Option III) by extending a statutory pay cap to all 4.2 million active and 2.7 million retired federal employees. For active employees a pay catch-up would occur when comparability is achieved the following year; no catch-up would occur for federal retirees. 10/

From an equity perspective, a pay cap should apply to all federal employees--active and retired alike. As a result of cost-of-living increases, the pay for federal retirees has gone up faster than that for active white-collar and military employees. In calendar years 1976 and 1977, Civil Service retirees received increases averaging 15.2 percent as compared with 12.6 percent for active federal employees. In the private sector, only about 3 percent of the pension plans provide for cost-of-living adjustments (COLA) on a formal basis, and 37 percent do not grant any COLA increases.

Opponents of this option argue that an extended pay cap places too much emphasis on controlling inflation by limiting income of federal employees. Federal employees and retired persons would be required to make financial sacrifices with no assurance that wages and prices in the private sector will be restrained.

Under this alternative, budget outlays for fiscal year 1979 would be about $2.2 billion lower than full comparability (Option I) and $634 million below the current Congressional ceiling. Nearly 70 percent of the $634 million reduction would result from extending the cap to retired employees. The corresponding reduction in inflation is estimated to be the same as the reduction under Option II.

10/ Under Option IV, the cost-of-living increase for federal retirees would be limited to 21.7 percent for the adjustments received in October 1978 and March 1979.

OPTION V: PLACE A ONE-YEAR MORATORIUM ON PAY INCREASES FOLLOWED BY COST-OF-LIVING ADJUSTMENTS

Option V would apply to all active and retired employees--including those of the U.S. Postal Service. Of the five options presented, this alternative would effect the largest budget reduction and would place the greatest hardship on federal employees. It is similar to the freeze on pay imposed on most California state and local employees following passage of Proposition 13 in June 1978. As with the California freeze, this option would nullify existing labor agreements.

No adjustments for federal pay or retirement benefits would be made in fiscal year 1979. Adjustments for the following two years would be indexed to changes in the Consumer Price Index (estimated at 6.4 percent for 1980 and 6 percent for 1981). This alternative is different from Options II, III, and IV since no catch-up is provided until 1982. Temporary indexation would allow flexibility in the future when fringe benefits (such as retirement and leave) may be considered along with pay in determining comparability.

Under Option V, cumulative pay increases for white collar and military employees are estimated to average 12.8 percent by the end of the third year. This is considerably lower than the estimated 24.7 percent increase under either full comparability or a one-time cap followed by a catch-up. The freeze on pay would result in a savings in fiscal year 1979 of $6.3 billion below full comparability (Option I) and $4.8 billion below the present Congressional ceiling. Since a catch-up is not provided, the saving in 1981 would be $9.6 billion below full comparability. Although this option would have the greatest initial impact on inflation (-0.5 percentage points in 1979), the effect in the fifth year is -0.2 percentage points. This is only slightly greater than the fifth-year effect of the other options since Option V also includes a pay catch-up.

The main objection to this alternative is that it would require federal employees to make financial sacrifices for three years while the private sector is asked to cooperate voluntarily. Tying pay to changes in the cost of living, even though temporary, could set a precedent for abandoning the principles of both comparability and collective bargaining. In addition, this option could have the most dramatic adverse impact on military recruitment.

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