CBO STAFF MEMORANDUM

FEDERAL WHITE-COLLAR PAY REFORM:

COSTS AND FINANCING

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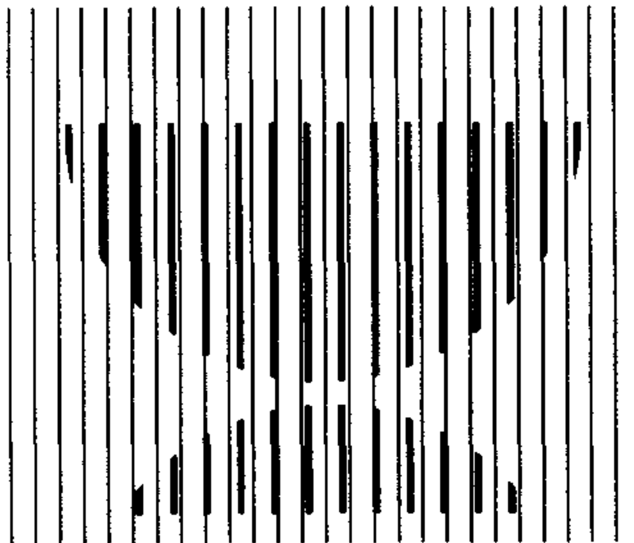

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NOTE

Unless otherwise indicated, all years referred to in this memorandum are government fiscal years.

PREFACE

This Congressional Budget Office staff memorandum analyzes proposals before the Congress to reform the system by which the government adjusts pay rates for its white-collar workers. The pay reform proposals all include provisions that would give recognition, in setting federal pay, to local labor costs. The analysis identifies the costs of each pay reform plan. It also describes cuts in federal employment and in retirement benefits for military and civilian personnel that could offset some or all of the cost of pay reform. The paper also includes a background section with information on the competitiveness of federal salaries and on the difficulties agencies have in recruiting and keeping employees.

The memorandum draws together information from a number of CBO analyses including cost estimates of H.R. 3979 and S. 2274, transmitted to the Congress on August 1, 1990, and August 22, 1990; *Reducing the Deficit: Spending and Revenue Options,* Chapter VI (February 1990); and *Meeting New National Security Needs: Options for U.S. Military Forces in the 1990s* (February 1990). Material from these reports has been updated. Actions by the Congress on budget deficit reduction could necessitate revisions in the analysis.

The memorandum was written by R. Mark Musell of CBO's Office of Intergovernmental Relations (OIGR), under the supervision of Stanley L. Greigg and Earl Armbrust. Richard Krop of CBO's Budget Analysis Division (BAD), prepared estimates of the cost of each pay reform proposal and contributed other analysis. BAD analysts Cathy Ellman, Barbara Hollinshead, and Amy Plapp prepared detailed cost estimates for the section of the memorandum describing reductions in employment and retirement benefits, which was coordinated by Stephen Celio of OIGR. Sandra Hoffman, also of BAD, provided valuable data processing support. Mary V. Braxton typed the drafts and final product.

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SUMMARY

The federal government currently employs about 1.7 million white-collar workers to carry out its many missions. According to many federal personnel managers and executives across government and to a wide variety of personnel analysts, salaries for these white-collar workers, which will total about $60 billion in 1991, are inadequate to meet federal recruitment and retention needs. Without changes in the current system, they argue, existing problems will intensify, and the quality and quantity of federal services will decline.

But reform could be expensive. The three pay reform proposals under consideration by the Congress, one each from the Administration, the House, and the Senate, could cost the government up to $15.5 billion (net outlays) over the next five years. How can the government reconcile its interest in recruiting and keeping a highly skilled and motivated work force with its interest in cutting federal budget deficits?

The Congress, of course, could simply choose to make no reform or to address only the most pressing problems. Stretching out the implementation of any reform offers another approach to limiting the costs, but only in the near term. Each of the proposals now before the Congress provides for some delay or phase-in of pay reform.

Should the Congress choose instead to implement major reform without further limitations or additional delays, it could consider cuts in various budget items as a way of limiting the cost impact of a new pay system. Such an approach might even facilitate adopting pay reform with less targeting or phasing. This paper describes six specific reduction options the Congress could consider to help finance pay reform. Four involve cuts in retirement benefits, and two would reduce the size of the federal work force. These cuts would not result in optimal decisionmaking in every instance--in some cases they involve sacrifices from those who would not benefit from pay reform. The cost cutting measures presented here, however, have merit wholly apart from pay reform, because they represent cuts in programs some analysts find excessive. The Congress could, therefore, adopt them even if it decides to enact no pay reform. Cuts in other areas, of course, could always be considered.

The particular personnel options presented in this memorandum would offer five-year savings ranging from $0.8 billion to $9.3 billion. If all six options were implemented, the 1995 savings would offset about two-thirds of the full pay and benefit cost of potentially the most expensive of the three pay reforms--comparability under a plan proposed by the Administration (see Summary Table 1). If Congress chose less expensive reform, savings from the six options could be sufficient to more than offset costs--producing net savings to the government. (In this analysis, the annual cost, measured in 1995 dollars, of pay reform when fully implemented is compared with the annual 1995 savings from changes in work-force levels and retire-

SUMMARY TABLE 1. SAVINGS FROM CUTS IN FEDERAL EMPLOYMENT AND RETIREMENT BENEFITS AND THE PERCENTAGE CONTRIBUTION TOWARD THE COST OF PAY REFORM

	Outlay Savings (Billions of dollars) Cumulative (1991-1995)	In 1995	1995 Savings As a Percentage of the Cost of the Administration Plan ($16.9 billion in gross outlays)
Savings from Reducing Civilian Work Force			
Reduce DoD civilian work force per Senate Committee plan	9.3	4.9	37[a]
Reduce non-DoD work force per across-the-board productivity goals	1.4	0.7	6[a]
Subtotal	10.7	5.7	42[a]
Savings from Reducing Federal Retirement and Thrift Benefits			
Defer COLAs for retirees until age 62	6.3	2.6	16
Limit some COLAs below inflation	3.7	1.6	9
Add one year to salary average used to set initial pensions	1.0	0.4	3
Restrict agency match on thrift plan contributions to 50 percent	0.8	0.2	1
Subtotal	10.3	4.3	25
Grand Total	21.1	9.9	67

SOURCE: Congressional Budget Office.

NOTE: Savings estimates for each option assume they were implemented alone. CBO, however, discounted the retirement and grand totals to reflect the interaction that would occur if both COLA options were adopted. In other cases, details may not add to totals because of rounding. The savings for work-force reductions assume the increased federal salaries under pay reform and the benefits available under the Federal Employees Retirement System.

a. The percentages represent the dollars saved, in both pay and benefits, from work force reductions divided by the cost, in both pay and benefits, of pay reform. By contrast, the dollar estimates of savings from work-force reductions in the table cover cash disbursements for pay and thrift plan contributions.

ment benefits. The 1995 savings estimates best approximate the recurring budgetary effects from the reduction options and, therefore, make for an appropriate comparison with the full costs of implementing pay reform.)

THREE PAY REFORM PROPOSALS AND THEIR COSTS

Each of the reform measures before the Congress would change the system the government uses to set pay raises for white-collar workers. But the three measures would not abandon, as one of the guiding principles for setting federal pay, the standard that the government offer competitive rates that are comparable with those of other employers. Each proposal has different cost implications; all, however, are expensive. They all also provide for some pay adjustments on a local basis. The three proposals are:

- **The Administration's Plan.** The Administration proposes maintaining a national pay system, much like the existing system, for professional and administrative workers. For technical and clerical workers, however, the plan would substitute a locality-pay system for the current national pay plan. Under the system, pay raises could vary from area to area depending on how federal salaries compare with nonfederal salaries.

- **The House Plan.** The House plan would provide comparability with nonfederal rates on a local basis for all workers, not just technical and clerical workers. The plan would also provide for automatic annual pay raises tied to changes in the Employment Cost Index (ECI).

- **The Senate Plan.** The Senate proposal would also link white-collar pay to changes in the ECI. The plan would provide for additional increases in localities with high labor costs--defined as those with nonfederal salaries significantly above a nonfederal national average. The proposal calls for a plan, in 1995, to close any remaining comparability gaps (subject to further Congressional action).

Of the three proposals, the Administration's plan could eventually prove the most expensive, but much depends on how the plan is implemented. The House plan could cost about as much. The Senate plan has the smallest costs, but takes a more targeted approach toward pay increases.

Summary Table 2 presents the pay and benefit costs of each pay reform option. Two types of estimates are set out. The estimates through 1995 consider transition measures, delays in implementation, agency absorption requirements, and other factors that limit costs in the near-term. Full-implementation cost estimates indicate the annual demand each reform will ultimately place on federal budgetary resources. To facilitate the comparison of plans, CBO prepared full-implementation estimates for all three plans using 1995 as the reference year, although implementation dates for the plans vary. All estimates are measured against the CBO baseline, which assumes pay raises of 4.0 percent per year. CBO's estimates include amounts for various supplements to pay and other measures that each plan would authorize, in-

SUMMARY TABLE 2. OUTLAY COSTS OF PAY REFORMS
(In billions of dollars)

Option	Annual 1991	1992	1993	1994	1995	Cumulative Five-Year	Full Imple-mentation
The Administration's Plan							
Scenario I, Transition Measures Only:							
Gross	0.4	0.7	0.8	0.8	0.9	3.6	0.9
Net	0.3	0.6	0.7	0.7	0.7	3.0	0.7
Scenario II, 15 Percent Pay Raise:							
Gross	0.4	0.7	0.8	3.3	9.5	14.7	16.9
Net	0.3	0.6	0.7	2.2	6.5	10.3	12.6
The House Plan							
Locality Pay							
Gross	0.2	1.6	4.0	6.5	9.1	21.4	16.4
Net	0.2	1.2	2.9	4.7	6.5	15.5	12.2
The Senate Plan							
Pay Relatives							
Gross	0.1	1.8	3.1	3.4	3.6	12.0	3.9
Net	0.1	1.3	2.3	2.6	2.7	9.0	2.9

SOURCE: The Congressional Budget Office.

NOTE: The new pay-raise procedures contained in the Administration, the House, and the Senate plans have different implementation dates. These dates affect the magnitude of costs the government incurs through 1995. Gross amounts include increased requirements to finance retirement and other benefits. Net amounts cover only the cash effects on the government's payroll and on its contribution to the Thrift Savings Plan.

cluding geographic pay differentials and higher rates for critically needed positions. Estimates also include amounts, where appropriate, for certain associated increases in pay for the government's blue-collar workers and uniformed military personnel. Rate increases for these workers are currently linked to increases for federal white-collar workers. The appendix to this memo gives detailed estimates by provision and pay system.

CBO has not considered the costs that could arise if the Congress chose not to reform pay. Should current predictions prove accurate, the future could find the government laboring under severe recruitment and retention problems that could lead to a decline in the level and quality of federal services.

The Administration's Plan

Under the Administration's plan, federal workers could receive pay raises sufficient to close any gaps between federal and nonfederal pay for comparable work, but not right away. Alternatively, this plan could mean little change in the pay raises federal workers receive because of the discretion the plan grants the government in implementing various provisions.

In contrast to current practice, the Administration plan would establish two major white-collar pay systems. Under the Locality Pay System (LS), most technical and clerical workers would receive pay raises sufficient to raise salaries to the comparable nonfederal rates in the same locality. These adjustments would begin in January 1994. Under the Federal National Pay System (NS), most professional and administrative workers would receive increases sufficient to raise their pay to the level of the nonfederal sector based on a national survey (as under current practice). These adjustments would begin in January 1995.

Because the Administration's plan gives the government wide discretion in limiting pay raises and because of uncertainties about the measurement of existing pay gaps, estimating the cost of the reform is problematic. Costs, assuming full implementation in 1995, could be as low as $0.7 billion per year. This estimate assumes the President would limit annual pay raises to the 4 percent that CBO's baseline assumes would occur anyway. The estimated $0.7 billion in higher costs covers various supplements to pay and other measures designed to give agencies flexibility in responding to recruitment and retention problems. These measures include higher starting salaries for entry-level workers and an extra 8 percent pay raise in three high-cost areas--New York, Los Angeles, and San Francisco. Through 1995, the plan would cost $3.0 billion under this scenario.

If the Administration chose instead to provide much higher raises, the annual cost under full implementation could reach $12.6 billion per year--making the Administration's plan the most expensive of the three proposals. Through 1995, costs could accumulate to $10.3 billion. The high-cost estimates assume the government would grant raises of 15 percent for all workers. The government might arrive at such an adjustment in a number of different ways. CBO's analysis of an

OPM research data base covering federal and private-sector workers in 48 metropolitan areas suggests that a 15 percent raise may approximate the level of adjustment needed to achieve comparability. Should the government report that a much higher raise would be needed, closer to the current 30 percent average based on BLS data, a 15 percent raise could fall somewhere around the low end of the authorized comparability range. (Under the Administration's plan, the government could choose to raise pay anywhere within a range of 10 percent above or below average rates paid by nonfederal employers.)

The House Plan

The House plan (H.R. 3979) would also close gaps between federal and nonfederal pay but would do so by bringing all workers, not just technical and clerical workers, up to the level of local rates. The government would abandon the practice of paying workers according to one national schedule. The plan would begin closing pay gaps in October 1992, a little over one year earlier than under the Administration's plan. The President, however, could choose to phase the adjustments in over a period not to exceed 10 years. (CBO estimates assume 10-year phasing.) Based on analysis of OPM data, CBO assumes that the phased adjustments would, over time, eliminate a pay gap that currently averages 15 percent. To keep federal salaries from lagging further behind nonfederal rates while gaps are being closed, the plan also calls for automatic annual adjustments, which would begin in October 1991, linked to the ECI.

The estimated annual cost of this plan under full implementation totals $12.2 billion, just under the cost of the Administration's plan. Through 1995, costs would total $15.5 billion. Where possible the estimates include the cost of various supplements to pay that, like the Administration plan, the House proposal would authorize.

The Senate Plan

The Senate plan also calls for pay adjustments that would vary by area, but the plan would not attempt to close gaps between federal and nonfederal pay rates. Instead it would grant raises only in areas with high labor costs. Specifically, federal workers would get raises based on the percentage difference between the nonfederal salaries in their area and a national average, when the nonfederal salaries are higher. (The legislation requires the government to issue a plan, in 1995, for closing any remaining pay gaps.) Like the House proposal, the Senate plan also calls for pay adjustments linked to the ECI.

The cost of the Senate plan would depend on the extent to which the President would use the discretion permitted him to limit the ECI and other pay adjustments. With modest limits, the Senate plan, assuming full implementation in 1995, would cost an estimated $2.9 billion annually. Over five years, cumulative costs would total $9.0 billion. If, however, the President limited raises to no more than the 4 percent

in CBO's baseline, costs for full implementation would total only $0.8 billion annually. This amount would cover the various supplements to pay and other measures authorized by the Senate plan.

PAYING FOR REFORM

Personnel resources represent a natural starting point, if the Congress chooses to reduce federal expenditures to help finance pay reform. Budget reductions in these areas would trim costs that some analysts find excessive and thus improve the cost effectiveness of government operations. Together, the options described below would produce outlay savings in 1995 of $9.9 billion--enough to cover a significant portion of pay reform under the Administration and House plans, and more than enough to cover costs under the Senate plan. About three-fifths of the savings would come from cuts in federal employment, the remainder from cuts in retirement benefits. Congress, of course, could choose to adopt one or more of the measures even in the absence of pay reform or to look for possible cuts in other areas of the budget. (All estimates assume implementation as of October 1, 1991.)

Reductions in Retirement Benefits

About 2.9 million federal employees are covered by federal civilian and military retirement programs. Generous federal retirement benefits have long been considered by some as fair recompense for below-market federal salaries. Should the Congress raise pay, a case could be made for bringing certain features of federal retirement more in line with private practice. And the options described here would still leave benefits more generous than those typically found in the private sector. The changes, however, would generate significant savings only if they applied to nondisabled individuals already retired under civilian and military programs. These individuals, numbering about 980,000, would not benefit from the higher federal salaries likely to result from pay reform. Nor would, in most cases, military personnel on active duty, even though they too could be affected by the retirement reductions.

Taken together, the measures described below would generate annual 1995 savings totaling $4.3 billion. Most of the savings come from limiting cost-of-living adjustments (COLAs). (The $4.3 billion estimate has been reduced to avoid double counting in case a benefit reduction package includes both of the COLA options, but the detailed estimates that follow assume enactment independent of other measures.) The savings from retirement reform could offset about a fourth of the most expensive pay reform plan.

Limit COLAs. The Congress could bring federal practice more into line with the private sector's by making adjustments in the COLAs it grants to workers under the Civil Service Retirement System (CSRS) and the old Military Retirement System (MRS).

Discontinuing the granting of COLAs until age 62 to nondisabled retirees who retire before reaching that age would save $2.6 billion in 1995. Delaying COLAs would be consistent with reform adopted for new civilian and military workers and could help the government keep experienced workers longer, but the change in retirement rules could cause hardships for some workers, especially MRS employees who tend to retire at a relatively early age.

Limiting COLAs to one percentage point below inflation for MRS employees, and to half a percentage point below inflation for CSRS employees would yield savings of $1.6 billion in 1995. Savings through 1995 would accumulate to $3.7 billion. (The different COLA limits produce comparable cuts in benefits, given the different structures of the two retirement programs.) These changes would conform to reforms made in other federal retirement programs. They would, however, hurt low-income retirees most. Reducing COLA protection would also go back on a commitment to employees covered by the CSRS who understood they would keep full COLA protection by not switching to the new civilian retirement program--the Federal Employees Retirement System (FERS).

Other Retirement Cuts. Smaller but *still* significant savings would accumulate from two other changes in retirement, both of which would move federal practice closer to that of the private sector. If Congress chose to add a year to the period over which employees' salaries are averaged for purposes of setting the size of initial pensions, those initial pensions would decline on average between 2 percent and 3 percent, and annual savings would reach $0.4 billion in 1995. Through 1995, savings would accumulate to $1.0 billion. (This estimate assumes the measure would apply to employees under both CSRS and FERS and to MRS employees hired before 1980.) The Congress could also restrict, to a uniform 50 percent, matching contributions to the Thrift Savings Plan that is part of FERS. Savings by 1995 would reach $0.2 billion annually. Savings through 1995 would accumulate to $0.8 billion.

Reduction in the Federal Work Force

Should pay reform lead to a more highly skilled and motivated work force, agencies could expect to operate more efficiently. Accordingly, the work-force levels the government might otherwise require could drop, thus easing expected federal recruitment and retention problems. Associated reductions in work-force needs could help pay for reform. The Congress could help ensure that agencies improve efficiency and reduce their work force by requiring them to find ways to fund part of pay reform out of existing resources, and by considering an agency's work load and productivity improvement record when enacting appropriations.

Civilian Agencies. If civilian agencies achieved a modest improvement in productivity of 0.5 percent per year for the period 1992 through 1995, agencies could eliminate 20,000 federal jobs without reductions in federal services. Savings in 1995 would be $0.7 billion; five-year savings would total $1.4 billion. Congress might want to tailor reductions to consider individual agency circumstances. Some

agencies already struggle to meet the growing demand for services, and the Congress might not want to place more demands on an already efficient program.

Defense Agencies. Efficiency improvement could prove more challenging for the Department of Defense (DoD). Agencies, such as DoD, that experience a drop in demand for services traditionally have difficulty improving efficiency. But the retrenchment itself, although unrelated to pay reform, could be viewed as a source of savings to apply to pay reform.

The savings could be substantial. If the government achieved the 23 percent multi-year reduction in active-duty strength that is part of a Senate Committee on Armed Services plan, associated reductions in civilian support in 1992 through 1995 could reach 145,000. Savings would total $4.9 billion in 1995 and $9.3 billion over five years. Of course, cuts in military strength will reflect a variety of considerations other than pay reform. Moreover, current planning assumes continuation of recent trends in the Soviet Union and Eastern Europe and no serious worsening of problems in the Middle East. But if cuts occurred and the Congress applied the savings to pay reform, as opposed to deficit reduction or to the many other national problems competing for funds, the savings would offset more than a third of the governmentwide cost of even the most expensive pay reform proposal.

INTRODUCTION

The Congress has before it three proposals for reforming the federal white-collar pay system. Each puts forward new procedures for determining federal pay raises, along with systems for bonuses and various other discretionary allowances that, when taken together, could significantly increase the salaries of the government's 1.7 million white-collar employees. Under current law, pay for these workers will total about $60 billion in 1991--about two-thirds for workers in professional and administrative jobs and one-third for workers in technical and clerical jobs.

The three proposals could, in time, provide pay raises necessary to make federal salaries more competitive with those offered by private-sector firms. But the government is in the midst of a budget crisis, and increasing the pay of federal workers is always expensive. Each 1 percent increase in federal white-collar salaries adds about $0.6 billion to federal pay costs and about another $0.2 billion to amounts needed to finance retirement and other benefits. According to estimates prepared from Bureau of Labor Statistics (BLS) data, federal salaries would have to increase on average by about 30 percent to make them comparable, as currently defined, with private-sector rates. By contrast, data from the Office of Personnel Management (OPM) suggest a 15 percent average pay gap. (Throughout this analysis, the term pay gap refers to the percentage by which federal salaries would have to rise to match comparable nonfederal rates.) While each of these proposals would change how the government measures comparability for purposes of setting pay, the new definitions could still require substantial pay raises. The three plans would substitute, for the current national system, one that requires some recognition of local labor costs.

The analyses in this memorandum compare the approaches the three proposals take to setting pay and examine the cost implications of each. They also describe cuts in federal work-force levels and in federal retirement benefits that would lower costs and help finance pay reform. The analyses show that the government could accomplish pay reform and enhance the efficiency of government without significant increases in federal spending.

The proposals for white-collar pay reform--one from the Administration and one each from the Authorizing Committees in the House and the Senate--follow on reforms enacted last year for Members of Congress, top Congressional staff, federal judges, and executive branch officials. (The reforms protect Members, judges, and top executives from pay erosion by linking salary rates to the Employment Cost Index and, with the exception of the Senate, allow one-time adjustments that range from 18 percent to 25 percent, effective January 1991.) The proposed reforms, as described below, respond to calls for change from several high-level reviews, and to widespread dissatisfaction with the current system for setting pay. [1]

1. For a discussion of the current mechanism for setting federal white-collar pay and of past proposals for reform, see Congressional Budget Office, *Adjustments in Federal White-Collar Pay: A Technical Review of Past Proposals and the Outlook for October 1983* (March 1983).

Recruitment and Retention of Federal Workers

The call for pay reform arose out of concern about the growing difficulties federal agencies have had in recruiting and keeping employees. Observers attribute these problems, in large measure, to uncompetitive federal salaries. In a recent comprehensive review of the federal work force, the National Commission on the Public Service (a private group chaired by Paul Volcker) concluded that federal salaries have fallen so low that they now represent an obstacle to federal efforts to attract and keep workers. [2] The commission's findings parallel those of several other recent studies and add credence to widespread complaints from federal managers who contend that the federal pay system is in disarray and in need of reform. Not all analysts share this view. [3]

Data do not exist to systematically quantify federal recruitment and retention problems, but, as reported by agencies themselves and by others concerned about personnel management, these problems are widespread. Inadequate pay, for example, left major regional offices of the FBI unable to keep many of their most experienced special agents or to find suitable replacements. The Department of Defense has experienced some problems in hiring scientists, computer specialists, and engineers. [4] In this year's report, the Advisory Committee on Federal Pay described a variety of agency staffing problems, including shortages of nurses, pharmacists, and physicians at the Veterans Medical Center in St. Louis. [5] A survey by the Merit Systems Protection Board (MSPB) found that many college graduates do not consider the government an employer of choice. Another MSPB survey found that employees leave federal service most often for better pay and

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2. National Commission on the Public Service, *Leadership for America: Task Force Reports to the National Commission on the Public Service* (Washington, D.C.: 1989), p. 199.

3. Some argue that federal salaries are more generous than those in the private sector. These analysts base their conclusions on comparisons of income for workers with similar experience, education, and other "human capital" characteristics. See, for example, Alan B. Krueger, "Are Public Sector Workers Paid More Than Their Alternative Wage," National Bureau of Economic Research, Inc., Working Paper No. 2500, January 1988. Comparisons of human capital have been challenged for employing old data and small samples and for failure to consider differences in the quality of workers compared, the type and level of duties, and the federal government's equal employment practices. See Sharon P. Smith, "Wages in the Federal and Private Sector" (comments delivered at the National Bureau of Economic Research Conference, November 1984); and Martin Asher and Joel Popkin, "The Effects of Gender and Race Differentials on Public-Private Wage Comparisons," *Industrial and Labor Relations Review*, vol. 38 (October 1984), pp. 16-25.

4. General Accounting Office, *Pay, Recruitment, and Retention of Federal Employees* (1987).

5. Advisory Committee on Federal Pay, *Annual Report*, (Washington,D.C.: Advisory Committee, July 1990), pp. 5-11.

advancement--especially employees who live in high cost areas, have more education, and have outstanding performance ratings. [6]

Recruitment and retention problems will probably increase in the future as departures from federal service increase. Provisions of the relatively new Federal Employees Retirement System (FERS) will cause part of this future increase. The new plan covers all employees hired since January 1984 and others who elected to join. FERS does not impose the financial penalties on those leaving government that the old Civil Service Retirement System (CSRS) does. [7] Accordingly, mid-level FERS employees who might otherwise have stayed in government to avoid financial losses under CSRS can be expected to leave government service in greater numbers. Later in this decade, moreover, the number of retirements will increase. The federal work force has a noticeable bulge of workers between the ages of 35 and 45. Most of these employees will probably begin to leave federal service after reaching age 55 and after completing the required years of service.

According to projections prepared for OPM, the government will have difficulty replacing workers. These projections show a decline in the growth of the nation's labor force throughout the 1990s, and in the portion of the work force with skills the government is expected to need. [8]

The Competitiveness of Federal Salaries

Under current law, most federal white-collar workers may receive annual pay raises sufficient to keep their pay comparable with rates in the private sector. While not precisely defined in law, the government has taken comparability to mean federal salaries on a par with some national measure of average private-sector rates for similar work. Mandatory consideration of comparability in setting federal white-collar pay originated with the Federal Pay Comparability Act of 1970 (Public Law 91-656, approved January 8, 1971). Primarily for budgetary reasons, however, successive Presidents and Congresses have capped raises below comparability. In fact, not once since October 1977 have annual adjustments for white-collar workers

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6. U.S. Merit Systems Protection Board, *Attracting Quality Graduates to the Federal Government: A View of College Recruiting* (Washington, D.C.: MSPB, June 1988), and *Why Are Employees Leaving the Federal Government?* (Washington, D.C.: MSPB, May 1990).

7. Under the new FERS program, Social Security coverage and the Thrift Savings Plan provide for a continuation of entitlement, without reduction, when employees leave government service. Under CSRS, by contrast, employees leaving service before retirement cannot draw benefits until age 62 and stand to have benefits eroded by inflation during the intervening years. For a discussion of the effect of retirement on employee turnover, see Congressional Budget Office, *Employee Turnover in the Federal Government* (February 1986), pp. 17-22.

8. The Hudson Institute, *Civil Service 2000*, report prepared for the Office of Personnel Management, (June 1988), pp. 17-31.

been at the levels needed to raise federal pay to achieve comparable salaries or to keep disparities from growing.[9]

Given recent history, just how competitive are federal salaries? Based on data collected by the Bureau of Labor Statistics for white-collar workers, the government estimates that private-sector pay averages about 30 percent above rates for comparable federal jobs. This single overall average, however, fails to give a clear picture of the serious competitive disadvantage faced by federal agencies in their attempts to get and keep workers for some jobs. For example, at the entry and senior levels of many professional and administrative jobs, on which federal recruitment and retention efforts will focus in the near future according to OPM, the problem is more serious. For many of these specific jobs, the average pay gap far exceeds the average for all occupations and levels of work (see Table 1).

Data compiled by OPM generally support the contention that federal salaries are below market rates. A Congressional Budget Office (CBO) analysis of an OPM research data base suggests that the overall pay gap stands at about 15 percent. The much lower CBO estimate reflects an estimating methodology that differs from the one used in deriving the figure based on BLS data and that may anticipate changes the government might adopt under pay reform. Specifically the CBO estimate incorporates weighting that reflects the occupational, work level, and geographic distribution of the federal work force. The weighting currently used by BLS does not expressly consider the location of federal workers. This could change, however, under pay reform.

The lower CBO estimate also reflects a different data base. The OPM data base upon which CBO based its estimate contains private-sector employment and salary information for dozens of different jobs with federal counterparts. OPM compiled the data for research on pay reform and other topics. Private-sector information was compiled from existing surveys in some cases and derived from existing survey data in other cases. Federal jobs included in the data base represent about half of the federal white-collar work force. The data cover 48 metropolitan areas. Though much more comprehensive than BLS data, the OPM data base is not a statistically drawn sample. (The BLS survey design considers firm size and type of industry.)

It is impossible to anticipate how the government would choose to estimate comparability under reform, or, given a certain methodology, what survey data would show. The current BLS surveys have been criticized for, among other things, the limited number of jobs surveyed. Survey methods used, moreover, may overstate the pay problem many agencies face. BLS uses detailed job descriptions that may tend to result in a disproportionate amount of data from larger, more specialized firms.

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9. Most of the white-collar pay raises granted between January 1971 and October 1977 were across-the-board adjustments--not the variable grade-by-grade adjustments recommended for jobs with different levels of difficulty and responsibility. (The October 1973 and October 1974 adjustments were exceptions to yearly, flat, across-the-board increases.)

TABLE 1. PERCENTAGE BY WHICH AVERAGE PRIVATE-SECTOR SALARIES EXCEED FEDERAL SALARIES (March 1990)

Occupation	Entry Level	Senior Level
Accountant	28	49
Auditor	37	47
Chief Accountant	37	72
Attorney	52	73
Buyer	36	43
Computer Programmer	36	26
Systems Analyst	30	20
Personnel Specialist	26	62
Chemist	50	43
Engineer	36	29
Registered Nurse	5	5

SOURCE: The Congressional Budget Office from data provided by the Bureau of Labor Statistics and the Office of Personnel Management.

NOTE: Entry and senior levels correspond to grades of the General Schedule and vary by occupation. Entry levels range from grade 5 to grade 11, depending on the occupation considered. Senior levels range from grade 11 to grade 15. The pay gaps estimated for registered nurse and engineer are significantly lower than they otherwise would be because federal salaries for these occupations were raised by the government under its special salary rate program.

Firms surveyed may also tend to be located in higher-cost metropolitan areas. But CBO analysis suggests that not all agencies face the degree of competition from larger firms and in high-cost areas that may be implicit in the BLS survey. Moreover, the pay comparison process does not take into account the special federal pay supplements, or special rates, that the government has used to aid recruitment and retention. In 1990, special rates covered more than 185,000 employees and added about $0.5 billion--or almost 1 percent--to federal white-collar payroll costs. Finally, BLS data could reasonably be expected to show lower pay gaps if they incorporated information on state and local government employees as provided for in all three pay reform proposals.

The OPM data base, by contrast, probably has a conservative bias attributable largely to the job survey methods employed. Surveys the OPM used to construct its data base rely on the cooperation of private firms. These firms report information by matching their jobs to abbreviated job descriptions. The type and size of respondents may not reflect those that typically participate in BLS surveys. The use of abbreviated job descriptions, moreover, may have permitted relatively more data to be obtained from smaller, lower-paying firms with less specialization. In addition, the matching of private data to specific federal jobs may also be influenced by the lack of specificity in job descriptions.

Despite these qualifications, the analysis that underlies CBO's cost estimates relied on data from the OPM data base. The OPM data base represents one of the most extensive of its kind ever compiled and provides comprehensive information on pay disparities by geographic area. The detailed information permitted the CBO estimates to reflect the effects of anticipated changes in the government's approach to comparability. To the extent that pay gaps estimated by CBO differ from those the government would report under reform, costs too will differ. [10]

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10. The Hay Company has nearly completed a data base for the General Accounting Office. Preliminary review by CBO suggests that the data base would give overall results not substantially different from those derived from OPM data. If further investigation suggests pay disparities that are very different from those derived from OPM data, CBO may need to revise its estimates and analyses accordingly.

THE PAY REFORM PROPOSALS AND THEIR COSTS

Each proposal now before the Congress would change the current process by which the government sets pay raises for white-collar workers. (The proposals do not address other frequently cited problems with federal personnel management, such as the misclassification of federal jobs and the complexity of hiring procedures.) But the three measures would preserve, as a guiding principle for setting federal pay, the idea that the government should offer competitive rates that are comparable with those offered by other employers. Each plan, however, adopts a different approach to applying a comparability standard. [11]

- **The Administration's Plan.** The Administration proposes maintaining a national pay system, much like the existing system, for professional and administrative workers. (Some of these workers, however, would receive supplements to pay based on geographic location.) For technical and clerical workers, however, the plan would substitute a locality-based pay system for the current national pay plan. Under the system, pay raises could vary from area to area depending on how federal salaries compare with nonfederal salaries.

- **The House Plan.** The House plan would provide comparability with nonfederal rates on a local basis for all workers, not just technical and clerical workers. The plan also would provide for automatic annual pay raises tied to changes in the Employment Cost Index (ECI).

- **The Senate Plan.** The Senate proposal would also link white-collar pay to changes in ECI. The plan would provide for additional increases in localities with high labor costs--defined as those with nonfederal salaries significantly above a nonfederal national average. The proposal calls for a plan, in 1995, to close any remaining comparability gaps (subject to further Congressional action).

All three plans also contain provisions that authorize a wide variety of supplements to pay and other measures that are designed primarily to give the government flexibility in meeting recruitment and retention needs. These provisions include higher pay for critically needed positions and payments for the travel

11. Other principles have been forwarded for setting federal pay. H.R. 182, for example, would have required consideration of geographic differences in the cost of living. (The bill was referred to the House Committee on Post Office and Civil Service on January 3, 1989, and is no longer under active consideration.) Analyses, in fact, suggest that differences in the cost of living significantly influence decisions by federal employees to quit government service. Under the various pay reform measures now before the Congress, the government could give some consideration to cost of living and other factors, such as unemployment rates, that influence recruitment and retention through the various discretionary provisions that the reform measures would authorize. For a discussion of the relationship between cost of living and federal quit rates, see Office of Personnel Management, *Supplement Federal White-Collar Pay System* (August 1989), Research Report III, pp. 31-35.

expenses of potential federal employees. Many of these payments are discretionary, and their application might vary widely from agency to agency.

The Administration's plan, under full implementation, could prove to be the most expensive of the three, but much depends on how the government would implement it. The House plan, fully implemented, would be about as expensive. The Senate plan would cost the least, because it sets narrower objectives for the near term. The CBO estimates of costs under full implementation permit comparison of the total annual demand each reform could make, in time, on federal resources. Differences between these estimates of full-implementation costs reflect the different pay raises stipulated in each plan. While all three plans could eventually lead to pay comparability with the private sector, they would nevertheless result in very different near-term pay increases because each approaches comparability differently. (To facilitate comparison, the CBO full-implementation estimates use 1995 as the year in which all three reform plans would be implemented in their entirety. Some plans, or elements of them, could be fully implemented earlier and some later.)

CBO also prepared estimates of costs that would occur over the next five years (1991-1995). In addition to the effects of different pay raises, these five-year estimates reflect differences among the proposals concerning effective dates, transitional measures, and phasing of implementation. They also assume, in contrast to estimates of costs that assume full implementation, that agencies would absorb 22 percent of the first-year cost of each year's pay raises. (The absorption assumption is required by law for the Balanced Budget Act baseline. Absorption refers to the portion of pay raise costs that agencies pay for from current resources rather than from higher appropriations.) All costs presented here are measured against the CBO baseline used to estimate the deficit for purposes of the Balanced Budget Act. This baseline assumes pay raises for federal workers of 4 percent per year through 1995. The baseline also assumes that annual governmentwide pay adjustments would take effect in October of each year.

CBO estimated the effects of each proposal on both gross and net budget outlays. The net outlay estimates indicate the near-term budgetary impact of each proposal. Nearly all of each net outlay estimate covers increases in federal payroll costs. The gross outlay estimates, however, reflect the effects of reform on both near-term payroll costs and on the amounts the government will need to finance the higher disbursements in later years for federal retirement and other benefits. Among the benefit costs considered is the anticipated increase in federal payments to cover retirement liabilities associated with pay raises. Table 2 summarizes the gross and net outlay costs of the three proposals over five years, and under full implementation in 1995. Table 3 gives the estimated percentages by which white-collar payroll costs would rise each year under current law and under proposed reform plans. It also identifies payroll increases that would occur if all reforms were fully implemented at the same time.

TABLE 2. OUTLAY COSTS OF HIGHER PAY RAISES UNDER THREE REFORM PROPOSALS (In billions of dollars)

Option	Annual					Cumulative Five-Year	Full Imple- mentation
	1991	1992	1993	1994	1995		
The Administration's Plan							
Scenario I, Transition Measures Only							
Gross	0.4	0.7	0.8	0.8	0.9	3.6	0.9
Net	0.3	0.6	0.7	0.7	0.7	3.0	0.7
Scenario II, 15 Percent Pay Raise							
Gross	0.4	0.7	0.8	3.3	9.5	14.7	16.9
Net	0.3	0.6	0.7	2.2	6.5	10.3	12.6
The House Plan							
Locality Pay							
Gross	0.2	1.6	4.0	6.5	9.1	21.4	16.4
Net	0.2	1.2	2.9	4.7	6.5	15.5	12.2
The Senate Plan							
Pay Relatives							
Gross	0.1	1.8	3.1	3.4	3.6	12.0	3.9
Net	0.1	1.3	2.3	2.6	2.7	9.0	2.9

SOURCE: The Congressional Budget Office.

NOTE: The new pay-raise procedures contained in the Administration, the House, and the Senate plans have different implementation dates. These dates affect the magnitude of costs the government incurs through 1995. The new procedures under Scenarios I and II under the Administration's plan take effect beginning in January 1994 and 1995. Estimates for the House plan assume that ECI adjustments begin in October 1991 and that 10-year phasing of locality adjustments begins in October 1992. Estimates for the Senate plan assume that new procedures become effective in October 1991. By contrast, full-implementation estimates assume the same effective date for all proposals, October 1, 1995. They also assume no agency absorption requirements. Detail may not add to totals because of rounding.

TABLE 3. ESTIMATED PERCENTAGE INCREASES IN FEDERAL WHITE-COLLAR PAYROLL UNDER CURRENT LAW AND UNDER PROPOSED PAY REFORMS

Option	Average Annual 1991-1995[a]	Cumulative Five-Year[a]	Full Implementation[b]
	Current Law		
CBO Baseline	4.0	21.7	4.0
	The Administration's Plan		
Scenario I	4.2	22.6	5.0
Scenario II	5.4	30.2	20.4
	The House Plan		
Locality Pay	5.1	28.3	19.8
	The Senate Plan		
Pay Relative	4.3	23.2	6.1

SOURCE: The Congressional Budget Office.

NOTE: Percentages are average payroll increases. They should not be interpreted as increases that apply to all workers. Some workers would receive higher raises and some lower raises because, under each reform, all categories of workers are not treated the same. Estimates do not cover proposed payments for uniforms and for travel and transportation.

a. Payroll increases reflect the different implementation dates of baseline adjustments and reform proposals, as well as requirements that agencies absorb some first-year costs.

b. Full-implementation estimates assume the same effective date for all proposals, October 1, 1995. They also assume no agency absorption requirements. The full-implementation estimates for each of the reform plans include the 4.0 percent annual adjustment assumed in the CBO baseline.

The cost estimates also include, where appropriate, amounts covering the potential secondary effects of pay reform on the compensation of both the government's uniformed military personnel and its blue-collar workers. Under current practice, pay increases for these employees are linked to increases in pay for the government's white-collar workers. For military personnel, white-collar raises have represented the minimum increase that the government may grant. For blue-collar workers, white-collar raises have represented a limit on annual increases. The Appendix Table gives detailed estimates by provision and pay system for each proposal.

The paper does not address the costs that could arise if the Congress makes no change in federal pay practices. Should current predictions concerning the future work-force requirements of government and the future supply of workers prove accurate, these costs will manifest themselves in a diminished capacity on the part of government to recruit, motivate, and keep a work force qualified to carry out the many responsibilities placed upon it by a demanding citizenry and a complex world. Although no methodology or data exist to quantify such costs, they should not be overlooked or their importance underestimated. The many challenges that face the nation as it approaches the next century will demand the talents of the best and the brightest in both the private and the federal sectors. The starting point for ensuring that the government can attract the talent it needs is a fair, rational pay system.

The Administration's Plan

The Administration proposes closing existing pay gaps, but not until 1994 and 1995. The plan also provides for a variety of bonuses, pay differentials, and other measures agencies could use, some as early as 1991, to address some of their more serious staffing problems. [12]

Under the measures designed to close the pay gap, the current white-collar pay system would be replaced by the Federal National Pay System (NS) for workers recruited on a national basis (generally, professional and administrative employees), and the Locality Pay System (LS) for workers recruited mostly from local labor markets (generally, technical and clerical employees). The NS would have one nationwide pay scale, and the LS would have separate pay scales for each locality.

The proposal would significantly change the process by which the government adjusts white-collar salaries. Under current law, the Pay Agent makes, to the President, an annual recommendation for pay increases based on the nationwide gap between federal and private-sector salaries. (Currently, the Pay Agent is the Secretary of Labor and the Directors of OPM and the Office of Management and Budget.) The BLS collects information on private-sector pay. The recommended

12. The plan described here is the legislative proposal transmitted to the Speaker of the House and the President of the Senate by Constance Berry Newman, Director of the Office of Personnel Management, in letters dated May 1, 1990.

nationwide adjustments apply to workers in all occupational groups. Under the Administration's proposal, by contrast, only workers under the NS would receive adjustments based on the nationwide pay gap. LS workers, on the other hand, would receive pay increases based on federal to nonfederal pay gaps in their local area. The Pay Agent and the OPM, moreover, would have to consider such factors as the ability of the federal government to compete in the labor market, federal employee turnover, unemployment trends, and the need for the government to provide services economically. (The latter could justify continuation of pay limits during periods of budgetary restraint.) Based on these factors, the Pay Agent and OPM would have the discretion to recommend NS and individual LS adjustments that would set salaries anywhere from 10 percent above to 10 percent below a nonfederal average. The President, as under current law, would then have the discretion to either implement the recommendations or provide for different adjustments.

The BLS would retain responsibility for collecting the data used to estimate pay gaps. Under the legislation, data would be collected at least 14 months before the implementation of the pay increase that the survey data would help determine. The OPM would have authority to determine pay areas for purposes of the local pay system. Pay adjustment under both the NS and LS would occur in January. (The January effective date somewhat lowers the five-year cost of the Administration's plan when measured against the CBO baseline, which assumes pay raises three months earlier, in October.)

The Administration's proposal would also allow the Pay Agent to authorize payment of "geographic differentials" for NS employees in areas where the government would have difficulty recruiting or retaining employees. The differential in any area may not exceed 25 percent of basic pay. The plan also allows OPM to grant "staffing differentials," not to exceed 60 percent of basic pay, in order to address labor market anomalies for specific occupations and grade levels in selected locations. (By contrast, geographic differentials apply to all workers in an area.) Staffing differentials would replace the current special salary rates, which allow higher pay of up to 30 percent. Under regulations issued by OPM, agencies could also pay recruitment, retention, and relocation bonuses of up to 25 percent of basic pay.

Three factors make it impossible to estimate precisely the size, and thus the cost, of the pay raises under the Administration's proposal:

- The discretion granted the Pay Agent and OPM to recommend pay raises that would set salaries within a range of plus or minus 10 percent of comparability.

- The discretion given the President to grant a pay raise outside the comparability range.

- Uncertainty about the size of the federal-to-nonfederal pay gap that the Pay Agent and OPM would consider, along with other factors, in developing a recommendation for pay adjustments.

Given the uncertainties associated with predicting pay raises under the Administration's proposal, along with those associated with anticipating the number and level of geographic and other differentials that the government could grant, CBO has prepared two sets of estimates. Each set assumes different pay raises. They are purely illustrative; the cost of restructuring the pay system would differ to the extent the Administration provides different salary adjustments.

Scenario I. The first scenario assumes the President uses his discretion to limit the size of pay adjustments, as has been the practice for many years, to a level well below comparability. Specifically, the estimates assume that governmentwide pay raises match those assumed in the CBO baseline--4.0 percent annually (effective in October of each year). Accordingly, this scenario's only costs are for selected measures that would provide for largely discretionary supplements to pay and that the Administration has slated for implementation before the new pay systems. These measures include:

- o Geographic differentials of up to 8 percent for employees in Los Angeles, New York, and San Francisco. Employees currently paid local special rates would have their salaries adjusted by less than the full 8 percent; that is, if an employee is paid a special rate that is 5 percent above the normal rate, he or she would receive an additional 3 percent. If the special rate is greater than the regular rate by 8 percent or more, it would not be adjusted.

- o Staffing differentials of 5 percent nationwide for entry-level professional and administrative positions at GS-5 and GS-7.

- o Expanded authority to hire above the minimum pay rate of each grade.

- o Exemptions from normal pay limitations for up to 400 critical positions requiring "world class" experts.

- o Authority to pay travel and transportation expenses for new employees.

CBO could not estimate the costs for all such measures. Most are discretionary and CBO does not always have grounds to make assumptions about how the government would use its discretion. In other cases, data were not available to make estimates. Some measures not estimated could be expensive, such as those that would authorize payment of recruitment, retention, and relocation bonuses of up to 25 percent of pay. With these qualifications in mind, CBO estimates that the net outlay cost of this scenario, assuming full implementation in 1995, would total at least $0.7 billion. About 60 percent of this amount covers differentials for the three metropolitan areas. Net costs for the period 1991 through 1995 would accumulate to at least $3.0 billion. (See Appendix Table for detailed estimates by provision.)

Scenario II. This scenario assumes that the government would grant a pay raise of 15 percent. (For technical and clerical workers paid under the LS, the 15 percent raise represents an average of various local adjustments that follow prevailing rates. For professional and administrative personnel, the increase represents an across-the-

board adjustment.) The government could arrive at an adjustment at this level in a number of different ways. CBO analysis of the OPM data base suggests that such an adjustment might be near average comparability. If the government reports a much higher pay gap, a 15 percent raise might fall somewhere around the low end of the comparability range the government must develop under the Administration's plan. The annual net outlay cost of this proposal, assuming full implementation in 1995, would total $12.6 billion including $1.4 billion for associated increases in costs for federal blue-collar workers and $0.6 billion for the various supplements to pay (see Appendix Table). The estimates for blue-collar workers assume wages would rise to prevailing local rates--an average increase of 10 percent. Over five years, costs under Scenario II would total $10.3 billion.

Keeping a national schedule for professional and administrative workers would result in certain over- and underpayments. Analysis of data for the 48 metropolitan areas covered by the OPM data base suggests that pay comparability gaps vary widely from area to area (see Box). Gaps appear to vary as much for professional and administrative jobs as they do for technical and clerical jobs. Given such variation, any single pay adjustment applied to all areas would leave the government granting raises higher than the local markets would require in some areas and lower than required in other areas. (In most cases, half would be overpaid and half underpaid.)

Maintaining a national system has several advantages. Such an approach would more closely resemble the reported practice of many major private firms. According to a Wyatt Company survey of pay practices of large firms, the vast majority emphasize national markets for executive, managerial, scientific, and professional positions. [13] A national plan also facilitates recruitment beyond local labor markets, a not uncommon requirement when filling professional and administrative jobs. It also offers a somewhat simpler structure, compared with a locality system, for management and oversight. Finally, a national system offers an approach that imparts a sense of equity and fairness.

The House Plan

Pay reform along the lines of H.R. 3979, as reported, would make two changes in the method used to increase federal salaries. One change would link future pay increases directly to the previous year's increase in private-sector salaries as measured by the ECI (wages and salaries for white-collar workers, excluding sales). [14] Indexing would help keep federal pay from falling further behind private rates. To close gaps that already exist, the second change would adjust the pay of federal employees to the level for nonfederal employees in the same local area (salaries can-

13. The Wyatt Company, *Study of Federal Employee Locality Pay*, Task 2.

14. Although other indexes could be used, the Employment Cost Index has the merit of holding employment by industry and occupation constant.

VARIATION IN PAY GAPS FOR PROFESSIONAL-ADMINISTRATIVE AND TECHNICAL-CLERICAL JOBS

Office of Personnel Management data for 48 metropolitan areas show a wide variation, from area to area, in differences between the pay of federal and private-sector workers. For professional and administrative (PA) jobs, pay gaps range from a low of 5 percent to a high of 34 percent. For technical and clerical (TC) jobs, the gaps range from 1 percent to 37 percent. For all areas combined, the pay gap averages 15 percent for both PA and TC jobs.

Dividing the federal work force for each of the two occupational categories by quartiles also illustrates the wide variation in pay gaps. For the fourth of the sampled work force in areas showing the highest gaps, the average is 24 percent for PA jobs and 26 percent for TC jobs. For the fourth of the work force in areas with the lowest gaps, the respective averages are 7 percent and 3 percent.

	Average Pay Gaps for Professional-Administrative Jobs	Average Pay Gaps for Technical-Clerical Jobs
Quartile with the highest average pay gaps	24	26
Quartile with the next highest average pay gaps	15	18
Median pay gap for sampled work force	13	14
Quartile with the next to lowest average pay gaps	11	11
Quartile with the lowest average pay gaps	7	3

SOURCE: Congressional Budget Office from data provided by the Office of Personnel Management.

not be lowered as a result of this provision). In moving to a locality system for all workers, the proposal contrasts with the Administration's plan, which adopts locality pay for technical and clerical workers only.

Under the locality pay system, the President, through a pay agent he selects, would determine the boundaries of each pay area and would report on the pay disparities in each, based on surveys by the BLS. The government would begin to make the adjustments in pay necessary to close locality pay gaps in October 1992, a year earlier than under the Administration proposal. In contrast to the Administration plan, the President would not retain authority to grant pay raises below comparability. He could, however, choose to phase in adjustments over a period not to exceed 10 years. (The CBO estimate assumes 10-year phasing of locality adjustments.) This approach has the advantage of limiting near-term costs. Like the Administration proposal, the House plan would authorize a wide variety of supplements to pay (see Appendix Table). The House plan also calls for pay raises, prior to 1993, of up to 8 percent in selected geographic areas. (CBO's cost estimates assume 8 percent raises only in the three areas specifically authorized in the legislation--New York, Los Angeles, and San Francisco. The President could grant raises in other areas.)

If fully implemented in 1995, the annual cost of this proposal would total $12.2 billion. Of this amount, about $10.7 billion covers provisions providing for locality-based pay increases. The estimates assume that a locality system, as prescribed in the House plan, would require a 15 percent pay raise evenly phased in over 10 years. Of the remaining $1.6 billion in cost, $1.4 billion would cover associated increases in pay for blue-collar workers and $0.2 billion would cover various supplements to pay (see Appendix Table). [15] As with the Administration plan, CBO could not estimate costs for all the various pay supplements the House plan would authorize. In some cases, the provision not estimated could be expensive. For example, annual costs could rise by $1.2 billion if agencies granted the performance-based bonuses provided for in the legislation. (The estimate assumes half the work force would get an average 5 percent award.)

Through 1995, the net outlay cost of this legislation would total about $15.5 billion. This amount includes $1.9 billion for associated increases in military pay. CBO assumes uniformed military personnel would receive annual adjustments tied to the ECI because the House plan does not break existing linkages between pay raises provided for white-collar workers and military personnel. The total five-year cost is higher than the Administration's plan, primarily because of the earlier implementation schedule and the secondary effects on military pay. These estimates assume that ECI adjustments would begin in October 1991 and that the 10-year phasing of locality adjustments would begin a year later.

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15. Estimates of costs under full implementation for both the House and the Senate plans do not include amounts for adjustments tied to the ECI. Over the long run, these adjustments should not vary dramatically from annual adjustments under current law.

The Senate Plan

Pay reforms passed by the Senate would also make two major changes to the method for adjusting federal employee salaries.[16] Like the House plan, the Senate plan would attempt to keep federal pay from falling further behind the private sector by providing for annual adjustments linked to changes in the ECI. The adjustments would begin in October 1991.

At the same time, employees could also receive an additional adjustment based on certain locality-based pay relatives computed by BLS. The legislation does not attempt to close gaps between federal and nonfederal pay. Rather, the proposed pay-relative adjustments would provide some additional pay raises for some localities with high labor costs. (The Senate legislation calls on the Pay Agent to issue a plan, in 1995, according to which the government could close any remaining pay gaps. Implementation of the future plan would require further legislation.) The President could limit both the locality adjustment and the adjustment linked to the ECI. If the President did not significantly limit pay raises, the annual net outlay cost of this proposal, assuming full implementation, would total $2.9 billion. This amount includes $1.4 billion for the 10 percent average increase assumed for blue-collar wages and $0.2 billion for various pay supplements that the legislation would authorize (see Appendix Table). If the President instead limited pay raises to the annual 4.0 percent assumed in the CBO baseline, costs for this plan would total only the $0.2 billion for the various pay supplements.

Through 1995, costs would accumulate to $9.0 billion. Like the estimate of costs under full implementation, this estimate assumes no significant limit on pay raises. (The estimate assumes only that the President uses his discretion, not permitted in the House plan, to limit annual adjustments to 0.5 percent below the ECI and thus avoids $0.9 billion in five-year costs.)

Pay relatives, as provided for in the Senate proposal, would measure nonfederal salaries in various localities as they compare with a national average. If pay relatives show that an area has nonfederal salaries above the national average, federal white-collar workers would receive an increase based on the percentage difference between the nonfederal rates in the area and the national average. CBO assumes federal salaries in areas below the national average would not change.

This bill does not specify the method by which BLS would compute pay relatives for local areas. The method used would significantly affect the cost of this provision. For purposes of this estimate, CBO computed pay relatives based on selected data from the OPM data base.

The pay relatives estimated by CBO reflect analysis of pay for 33 selected jobs and 16 selected metropolitan areas. The selected jobs and areas account for

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16. The plan was passed by amendment to the Senate bill making fiscal year 1991 appropriations to the Treasury, the Postal Service, and other agencies.

significant numbers of federal workers. Effort was made, within the limitations imposed by the data available, to develop a sample with a fair mix of occupations, areas, and levels of responsibility. The constructed sample covers about 6 percent of the federal white-collar work force in full-time jobs. Based on analysis of the sample data and examination of supplemental information, CBO estimates that about 45 percent of the white-collar work force, in all occupations, would receive an increase under the provision for locality-based adjustments. These adjustments would average about 5 percent before offsets for special rates.

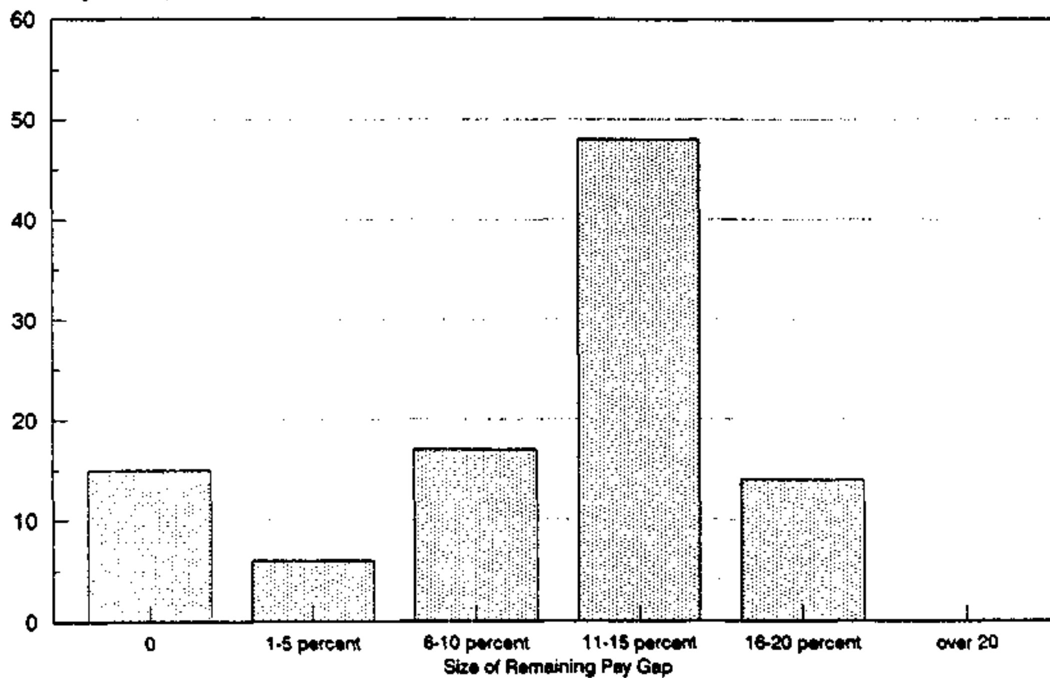
In computing pay relatives, CBO calculated how the private-sector pay for each selected job in a metropolitan area compared with an imputed national average salary for that job. The pay relatives for all selected jobs in an area were combined using weights based on the number of federal employees in those jobs. Therefore, the pay relatives reflect differences from area to area in both the cost of labor and the mix of skills the government requires.

The cost of this provision would vary to the extent that the BLS survey results and estimating methodology differ from those assumed in this estimate. Such differences would likely change the areas that would appear eligible for an adjustment and the level of adjustment indicated. This estimate represents a best guess, given the limitations of data currently available, as to the kind of costs that might occur as a result of this provision.

Based on estimates that assume full implementation, the Senate plan represents the least costly of the three plans considered in this report. The relatively low cost of the plan can be attributed primarily to the nature of the proposed locality-based adjustment. The Senate plan calls for locality adjustments only in high-cost areas as defined by pay relatives. Pay gaps, the factor determining the size of adjustments under other plans, may exist in other areas, but no locality adjustment would occur in such areas under the Senate plan. In fact, the use of pay relatives would leave significant pay gaps in most areas. CBO analysis of selected data, suggests that over three-quarters of the work force is located in areas that would still have a pay gap above 5 percent even after receiving pay increases based on pay relatives (see Figure).

The Senate plan appears to have the merit, in an era of budgetary restraint, of generally targeting higher pay raises only for areas that face greater competition from the private sector. The pay gap problems not addressed, however, could cost the government in the long run in terms of its position in competing for workers.

DISTRIBUTION OF FEDERAL WORKERS BY THE SIZE OF REMAINING PAY GAPS AFTER ADJUSTMENTS BASED ON PAY RELATIVES



SOURCE: Congressional Budget Office from data provided by the Office of Personnel Management.

NOTE: Data reflect analysis of pay for 33 selected jobs and 16 selected metropolitan areas. Together these cover about 6 percent of the federal white-collar work force. CBO selected areas based on the availability of data on the occupations covered by the analysis.

PAYING FOR REFORM

Although each of the pay reform proposals described in the previous section has different cost implications, they all have high price tags. Given the government's continuing fiscal difficulties, the Congress could set aside pay reform altogether. If reforms were enacted, the Congress could minimize the financial burden by strictly limiting the changes made--for example, by deferring a major overhaul of the government's pay system and instead enacting a limited, one-time increase. Alternatively, the Congress could address only the most severe federal recruitment and retention problems. Measures so targeted might resemble the supplemental geographic pay differentials provided for in both the House and the Administration plans. Or they could resemble the targeted locality pay increases provided for in the Senate plan. Delaying action now, however, will only worsen the government's recruitment and retention problems in the future.

Stretching out implementation offers another approach to minimizing, at least in the near term, the cost of reform. Each of the proposals before the Congress already phases in or delays implementation to some degree. Such phasing, however protracted, would not change the ultimate annual costs incurred, but it would keep costs low during the current period of fiscal restraint. Phasing also makes it easier to refine or revise reform measures in light of unanticipated adverse consequences and unforeseen developments in labor markets and federal labor requirements.

The Congress could also consider cuts in various budget items in order to offset the cost of a new pay system. This approach would carry forward a general principle, referred to with increasing frequency of late, that the Congress try to find ways to finance the cost-raising initiatives that it enacts. While the whole gamut of deficit-reducing measures could be the target, programs related to the initiatives under consideration offer a natural place to begin consideration of what to cut. Such cost-cutting measures, however, ought to make sense on their own merits, wholly apart from the measures they intend to help finance. Even so, confining the search for offsets to related programs may still lead to less-than-optimal decisions. Related programs, moreover, may not offer sufficient savings to offset all costs.

With these caveats in mind, this paper describes specific cuts in federal employee retirement benefits and in federal employment levels that the Congress could consider in deciding what to do about financing the cost of pay reform. From this perspective, these cost-cutting measures would not result in equitable outcomes in every case--sometimes they ask for sacrifices on the part of those who would not benefit from the reforms that need financing. The budget reduction options, however, offer the opportunity to cut certain personnel costs that some analysts find excessive. The Congress, therefore, could consider adopting the measures even in the absence of pay reform. Of course, cuts in other budget areas could always be considered. If adopted, cuts in personnel costs could permit pay reform to proceed without delays beyond 1995, without additional targeting, and without increasing budget deficits.

If the Congress adopted all six of the cost-cutting options described in this section, outlay savings in 1995 would total $9.9 billion. This amount would more than offset the full-implementation cost of reform under the Senate plan, producing net savings in federal labor costs. If the government adopted the Administration's proposal, the $9.9 billion in savings would offset about two-thirds of the cost of the plan, thus rendering reform almost budget neutral (see Table 4). Here and throughout this section, the annual 1995 savings from work-force reductions and retirement reforms are compared with the full-implementation cost of granting pay comparability under the Administration's plan. The 1995 savings estimates approximate the recurring annual cost reductions from the various retirement and work-force options and therefore make an appropriate comparison with the estimated cost of pay reform under full implementation. These comparisons are designed to give the reader a measure of the portion of reform cost that the various retirement and work-force options would offset. Of course, if the Congress enacts less expensive reform, offsets would be greater. Text and tables also present cumulative savings over the next five years.

Of the $9.9 billion in identified potential savings, almost three-fifths comes from cuts in employment, and the remainder from cuts in retirement benefits for civilian and military personnel. About half of the savings comes from national defense activities.[17] (All estimates of savings from retirement and work-force options assume that implementation starts on October 1, 1991.)

The individual savings proposals are adapted largely from two CBO reports prepared this year: *Meeting New National Security Needs: Options for U.S. Military Forces in the 1990s* (February 1990), and *Reducing the Deficit: Spending and Revenue Options*, Chapter VI, (February 1990). Potential savings from the measures described below would not be available to offset pay reform if they are dedicated to other purposes in overall budget reduction actions.

Reductions in Federal Retirement Benefits

Currently, about 2.9 million civilian employees are covered by federal civilian and military retirement programs. FERS covers employees hired since January 1984 and others who elected to join. Most civilian employees not covered by FERS receive coverage under the FERS predecessor, CSRS. Uniformed military personnel receive coverage under the Military Retirement System (MRS). This system was last revised for personnel entering military service after August 1, 1986, and military personnel will continue retiring under the plan through the next century.

17. Of the $9.9 billion of potential savings from possible cutbacks in employment and federal retirement benefits, about $4.9 billion or 51 percent come from national defense resources (budget function 050), about $4.0 billion or 40 percent from income security resources (budget function 600), and about $0.9 billion or 9 percent from other functions carried out by nondefense agencies.

TABLE 4. SAVINGS FROM POSSIBLE CUTS IN FEDERAL EMPLOYMENT AND RETIREMENT BENEFITS AND PERCENTAGE CONTRIBUTION TOWARD THE COST OF PAY REFORM

	Savings (Billions of dollars)		1995 Savings As a Percentage of the Cost of Comparability: the Administration Plan	
	Cumulative Savings (1991-1995)	Outlay Savings in 1995	Percentage of Pay Cost ($12.6 billion net outlays)	Percentage of Pay and Benefit Costs ($16.9 billion gross outlays)
Savings from Reducing Civilian Work Force				
Reduce DoD civilian work force per Senate Committee plan	9.3	4.9	39	37[a]
Reduce non-DoD work force per across-the-board productivity goals	1.4	0.7	6	6[a]
Subtotal	10.7	5.7	45	42[a]
Savings from Reducing Federal Retirement and Thrift Benefits				
Defer COLAs for retirees until age 62				
Military retirement	5.4	2.3	18	14
Civilian retirement	0.9	0.3	2	2
Limit some COLAs below inflation				
Military retirement	2.4	1.0	8	6
Civilian retirement	1.3	0.6	5	3
Add one year to salary average used to set initial pensions				
Military retirement	0.7	0.3	3	2
Civilian retirement	0.3	0.1	1	1
Restrict agency match on thrift plan contributions to 50 percent				
Military retirement	n.a.	n.a.	n.a.	n.a.
Civilian retirement	0.8	0.2	2	1
Subtotal	10.3	4.3	34	25
Military retirement	7.2	3.1	24	18
Civilian retirement	3.2	1.2	9	7
Grand Total	21.1	9.9	78	67

SOURCE: Congressional Budget Office.

NOTES: Savings estimates for each option assume they were implemented alone. CBO, however, discounted the retirement and grand totals to reflect the interaction that would occur if both COLA options were adopted. In other cases, details may not add to totals because of rounding. The savings for work-force reductions assume the increased federal salaries under pay reform and the benefits available under the Federal Employees Retirement System. DoD is the Department of Defense; COLAs are cost-of-living adjustments.

a. The percentages represent the dollars saved, in both pay and benefits, from work-force reductions divided by the cost, in both pay and benefits, of pay reform. By contrast, the dollar estimates of savings from work-force reductions in the table cover only cash disbursements for pay and for thrift plan contributions.

Alignment with practices representative of private employers is a long-standing objective of federal personnel policy. Cutting selected federal retirement benefits and increasing federal salaries would further this objective by producing a mix of current and deferred compensation more closely aligned with that found in the private sector. [18] Even with the cuts described below, however, federal retirees would still receive benefits that exceed those typically received by employees retiring from private firms.

In addition to better alignment with private-sector practice, the measures outlined below could, in some cases, reinforce an objective of pay reform--to improve the ability of government to retain high-quality workers. They might also offer a way to settle a major point of contention in the debate on pay reform--the amount of discretion given the Administration to grant pay adjustments that depart from comparability. While the Administration favors retaining authority to limit pay raises, some policymakers contend that providing such authority would mean a continuation of pay raises capped below the levels needed to provide competitive federal salaries. Permanent cuts in federal retirement benefits could be supported, for budget decisionmaking, as a fair trade for pay reform structured to provide a relatively permanent source of equitable pay raises. (One approach would be to give the Administration authority to alter the comparability pay raise only by the portion of costs left unfunded after retirement cutbacks.)

Some of the options described below produce substantial savings only if they apply to both current and future retirees. Currently, about 980,000 nondisabled retirees receive benefits under CSRS and MRS. These retirees, who would bear about 90 percent of the burden of proposed COLA cuts, view their relatively generous pensions as just recompense for working long years at below-market federal salaries. Cutting COLAs to finance pay reform would ask civilian retirees to foot the bill for the competitive federal salaries that were not available when they were still working.

Extending retirement cuts to military personnel would also meet with criticism. Certain cuts may lead some military personnel to delay retirement--a response that would not facilitate efforts to reduce the size of the military. Some observers may also question the fairness of cutting military retirement benefits as a means of financing pay raises for civilian employees. But such a concern overlooks the fact that, at least under the House plan, military salaries also would rise somewhat. Moreover, the Congress would not be likely to adopt retirement reforms solely as a means of offsetting the costs of pay reform. The various measures set forth below offer advantages wholly apart from their savings--for example, closer alignment with private-sector practices. The Congress may, therefore, have good reasons to adopt

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18. Alignment with private-sector practice has not been the only policy standard for federal compensation. In the past, generous retirement benefits have been maintained as an incentive for keeping an experienced corps of career employees. Reforms in the last two decades have moderated certain benefit provisions, especially for new employees, while keeping a retirement package that competes with the best private-sector plans.

the measure for all workers. Also, modifying retirement for all federal workers could be considered more equitable. But in the event that the Congress may wish to exclude military personnel from retirement reform, Table 4 separately identifies savings from military retirement.

Taken together, the measures described below would generate annual 1995 savings under full implementation totaling about $4.3 billion--if applied to all former federal workers. (The options identified below cover certain federal workers, such as Foreign Service officers and selected personnel, who are under separate retirement systems similar to FERS and CSRS.) Exempting current retirees from the COLA proposals would mean total retirement savings of about $1.1 billion. The $4.3 billion would contribute about 25 percent of the cost of even the most expensive pay reform.

Defer Cost-of-Living Adjustments Until Age 62. CSRS and the old MRS provide full cost-of-living protection to employees who retire before reaching age 62. Such protection is expensive relative to that available under the largest and most generous private pensions. Deferring COLAs until age 62 for all nondisabled employees under CSRS and MRS who retire before that age would yield savings in 1995 totaling $2.6 billion. (Nearly 90 percent of the estimated savings would derive from MRS because over half of its annuitants are nondisabled retirees under age 62.) Through 1995, savings would accumulate to $6.3 billion.

Deferring COLAs would moderate the government's cost for early retirement, consistent with reforms enacted in 1986 for new federal employees covered by FERS and by MRS. (Consistent with the MRS reforms, this option allows a catch-up adjustment at age 62 for inflation since the date of retirement. Retirees under FERS do not receive a catch-up at age 62.) [19] Deferring COLAs would also enhance federal efforts to keep experienced workers, by discouraging early retirement. But changing the rules of retirement could cause significant hardships for some individuals--especially MRS employees who usually retire at a relatively young age. Many retirees targeted by this option, however, should be in a position to supplement their pensions by working--as most military retirees already do. [20]

Limit Some COLAs to Below Inflation. Current indexing of COLAs is expensive and generous when compared with private-sector practice. [21] This

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19. The option's catch-up adjustment restores the monthly pension to what it otherwise would have been at age 62, but the annuitant is not compensated for the smaller payments received during the period COLAs are deferred.

20. For a detailed explanation of deferring or limiting COLAs until age 62, see Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options* (February 1990), pp. 334-336.

21. Most private pension plans adjust postretirement benefits on an ad hoc basis that, over time, may cover about 30 percent of the erosion that would otherwise occur because of inflation. Inflation protection for other sources of retirement income, such as Social Security and employer-sponsored thrift plans, could boost the overall inflation coverage typically found in the private sector to as much

option would limit COLAs to one percentage point below the rate of inflation for the old MRS and to a half-point below inflation for CSRS. (The smaller half-point limitation for CSRS would apply to a more comprehensive benefit that, unlike the defined benefits under FERS and MRS, substitutes for both Social Security and employer-sponsored benefits. Therefore, the smaller cut would produce a reduction comparable with the one-point limit for MRS employees.) [22] These changes would conform to the postretirement COLAs (1 percentage point below the rate of inflation) that will apply to employees under FERS and the revised MRS. This option, however, would hurt low-income retirees most. It would also renege on an understanding that workers in the CSRS, who had a chance to switch systems, would retain their full protection against inflation. By 1995, annual savings under this option would total $1.6 billion. Through 1995, savings would accumulate to $3.7 billion. [23] (These amounts would shrink to $0.9 billion and $2.2 billion, respectively, if this option were coupled with the preceding one that would defer COLAs until age 62.)

Add a Year to the Average Salary Used to Set Initial Pensions. Under current law, the CSRS and FERS provide initial benefits based on an average of an employee's three highest salaried years. The MRS uses a different salary base for personnel hired before September 1980; benefits are calculated using the salary at the date of retirement. If, instead, a four-year average were adopted for CSRS and FERS and a 12-month average were adopted for MRS, initial benefits for most new retirees would decline by about 2 percent to 3 percent, producing annual savings by 1995 of $0.4 billion. Through 1995, savings would total $1.0 billion. This option would align federal practice more closely with practice in the private sector, where five-year averages are commonly used. [24] Moreover, it could encourage some employees to stay on another year in order to take full advantage, when calculating retirement benefits, of the higher salary under pay reform. (To discourage workers from accelerating their planned date of retirement to avoid the new formula, the change in base salary would need to be phased in. The estimates here assume a phase-in period of 12 months.)

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as 70 percent. CSRS, by contrast, currently provides 100 percent, automatic protection from the effects of inflation. See Congressional Research Service, for the House Committee on Post Office and Civil Service, *Designing a Retirement System for Federal Workers Covered by Social Security*, Committee Print 98-17 (December 1984), pp. 47, 62, 68-70, and 84.

22. On the basis of employer-provided benefits, roughly half the CSRS pension is akin to Social Security coverage, which is indexed to 100 percent of inflation, and the remainder to supplemental benefits. Thus, for CSRS retirees, this option amounts to complete indexation for half of the CSRS pension and to a one-percentage-point reduction for the other half.

23. For other COLA limitations on federal retirement systems see Congressional Budget Office, *Reducing the Deficit*, pp. 163-168, and p. 331.

24. Congressional Research Service, *Designing a Retirement System*, p. 68; and The Wyatt Company, *1987 Survey of Retirement and Capital Accumulation Plans* (1988), p. 37.

Restrict Matching Contributions to Thrift Savings. On behalf of any worker covered by FERS, federal agencies automatically contribute 1 percent of individual earnings to the Thrift Savings Plan. In addition, the employing agency matches any voluntary employee deposits up to 5 percent of earnings. The agency matches dollar for dollar up to employee contributions of 3 percent of pay. Thereafter, the match is 50 cents for each dollar contributed up to the full 5 percent of pay. The entire federal contribution, including the automatic contribution, for employees putting aside a full 5 percent amounts to a sum equal to 5 percent of pay. [25] If the government limited matching contributions to a uniform 50 percent rate (50 cents on the dollar), savings in 1995 would total $0.2 billion. Through 1995, savings would total $0.8 billion. Private employers typically match an individual's voluntary thrift deposits up to 6 percent of pay at a 50 percent rate. [26] As modified, the government's approach would still remain superior because of the automatic 1 percent contribution. The cut in matching would hit higher-salaried professional and administrative workers hardest, as they use the thrift plan most. But these workers currently face some of the widest pay gaps and thus stand to gain most from a comprehensive pay reform package.

Reductions in the Federal Work Force

Major pay reform ought to lead to a more highly skilled and motivated work force. Accordingly, federal agencies could reasonably be expected to experience some improvement in efficiency. Savings from associated reductions in the government's civilian work force could help offset the cost of pay reform.

Congress could adopt measures to help ensure that agencies take advantage of opportunities to improve efficiency and reduce employment. One relatively simple approach would require agencies to absorb part of the ongoing cost of reform by withholding some of the funding necessary to cover higher agency expenses. Such action would encourage agencies to pursue improved operating procedures, more productive use of training programs, increased use of computers and other labor-saving devices, and better management of human resources. Congress could encourage such efforts by considering both an agency's work load and productivity improvement record when enacting annual appropriations for agency operations and for pay reform. [27]

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25. For additional information on reducing agency thrift plan contributions, see Congressional Budget Office, *Reducing the Deficit*, pp. 328-333.

26. Congressional Research Service, *Designing a Retirement System*, pp. 52-53 and 68-70; and The Wyatt Company, *1987 Survey of Retirement and Capital Accumulation Plans*, pp. 12-13.

27. The budget savings of any employment reduction measure would depend on the timing and the specific language in authorizing and appropriation legislation. The Budget Committees, of course, help resolve any significant scoring problems that may arise concerning employment limitations.

Nondefense Activities. Even with better staff and greater productivity, however, it would be unrealistic to assume that agencies could absorb the entire cost of pay reform. Civilian agencies, in particular, would find it difficult to meet pay absorption requirements. Many already struggle to keep up with the growing demand for services, given the limited budgetary resources that have been available in recent years. The work load of many agencies will probably continue to grow. The aging of the U.S. population, for example, will increase the number of pensions handled by the Social Security Administration and the amount of health-care services demanded by veterans and other beneficiaries. And, with no abatement in drug and other criminal activity on the horizon, the demands on the agencies responsible for federal prisons and the administration of justice will probably continue to rise. For such agencies, strict absorption requirements could represent just one more call to do more with less.

Even so, some increase in efficiency of civilian agency operations could be expected. And the overall level of improvement would not have to be dramatic to make a significant contribution toward the price of pay reform. For example, a four-year requirement for productivity improvement averaging only 0.5 percentage points more per year (1992-1995) could permit elimination of about 20,000 federal jobs, and--without lowering the level and quality of service--reduce 1995 net outlays by about $0.7 billion. This amount represents about 6 percent of the governmentwide pay and benefit cost of the most expensive pay reform option. The amount would cover about 10 percent of costs at civilian agencies, supporting an absorption rate about half as large as that assumed in the CBO baseline. Through 1995, savings from eliminating 20,000 jobs would accumulate to $1.4 billion. [28] If agencies planned for reductions far enough in advance, current retirement and quit rates should make it possible to cut employment without layoffs or new incentives for employees to retire. If reductions started in 1991, agencies could achieve targeted adjustments by not filling one out of 16 vacancies in full-time permanent employment. Congress would, of course, want to tailor the required reductions to meet the particular circumstances of an agency. In so doing, an effective, efficient, or high-priority program might have to meet smaller reductions than other programs.

National Security Activities. At the Department of Defense (DoD), improving civilian labor productivity could also be difficult to achieve, but for different reasons. Most organizations experiencing a sustained decline in demand for service find it difficult to maintain efficiency because required job cutbacks often lag behind or do not run as deep as the decline in work load. Over time, the work load at DoD will probably drop, given recent major developments in Eastern Europe and in the Soviet Union and assuming no serious worsening of the crisis in the Middle East. Associated multi-year reductions in civilian employment at DoD could be significant. Although driven by factors unrelated to pay reform, the Congress could target the

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28. CBO assumes that productivity improvements begin on October 1, 1991, and that one-time costs for investment in new equipment and other resources to improve productivity would offset savings in that year. For a similar work-force reduction item, see Congressional Budget Office, *Reducing the Deficit*, pp. 299-301.

associated savings from DoD, through absorption rates, to finance a large share of civilian salary increases under pay reform. Of course, civilian pay reform, if enacted, would be only one of many priorities in competition for potential resources freed up by lower military requirements in future years.

The timing and level of cuts in personnel at DoD will reflect a variety of strategic and other considerations. Current planning by the Senate Committee on Armed Services assumes active-duty strength could fall by 23 percent by 1995. In the years 1992 through 1995, uniformed personnel cuts would total 375,000. [29] Associated reductions in the Department's civilian support jobs could reach 145,000, generating net savings in 1995 of $4.9 billion. This amount would cover about four-fifths of the pay and benefit costs of comparability raises at DoD and about two-fifths of the costs for all agencies. Through 1995, savings could accumulate to $9.3 billion. [30] DoD could achieve such a cut in its civilian work force, without layoffs, by not filling five out of nine vacated positions.

A cut of 475,000 in U.S. military forces (including the proposed 100,000 cut in 1991) is a bit more conservative than the long-term plan recently announced by the Administration. [31] It is also not quite as steep as a more far-reaching alternative described earlier this year by CBO. [32] Compared with the more far-reaching alternative, this option allows a margin of about 100,000 uniformed personnel for any new requirements. Even so, some planners might be reluctant to commit to any large cuts in the military now because of uncertainty about the outcome of events in the Middle East and because of doubts about the capacity of the United States to reestablish its military capabilities, should new long-term threats emerge.

Some analysts may also argue that potential cuts in the civilian and military personnel at DoD would reduce the need for pay reform by increasing the supply of experienced employees available to meet other federal requirements. Any change in the supply of qualified workers, however, would probably address only short-term federal needs. Thereafter, the government would still have a pay system unable to produce a competitive salary structure. In addition, cuts at DoD would probably not match all requirements for federal workers. Those workers who leave a DoD job in one area may not help a recruitment problem in a civilian agency located in another. The jobs targeted at DoD for reduction, moreover, may not always represent the skills required by civilian agencies.

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29. Senate Report No. 101-384, *National Defense Authorization Act for Fiscal Year 1991* (July 1990), accompanying S. 2884, p. 157.

30. The estimated civilian work-force savings do not, of course, include the much larger resources that would be freed up directly from having fewer uniformed personnel and less military procurement.

31. See George Bush, *Address to the Aspen Institute*, August 2, 1990.

32. Congressional Budget Office, *Meeting New National Security Needs: Options for U.S. Military Forces in the 1990s* (February 1990), pp. 25-32.

APPENDIX

TABLE A-1. DETAILED ESTIMATES OF OUTLAY COSTS FOR THREE REFORM PLANS (In millions of dollars)

	Administration's Plan				House Plan		Senate Plan	
	Scenario I		Scenario II					
	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation
Costs for Basic Changes in Pay System								
Civilian Pay Adjustments Linked to Employment Cost Index								
Net Cost	n.a.	n.a.	n.a.	n.a.	2,183	a/	-930a/	a/
Military Pay Adjustments Linked to Employment Cost Index								
Net Cost	n.a.	n.a.	n.a.	n.a.	1,855b/	n.a.	n.a.	n.a.
Locality Adjustments								
Net Cost	n.a.	n.a.	5,742c/	10,657c/	4,851	10,657	4,473	1,331
Pay Blue-Collar Employees at the Prevailing Rated/								
Net Cost	n.a.	n.a.	1,771	1,393	4,632	1,393	4,632	1,393
Total Net Cost	n.a.	n.a.	7,513	12,050	13,521	12,050	8,176	2,724
Costs for Supplements to Pay and Other Measures								
Geographic Differentials for New York, Los Angeles, and San Francisco								
Net Cost	1,796	440	1,539e/	308e/	1,274	f/	n.a.	n.a.
Staffing Differentials for GS-5 & GS-7								
Net Cost	500	124	500	124	n.a.	n.a.	n.a.	n.a.
Pay for Senior Civil Servants								
Net Cost	104	25	104	25	101	25	109	25
Pay for Critical Positions								
Net Cost	97	24	97	24	94	24	203	47

(Continued)

TABLE A-1. (Continued)

	Administration's Plan							
	Scenario I		Scenario II		House Plan		Senate Plan	
	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation	1991-1995 Total	Cost Under Full Implementation
Costs for Supplements to Pay and Other Measures (Continued)								
Uniform Allowances								
Net Cost	124	29	124	29	117	29	130	29
Travel and Transportation Expenses								
Net Cost	177	40	177	40	169	40	186	40
Physicians Comparability Allowances								
Net Cost	123	30	123	30	123	30	123	30
Pay for Administrative Law Judges and Members of Boards of Contract Appeals								
Net Cost	80	19	80	19	77	19	83	19
Total Net Cost	3,000	731	2,744	599	1,955	167	833	191
Total Costs								
Net Cost	3,000	731	10,257	12,649	15,476	12,217	9,009	2,915
Gross Cost[g]	3,550	862	14,745	16,871	21,399	16,354	12,044	3,873

SOURCE: Congressional Budget Office.

NOTES: Details of estimates for the House and Senate plans can be found in CBO cost estimates for H.R. 3979 (August 1, 1990) and S. 2274 (August 22, 1990).

n.a. = not applicable.

a. Estimates of full-implementation costs under both the House and Senate plans do not include amounts for adjustments linked to the Employment Cost Index (ECI). Over the long run, these adjustments should not vary dramatically from current law. The negative amount under the Senate plan assumes a discretionary limit on ECI adjustments.

b. CBO assumes that uniformed military personnel would receive adjustments linked to the ECI because the House plan, unlike the Administration and Senate plans, does not break existing links between annual pay raises for white-collar workers and military personnel. The estimate does not reflect amounts for either pay adjustments or new active-duty personnel called to service as a result of the crisis in the Middle East.

c. Includes the cost of raises received by professional and administrative workers under the National Schedule.

d. CBO assumes that an average raise of 10 percent would be required to raise blue-collar wages to prevailing rates, effective at the same time as locality adjustments for white-collar workers.

e. CBO assumes that technical and clerical workers would not receive geographic differentials under Scenario II because the raises granted under the scenario could raise salaries for these workers to prevailing local rates, making the need for additional payments unlikely.

f. Geographic differentials under the House plan are transition measures that would not occur under full implementation.

g. Gross costs include amounts for financing employee benefits, including retirement fund liabilities caused by pay raises.