CBO STAFF MEMORANDUM

MEASURING THE BUDGETARY EFFECTS OF CHANGES IN FEDERAL PAY POLICY

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As part of his effort to reduce the deficit, President Clinton has proposed a number of limits on the pay of federal employees. This staff memorandum explains how the Congressional Budget Office (CBO) estimates the savings from the President's plan and how such estimates are affected by requirements in the Budget Enforcement Act of 1990. It also provides background information about current law covering federal employee pay raises and proposed changes to that law. R. Mark Musell of CBO's Special Studies Division prepared the memorandum under the supervision of Robert Hartman. Leslie Griffin and Amy Plapp of CBO's Budget Analysis Division prepared the budget estimates. Questions about the analysis may be addressed to the author at (202) 226-2616.

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The starting point for estimating the costs or savings from a change in federal pay policy is the baseline--that is, the assumption about what the government would have spent to pay employees in the absence of any change. Under provisions of the Budget Enforcement Act of 1990 (BEA), the Congressional Budget Office uses a baseline that assumes that federal personnel costs increase each year at the same rate as pay in the private sector, as measured by the employment cost index (ECI). The BEA baseline does not reflect pay raises likely to occur under authority of the Federal Employees Pay Comparability Act of 1990 (FEPCA). Generally, a baseline that assumed increases in pay more closely following FEPCA would show larger growth and thus produce larger costs and savings when used to measure the effects of changes in current policy.

CURRENT LAW: THE FEDERAL EMPLOYEES PAY COMPARABILITY ACT OF 1990

Under FEPCA, white-collar workers may receive two pay adjustments each year beginning in January 1994. The first is intended to keep federal salaries abreast of changes in private-sector salaries as measured by the ECI. Specifically, FEPCA provides for raises tied to the change in the ECI less one-half of one percentage point. The ECI change is measured over the year ending 15 months before the effective date of the raise.

The other adjustment is intended to close, over nine years, any gaps that already exist between federal and private-sector pay rates. The adjustments would vary from area to area based on how federal salaries compare locally with their private-sector counterparts. These locality adjustments replace the national adjustments that were made prior to FEPCA.

CBO'S ESTIMATES OF PAY RAISES UNDER CURRENT LAW

The Congressional Budget Office (CBO) estimates that ECI adjustments over the next five years would average 2.6 percent of payroll, and locality adjustments would average 1.9 percent of payroll (see Table 1). CBO's estimates of locality adjustments assume that the pay gap between federal and private-sector salaries averages 20 percent. Under provisions of FEPCA, the government would grant a raise in 1994 that represents two-tenths of the amount needed to close the pay gap to 5 percent or less.[1]

CBO's estimate of the pay gap represents approximately the middle of a range of estimates from different sources that conducted surveys at the time the Congress deliberated FEPCA. The CBO estimate still represents about

1. A simple way to follow CBO's calculation of the 2.9 percent locality raise for 1994 is to consider a specific example. If the gap is 20 percent, a federal salary of $10,000 would compare with a private-sector salary of $12,000. To raise federal pay to within 5 percent of the private-sector rate would require increasing it to $11,429, an increase of 14.29 percent. Two-tenths of this amount, the required raise in 1994, is 2.9 percent.

TABLE 1. PERCENTAGE PAY RAISES UNDER CURRENT LAW, FISCAL YEARS 1994-1998

	1994	1995	1996	1997	1998	Five-Year Average
ECI Adjustments	2.2	3.0	2.7	2.6	2.3	2.6
Locality Adjustments	2.9	1.6	1.7	1.7	1.8	1.9

SOURCE: Congressional Budget Office.

NOTE: ECI = employment cost index.

the midpoint of the range of estimates now being used. The Bureau of Labor Statistics has completed surveys for nearly all of the localities it plans to survey for pay reform. (The bureau plans to finish all surveys by August 1994.) Preliminary analysis of these data suggests an average pay gap of around 30 percent. The Office of Management and Budget has expressed concerns about the methodology for estimating the pay gap, although it has only begun to detail those concerns. Administration budget estimates assume, based on unspecified revisions of current methods, a pay gap of less than 10 percent. The locality raises that would occur in 1994 under these different estimates of the gap between federal and private-sector salaries are as follows:

pay gap at 30 percent	4.8 percent raise
pay gap at 20 percent	2.9 percent raise
pay gap at 10 percent	1.0 percent raise

The Federal Salary Council, which was established by FEPCA to make recommendations on matters concerning pay reform under the act, has yet to settle all the details about implementing locality pay. CBO may revise its estimate of the locality pay gap and locality pay raises once the council has acted.

THE PRESIDENT'S PROPOSALS FOR CHANGING CURRENT LAW

Payroll for federal employees, which totaled about $80 billion in 1992, has been a frequent target of the deficit reduction efforts of successive administrations.[2] Under President Clinton's 1994 budget plan, federal employees would receive no ECI-based adjustment in 1994 and an adjustment equal to the change in ECI less 1.5 percentage points in each year thereafter for three years. The capped raises would be 1 percentage point per year below those provided for under FEPCA. In addition, the first locality adjustment would be pushed from 1994 to 1995. These changes would lower the average pay raise between 1994 and 1998 substantially (see Table 2).

2. The $80 billion figure excludes benefits and covers civilian employees in the Executive Branch, excluding the U.S. Postal Service.

TABLE 2. PERCENTAGE PAY RAISES UNDER THE PRESIDENT'S PLAN, FISCAL YEARS 1994-1998

	1994	1995	1996	1997	1998	Five-Year Average
ECI Adjustments	0	2.0	1.7	1.6	2.3	1.5
Locality Adjustments						
CBO assumption	0	2.9	1.6	1.7	1.7	1.6
OMB assumption	0	1.0	0.5	0.5	0.5	0.5

SOURCE: Congressional Budget Office.

NOTES: ECI = employment cost index; CBO = Congressional Budget Office; OMB = Office of Management and Budget.

ESTIMATING THE SAVINGS FROM THE PRESIDENT'S PAY PLAN

CBO estimates that the outlay savings from the Administration's pay proposal would amount to $29 billion over five years.[3] This estimate was prepared using a BEA baseline that inflates current-year personnel costs at a rate equal to changes in the ECI for each year. The raises amount to 3.2 percent in 1994 and 1995 and 2.9 percent in each year thereafter through 1998. The five-year average is 3.0 percent. (By contrast, the ECI used in FEPCA is capped and lagged, as described earlier.) The BEA baseline does not include an amount for locality pay.

3. The estimate represents gross savings before reductions due to lost retirement contributions. This is the figure used by the Budget Committees for purposes of reconciliation. The comparable net figure is $25.4 billion.

A current-law baseline that incorporated locality raises would show greater growth in payroll. Using such a baseline to estimate the effects of the Clinton plan, therefore, would produce larger savings. In fact, although overall savings are larger, results of the use of a current-law baseline vary depending on the agency considered (see Table 3).

Savings for Civilian Agencies

Using a current-law baseline, CBO estimates that the President's pay plan would save $23.0 billion over five years--compared with $13.9 billion using a BEA baseline. Baselines reflect a variety of assumptions about pay raises, spendout rates, and increases in benefit costs. Overall, however, the difference between the two estimates for civilian agencies reflects a difference in the pay raise assumption. The BEA baseline assumes raises based on the current change in the ECI; the raise is effective at the start of the year and averages 3.0 percent.

The current-law baseline, by contrast, assumes ECI raises that average 2.6 percent (capped and lagged as required under law) and locality raises of 1.9 percent. Under current law, the combined averages adjusted for the fact that raises occur in January, one-quarter of the way through the fiscal year,

TABLE 3. OUTLAY SAVINGS FROM THE PRESIDENT'S PAY PLAN MEASURED AGAINST DIFFERENT BASELINES
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Savings Compared with the Budget Enforcement Act Baseline						
BEA Baseline[a]						
DoD civilian	33.1	43.0	46.2	48.5	50.6	221.3
Other civilian	55.7	60.0	61.9	63.9	65.9	307.4
Total	88.8	103.0	108.1	112.4	116.5	528.7
Clinton Pay Plan[b]						
DoD civilian	31.8	40.7	43.1	44.6	46.0	206.2
Other civilian	54.0	57.6	59.1	60.5	62.3	293.5
Total	85.9	98.3	102.2	105.2	108.3	499.8
Savings for Clinton Plan						
DoD civilian	1.2	2.3	3.1	3.9	4.6	15.1
Other civilian	1.7	2.4	2.8	3.4	3.6	13.9
Total	2.9	4.7	5.9	7.3	8.2	29.0
Savings Compared with the Current-Law Baseline						
Current-Law Baseline[c]						
DoD civilian	32.7	42.6	45.9	48.4	50.5	220.1
Other civilian	55.9	60.9	63.7	66.5	69.4	316.5
Total	88.6	103.5	109.6	114.9	119.9	536.6
Clinton Pay Plan[b]						
DoD civilian	31.8	40.7	43.1	44.6	46.0	206.2
Other civilian	54.0	57.6	59.1	60.5	62.3	293.5
Total	85.9	98.3	102.2	105.2	108.3	499.8
Savings for Clinton Plan						
DoD civilian	0.9	1.9	2.8	3.7	4.5	13.8
Other civilian	1.9	3.3	4.6	6.0	7.2	23.0
Total	2.8	5.2	7.4	9.7	11.7	36.8

SOURCE: Congressional Budget Office.

NOTES: Estimates do not reflect planned reductions in the work force. All numbers are estimates of gross budgetary impacts—that is, they have not been adjusted to reflect the effect of employee retirement contributions. For defense, the outlay estimates assume a spendout rate of budget authority of 75 percent. For civilian agencies, the rate is 96 percent. Estimates cover the Executive Branch only. Numbers may not add to totals because of rounding. DoD = Department of Defense.

a. Assumes employment cost index (ECI) raises at the start of the year as required by the Budget Enforcement Act (BEA). Defense amounts assume benefit increases averaging 1 percent. For civilian agencies the average is 0.32 percent.

b. Assumes no raises in 1994. ECI raises assumed capped, locality raises assumed at the level used in the President's budget (1.0 percent in 1995 and 0.5 percent in 1996 and thereafter).

c. Assumes locality and ECI raises in 1994 and thereafter as specified in the Federal Employees Pay Comparability Act of 1990. Assumes locality raises at the level estimated by CBO (2.9 percent in the first year).

increase payroll by 4.2 percent. These larger raises, compared with assumptions in the BEA, mean that estimates of savings from the President's plan will be larger.

Savings for the Department of Defense

For the Department of Defense (DoD), using a current-law baseline actually produces smaller savings: $13.8 billion over five years compared with $15.1 billion from the BEA baseline (see Table 3). This occurs for two reasons. First, the estimates incorporate a smaller amount for benefits. Second, although the raises implicit in the current-law baseline are still larger, they apply to only part of the work force. About one-third of DoD's workers are blue-collar and not eligible for locality pay. Moreover, ECI raises for this group generally occur later in the year than the January adjustment for white-collar workers.[4] Adjusting for these factors, the average increase in payroll for ECI and locality raises at DoD comes to 3.6 percent, still above the BEA but not as far above as in civilian agencies. With benefit increases, the average increase in the current-law baseline for DoD is 3.9 percent, compared with 4.0 percent using the BEA baseline. With smaller increases, the current-law baseline produces smaller savings.

4. Raises for blue-collar workers occur throughout the year, although most of them occur late in the year. The CBO assumption is that, on average, the raises occur about two-thirds of the way through the fiscal year.

House Reconciliation Action

For purposes of reconciliation, the House adopted the President's plan to skip the 1994 ECI adjustment and to cap adjustments in 1995, 1996, and 1997. In contrast to the President's proposal, however, the House plan provides for a locality adjustment in 1994. To help pay for the locality raise, the House plan would delay all raises until July.

Table 4 sets out CBO's estimates of savings for the House proposals on pay.[5] The figures follow the same pattern as described in estimating the Clinton plan. Gross outlay savings for defense and nondefense agencies combined are larger when measured against a current-law baseline than against a BEA baseline ($30.8 billion over five years compared with $24.4 billion over five years). Also, as in the previous discussion, when compared separately, figures for defense and nondefense agencies move in the opposite direction.

5. The House plan would also limit leave accumulation for members of the Senior Executive Service and eliminate payment of cash awards to all employees for five years. In addition, it calls for increasing the Administration's work force reduction target from 140,000 to 150,000. The budgetary effects of these changes are not shown in Table 4.

TABLE 4. OUTLAY SAVINGS FROM THE HOUSE PAY PLAN MEASURED AGAINST DIFFERENT BASELINES (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Savings Measured Against BEA Baseline						
DoD civilian	1.1	2.1	2.8	3.5	4.0	13.5
Other civilian	1.3	1.9	2.3	2.7	2.7	10.9
Total	2.4	4.0	5.1	6.2	6.7	24.4
Savings Measured Against Current-Law Baseline						
DoD civilian	0.8	1.4	2.2	3.0	3.5	10.9
Other civilian	1.6	2.9	4.1	5.3	6.0	19.9
Total	2.4	4.3	6.3	8.3	9.5	30.8

SOURCE: Congressional Budget Office.

NOTES: Estimates do not reflect planned reductions in the work force. All numbers are estimates of gross budgetary impacts--that is, they have not been adjusted to reflect the effect of employee retirement contributions. For defense, the outlay estimates assume a spendout rate of budget authority of 75 percent. For civilian agencies, the rate is 96 percent. Estimates cover the Executive Branch only.

BEA = Budget Enforcement Act; DoD = Department of Defense.