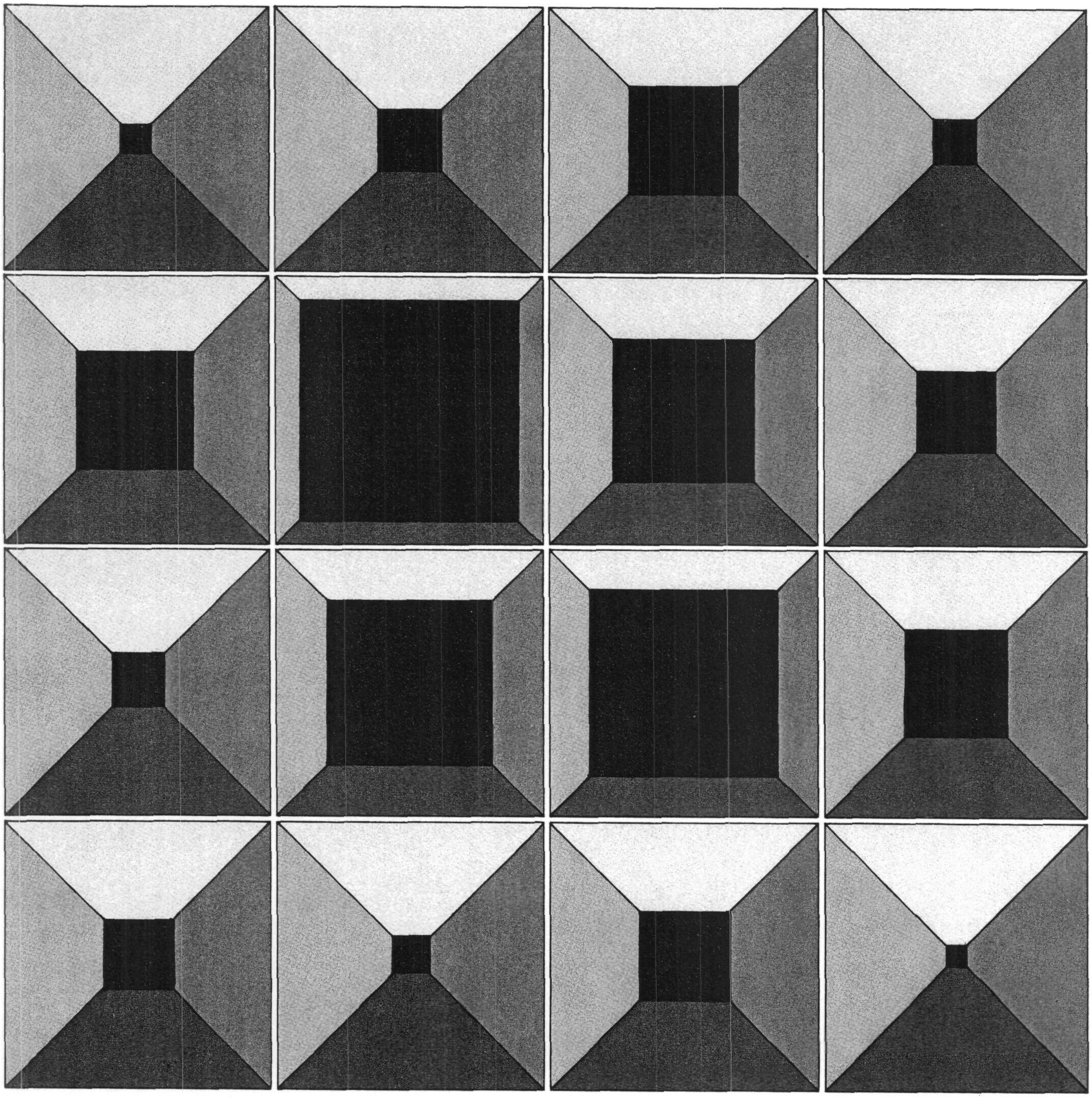
BACKGROUND PAPER

Compensation Reform for Federal White-Collar Employees: The Administration's Proposal and Budgetary Options for 1981

May 1980

Congress of the United States
Congressional Budget Office



COMPENSATION REFORM FOR FEDERAL WHITE-COLLAR EMPLOYEES: THE ADMINISTRATION'S PROPOSAL AND BUDGETARY OPTIONS FOR 1981

The Congress of the United States

Congressional Budget Office

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PREFACE

This report, which was prepared at the request of the Senate Committee on Governmental Affairs, is intended to provide the Congress with a basis for assessing the Administration's compensation reform proposals that would affect federal white-collar employees. It also identifies budgetary options for compensation in fiscal year 1981.

The paper was prepared by Earl A. Armbrust and David M. DelQuadro of the General Government Management staff of CBO's Office of Intergovernmental Relations, under the general supervision of Stanley L. Greigg. The authors gratefully acknowledge the special assistance provided by Sherri Kaplan and Susan Leverone. Francis Pierce edited the paper, and Norma Leake typed the various drafts and prepared the paper for publication.

In keeping with CBO's mandate to provide objective analysis, the report contains no recommendations.

Alice M. Rivlin
Director

May 1980

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SUMMARY

The pay of federal employees is adjusted every year through a process that compares federal salaries with those paid for similar work in private industry. The adjustment process does not take into account fringe benefits such as health insurance, life insurance, paid time off, and retirement. These benefits are established by independent authority and may be changed through separate legislative action. As a logical refinement of the existing process, the Administration has proposed legislation that would bring fringe benefits into consideration when comparing federal and nonfederal pay levels.

The Administration would also make other changes in the way compensation is determined. It would: adjust the pay of employees in different geographic areas according to the pay levels of nonfederal employees in those localities; take into consideration the compensation of state and municipal employees; and make changes in the determination of pay for federal blue-collar workers. The legislative proposal also would discontinue the practice of linking military pay increases directly to changes in the pay of federal civilian employees. Many of these reforms have been recommended before as being more equitable for employees and more cost-effective for the taxpayer.

The most fundamental change would be to include both pay and benefits in arriving at future federal compensation adjustments. In effect, the policy that government salaries be comparable with those in private industry would be extended to cover total compensation. Administrative latitude--already considerable in the current determination of federal pay adjustments--would increase. The President would be authorized to determine which benefits should be considered, how they should be compared and valued, and what adjustments should be made in the total compensation package to keep it comparable with private-sector levels. For five years, however, there could be no reduction in federal benefits. In consequence, federal pay adjustments during that time would be smaller or greater to the extent that federal fringe benefits were found to be greater or smaller than those typically available in the private sector. 1/

1/ Under the proposed legislation, the current cost to the government of federal pay and benefits would be compared to the cost that would obtain if the government adopted benefit practices typical of the nonfederal sector. This is known as a level-of-benefits or standardized cost approach to total compensation.

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The purpose of this paper is twofold: to assist the Congress in assessing the proposed compensation reforms, and to identify budgetary options for fiscal year 1981. Its scope is limited to federal white-collar employees covered by the General Schedule (GS) or related pay systems. The impact of the reform bill on blue-collar workers covered by the Federal Wage System is analyzed in a forthcoming CBO report.

Under current law, the President adjusts GS salaries every October after considering salary data for similar work in the private sector. The President may, subject to Congressional disapproval, propose alternative adjustments based on factors other than pay comparability. Pay adjustments in fiscal years 1979 and 1980 were held down because of budgetary and economic considerations.

At present the salaries of federal and private-sector employees differ noticeably in particular occupations and levels of work. The differences arise from: the 7 percent pay cap in 1980; the common use of average across-the-board increases for all employees rather than grade-by-grade adjustments; and the structure of the General Schedule, which covers a wide variety of professional, administrative, technical, and clerical occupations. For example, entry-level engineers receive salaries that are 14 percent below those of their private-sector counterparts. Average pay for federal secretaries, on the other hand, is 13 percent ahead of private practice. Not surprisingly, such discrepancies have led to considerable criticism of federal salaries and pay-setting procedures in recent years, together with various proposals for reform.

IMPACT OF THE PROPOSED COMPENSATION REFORMS

Adjusting White-Collar Pay

Under the Administration's proposal, pay comparisons with the nonfederal sector would be broadened to include salaries in state and local governments. Locality pay differentials--reflecting geographic salary variations--would also be developed. The overall budgetary impact of these reforms would be small, reducing the future size of the GS payroll by about 1 percent.

With locality pay differentials, average increases in some areas would offset average reductions in others, although the effects on individual salaries would differ widely. Sample data from 13 of 26 large standard metropolitan statistical areas (SMSA) indicate that nonfederal salaries for white-collar occupations in these areas in 1978 were at least 10 percent above the national average. Conversely, salaries in non-SMSAs, as a group, were 16 percent below the national average.

The proposed changes do not address the broad occupational coverage of the General Schedule. The Congress may wish to consider changes that would replace the General Schedule with two or more pay systems to permit more correct adjustments in federal pay. The proposals also leave the number and mix of jobs that are compared in the annual pay surveys to administrative discretion.

Considering Fringe Benefits in Adjusting White-Collar Pay

The Administration's reform proposal would base the upcoming GS pay raise on the percentage difference between the current cost to the government of pay and benefits per hour worked and the cost that would result if practices typical of the private sector were adopted. The amount of this difference cannot be estimated precisely. Under one set of assumptions the approach could reduce the 11.7 percent adjustment, necessary to achieve pay comparability as now defined, to around 3 percent. Under another set of assumptions it could increase the adjustment to approximately 15 percent. The actual result would depend upon the benefit practices found to be typical of the nonfederal sector; upon the specific benefits selected for comparison; and upon the methodology used to appraise the costs of the benefits.

No definitive survey results of employer-provided fringe benefits are available. Information must be pieced together from several different sources--especially data concerning the size and frequency of private pension cost-of-living adjustments, which seem to be made mostly on an ad hoc basis. It is also hard to say what is typical of private-sector holiday and paid vacation provisions, or how federal employees would behave if such provisions were adopted. The associated costs to the government are thus difficult to estimate exactly.

COMPENSATION REFORM ISSUES

The Administration's compensation reform bill raises three major issues:

- o What the respective roles of the executive branch, the Congress, and the employee unions should be.

- o Whether the size of future pay increases should be modified to reflect differences in fringe benefits between federal and nonfederal employees, as proposed by the Administration, or whether pay and benefit reforms should be considered separately.

- o Whether to provide Congressional guidance in implementing some of the compensation reforms.

Roles of the President, the Congress, and the Unions. The proposed reforms would give the President new powers to adjust federal employee benefits (other than retirement), and diminish Congressional authority. Although the pay and benefit adjustments would be subject to Congressional review, disapproval would effectively require enactment of separate legislation. Employee organizations would retain their present advisory role in the determination of compensation levels for federal workers. The proposals could, of course, be modified to give the Congress and the unions more say.

Combining Pay and Benefits. In practice, the proposed reforms would balance the future pay increases against future pension income. Federal employee unions and others argue that this trade-off approach would penalize employees who do not make a career in the government, who do not marry, or who have not served in the military. Another difficulty is that cost comparisons of retirement benefits rely heavily on projections of employee behavior and economic conditions over a 50-year period. In the long run, slight differences in pay rates, interest rates, and rates of inflation can have an important influence on retirement costs. For example, a half-percentage-point reduction in the average annual interest rate would increase retirement costs by 4.4 percentage points of pay. Likewise, about half of the total cost of civil service retirement, or 14 to 18 percent of the present payroll, is attributable to cost-of-living adjustments.

Implementation Policy. Adjusting pay to take account of differences in fringe benefits requires a number of judgments as to what benefits to compare and how to measure their costs. Depending on these judgments, the Administration's estimate of the October 1980 pay adjustment could change by 8 percentage points of pay. The elements contributing to this change include: bonuses provided by private employers; the relative advantage of tax-free Social Security income for those employed in the private sector; the basis used to estimate the cost of Social Security benefits; and differences in actuarial techniques.

Alternative Reform Strategies

As alternatives to the Administration's bill, the Congress could consider other legislative strategies that would lead to long-term changes in federal compensation. For example, pay and benefit reforms could be enacted independently of each other. Or the President could be authorized to submit to the Congress an alternate pay plan based on specific differences between federal and nonfederal benefits, which the Congress could revise or reject.

Under such reform strategies, the Congress would not be limited to comparability with private-sector compensation as the sole criterion for changes in federal compensation. A strategy taking into consideration other factors would allow greater flexibility in dealing with uncertainties in information; in selecting benefits and appraising costs; in avoiding long-range cost changes; in minimizing differences in impacts upon different groups of federal employees; and in viewing federal compensation practices as a model for private employers.

BUDGETARY OPTIONS FOR FISCAL YEAR 1981

The paper presents four options for federal compensation in fiscal year 1981. Each would result in an October 1980 pay adjustment below the estimated 11.7 percent increase that would occur under comparability as that term is currently defined. Options II and III would also make changes in employee benefits. The budgetary impact of each option is measured by comparing its costs in fiscal years 1981-1985 with the cost of current law, as estimated by CBO for the Senate Budget Committee. Those estimates assume a 6.2 percent increase in GS pay for fiscal year 1981.

Option I: The Administration's Proposal. The most controversial aspect of the Administration's proposal is its tradeoff between fringe benefits and pay increases. As previously indicated, the October 1980 pay increase under Option I could range between 3 percent and 15 percent depending on what benefits are selected for comparison, how they are measured, and what benefit provisions are considered typical of the private sector. For budgetary purposes, CBO estimates that implementation of Option I would result in an October pay adjustment of 8.1 percent, rather than the 6.2 percent estimated by the Administration, and therefore increase 1981 outlays by $694 million. If bonuses and the tax advantages of Social Security were included in the benefit comparisons, the estimated pay adjustment would become 11.5 percent and costs would increase accordingly.

Option II: Indexation of the October Pay Adjustment and Reform of Certain Federal Retirement and Life Insurance Provisions. Option II would consider pay and fringe benefits independently. The October 1980 pay adjustments would be based on the average annual increase in private salaries for white-collar occupations--about 8.2 percent.

At the same time, federal benefits would be modified to bring them more in line with private practice. The major changes would: reduce the size and frequency of cost-of-living adjustments for federal annuitants; provide federal group life insurance at no cost to the employee; and tighten eligibility for civil service disability benefits. The net budgetary effect in 1981 would be relatively small, increasing current law outlays by $147 million. However, the cumulative five-year impact would reduce outlays by $5 billion because of reduced retirement costs.

Option III: A 6.2 Percent Cap on the October Pay Increase and Cost-of-Living Adjustments for Civil Service Annuitants. In the past two years, federal retirement benefits have increased by 23.5 percent while pay raises for active employees have been limited to 12.9 percent. Under Option III, the burden of reducing budgetary expenditures in a time of high inflation would be shared by retired federal employees. To protect low-income annuitants from inflation, the cap on postretirement adjustments would not apply to persons receiving civil service annuities of less than $500 per month. Option III would reduce benefit outlays by $600 million in 1981.

Option IV: A One-Year Moratorium on Pay Increases for Federal White-Collar Employees. The rationale for this alternative is a desire to reduce federal spending severely. Although many believe a pay moratorium would run counter to a rational consideration of compensation reform, it would offer potential outlay savings in 1981 of $2.2 billion.

CHAPTER I. INTRODUCTION

Pay for federal employees is adjusted each year under a process that considers salaries paid in the private sector for similar work. This process is not applied to federal fringe benefits, which are set independently of pay on an ad hoc basis. The Administration has proposed legislation--the Federal Compensation Reform Act (S.1340)--that would greatly change the process.

The proposed legislation would affect 2 million federal civilian employees with a combined annual payroll of $45.3 billion. These workers are paid under the General Schedule (GS), under other pay systems that follow annual adjustments in GS rates, or under the Federal Wage System covering most blue-collar occupations (see Table 1). Other alternatives for fiscal year 1981 could also affect the 1.7 million annuitants receiving benefits under the federal civil service retirement system.

The purpose of this paper is twofold: to assist the Congress in assessing the Administration's proposal, and to identify budgetary options for fiscal year 1981. The report focuses on the compensation of employees covered by the General Schedule and related systems. This chapter provides an overview of the Administration's reform proposals. Chapter II analyzes the current system for compensating GS employees and criticisms that have been made of it, including the impact of proposed reforms on employee pay. Major issues of policy are examined in Chapter III. Chapter IV presents four options for adjusting federal compensation in fiscal year 1981, together with their estimated budgetary impacts over the years 1981-1985.

The impact of the reform bill on blue-collar workers covered by the Federal Wage System is analyzed in a forthcoming CBO report.

THE ADMINISTRATION'S PROPOSAL--AN OVERVIEW

The most far-reaching and controversial of the changes proposed by the Administration would require that differences between federal and nonfederal fringe benefits be considered in determining the size of future pay increases. For the first five years, federal pay adjustments would be smaller or greater to the extent that federal fringe benefits are determined to be more or less

TABLE 1. PAYROLLS FOR FEDERAL CIVILIAN EMPLOYEES AND CIVIL SERVICE ANNUITANTS

Pay Plan	Number (in thousands)	Estimated Outlays in Fiscal Year 1981 (in millions of dollars) a/
Active Employees b/		
General Schedule	1,397	32,583
Related pay systems	105	3,168
Subtotal, white-collar	1,502	35,751
Federal Wage System	457	9,503
Total, active employees	1,959	45,254
Civil Service Annuitants	1,656	15,749
Grand Total	3,615	61,003

a/ Outlay estimates do not reflect any pay or retirement adjustments that would be received in fiscal year 1981.

b/ Full-time employees, excluding the Postal Service. Source: Office of Personnel Management, Pay Structure of the Federal Civil Service (March 31, 1979).

liberal than those in the private sector. After five years, the executive branch would have the authority to reduce benefits (other than retirement) without Congressional action. The Administration's bill would also authorize the following reforms:

- Geographic salary differentials for most federal white-collar employees;

- Reference to pay and benefits of state and local government employees in the determination of future federal compensation levels;

- o Changes in the annual pay adjustment process for employees paid under the Federal Wage System; and

- o Elimination of the direct link between General Schedule pay increases and the annual increases received by 2 million active military employees. 1/

Applying the principle of comparability to federal employee pay and benefits is not new. It was put forward even before enactment of the Federal Pay Comparability Act of 1970. At that time, however, federal fringe benefit costs were much smaller; as a percentage of payroll, they were less than those in the private sector. Since 1970 the cost of federal fringe benefits, especially of retirement annuities, has increased, and significant differences between federal and nonfederal practices have appeared. Several recent studies of federal compensation have recommended extending the principle of comparability to benefits. 2/ Doing so, however, would raise several issues of policy: the role of the Congress in adjusting federal pay and benefits; whether to consider pay and benefits together or separately; and what sort of guidance the Congress should give in implementing the changes. These issues are discussed in Chapter III.

Under the proposed legislation, the current cost to the government of federal pay and benefits would be compared to that of adopting benefit practices typical of the nonfederal sector. This is known as a level-of-benefits or standardized cost approach to total compensation. The cost to the government is equal to the

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1/ A detailed description of the Administration's reform bill has been prepared by Sharon S. Gressle, Federal Employees Compensation Reform, Congressional Research Service (April 1, 1980).

2/ Report to the President of the President's Panel on Federal Compensation (December 1975); the President's Reorganization Project, Personnel Management Project, Final Staff Report, Volume 1 (December 1977); General Accounting Office, Need For a Comparability Policy for Both Pay and Benefits of Federal Civilian Employees (July 1, 1975); and Civil Service Commission, Bureau of Policies and Standards, Total Compensation Comparability (October 1975).

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standardized cost of benefits less employee contributions. 3/ Standardized cost measures would use federal employment data; thus, cost comparisons would not be distorted by differences in federal and nonfederal demographic characteristics or in other factors such as mortality, disability, and employee separation rates. 4/

Implementation of the Administration's reform legislation would require regular collection of reliable and comprehensive data on employee benefits in the nonfederal sector. As now proposed, compensation data would be collected on an annual basis, primarily by the Bureau of Labor Statistics (BLS). BLS surveys would include information on pay and major benefits provided by private-sector employers--retirement and long-term disability; health and life insurance coverage; and vacations, holidays, and sick leave. Within five years the bill would expand the BLS survey to include state and local government pay and benefit data.

3/ Standardized cost estimates are not the same as budgetary outlays. Some benefits, such as pensions, have long-term costs. The standardized cost of these deferred benefits is the estimated level percentage of salary, while employed, necessary to fund the expectei value of future payments. Other benefits, such as medical insurance premiums, are funded on an annual basis; their standardized cost would be equivalent to annual budgetary expenditures. Employee behavior and differences between federal and nonfederal participation rates (especially for retirement and insurance type benefits) would also be reflected in the calculations of standardized costs.

4/ Demographic characteristics include employees' age, sex, income, and marital status.

CHAPTER II. THE CURRENT SYSTEM AND CRITICISMS OF IT

A major consideration in adjusting federal pay is that it be kept comparable with pay for similar work in the private sector. Annual pay adjustments in recent years have departed from this principle as budgetary and economic considerations have kept the size of federal pay increases below those of the private sector. The credibility of the current process has suffered because of the repeated use of pay caps rather than adjustments based on comparability, according to the General Accounting Office. 1/ Aside from this, critics charge that, in practice, the processes for adjusting federal pay do not always observe comparability for particular occupations and levels of work; many federal employees are said to be underpaid or overpaid in comparison with their private-sector counterparts. Another focus of criticism is the current package of federal fringe benefits, which many say is more generous than benefits in the private sector.

PROBLEMS IN ADJUSTING WHITE-COLLAR PAY

Current law requires the President to adjust General Schedule salaries each October according to salaries for similar work in the private sector. But the President has broad authority to determine the size of pay adjustments and may, subject to Congressional disapproval, propose adjustments based on considerations other than pay comparability. 2/

The current method of determining October pay increases uses an annual survey of private employers to collect salary data for

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1/ The annual October adjustments for federal white-collar and military employees have been capped below comparability levels in three of the last five years. In fiscal years 1979 and 1980, pay increases for most federal employees were limited to 5.5 percent and 7.0 percent, respectively. For a discussion of problems in white-collar pay setting processes, see General Accounting Office, Determining Federal Compensation: Changes Needed to Make the Processes More Equitable and Credible (November 13, 1979).

2/ The President may propose a pay adjustment not based on comparability in the case of a national emergency or economic conditions affecting the general welfare.

approximately 90 specific job descriptions, such as Accountant Level III or Key Entry Operator II. On the basis of the survey, proposed adjustments are developed for grades 1 through 15 of the General Schedule (GS). An adjustment is calculated for each individual grade, reflecting pay for comparable levels and types of work in the private sector. However, in eight of the ten annual adjustments that have occurred since enactment of the Federal Pay Comparability Act, a single average increase has been applied across-the-board for most GS employees. 3/

Several aspects of the current system have been criticized in recent years--namely: the scope and structure of the General Schedule; the number and mix of jobs surveyed; the time lag between changes in federal and private-sector salary levels; the disregard for geographical differences in private-sector pay; the exclusion of data from state and local governments; and, especially important, the practice of not considering the value of fringe benefits. Not all of these possibilities for reform are addressed in the Administration's proposed legislation.

The General Schedule. At present there are noticeable differences between federal and private-sector salaries for particular occupations. This results partly from across-the-board rather than grade-by-grade pay adjustments made in the past, and partly from the monolithic structure of the General Schedule--which covers a variety of occupations ranging from messengers and clerks to managerial and professional categories. Paying clerical and professional employees from the same schedule has contributed to salary discrepencies between the federal and private sectors. For example, pay for entry-level engineers (GS-5 to GS-9) would have to increase by 13.5 percent to achieve comparability, as now defined, with pay in the private sector. On the other hand, pay for federal secretaries as a group would have to decrease by 12.7 percent (see Table 2).

Seeking to recognize job market differences among broad occupational groups, the 1975 President's Panel on Federal Compensation (the Rockefeller Commission) and the President's Advisory Committee on Federal Pay both recommended that the General Schedule be split into two or more pay systems--and that pay for clerical and related occupations be adjusted on a locality basis. If the Rockefeller proposal were adopted, future federal pay increases for clerical occupations as a group would diminish while the adjustments for most professional and administrative positions would increase. The net result could be to increase the federal payroll by some $100 million.

3/ The October 1979 pay cap of 7 percent did not apply to GS grades one and two.

TABLE 2. COMPARISON OF AVERAGE FEDERAL AND PRIVATE-SECTOR SALARIES FOR SELECT OCCUPATIONS

Occupation	GS Grade	Average Salary: Private Sector March 1979	Average Salary: Federal October 1979	Percent Change to Achieve Comparability a/
Key Entry Operator	2	9,094	8,230	+10.5
Typist	3	10,125	9,601	+5.4
Accounting Clerk	4	11,367	11,292	+0.7
Secretaries	4-8	12,355	14,151	-12.7
Engineers	5-9	20,264	17,846	+13.5
Computer Operator	7	14,921	15,668	-4.8
Auditor	9	20,303	17,968	+13.0
Accountant	11	24,045	22,553	+6.6
Buyer	11	25,508	22,881	+11.5
Personnel Director	14	43,933	39,248	+11.9
Engineer	15	45,221	48,240	-6.3

SOURCE: Derived from information in the report of the Advisory Committee on Federal Pay, Eight Years of Federal White-Collar Pay Comparability (June 29, 1979), Table 1, pp. 3-5; and BLS data in the 1979 Report of the President's Pay Agent, Comparability of the Federal Statutory Pay Systems With Private Enterprise Pay Rates (August 6, 1979), Table 1, pp. 11-16.

a/ Pay comparability as currently defined excludes consideration of fringe benefits, and data from state and local governments.

The Administration is not adopting this idea, partly because clerical and technical jobs at middle and lower levels are filled by large numbers of women and minority employees. Rather than splitting the General Schedule, the Administration proposes to use geographic wage differentials at GS grades 4 and 11 to establish local pay schedules for all occupations. It is unclear, however, whether this would minimize the impact on employees at middle and lower levels.

Job Surveys. The particular jobs surveyed each year are not selected according to statistical sampling criteria. In general, professional positions are overrepresented in the surveys, while technical and administrative positions are underrepresented. For example, no jobs corresponding to those of the 39,000 federal technical employees in GS grades 11 through 15 are surveyed. The position of Personnel Director is the only administrative job in the private sector surveyed for GS grades 12 through 14, even though it represents less than 1 percent of the 170,000 administrative employees at these levels and historically is a highly paid position in the private sector. Changes in the survey selection have been made in the past, and some modifications are currently being considered. The Administration's proposal would leave decisions on the number and mix of jobs surveyed to administrative discretion.

Timeliness of Adjustments. The annual GS pay adjustment process uses March as a reference point in compiling data on pay levels, and October as the month in which increases take effect. Changes in private-sector pay that occur between March and October cannot be taken into account until the following year. In contrast to the GS pay system, federal blue-collar pay adjustments must become effective 45 days after the local wage survey is ordered. The proposed reform bill does not address this issue although past Administrations have recognized, in principle, the desirability of reducing the time lag.

Employee organizations favor changes that would eliminate or reduce the time lag, which they say creates a particular hardship for federal employees in times when wages and prices are increasing rapidly. The Bureau of Labor Statistics cannot move the March reference point for annual pay surveys closer to October. Pay adjustments could be made more timely by other measures, however, such as making the pay increase retroactive to March, or adjusting the October increase according to a statistical estimate of private-sector changes since March. The size of such an adjustment in fiscal year 1981 could be about 4 percentage points, increasing the year's payroll by approximately $1.4 billion.

Locality Pay. Pay for most federal white-collar employees is not affected by the geographic area in which they work. 4/

4/ Exceptions are Alaska and Hawaii. In these states, GS pay rates are adjusted to reflect the higher cost of living as measured by the Consumer Price Index. The Administration's bill would discontinue these adjustments and, as in other areas, base pay on local standards.

Nonfederal salaries, on the other hand, often vary for the same occupation throughout the country. Many observers conclude that nationwide GS pay rates result in some federal employees being paid more, and some less, than their local counterparts in the nonfederal sector. Locality pay differentials would reduce such inequities. Since increases in some areas would offset reductions in others, the geographic differentials would probably have little effect on the total GS payroll.

In some areas, adjustment to local standards would have a significant impact on the pay of federal white-collar employees. For illustration, in half of the 26 largest standard metropolitan statistical areas, excluding the Washington, D.C. area, nonfederal salaries for white-collar occupations are estimated to be at least 10 percent above national averages; salaries in nonmetropolitan areas, as a group, average 16 percent below the national average (see Table 3). 5/

Data From State and Local Governments. State and local employees comprise about 16 percent of the white-collar work force in the nonfederal sector. 6/ Several studies recommend including them in future federal comparability surveys. 7/ Analysis of the 1978 current population survey indicates that nationwide average salaries for nonfederal white-collar employees are about one percent lower if state and local government employees are included. This suggests that, on average, federal salaries are slightly higher than they would be if state and local data were included in annual pay surveys. Although inclusion of state and local data on employee benefits could also make a difference, the effect cannot be quantified at this time.

5/ The Administration's proposal would not necessarily have a similar impact. It would establish local GS pay rates by surveying a limited number of nonfederal occupations to determine rates of pay at GS grades 4 and 11. Rates for the remaining grades would be extrapolated from these. The results would depend heavily on the specific job matches selected.

6/ The estimate excludes occupations (such as teaching, public safety, and administration of justice) predominately found in state and local governments.

7/ Reports to the President of the President's Panel on Federal Compensation (December 1975); Advisory Committee on Federal Pay, Eight Years of Federal White-Collar Pay Comparability (June 29, 1979); General Accounting Office, Improvements Needed in the Survey of Non-Federal Salaries Used as Basis for Adjusting Federal White-Collar Salaries (1973).

TABLE 3. SALARIES OF WHITE-COLLAR EMPLOYEES IN THE NONFEDERAL SECTOR, BY SELECTED STANDARD METROPOLITAN STATISTICAL AREAS, 1978

	All White-Collar		Professional-Administrative		Clerical-Technical	
	Average Salary	Relation to Nationwide Index = 1.000	Average Salary	Relation to Nationwide Index = 1.000	Average Salary	Relation to Nationwide Index = 1.000
New York, N.Y.	$12,001	1.134	$15,255	1.137	$8,895	1.186
Los Angeles-Long Beach, Calif.	10,283	.972	12,080	.900	8,143	1.086
Chicago, Ill.	12,879	1.217	16,648	1.241	8,649	1.154
Philadelphia, Pa.	11,360	1.074	14,137	1.054	8,413	1.122
Detroit, Mich.	13,500	1.276	17,497	1.304	9,018	1.203
Boston, Mass.	10,816	1.022	13,713	1.022	7,972	1.063
San Francisco-Oakland, Calif.	11,795	1.115	14,252	1.062	8,409	1.122
Dallas, Texas	10,559	.998	13,206	.984	7,951	1.061
Nassau-Suffolk, N.Y.	12,475	1.179	15,836	1.180	8,509	1.135
St. Louis, Mo.-Ill.	11,789	1.114	15,713	1.171	8,516	1.136
Pittsburgh, Pa.	11,696	1.105	15,228	1.135	7,936	1.059
Baltimore, Md.	11,635	1.100	15,262	1.138	8,231	1.098
Minneapolis-St. Paul, Minn.	12,826	1.212	16,283	1.214	9,005	1.201
Newark, N.J.	14,186	1.341	18,045	1.345	7,775	1.037
Cleveland, Ohio	13,114	1.239	17,231	1.284	8,386	1.119
Atlanta, Ga.	11,094	1.048	13,674	1.019	8,257	1.101
Anaheim-Santa Ana-Garden Grove, Calif.	12,764	1.206	15,392	1.147	8,406	1.121

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TABLE 3. Continued

San Diego, Calif.	10,517	.994	12,437	.927	7,682	1.025
Denver, Colo.	11,844	1.119	15,840	1.181	7,581	1.011
Seattle-Everett, Wash.	11,413	1.079	14,364	1.071	8,020	1.070
Miami, Fla.	9,679	.915	11,753	.876	7,122	.950
Milwaukee, Wis.	10,949	1.035	14,823	1.105	8,115	1.082
Tampa-St. Petersburg, Fla.	9,217	.871	10,896	.812	7,122	.950
Cincinnati, Ohio	11,179	1.056	12,873	.959	9,432	1.258
San Bernardino-Riverside-Ontario, Calif.	8,116	.767	9,362	.698	7,037	.939
Kansas City, Mo.-Kansas	10,756	1.016	13,938	1.039	8,179	1.091
All Select SMSAs	11,691	1.105	14,715	1.097	8,357	1.115
Other SMSAs	10,646	1.006	13,755	1.025	7,425	.990
Non-SMSAs	8,904	.841	11,202	.835	6,368	.849
Average a/	10,582	1.000	13,417	1.000	7,497	1.000

SOURCE: Derived from sample data in the 1978 Current Population Survey conducted by the U.S. Bureau of the Census. The salary comparisons include occupations common to those in the federal civil service and the nonfederal sector, excluding jobs found predominantly in state and local governments (such as teaching, public safety, and administration of justice). The analysis is limited to persons aged 16 and over employed full-time.

a/ The Washington, D.C., Maryland, Virginia Standard Metropolitan Statistical Area is excluded from the comparative analysis because the federal government has a significant influence on salary levels in the region.

Pay Comparisons

Some analysts believe that federal workers, on average, receive more pay than their nonfederal counterparts. This conclusion was supported by comparing average salaries received by groups of federal and private-sector employees of similar educational levels or occupations. 8/ This method of comparison differs from the federal practice of surveying private employers to determine salaries for a select number of specific job descriptions, such as Accountant Level III or Key Entry Operator II.

When salaries of white-collar employees in similar occupational groups are weighted according to their educational level, it becomes possible to take into account some of the differences in qualifications, levels of responsibility, and work requirements. Average 1978 earnings for federal employees in clerical occupations appear about 23 percent above those for private-sector employees, according to a CBO analysis that considers educational background. On the other hand, earnings for professional, administrative, and technical occupations, as a group, are nearly equal (see Table 4). The higher pay for federal clerical workers, as a group, most likely results from the use of a single pay system for all white-collar employees and the practice of granting annual comparability adjustments across the board rather than on a grade-by-grade basis.

Average earnings for women employed by the federal government are 39 to 44 percent greater than private-sector averages (see Table 4). The difference in average earnings for women cannot be readily explained, but contributing factors probably include greater job equality for women in the federal government.

THE EFFECT OF INCLUDING FRINGE BENEFITS

The major fringe benefits currently provided federal employees are: retirement and disability; life and health insurance; and

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8/ One analyst writes that comparisons of federal and private pay for the period 1973 through 1975 indicate that "federal workers, on average, received pay that was at least similar and usually superior to that of comparable private-sector workers." The current pay comparability system was found to help "reinforce the upward bias...in Government pay." Sharon P. Smith, "Federal pay scales: how much is too much?" Federal Reserve Bank of New York, Quarterly Review (Autumn 1978), pp. 7-15.

TABLE 4. AVERAGE EARNINGS RECEIVED BY WHITE-COLLAR EMPLOYEES IN THE FEDERAL GOVERNMENT AND IN THE PRIVATE SECTOR, WEIGHTED BY EDUCATION, 1978

Occupation and Sex	Federal a/	Private b/	Federal as Percent of Private
Professional, Administrative, and Technical			
Men	$19,550	$20,000	97.8
Women	12,312	8,875	138.7
Weighted c/	17,919	17,494	102.4
Clerical			
Men	13,024	11,680	111.5
Women	8,715	6,060	143.8
Weighted c/	10,852	8,848	122.6

SOURCE: Derived from sample data in the 1978 Current Population Survey conducted by the U.S. Bureau of the Census.

a/ Covers civilians receiving federal earnings from all pay systems, excluding the U.S. Postal Service.

b/ Private salaries are weighted to reflect the distribution of federal employees among education levels.

c/ These weighted salaries reflect the relative numbers of men and women.

paid time off for vacations, holidays, and sick leave. These account for 31 to 36 percent of the total compensation received by federal employees. They are authorized by separate legislation, amended from time to time on an ad hoc basis. Several studies have recommended that fringe benefits should be included in any realistic comparison of federal and nonfederal compensation practices.

A comparison of fringe benefits is made difficult by the fact that there is no definitive analysis of fringe benefits received by white-collar employees throughout the United States. Thus, it is not possible to determine whether federal employees currently receive more or less compensation in the form of fringe benefits than they would if practices typical of the nonfederal sector were adopted. Federal fringe benefits may range from the equivalent of 2.8 percent of pay behind private-sector practices to 7.4 percent of pay ahead. The range (10.2 percentage points) results both from uncertainty about what benefit provisions are to be considered representative of the private sector and from differences in implementation assumptions, especially as to the selection of benefits and the way of measuring their costs. The impact of different implementation assumptions is discussed in Chapter III. Two particular benefit provisions for which there is neither complete nor comprehensive information on private practices are the size of post-retirement cost-of-living adjustments and the average number of days provided for holidays and vacations.

Cost-of-Living Adjustments for Retirement. The degree to which retirement benefits are adjusted for inflation significantly affects the value of different pension plans to employees and their relative cost to the employer. At present, civil service annuities are automatically adjusted twice a year for cost-of-living increases as measured by changes in the Consumer Price Index. If no provisions were made for post-retirement adjustments, the standard level cost to the government would be reduced by 14 to 18 percentage points of pay. Most private plans do not provide for automatic cost-of-living increases, but when adjustments are made--including those that occur on an ad hoc basis--they may compensate for an average of 30 percent of the increase in the Consumer Price Index. A longitudinal comparison over a number of years would provide a more precise estimate, but there is no assurance that future increases will be the same as in the past. The guarantee of full inflation protection for federal retirement is obviously an important value to employees.

Holidays and Vacations. If typical private-sector practices were adopted, federal white-collar employees would receive nearly 23 days off per year for holidays and vacations according to the Federal Office of Personnel Management (OPM). A Congressional Budget Office estimate based on data provided by Hay Associates indicates that federal employees would continue to take an average of 28 days off per year if private provisions were adopted. 9/ The difference of five days between the two estimates is equivalent to about 2.4 percent of pay.

9/ Hay Associates, an independent actuarial firm specializing in employee compensation, was retained by CBO to analyze employee benefit plans.

Total Compensation Comparisons

Under current procedures for adjusting GS pay rates, an October 1980 adjustment of 11.7 percent would be necessary to keep pace with changes in private-sector salaries in the past two years. 10/ If differences between federal and private-sector benefits were also taken into account, the upcoming GS pay adjustment could be reduced to as little as 3.4 percent or increased to as much as 14.8 percent (see Table 5)--depending on the assumptions made about private-sector benefits and their associated costs. These estimates were prepared by CBO to demonstrate the potential impact of modifying GS pay increases to reflect fringe-benefit differences.

Estimated 3.4 Percent Adjustment. The low estimate, based mainly on data and illustrative examples supplied by OPM, 11/ assumes that typical private-sector pension plans provide cost-of-living adjustments equal to 25 percent of annual increases in the Consumer Price Index. Social Security is valued at 10.7 percent of pay (the difference between total cost and the employee contribution) without regard to tax considerations. In addition, federal employees are believed to use the equivalent of 1.4 more days off per year than they would if private-sector practices were adopted.

Estimated 14.8 Percent Adjustment. The high estimate, based largely on data and actuarial analyses prepared for CBO by Hay Associates, assumes more liberal private-sector retirement provisions, includes employee bonuses, and assumes that federal employees would use an average of four more days of paid leave per year if private practices were adopted. In addition, cost-of-living adjustments in private plans are assumed to average 30 percent of changes in the CPI, and consideration is given to the tax-free advantage of Social Security income--increasing its estimated value from 10.7 to 13.4 percent of pay.

10/ The 11.7 percent adjustment is based on CBO projections. Using slightly different economic assumptions, OPM estimates a pay comparability adjustment of 10.9 percent. Both estimates include a 1979 catch-up amount equivalent to 3.2 percentage points, to compensate for the October 1979 federal pay cap of 7 percent.

11/ Office of Personnel Management, Standardized Cost Estimates of 'Typical' Benefit Plans (May 25, 1979). Estimates of private-sector benefits are based on "Plan B" provisions. The private pension valuation is based on an OPM reestimate of October 12, 1979.

TABLE 5. ESTIMATED CHANGES IN FEDERAL COMPENSATION COSTS IF PRIVATE-SECTOR PRACTICES WERE ADOPTED

	High Increase		Low Increase	
	Present Federal Practices	Adoption of Private Practices	Present Federal Practices	Adoption of Private Practices
Average Salary (Estimated for March 1980) a/	$20,000	$22,332	$20,000	$22,332
Benefits as a Percent of Payroll b/				
Retirement and disability	20.2	18.3	29.5	19.2
Health and life insurance	2.8	5.7	2.7	4.6
Bonuses and lump-sum payments	0.8	1.0	0.7	--
Total	23.8	25.0	32.9	23.8
Productive Hours				
Total scheduled hours	2,080	2,045	2,080	2,044
Paid time off	-300	-298	-300	-253
Productive work hours	1,780	1,747	1,780	1,791
Cost per Productive Hour c/	$13.91	$15.97	$14.93	$15.44
Pay Increase Needed to Achieve Comparability	14.8%	--	3.4%	--

a/ The difference between federal and private-sector salary levels reflects an estimated pay comparability adjustment of 11.7 percent.

b/ Benefits for paid time off (holidays, vacations, sick leave, and shorter workweek) are included in the calculations of productive work hours. The estimates do not include an additional national holiday in honor of Dr. Martin Luther King, Jr.

c/ The cost per productive hour is calculated as:

$$\frac{\text{(Average Salary) (1 + Benefits as a Percent of Payroll)}}{\text{Productive Work Hours}}$$

THE UNION PERSPECTIVE

Unions and employee organizations generally hold that decisions about changes in employee compensation should not be based solely on mathematical comparisons but should also allow for the expression of employee views and the consideration of factors other than comparability. In the unions' view, federal compensation decisions ideally should be reached through the collective bargaining process, which is commonly used in the nonfederal sector. 12/

Employee organizations point out that fringe-benefit comparisons do not differentiate between adequate and inadequate benefit levels. From this perspective, certain federal provisions such as early retirement and full protection against inflation should be regarded as a model for the private sector rather than as an advantage to be traded off by reducing the size of future pay raises.

Employee organizations challenge the Administration's reform proposal on several other grounds, including the following:

- It focuses largely on changes in the pay adjustment process that would reduce federal compensation, excluding others that would increase it, such as: increasing the minimum size of establishments surveyed, reducing the time lag in making GS pay adjustments, and including pay and benefit data from the U.S. Postal Service.

- Federal pay and benefit adjustments should be considered independently because benefit comparisons are highly sensitive to the selection of evaluation methodology and assume an ability to accurately forecast pay, interest, and cost-of-living increases over a period of 40 or 50 years.

- Locality pay differentials based on a limited number of job matches could be inaccurate. Regional pay differentials might be preferable.

12/ For a brief discussion of collective bargaining as a means of determining federal compensation, see CBO, Federal White-Collar Employees--Their Pay and Fringe Benefits (April 1979), p. 4.

- Three of the last five GS pay adjustments have been capped below comparable private-sector levels, as currently defined, and there is no assurance that pay caps will be less frequent after enactment of the reform bill. These caps have aggravated the loss of real income; GS pay increased 33.4 percent in fiscal years 1976-1980 while the cost of living increased 53.0 percent.

CHAPTER III. COMPENSATION REFORM ISSUES

In considering the Administration's federal compensation reform bill, the Congress may face several policy questions:

- o What the respective roles of the executive branch, the Congress, and the employee unions should be.

- o Whether the size of future pay increases should be modified to reflect differences in fringe benefits between federal and nonfederal employees, as proposed by the Administration, or whether pay and benefit reforms should be considered separately.

- o Whether to provide Congressional guidance in implementing some of the compensation reforms.

ROLES OF THE PRESIDENT, THE CONGRESS, AND THE UNIONS

The proposed reform bill would give the President new authority. Five years after enactment, he would be empowered to adjust federal benefits other than retirement benefits. 1/ The President could also, as under current law, propose compensation adjustments not based on comparability with the private sector. Although such adjustments would be subject to Congressional review, disapproval would, in effect, require separate legislation. 2/

The Administration's proposals could be modified to retain the existing division of roles between the Congress and the executive branch in determining federal compensation. All fringe benefit modifications would then require legislative action, and the Congress would retain the power to reject, by a simple majority of either house, alternate pay adjustment not based on comparability.

1/ In the first five years, federal benefits could not be reduced through administrative action.

2/ At present, an alternative pay adjustment based on considerations other than comparability may be disapproved by a simple majority of either the House of Representatives or the Senate within 30 days of its submission to Congress.

Under the Administration's reform bill, employee organizations would continue to play only an advisory role in deciding compensation levels for federal workers. In the unions' view, however, the role of employee organizations should be more consistent with the collective bargaining process used for setting compensation in the nonfederal sector. Although this is a separate and complex issue, the Congress may want to consider giving employees greater participation in carrying out compensation reforms.

SHOULD PAY AND BENEFITS BE CONSIDERED TOGETHER OR SEPARATELY?

The Administration's bill would consider fringe benefits in determining the size of future pay increases. That is, it would trade income received during active employment for other forms of compensation, especially pension income received in retired years. This approach to comparability would achieve immediate savings in outlays, but it has two drawbacks: it would be subject to long-range uncertainties, and it would create inequities for certain groups of federal employees.

Long-Range Uncertainties

The provisions of the bill would require the Administration to compare the current cost to the government of federal pay and benefits per hour worked to its cost if benefit practices typical of the nonfederal sector were adopted. But the costs of specific benefits may vary considerably if long-range economic conditions change. For example, a half-percentage-point change in the average annual inflation rate over the next 50 years would change the estimated cost of existing federal retirement benefits by 1.9 percentage points of pay. Even more dramatic, a half-percentage-point reduction in long-term interest rates would increase retirement costs by 4.4 percentage points of pay. 3/ Thus it is not possible to compare precisely the value of federal and nonfederal benefits.

Potential Inequities Among Employees

Federal employees do not all receive the same fringe benefits because of age, sex, marital status, income level, or other differences not related to job performance. The bill's approach to total

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3/ These estimates assume that all other conditions remain unchanged.

compensation, however, would reduce the pay of all employees by the same percentage, regardless of the benefits they receive. Thus, the compensation for many non-career employees, single persons, women, and younger workers, whose benefits are relatively less, could be affected disproportionately.

Non-Career Employees. Approximately 40 percent of the more than 88,000 persons newly hired each year leave the government within five years. They are mainly younger employees and working women, who will not receive federal retirement benefits. Under the Administration's proposal, however, their next salary adjustment could be as much as 8.6 percentage points lower than if retirement benefits were not considered.

Single Persons. Survivor benefits available to the spouses of federal employees and annuitants cost the government approximately 4.3 percent of pay. The Administration's total compensation approach, however, would provide the same pay adjustments for single and married employees alike. While the availability of survivor benefits may be worth something to single employees who are contemplating marriage, many single workers leave the government before marrying; about 20 percent will be single at the time they retire.

Women and Younger Employees. Pay adjustments under the Administration's plan would also reflect retirement credit currently granted for past military service, costing an estimated two percent of payroll. The total compensation approach would therefore penalize civilian workers who have not had military service, mostly women and younger employees.

CONGRESSIONAL GUIDANCE

The impact of fringe benefit comparisons on future pay adjustments would depend, in part, on which benefits were selected for comparison and how they were valued. The Administration's proposal would give broad discretion in these matters to the President. Alternatively, the bill could be modified to provide guidance in certain areas.

Depending on the guidance provided, the impact of the pay reform could be quite different from that anticipated by the Administration. The President's budget estimates assume that a comparison of federal and private-sector fringe benefits would reduce the October 1980 pay comparability adjustment, as now defined, by 4.7 percentage points. Under certain changes in the selection of benefits and in the cost methodology used, the October adjustment could be as much as 14.6 percent--or 3.7 percentage points greater than the Administration's 10.9 percent estimate of pay comparability if fringe benefits are not considered. The estimates in Table 6 are provided for illustrative purposes to indicate the potential impact of Congressional guidance on the Administration's estimates. The impact would be different, of course, if different estimating techniques or assumptions were used, or if changes other than those illustrated were adopted. The estimates are discussed in detail below.

Selection of Benefits

The Congress could identify specific benefits to be included in the survey of nonfederal practices, rather than leaving the selection to the executive branch as provided in the proposed legislation.

Administration plans for comparing fringe benefits would consider retirement and disability pensions, life and health insurance, and paid leave. Estimates published by the Administration do not consider employer-provided bonuses or the advantage of tax-free Social Security income, although their inclusion has not been ruled out. These could increase the 1981 GS pay adjustment by 3.3 percentage points above the estimate in the President's budget. Other benefits, such as thrift plans and employee discounts, could also be considered, but probably would have little impact. 4/

Bonuses. In the past, the Administration has opposed the inclusion of bonus data in annual pay surveys since reliable private sector data could only be collected on a broad occupational basis. On this basis, bonuses for white-collar employees in the private sector average about 1.0 percent of pay per year as compared with cash awards of 0.1 percent to federal white-collar workers. Inclusion of bonuses in future compensation comparisons could increase the size of the GS payroll by 0.8 percent over that in the President's 1981 budget.

Social Security Tax Advantage. Social Security income is tax-free; in combination with other sources of retirement income, including company pensions, it results in lower tax brackets than would be applied to equivalent income received by civil service

4/ The General Accounting Office is currently collecting information from nonfederal employers on benefits not generally included in Bureau of Labor Statistics reports.

TABLE 6. POTENTIAL IMPACT OF CONGRESSIONAL GUIDANCE ON THE ADMINISTRATION'S ESTIMATED PAY INCREASE FOR 1981

		Percentage Points of Pay
Full Comparability Increase, as Estimated in the President's Budget		10.9
Impact of Considering Fringe Benefits, as Estimated in the President's Budget		-4.7
Pay Increase as Estimated in the President's Budget		6.2
Potential Impact of Congressional Guidance: a/		8.4
Including employee bonuses	(+0.8)	
Considering private sector advantage of tax-free Social Security income	(+2.5)	
Changing basis for costing social security to reflect portion not paid by employee	(+2.3)	
Adopting different actuarial methods for costing retirement	(+2.4)	
Measuring paid time off on basis of leave used by federal workers rather than leave earned	(+0.5)	
Possible Increase if Above Approaches Were Adopted		14.6

NOTE: The impact is attributable to differences in the selection of benefits and in the cost methodology employed--not to uncertainties as to private benefit provisions. The estimates represent a one-time effect on federal pay levels.

a/ The combined effect of these changes, as estimated by CBO, would be slightly less than the sum of the individual effects.

annuitants. Civil service retirement benefits, generally viewed as a substitute for both the Social Security program and an employer-provided retirement plan, are subject to federal income tax.

The Social Security tax advantage varies greatly among individuals, depending upon the amount of their pensions and other taxable income, the number of their dependents, and their age. Thus retired persons at lower income levels have little if any tax advantage; at the other extreme, the combination of Social Security and a private pension plan can reduce the average tax rate for certain persons by about one-third. 5/ Although the relative Social Security tax advantage is difficult to determine, if it were taken into consideration in federal-private pay comparisons it would probably increase the October pay adjustment by around 2.5 percentage points.

Cost Methodology

The methodology chosen for calculating the cost of Social Security, retirement annuity plans, and paid leave would significantly influence fringe benefit comparisons, and thus the size of future pay adjustments under the Administration's proposal.

Social Security. Analyses prepared by OPM place the value of benefits provided by the Old-Age, Survivor and Disability (OASDI) program at 15.7 percent of pay, splitting the cost evenly between employer and employee. Given the composition of the federal work force and projected increases in Social Security withholdings, CBO estimates that total employee contributions over an employee's work career would equal 5 percent of the average annual payroll. On this basis, but without considering tax advantages, the cost to the government of providing OASDI benefits is estimated at 10.7 percent of pay--2.8 percent of pay more than OPM's estimate of 7.9 percent. 6/ This cost method is consistent with that used for valuing civil service retirement.

5/ The average tax rate of 36 percent paid by certain federal annuitants with relatively high income levels would be reduced to 23 percent if their civil service annuity were replaced with a combination of Social Security and a typical private pension.

6/ The standard level cost of Social Security to the government, as estimated by CBO, assumes a total actuarial cost of 15.7 percent of pay less estimated employee contributions.

Retirement Plans. Cost comparisons between civil service retirement and any particular private pension plan vary depending upon the actuarial model used; OPM has estimated an average cost difference of 22 percent of payroll. A cost comparison by Hay Associates 7/ of federal retirement on the one hand and of OPM's private plan provisions on the other reduced the estimated difference to 19 percent of payroll. The latter figure, if applied to pay comparisons, would entail a pay increase for federal employees 2.4 percentage points higher than that in the President's 1981 budget.

In light of the dynamic and highly technical nature of retirement valuations, it is not surprising that models based on acceptable actuarial techniques produce different results. Because the selection of a particular model has an important effect on pay levels, the Congress may wish OPM to consider alternative models, or possibly an average of several estimates.

Paid Time Off. The choice of methodology for valuing paid time off for federal employees is another area in which Congressional guidance might be considered. OPM values paid time off according to days earned, even though some unused leave is forfeited each year. An alternative method would calculate leave on the basis of days used, and include the cost of lump sum payments for unused leave. This method would more accurately reflect the behavior of federal employees and be consistent with the cost-per-productive-hour approach used by the Administration. Valued on this basis, hours worked by federal employees would be greater than the Administration's estimate, entailing a pay increase 0.5 percentage points over that in the President's 1981 budget.

STRATEGIES FOR COMPENSATION REFORM

As an alternative to the Administration's bill, the Congress could consider pay and benefit reforms independently. The Advisory Committee on Federal Pay supports legislation "to test and develop a comparability system for employee benefits" but believes that "benefit comparability and pay comparability can best be achieved

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7/ Hay Associates, an independent actuarial firm specializing in employee compensation, was retained by CBO to provide actuarial cost estimates of federal and private retirement plans.

independently." The committee recommends against reductions in pay designed to offset differences between federal and nonfederal benefits. 8/

One strategy would be to adopt reform measures that would bring federal practices into closer alignment with those in the nonfederal sector. Possibilities for reform under this approach include:

- Pay reforms proposed by the Administration, including changes in the Federal Wage System, use of locality pay differentials for federal white-collar employees, and inclusion of salary data from state and local governments in making annual comparisons;

- Other pay reforms, such as splitting the General Schedule into two or more pay systems or establishing statistical criteria for the number and mix of white-collar jobs surveyed annually by the Bureau of Labor Statistics;

- Federal benefit reforms recommended by the General Accounting Office with respect to eligibility for disability retirement and workmen's compensation; the GAO has also recommended changes in calculating initial post-retirement cost-of-living adjustments;

- Reforms that would make the federal retirement system more comparable with private practices as to the size and frequency of cost-of-living adjustments; and

- Select increases in federal benefits, such as life insurance and disability.

Another strategy would be to enact reforms in the Federal Wage System and at the same time provide for collection and evaluation of data on: fringe benefits; compensation practices of state and local governments; and geographic pay differentials for General Schedule employees. Further authorization would be required, however, before the new information could be used to adjust federal pay. This approach, greatly limiting the authority contained in the Administration's bill, would allow more time to develop the proposed trade-off between fringe benefits and future federal pay increases.

8/ Advisory Committee on Federal Pay, Eight Years of Federal White-Collar Pay Comparability (June 29, 1979), pp. 27-28.

A third strategy would authorize the President to submit an alternative pay plan based on differences in fringe benefit values. The Congress could review the methods and assumptions used by the Administration and, if necessary, revise or reject the plan. After several years' experience, the Congress could consider granting the executive branch more authority to make administrative changes.

In reviewing these or other reform strategies, the Congress would not be limited to a single criterion--that of comparability with the nonfederal sector. Consideration could be given to factors such as budgetary limitations and the extent to which the federal benefits would set an example for private industry. The latter consideration is important to employee organizations, especially with regard to provisions that are designed to protect employee benefits from inflation. These strategies would also allow greater flexibility in dealing with uncertainties in information; in selecting benefits and appraising costs; and in minimizing differences in effects on different groups of federal workers.

CHAPTER IV. BUDGETARY OPTIONS FOR FEDERAL COMPENSATION IN FISCAL YEAR 1981

The October 1979 pay adjustment was capped at 7 percent for budgetary and economic reasons. As a result, salaries for most federal employees are now below "comparability" with the private sector, as comparability is currently determined. To achieve full comparability in fiscal year 1981 under current law, federal pay adjustments would have to average an estimated 11.7 percent for General Schedule and related white-collar employees. Such increases would exceed both the President's 1981 budget estimate of 6.2 percent and the national wage guidelines. 1/

If the Congress wishes to limit federal employee compensation to less than full comparability, several alternatives are available. This chapter presents four options for federal compensation in fiscal year 1981 that would limit the October 1980 pay adjustment below comparability. Options II and III would also change certain employee benefit provisions. The options illustrate the kinds of changes that could be considered, although they do not exhaust the possibilities.

Option I: Adopt the Administration's reform plan;

Option II: Index the October pay adjustment, and reform certain federal retirement and life insurance provisions;

Option III: Establish a 6.2 percent cap on pay and retirement adjustments in 1981;

Option IV: Enact a one-year moratorium on pay increases for federal white-collar employees.

Changes in federal compensation affect the budget over time, increasing or reducing future outlays for pay and benefits. For

1/ The Council on Wage and Price Stability views the 7.5 percent to 9.5 percent wage guidelines as a voluntary ceiling, intended to limit the size of wage settlements. Employee organizations maintain that the Administration agreed that the pay increase for federal workers would be the same rate as the guideline for all workers throughout the nation.

this reason it is useful to compare the impacts that alternative changes--often small in initial years--have over a longer term. In Table 7 the budgetary impact of each alternative represents the difference between its cost in fiscal years 1981-1985 and the cost of current law projections, based on five-year estimates prepared by CBO for the Senate Budget Committee. The current law estimates assume an October 1980 pay increase of only 6.2 percent, implying 1981 outlays would be $2.0 billion less than an adjustment according to the present comparability standard.

Compared to the current law estimates, the four options would have a cumulative budgetary impact in 1981-1985 ranging from outlay increases of $4.1 billion (Option I) to further reductions of $13.2 billion (Option IV).

OPTION I. THE ADMINISTRATION'S REFORM PLAN

The Administration's proposal, Option I, is advanced as a logical refinement of the existing pay comparability process. This option is the most far-reaching and comprehensive, requiring: consideration of fringe benefits, locality pay differentials for most federal white-collar employees, inclusion of compensation data from state and local governments, and changes in the determination of pay levels and of future increases for the Federal Wage System. Military pay increases would no longer be linked directly to rate changes in the General Schedule. Several of these reforms have been repeatedly recommended from the standpoint both of equity among employees and of cost to the taxpayer.

The most controversial aspect of the Administration's proposal is its trade-off between fringe benefits and pay increases. In effect, pay comparability as a principle would be subsumed under a total compensation approach that would include both pay and fringe benefits. Administrative discretion--already considerable in the current determination of federal pay adjustments--would increase. The President would be authorized to determine which benefits should be considered, how they should be compared and valued, and what types of adjustments should be made both in pay and, eventually, in benefits.

The federal retirement program is the single most costly fringe benefit, and the one that differs most from practices in the private sector, allowing employees to retire earlier and affording them greater protection against inflation. Under the Administration's proposal, pay increases would be reduced in fiscal year 1981 to offset the advantages in future retirement income for federal employees.

TABLE 7. BUDGETARY IMPACT OF COMPENSATION OPTIONS, FISCAL YEARS 1981-1985
(In millions of dollars)

		1981	1982	1983	1984	1985	Cumulative Five-Year Impact
Option I:	The Administration's Reform Plan	694	758	818	887	957	4,114
Option II:	Indexation of Pay and Reform of Certain Federal Benefits:						
	Pay	711	778	847	919	990	4,245
	Retirement a/	-828	-1,340	-2,096	-2,838	-3,675	-10,777
	Life Insurance	264	288	314	341	368	1,575
	Total	147	-274	-935	-1,578	-2,317	-4,957
Option III:	A 6.2 Percent Cap on 1981 Increases in Federal Pay and Retirement Benefits:						
	Pay	--	--	--	--	--	--
	Retirement	-592	-721	-778	-829	-880	-3,800
Option IV:	A Pay Moratorium for Federal White-Collar Employees	-2,216	-2,423	-2,638	-2,862	-3,086	-13,225

NOTE: Budget estimates are based on full-year impacts and do not consider federal agency absorption of pay increases. Changes in federal retirement provisions are limited to the Civil Service Retirement and Disability Program.

a/ Estimates include annual post-retirement cost-of-living adjustments beginning in March 1980 and subsequent annual adjustments.

Employee organizatons, among others, oppose the trade-off approach to total compensation. They point out that Option I would depend heavily on long-term forecasts and actuarial methods used to estimate present values; they also note that it would affect different groups of employees unequally.

As indicated in Chapter II, the estimated fiscal year 1981 pay increase for federal white-collar employees under this option could range from 3.4 percent to 14.8 percent, depending on the selection of benefits, how they are measured, and on what benefit provisions are considered typical of the private sector. For budgetary purposes, CBO estimates that the October 1980 GS pay adjustment would be 8.1 percent if the reform legislation did not take into consideration employer-provided bonuses and the tax advantages of Social Security. 2/ If these two factors were considered, the CBO estimate would increase to about 11.5 percent. Estimated pay adjustments for fiscal years 1982 through 1985 average 8.4 percent. Table 8 compares GS pay increases for each of the four options and, where appropriate, annual adjustments for civil service annuitants. Compared to current law estimates, outlays under Option I would increase by $694 million in 1981. Cumulative increases through 1985 would reach $4.1 billion.

OPTION II. INDEXATION OF THE OCTOBER PAY ADJUSTMENT AND REFORM OF CERTAIN FEDERAL RETIREMENT AND LIFE INSURANCE PROVISIONS

Option II would consider pay and fringe benefits independently. The 1981 pay increase for General Schedule and related white-collar employees would be based on the average increase in private salaries for white-collar occupations--about 8.2 percent. Certain federal retirement, disability, and life insurance practices would be changed to bring them more in line with private sector practices.

2/ The Administration estimates that enactment of the reform bill would limit fiscal year 1981 pay adjustments to about 6.2 percent rather than the 8.1 percent estimated by CBO. The two estimates differ mainly in the costs they associate with: (a) Social Security benefits (CBO uses total cost less employee contributions, while OPM uses 50 percent of total cost); and (b) paid time off for federal workers (CBO calculates leave used plus lump-sum payments for unused leave, while OPM compares the amount of leave earned).

TABLE 8. ANNUAL PERCENTAGE INCREASES IN FEDERAL PAY AND BENEFITS BY OPTION, FISCAL YEARS 1981-1985

		Fiscal Year 1981	Average Increase in Fiscal Years 1982-1985	Cumulative Five-Year Increase
Current Law:				
GS pay increases		6.2	8.6	47.8
Increases for Civil Service annuitants		11.5	8.8	56.0
Option I:	The Administration's Reform Plan:			
	GS pay increases	8.1	8.4	49.2 a/
Option II:	Indexation of Pay and Reform of Certain Federal Benefits:			
	GS pay increases	8.2	8.6	50.6
	Increases for Civil Service annuitants	8.0	6.1	37.1
Option III:	A 6.2 Percent Cap on 1981 Increases in GS Pay and Retirement Benefits:			
	GS pay increases	6.2	8.6	47.8
	Increases for Civil Service annuitants	7.1 b/	8.8	49.9
Option IV:	A Pay Moratorium for Federal White-Collar Employees:			
	GS pay increase	--	8.6	39.2

a/ Includes a reduction of one percentage point for the estimated impact of state and local government pay data and geographic salary differentials.

b/ The 7.1 percent increase reflects: a 6.2 percent increase for those receiving federal annuities of more than $500 per month; and an estimated 11.5 percent increase, under current law, for those receiving annuities of less than $500 per month.

Specific benefit changes in Option II would: reduce the frequency of cost-of-living adjustments for federal annuitants from twice to once a year 3/; limit the size of annual increases to 70 percent of changes in the Consumer Price Index; and offer employee group life insurance at no cost to the employee. Option II would also adopt GAO recommendations that eligibility for civil service disability benefits be tightened and that cost-of-living adjustments be restricted to inflationary increases occurring after retirement. Option II would increase 1981 payrolls by $711 million and reduce total benefit outlays by $564 million--a net increase of $147 million. Through fiscal year 1985, costs would decrease by $5 billion.

Cost-of-Living Adjustments. Under current law, civil service and military pensions are automatically adjusted twice a year to recover 100 percent of the rate of inflation--without limit--as measured by changes in the Consumer Price Index. Over the next five years (1981-1985) cost-of-living adjustments are projected as averaging 9.3 percent per year. This average is substantially greater than cost-of-living adjustments in the private sector under a combination of Social Security and a typical private plan, estimated by CBO to average 6.5 percent. 4/

Federal civilian retirees also benefit from cost-of-living increases that occur before they actually retire. Under current law, employees have the option of calculating their annuities as if they had retired before the previous cost-of-living adjustment. In addition, the first cost-of-living increase after retirement is not prorated to reflect the number of months in retirement status. If, as recommended by GAO, legislative amendments

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3/ Both the House and Senate budget resolutions include this change as part of their plans to balance the budget for fiscal year 1981.

4/ Social Security benefits are automatically adjusted once a year for 100 percent of change in the CPI, income tax considerations notwithstanding. Most private plans do not provide for automatic cost-of-living increases; it is assumed that, over time, the typical private plan recovers about 30 percent of CPI increases. If federal pensions were adjusted according to the Social Security formula and the experience of a typical private plan, the adjustment would probably represent about 70 percent of the change in the CPI. For a further discussion of pension adjustments for cost-of-living increases, see the CBO Budget Issue Paper, Options for Civil Service Retirement (December 1978), pp. 16-20.

corrected these technical provisions, the size of benefits for future retirees would decline slightly.

Eligibility for Civil Service Disability. GAO has concluded that eligibility standards for civil service disability benefits are too permissive. 5/ Under current law, the probability that males aged 30 to 50 will receive civil service disability is at least 50 percent greater than it would be if private-sector standards were adopted. A federal employee is eligible for civil service disability if he is unable to perform one or more significant functions of his present job, but the private-sector applicant must be unable to hold any gainful employment. Legislative reforms under consideration would change eligibility standards and other disability provisions. 6/

Federal Employees Group Life Insurance. The federal government now contributes about one-third of the premium cost for employees who elect to participate in the federal group life insurance program, which offers basic coverage equal to annual salary plus $2,000. In the private sector, basic group life coverage is provided most workers at no cost to the employee. If federal civilian workers were provided existing life insurance coverage entirely at government expense, outlays in 1981 would increase by approximately $264 million.

OPTION III. A 6.2 PERCENT CAP ON PAY AND RETIREMENT ADJUSTMENTS IN 1981

Option III would cap, at 6.2 percent, the upcoming General Schedule pay increase and the combined effect of the two post-retirement cost-of-living adjustments to be received by civil service annuitants in fiscal year 1981. To protect lower-income annuitants, the cap on post-retirement adjustments need not apply to all persons receiving civil service annuities. This option, for example, assumes that federal pensioners receiving benefits of $500 per month or less would be exempt. 7/ The pay

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5/ General Accounting Office, Civil Service Disability Retirement: Needed Improvements (November 19, 1976).

6/ S. 2449 would change eligibility standards and other civil service disability provisions. Benefit levels, although lower than those generally available in the private sector, would not be changed.

7/ A monthly annuity exceeding $500 would provide an annual income greater than the estimated poverty level ($5,689) for a two-person family during fiscal year 1981.

increase would be the same as that estimated in the President's budget but would not require enactment of the proposed reform bill. 8/ Increases in subsequent years would not allow a catch-up, and reflect the assumptions included in CBO five-year budget projections.

In the past two years, federal retirement benefits have increased by 23.5 percent while pay raises for most federal employees have been limited to 12.9 percent for economic and budgetary reasons. A 6.2 percent limitation on 1981 pay and retirement adjustments would recognize the need to limit government spending and the extraordinary expense of federal post-retirement adjustments during a period of double-digit inflation. Under this option, Congress would have time to consider individual reforms at greater length: those already proposed, forthcoming recommendations of the Commission on Pension Policy, and other possible measures concerning the scope and structure of the General Schedule and annual pay comparability surveys.

A 6.2 percent cap on post-retirement adjustments for civilian annuitants would reduce 1981 benefit outlays by $592 million. Cumulative outlay reductions through fiscal year 1985 would reach an estimated $3.8 billion. Without a cap or reform legislation, federal white-collar pay and civil service retirement adjustments in fiscal year 1981 would increase by an estimated 11.7 percent and 11.5 percent, respectively.

OPTION IV. A ONE-YEAR MORATORIUM ON PAY INCREASES FOR FEDERAL WHITE-COLLAR EMPLOYEES

The rationale for Option IV derives from a view that worsening economic and budgetary circumstances call for drastic reductions in federal spending. 9/ Many regard a pay moratorium as unthinkable, however, and as running counter to rational compensation reform. A one year moratorium could be coupled with a Congressional mandate that the Administration examine other possibilities

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8/ The 6.2 percent pay increase could be applied to all employees, or distributed on a grade-by-grade basis that considers private-sector salary levels or other factors.

9/ The possibility of a pay moratorium was identified in the President's January budget for fiscal year 1981 as one of many alternate budget proposals that, if adopted, together would eliminate the estimated budget deficit.

for reform, including changes in the scope and structure of the General Schedule. Pay raises in subsequent years would follow CBO projections without a catch-up.

Although Option IV represents an extreme measure not likely to be considered under most circumstances, it would effect large budgetary savings. Freezing federal white-collar pay in fiscal year 1981 would reduce outlays by $2.2 billion in the first year and by $13.2 billion through 1985. If the pay moratorium were extended to all civilian and military employees, outlay savings would more than double.