Testimony for the Record
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Subcommittee on the Federal Workforce, the Postal Service and the District of Columbia
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In Search of Equity: An Examination of Locality Pay

Transitioning from COLA to Locality Pay: A Vital Step to Recruiting and Retaining a Qualified Workforce in Hawaii

Statement Submitted for the Record by
The Federal Managers Association

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Chairman Davis, Ranking Member Marchant and Members of the House Subcommittee on the Federal Workforce, the Postal Service and the District of Columbia:

On behalf of the 200,000 managers, supervisors, and executives in the federal government whose interests are represented by FMA, I would like to thank you for allowing us to express our views regarding proposals to change the pay system for federal employees in Alaska, Hawaii and the United States Territories.

Established in 1913, FMA is the largest and oldest Association of managers and supervisors in the federal government. FMA originally organized within the Department of Defense to represent the interests of its civil service managers and supervisors, and has since branched out to include some 35 different federal departments and agencies. We are a non-profit, professional, advocacy organization dedicated to promoting excellence in government.

Since 1948, federal employees outside of the contiguous U.S. have received a non-foreign cost of living adjustment (COLA) to ensure that their pay reflects the high cost of living in these areas. In Hawaii, this non-taxable payment can be up to 25 percent of an employee's basic pay; however, COLA is not credited towards an employee's retirement annuity. At the time of its inception, COLA was viewed as "hardship pay" for federal employees. Today, however, we are faced with a much different population and a situation where a COLA no longer makes sense.

Since the passage of the Federal Employee Pay Comparability Act (FEPCA) in 1990, there has been much discussion and consternation that employees in Hawaii and Alaska have not been included in the locality pay pool authorized by FEPCA. In the beginning, locality pay was rather low and a cost of living allowance seemed to offer reasonable compensation for the high cost of living in these remote states. As time went on, it became apparent that COLA recipients were at a disadvantage because locality pay is tied to basic pay for retirement purposes. This practice denies residents of Alaska and Hawaii substantial benefits for no other reason than that their residence is outside the contiguous U.S.

High locality pay in the continental 48 states lures managers, high-level technicians, and engineers to leave Hawaii and Alaska to seek higher pay and an increased annuity towards the end of their careers. With the Los Angeles area offering a 25.26 percent locality adjustment and the San Francisco area offering 32.53 percent, it is easy to see why employees nearing the end of their careers would be looking to complete their final three years in these cities. Specific data to document this migration is hard to come by, but the stories are endless. In one such instance, a husband and wife have separated for their careers. The wife has gone to San Francisco to finish up her career with the government while her husband continues to work in Hawaii. They both plan to retire in Hawaii, but must endure a long distance relationship in order to properly plan for their retirement.

Backfilling vacant positions in Hawaii, especially managerial and supervisory positions, which by their nature are held by older workers, becomes increasingly difficult with COLA not contributing to retirement annuity calculations. Qualified workers are reluctant to accept positions in Hawaii and jeopardize their retirement. At the Pearl Harbor Naval Shipyard, vacancies remain open for months and delays in hiring at this level undoubtedly impact agency mission. Similar refusals spread across all of the federal agencies in Hawaii and Alaska negatively affect the federal government.

Over the years, we have seen that annuity payments for residents of Hawaii were as much as 30 percent less than their counterparts on the west coast. By 2003, there was enough interest that a working group was put together in Hawaii to study this issue and the group subsequently submitted a request to the Office of Personnel Management (OPM) to look into converting non-foreign COLA to locality pay. With each passing year, the voice for locality pay grew louder and in 2006, the Hawaii State Legislature passed House Resolution 47 in support of locality pay for Hawaii federal workers. In May 2007, at the urging of the President, OPM issued the Locality Pay Extension Act of 2007 and submitted the legislative proposal to the Senate for consideration. In his fiscal year 2008 and 2009 budget request, the President also proposed to phase-in locality pay and phase-out the non-foreign cost of living allowance.

We at FMA appreciate the support and attention the Administration is placing on this problem. For too long, federal employees outside the continental U.S. have been punished for their residence in these areas. However, we have serious concerns about the OPM proposal as submitted to Congress. In short, the Locality Pay Extension Act would transition federal employees in non-foreign COLA areas to locality pay over seven years by adjusting their pay every year. This would be done by increasing the locality pay component and decreasing the COLA component each year. For computation purposes COLA would be "frozen" at the first year of inception and reduced by 15 percent of the difference between the original COLA rate and the yearly locality pay rate. It is our understanding that in the eyes of the Administration, the proposal offered by OPM would do three things:

- Reduce the cost of litigation associated with the COLA program;
- Lessen the budget impact that a full first year of locality pay would bring; and,
- Apply contemporary compensation practices to all federal workers.

FMA believes that the Locality pay Extension Act does not go far enough to recognize the needs of today's hardworking federal employees outside the contiguous U.S. In fact, it is our belief that the OPM proposal continues the discriminatory, illogical and possibly unconstitutional denial of full locality pay for federal employees in Alaska and Hawaii for seven years. In short, the Act would needlessly stretch out the transition and not do enough to protect the take home pay of employees. The time for a seven year phase-in was seven years ago. Today we are facing real retention and recruitment issues and we need to move up the timetable on any COLA to locality pay conversion in order to compete with not only the private sector, but also our federal counterparts on the mainland. As such, it is our belief full locality adjustments should be added to pay the first year it is authorized.

For the federal government to remain the employer of choice, we must offer a competitive salary. Locality pay takes into account the cost of labor in a given area and was originally enacted to close the gap between public and private sector wages. The OPM proposed actually *reduces* net take home pay for most federal employees in Hawaii and Alaska, since the added locality pay component also brings with it a tax burden. OPM recognizes this with a 15 percent "offset" to adjust for the added taxes, but most employees in Hawaii and Alaska fall into the 25 or 28 percent tax bracket. By applying a 15 percent offset, most employees will see less money in their paychecks than if we left the system as is. Simply put, this is unacceptable and will only exacerbate our growing recruitment problem. The federal workers in the contiguous 48 states were not asked to take a cut in pay for increased retirement benefits when FEPCA was enacted; they were given both - increased pay and increased annuity. It is only fair we do the same in this situation.

We at FMA request Congress work with OPM to develop a fair and equitable conversion from non-foreign COLA to locality pay focusing on two key features to help with recruitment and retention:

- Implement full locality pay the first year it is authorized; and,
- Apply an offset to COLA that is at least 25 percent to minimize adverse affects to take home pay.

The Federal Managers Association proposed an alternative to the OPM plan, but one based on similar calculations. Under our proposal, the Rest of the United States (RUS) locality pay should be applied to the basic pay of federal workers in the first year of implementation, since no Hawaii locality rate currently exists. COLA for these employees would be reduced by the RUS rate multiplied by 75 percent, not 85 percent as proposed by OPM. For example, if the RUS rate was 15 percent and COLA was frozen at 25 percent as it is now, the employee would receive 15 percent taxable locality pay and a 13.75 percent COLA in the first year. Workers between GS-6 step 2 and GS-12 step 9 would see no change to their take home pay under this plan if they took the standard deduction on their taxes. Workers below the GS-6 level would see slightly more in their pay than under the current COLA system. Conversely, workers above the GS-13 level would see a manageable decrease in pay. The FMA plan targets the majority of workers in Alaska and Hawaii. Taking budgetary matters into consideration, the FMA proposal likely would not cost the federal government any additional money as the same Locality Pay Pool would be spread over a slightly larger population while increasing the amount of federal taxable income for Alaska and Hawaii federal employees.

After the first year of implementation, a Hawaii area locality pay should be established and the proper amount of compensation applied. We have seen some preliminary studies that put Hawaii's locality pay around 20 percent and Alaska's at 28 percent. With these rates applied in the second year, COLA should be eliminated in Alaska and greatly reduced in Hawaii. The additional taxes collected as a result of locality pay conversion would help offset increased annuity amounts and the cost of administering the pay conversion.

We would like to take a moment to address recently introduced legislation, S. 3103, the Non-Foreign Area Retirement Equity Assurance Act, introduced by Senators Akaka, Inouye, Stevens and Murkowski. We were encouraged to read that several of our concerns were addressed in the bill and we congratulate the fine Senators from Alaska and Hawaii on developing this critical piece of legislation.

The bill proposes a three year phase-in of locality pay combined with an annuity buy-in aimed at stabilizing the current retirement eligible workforce. The legislation also advises a 35 percent offset to COLA to protect the pay of all federal employees as they transition to locality pay. This is critical to retaining younger employees who have told us they would not support any change that could adversely affect their pay check.

Additionally, we are supportive of the phase-in process of locality pay as laid out in S. 3103. During the phase-in, non-foreign COLA is adjusted based on the amount of locality pay phased in. Under the legislation, in the first year of conversion, employees would receive one-third of the locality pay percentage for the Rest of U.S. and still receive a sufficient amount of COLA to pay the additional taxes they will incur. In the second year, when a locality pay area could be established for each non-foreign area, two-thirds of the locality pay percentage approved by the President for the area would be applied, with the percentage of COLA being lowered but still offsetting increased taxes and mandatory payroll deductions. In the final, third year, full locality pay would be implemented, but a COLA portion of pay would still be authorized. This process would continue after the third year until the locality pay surpasses the offsetting COLA rate. We are encouraged that the bill expresses the sense of Congress that employees should not have a decrease in take home pay due to enactment of the legislation.

FMA's plan calls for full locality pay in the first year based on the assumption current employees would be less likely to transfer out of state to take jobs as they near retirement. They would be able to retire on their own terms, in their own homes and in their own communities. While S. 3103 would implement locality pay over three years, we believe the outcome would remain the same due to the provision which would allow employees to pay into the Civil Service Retirement and Disability Retirement Fund to cover the amount of what they would have paid if they had been covered under the legislation.

However, we have serious concerns regarding the buy-in provision in the legislation. As written, the buy-in would allow an employee to pay the retirement fund the amount that would be collected if COLA was credited towards retirement. This would only be possible during the transition and would allow that employee to then collect a pension based on his/her high three including COLA, not locality pay. While we are a supportive a buy-in process, the bill would grant employees who retire during the three year phase-in a benefit that no other employee in history has ever or will ever get.

One can reasonably assume that this could cause further litigation. Additionally, the bill encourages employees to retire during the phase-in, which could cause the very same retirement wave we are looking to prevent. For employees who are retirement-eligible, retiring during the third year of transition will benefit them more in retirement than if they retired after the phase-in. We at FMA propose that employees who retire after the bill is enacted be the only people allowed to buy-in. Those who buy-in would pay back the government the amount that would have been withheld if they were still working during the transition and their annuity computation adjusted by the additional locality pay.

For example, employees who retire in year one could buy-in to one-third RUS locality pay retirement withholdings. In the second year, they could buy-in to two-thirds the Hawaii locality pay (if one is determined) and in the third year, buy-in to full Hawaii locality pay. The high three would be adjusted every year that an employee bought in so that the annuity would go up accordingly. At the end of the transition, a buy in would no longer exist. We believe this approach would work well to meet our goals of stabilizing the current retirement eligible workforce and protect take home pay.

OPM has stated that a significant retirement wave would occur after if full locality pay was introduced right away. We at FMA believe the "retirement tsunami" has already begun. By implementing locality pay right away, agencies can prevent what otherwise would have been a mad scramble as senior leaders shuffle around and jockey for advantageous retirement positions. Implementing full locality pay sooner rather than later will allow these outgoing leaders to focus more on succession planning and less on how they will be planning for their own retirement. Eliminating an arbitrary phase-in period will stabilize the current retirement eligible employees who make up nearly half the workforce.

The other half of the workforce, those just entering civil service, is less concerned about high three and more concerned with take home pay. By increasing the offset to COLA to 65 percent, these younger workers will not be adversely impacted by a change in the pay system. Additionally, employees in the Federal Employee Retirement System (FERS) will see increased eligible matching funds for their Thrift Savings Plan (TSP) because their base pay will be increased by the locality pay amount. In fact, over a career, these matching funds can amount to an estimated $31,000 for a GS-9. The resulting compensation package will make the federal government more competitive in the current tight labor market. This is essential if the highly critical missions of the federal agencies in Hawaii and Alaska are to be met. Currently, the Defense Intelligence Agency employees are given a compensation package that includes the Washington D.C. locality pay *and* a COLA for the Honolulu area. Please note we are not advocating for both COLA and locality pay. We are simply asking for the tools that allow us to be competitive in the job market.

In recent months, we have been advised that COLA will be decreased to 24 percent for Honolulu in the next cycle. This is not because the cost of living is decreasing in Hawaii, but rather the cost of living in Washington D.C. is increasing faster. This is particularly important for our friends in Alaska who see a huge disparity between their COLA at 18 percent and the estimated locality pay of 28 percent. COLA served its purpose half a century ago. It is now outdated and acts as a barrier to federal employment. By acting now and implementing this market-oriented approach to determining local salaries, Congress can arm Hawaii and Alaska managers with one more tool to attract and retain today's highly mobile and talented workforce. Thank you for your time and consideration of our views.