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THE FEDERAL EMPLOYEES' RETIREMENT SYSTEM

Potential Changes in Agency Retirement Costs Following an Open Season

Statement by Michael Brostek
Associate Director, Federal Management and Workforce Issues
General Government Division

The Federal Employees' Retirement System: Potential Changes in Agency Retirement Costs Following an Open Season

The Federal Employees' Retirement System (FERS) was implemented in 1987 and generally covers those employees who first entered federal service after 1983. When FERS began, employees covered by the Civil Service Retirement System (CSRS) were provided an opportunity to transfer to FERS during a 6-month open season that ended in December 1987. The Federal Employees' Retirement Open Season Act of 1997, passed by Congress but vetoed by the President, would have allowed employees currently enrolled in CSRS or the CSRS Offset program a second chance to transfer. Transferees under the act would have received substantially the same coverage and benefits that were provided to those who transferred during the first open season.

GAO was asked to examine the potential impact of a new FERS open season on agency retirement costs. GAO developed illustrations that estimated the effect if differing proportions of about 500,000 permanent general schedule CSRS and CSRS Offset Plan employees (excluding employees of the Postal Service and certain other groups such as Wage Grade employees) decided to switch. GAO used information on current retirement practices and work it had performed on the early implementation of FERS to provide perspective on the difficulty of predicting how many employees might switch. GAO applied different assumptions about the portion of eligible employees who might switch and their salary levels and calculated the resulting differences in agency retirement costs.

GAO found that:

- It is difficult to predict who among the eligible employees would switch. GAO's review of the first FERS transfer program in 1987 showed that although eligible employees were provided the information and counseling that they would need to make a decision, about 4 percent of the eligible employees transferred to FERS. The review suggested that employee decisions can be based on situational factors that are economic as well as noneconomic.
- Assuming some employees opt to switch, agency retirement costs would increase following an open season because of differences in the way CSRS and FERS are funded. The amount of any cost increase would critically depend on the number of employees who switch and their salary levels. For example, assuming (1) a 10 percent switch rate—which would be twice the largest percentage of employees who transferred in 1987 in the agencies GAO reviewed—and (2) that employees earning higher salaries would be most likely to switch, agency costs for the period January 1997 through December 1997 would have been an additional $332 million.

- Given the uncertainty regarding how many employees might transfer, it is correspondingly difficult to estimate whether agencies would have a difficult time absorbing the cost increases. Although the largest increase in retirement costs GAO calculated—$332 million—would appear small in proportion to the cost of personnel benefits governmentwide, some agencies might find the costs difficult to absorb, depending on their different circumstances. Regardless of the size of the increases in costs, under the budget process discretionary spending is capped, and Congress may choose not to provide agencies extra funding to cover their increased retirement costs.

The Federal Employees' Retirement System: Potential Changes in Agency Retirement Costs Following an Open Season

Dear Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the potential impact on agency retirement costs of a retirement system open season in which anyone who is a general civilian employee of the federal government and is participating in the Civil Service Retirement System (CSRS) or the CSRS Offset plan would be allowed to transfer to the Federal Employees Retirement System (FERS).[1] As you requested, the focus of my statement is on the potential changes in retirement costs charged to federal civilian agencies that might follow such a transfer program. Because agencies would be responsible for paying any additional costs, information about changes in retirement costs could be important for workforce planning and management.

My statement has three main points. First, it is difficult to predict the number and salary levels of those eligible employees who would switch. Our review of the original FERS open season suggested that employee decisions can be based on situational factors that are economic as well as noneconomic. Second, assuming that some employees opt to switch, agency retirement costs would increase following an open season because of differences in the way CSRS and FERS are funded. The amount of any such increase in agency retirement costs would depend on the numbers of employees who switch and their salary levels. Finally, given the uncertainty regarding how many employees might transfer, it is correspondingly difficult to estimate whether agencies would have a difficult time absorbing such an increase. Although the largest increases in retirement costs that we calculated could appear small in proportion to the costs of personnel benefits governmentwide for the employees included in our analysis, some agencies might find the costs difficult to absorb, depending on their individual circumstances. Regardless of the size of the cost increase, under the budget process discretionary spending is capped, and Congress may choose not to provide agencies extra funding to cover their increased retirement costs.

The Federal Employees' Retirement Open Season Act of 1997, passed by Congress but vetoed by the President, would have allowed employees currently enrolled in CSRS or the CSRS Offset program to transfer to FERS. Under the act, an open season for transfers would have begun on July 1, 1998, and run through December 31, 1998. Transferees under the act

[1]Typically, the CSRS Offset plan covers employees who (1) had a break in service that exceeded 1 year and ended after 1983 and (2) had 5 years of creditable civilian service on January 1, 1987. CSRS Offset plan coverage is described in greater detail in Federal Retirement: Federal and Private Sector Retirement Program Benefits Vary (GAO/GGD-97-40, April 7, 1997).

would have received substantially the same coverage and benefits that were provided to those who transferred during the first FERS open season. Those who transferred would have received a single annuity upon retirement. That annuity would have included a CSRS component, calculated on the basis of the employee's final high-3 average salary and his or her years of CSRS service, and a FERS component using the same high-3 salary and based on the employee's years of FERS service. In addition, transferees would have received Thrift Savings Plan (TSP) and Social Security benefits from their FERS service.

Because of the Committee's interests, our analysis was only of the potential changes in agency retirement costs that would affect agencies' workforce and management decisions. We did not examine the change in the total or the government's share of normal costs of the CSRS and/or FERS programs, which is OPM's responsibility, or the budgetary effects on discretionary and direct spending, which are the responsibility of the Congressional Budget Office. It is worth noting that any comparison of the total budgeted costs for CSRS and FERS is driven by the fact, as discussed later in this statement, that the costs are recorded in the budget on a different basis. Had we examined the costs on a governmentwide basis the results may have been different.

To assess the potential impact on agency retirement costs of a new FERS open season, we developed several illustrations that estimated the effect if differing proportions of the eligible employees included in our analysis decide to switch. We used information from work that we performed 10 years ago when we examined the early implementation of FERS, including the first FERS open season and employee decisions related thereto, and our knowledge of current retirement practices to provide perspective on the difficulty of predicting how many employees might switch to FERS.[2] In developing our illustrations of the potential costs to agencies of a new open season, we used benefit assumptions reflected in the recently vetoed Federal Employees' Retirement System Open Enrollment Act of 1997—that transferees would receive substantially the same coverage and benefits as those provided to employees who transferred during the first FERS open enrollment. To illustrate the range of changes in civilian agency retirement costs that might occur, we applied different assumptions about the portion of eligible employees who might switch and their salary levels, and calculated the resulting differences in agency retirement costs. We developed two sets of illustrative examples, each assuming that 1, 5, or 10

[2]Federal Personnel: Views From Two Agencies on Why More Employees Did Not Join the New Retirement System (GAO/GGD-88-52FS, Mar. 11, 1988) and Federal Retirement: Implementation of the Federal Employees Retirement System (GAO/GGD-88-107, Aug. 4, 1988).

percent of the eligible employees would transfer.[3] In making our calculations, we used the most recent available data from the Federal Retirement Thrift Investment Board on agency TSP payments, which were 1996 data. We used 1997 Office of Personnel Management (OPM) data on the number of nonpostal permanent civilian employees of the federal government at the various grade levels[4] and 1996 OPM data on the share of CSRS and FERS normal cost percentages charged to agencies for their CSRS and FERS employees. As described in greater detail later in this statement, normal cost is the term used to describe costs that are calculated to reflect the cost of pension benefits as these benefits are earned, rather than as they are paid. Our illustrations show how agencies' retirement costs could have changed for the period from January 1, 1997, through December 31, 1997, if all of the transferring employees in each illustration were in FERS for the full year.

CSRS and FERS Are Designed and Funded Differently

CSRS and FERS are the two largest retirement programs for federal civilian employees. At the beginning of fiscal year 1995, these programs covered about 2.8 million federal employees, or 90 percent of the civilian workforce, including postal employees. OPM administers CSRS and FERS. CSRS and FERS pension benefits are financed partly by federal agency and employee contributions and partly by other government payments to the Civil Service Retirement and Disability Fund (CSRDF).[5]

[3]We selected 1 percent because it was the percentage used by the Congressional Budget Office in making its preliminary cost estimate of the vetoed Federal Employees' Retirement System Open Enrollment Act of 1997. We selected 5 percent because it represented about the largest percentage of employees who actually transferred in the agencies we visited during our review of the first FERS open enrollment. We added a 10-percent calculation to our analysis because some observers have speculated that large numbers of eligible employees would switch.

[4]OPM's Central Personnel Data File (CPDF) contains general schedule employees, members of the Senior Executive Service (SES), blue collar employees, and others. Of those employees in the CPDF, about 1.3 million are covered by the general schedule pay plan. Because the methodology for our calculations used general schedule salaries for calculating per employee increases in agency retirement costs, we identified 1,042,112 permanent general schedule employees in Career, Career-Conditional, Schedule A, and Schedule B appointments. Of the general schedule employees who we used in our analysis, 548,377 were covered by FERS, 457,084 were covered by CSRS, and 36,651 employees were covered by the CSRS Offset plan. Had we analyzed changes in agency retirement costs for non-general schedule employees (e.g., postal service employees, blue collar, and SES), our combined estimate of these increases would have been higher.)

[5]The Department of the Treasury also makes annual payments that are to cover interest on CSRS unfunded liability, payments for spouse equity, and amortization payments to finance supplemental liabilities for FERS, including those attributable to CSRS service for employees who elected FERS. The Treasury Department's FERS payments are quite small as a share of total normal costs. According to OPM actuarial reports, in 1996 these payments were about $48 million, which represents $1 in Treasury payments for each $138 in agency and employee contributions. Thus, for all practical purposes, agency and employee contributions cover the full normal cost of FERS benefits.

Program Design Differences

Although CSRS and FERS both provide pensions, the programs are designed differently. CSRS was established in 1920 and predates the Social Security system by 15 years. When the Social Security system was established, Congress decided that employees in CSRS would not be covered by Social Security through their federal employment. CSRS is a stand-alone pension program that provides an annuity, determined by a formula, as well as disability and survivor benefits. The program was closed to new entrants after December 31, 1983. According to OPM actuaries, the program is estimated to end in about 2070, when all covered employees and survivor annuitants are expected to have died.

FERS was implemented in 1987, and generally covers those employees who first entered federal service after 1983 as well as those who transferred from CSRS to FERS. The primary impetus for the new program was the Social Security Amendments of 1983, which required that all federal employees hired after December 1983 be covered by Social Security. FERS is a three-tiered retirement program that includes Social Security and TSP benefits in addition to a pension. Like CSRS, FERS provides disability and survivor benefits.

Differences in Program Funding

CSRS and FERS also are funded differently. The costs of FERS retirement benefits are paid by agencies and participating employees as these benefits are earned, but some of the government's CSRS pension costs are deferred.

To better appreciate how this occurs and the impact that the two programs' different funding approaches have on agency retirement costs, it is useful to understand differing methods for measuring retirement program costs. The cost of a retirement plan is generally not well measured by annual cash expenditures, because annual cash expenditures simply cover the payments to existing beneficiaries in any given year. An alternative measure of retirement costs assumes that funds are set aside in roughly equal payments over the working life of the employee to cover current and future liabilities for benefit payments. "Normal cost" is the term used to describe costs calculated in this manner; it measures the costs of pension benefits, which are earned during an employee's working years but paid during retirement, on an accrual rather than a cash basis. If resources including interest amounts are set aside that are sufficient to fully fund employees' retirement benefits as measured by normal cost (including the pay increases for employees and cost of living adjustments for annuitants), the retirement plan is said to be fully funded on a dynamic normal cost basis.

It has long been our position that the appropriate way to calculate and fund retirement costs is as the benefits are accruing.[6] When done properly, recognizing retirement costs as they are being earned reflects the full cost of providing these benefits to federal personnel at the time their service is rendered. The annual normal cost of CSRS, which is a much older program than FERS and predates modern financing methods (which attempt to finance pension plans on an actuarial basis),[7] is calculated for CSRS by OPM, but these costs are not fully funded from agency and employee contributions. According to OPM, when CSRS costs were estimated in this way, the normal cost for fiscal year 1996 was 25.14 percent for CSRS. For that year, the combined contributions of agencies and employees was 14 percent, or about 11 percent less than the full normal cost. Beginning in fiscal year 1998, agencies will pay an additional 1.51 percent of pay towards their CSRS employees' retirement costs. Employees covered by CSRS as well as those covered by FERS will also pay an additional .25 percent in 1999, another 0.15 percent in 2000, and a final extra 0.1 percent in 2001. Payment of a portion of the difference between the full normal cost and agency and employee contributions is funded through various means, and the remainder is deferred.[8] When Congress established FERS in 1986, it adopted our recommendation to charge agencies for all accruing retirement costs not covered by employee contributions.

[6]For example, see Federal Retirement Systems Unrecognized Costs, Inadequate Funding, Inconsistent Benefits (GAO/FPCD-77-48, Aug. 3, 1977); The Design of a New Retirement Program for Federal Employees Covered by Social Security (Apr. 12, 1985); Overview of Federal Retirement Programs (GAO/T-GGD-95-172, May 22, 1995) ; and Federal Retirement System Financing (GAO/T-GGD-95-197, Jun. 28, 1995).

[7]In establishing a defined benefit pension plan, an employer is promising to pay benefits that will come due in the future. Generally the money used to pay these benefits is obtained in one of two ways, either through pay-as-you-go financing or through reserve funding. The pay-as-you-go method would pay the pension benefits to retired employees as these benefits come due out of appropriations. Under the reserve funding method, contributions are made as benefits are earned based on actuarial estimates of the value of the benefits. CSRS was originally funded on a pay-as-you-go basis, and as a consequence, built up an actuarial unfunded liability. Regarding federal government pension plan liabilities, Public Law 95-595, 31 U.S.C. 9501-9504, enacted in 1978, established financial and actuarial reporting requirements to such plans and required the plans to report financial and actuarial information regarding plan liabilities in annual reports. According to our summarization of these reports in 1996, most of the 34 plans that we examined were underfunded on a dynamic cost basis. However, FERS is fully funded, and statutory provisions for the future elimination of the unfunded benefit obligations of CSRS and the Military Retirement System have already been enacted. See Public Pensions: Summary of Federal Pension Plan Data (GAO/AIMD-96-6, Feb. 16, 1996).

[8]The funded portion is covered by other government contributions to the retirement fund. OPM makes annual contributions to the fund from its appropriation to amortize the liabilities created by employee pay raises, once enacted, and other benefit improvements when they are made; the Postal Service makes contributions to the fund to cover retirement system liabilities resulting from collective bargaining agreements with its employee unions and COLAS postal retirees receive; and the Treasury pays the cost of benefits attributable to military service and interest on the system's unfunded liability as if it were funded. No provision exists to fund COLAs received by nonpostal retirees. The remainder is addressed in the FERS statute (Public Law 93-335) approved June 6, 1986, which requires that when the budget authority in the retirement fund for CSRS benefits is exhausted, automatic annual appropriations will be made to amortize the shortfall over 30 years.

Agency Costs for CSRS and FERS Differ

Because of these differences in the way in which CSRS and FERS are designed and funded, agencies are charged more as a percentage of pay for employees who are covered under FERS compared to their employees who are covered under CSRS. As shown in table 1, when the three components of the FERS benefit package are combined, beginning in 1999, agencies could contribute a total of 20.9 percent of pay for their FERS employees, compared with 8.5 percent for their CSRS employees.[9] Under these assumptions, agencies would pay a higher percentage of pay for each employee who transfers from CSRS to FERS than is currently paid. This is because agencies would need to contribute 2.2 percent more for the FERS pension benefit, plus an additional 6.2 percent for the employer's share of the Social Security benefit up to a maximum salary of $65,400, and about 4 percent for the TSP benefit.[10] As the table also shows, the percentage increase in agency costs per transferring employee would be smaller in the case of employees under the CSRS Offset plan.

[9]The CSRS Offset percentage is 14.7. The figures presented in figure 1 and used for our analysis are only designed to illustrate the potential changes in agency retirement costs. As noted earlier in this statement, in 1996, agencies actually contributed 7 percent for the CSRS defined benefit and will continue to contribute this percentage through fiscal year 1997. Also in this regard, in 1996, agencies contributed 11.4 percent for the FERS defined benefit, although as noted elsewhere in this statement and as used by CBO in its cost estimate of the budgetary impacts of an open season, the most recent OPM estimate of this cost is 10.7 percent.

[10]With respect to the pension benefit, agencies are to pay the difference between employee contributions of 0.8 percent and the full dynamic normal cost. According to the most recent OPM actuarial estimates, this difference is 10.7 percent. With respect to TSP, the maximum employer potential cost, or liability, for contributions for FERS-covered employees is 5 percent of pay—consisting of up to 4 percent in matching contributions, plus 1 percent in nonmatching contributions. In 1996, the most recent year for which data were available, the Thrift Board reported that agencies contributed about $2 billion to FERS employees' TSP accounts. According to OPM actuaries, the dynamic normal cost of TSP benefits has been rising and is now estimated to be about 4 percent of pay.

Table 1: Comparison of the Percentages of Pay Agencies Could Contribute for Employees Covered by the FERS, CSRS, and CSRS Offset Retirement Plans

	Federal retirement plans		
	FERS	CSRS	CSRS Offset
Defined benefit	10.7%	8.5%	8.5%
Social Security[a]	6.2%		6.2%
TSP (average match)	4.0%		
Agencies' total contribution percentages	20.9%	8.5%	14.7%
Percentage increase in agencies' costs if employees transfer to FERS		12.4%	6.2%

[a]As is true for private employers, this shows the employer contribution to Social Security, not the full actuarial cost of the system. See Retirement Income: Implications of Demographic Trends for Social Security and Pension Reform (GAO/HEHS-97-81, July 11, 1997).

Source: 1997 OPM actuarial data.

Although agency costs generally could rise by 12.4 percent of pay for each employee who transferred to FERS during the open season, the actual dollar impact of each such transfer would vary depending on employees' salaries, with the most highly compensated transferring employees causing the greatest increase in agency retirement costs. Table 2 provides the range of these dollar increases for general schedule (GS) employees and shows that the smallest increase would be $1,571 per employee, and the greatest would be about $9,769. Our results for the CSRS Offset plan participants ranged from a low of $785 to a high of $5,714 and are presented in appendix I.

Table 2: Comparison of Agency Cost Increases for Each CSRS General Schedule Employee Who Transfers to FERS, by Grade and Step

	Steps									
Grades	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
GS-1	$1,571	$1,623	$1,675	$1,728	$1,780	$1,811	$1,862	$1,914	$1,916	$1,965
GS-2	1,766	1,808	1,867	1,916	1,938	1,995	2,052	2,109	2,166	2,223
GS-3	1,927	1,991	2,056	2,120	2,184	2,248	2,313	2,377	2,441	2,505
GS-4	2,163	2,236	2,308	2,380	2,452	2,524	2,596	2,669	2,741	2,813
GS-5	2,420	2,501	2,582	2,663	2,743	2,824	2,905	2,986	3,066	3,147
GS-6	2,698	2,788	2,878	2,968	3,058	3,147	3,237	3,327	3,417	3,507
GS-7	2,998	3,098	3,198	3,298	3,398	3,498	3,598	3,698	3,798	3,898
GS-8	3,320	3,431	3,542	3,653	3,763	3,874	3,985	4,095	4,206	4,317
GS-9	3,668	3,790	3,912	4,034	4,157	4,279	4,401	4,523	4,646	4,768
GS-10	4,039	4,173	4,308	4,443	4,577	4,712	4,847	4,981	5,116	5,251
GS-11	4,437	4,585	4,733	4,881	5,029	5,177	5,325	5,473	5,621	5,769
GS-12	5,318	5,496	5,673	5,850	6,028	6,205	6,382	6,560	6,737	6,914
GS-13	6,324	6,535	6,746	6,957	7,168	7,378	7,589	7,800	8,011	8,166
GS-14	7,473	7,723	7,972	8,165	8,290	8,414	8,539	8,663	8,788	8,913
GS-15	8,450	8,597	8,743	8,890	9,036	9,183	9,329	9,476	9,622	9,769

Source: GAO analysis of OPM data.

It Is Difficult to Predict the Number or Salary Level of Employees Who Would Transfer to FERS

Because each transferring employee would add to an agency's retirement costs, assessing the effect of an open season on agencies' retirement costs is critically dependent on the number of employees who would switch and their salary levels. Exclusive of the Postal Service, about 457,000 permanent civilian GS employees covered by CSRS and about 37,000 covered by the CSRS Offset plan would be eligible and could transfer to FERS during a new open season. Given the potential range of impacts on agency retirement costs and the difficulty of making a precise estimate of these costs, it is useful to consider what factors employees might consider in making their decisions and the salary levels of those who might be most likely to switch.

When FERS was created, Congress asked us to evaluate the act's initial implementation. During the course of our work, we developed information on the reasons why eligible employees chose not to transfer to FERS. One lesson from this work was that it is difficult to predict whether an individual employee will decide to change his or her retirement coverage.

For example, at the time of the initial open season in 1987, the Office of Management and Budget estimated that as many as 40 percent of eligible employees would transfer to FERS, while after the open season ended in January 1988, OPM confirmed that about 86,000 CSRS employees (about 4 percent) actually transferred..

Also, transfer rates during the first FERS open season varied across the agencies that we reviewed. At sites we visited, we found that transfer rates ranged from less than 1 percent to more than 4 percent, which translates into a fourfold difference in the increases in the agencies' retirement costs.[11]

During our 1987 work, we also examined the manner in which agencies fulfilled their implementation responsibilities during the open season, in part to understand the role that information provided to employees may have played in their decisions. We found that although fewer eligible employees than expected actually transferred, there were no underlying deficiencies in the implementation of the transfer program that might have accounted for the low percentages. FERS information was widely available and distributed. Advisors who were to provide individual counseling were trained by OPM, and these advisors were available to assist employees. Computer models were also widely available, and analyses and estimates were generally provided to employees who requested them. Notwithstanding such agency efforts, briefings at the sites we visited were not well attended. Also, only a small percentage of employees requested computer estimates of their potential retirement benefits.

We interviewed personnel officials and advisors who were responsible for counseling employees during 1987 on the advantages and disadvantages of transferring to FERS. On the basis of the views of advisors and personnel officials at the sites we visited, we identified four primary reasons why employees decided not to transfer to FERS. The reasons—both economic and noneconomic—were as follows:

- Employees regarded FERS as too complex to understand.
- Employees believed they could not afford to contribute to TSP.

[11]We visited 23 Department of the Army and Veterans Administration field activities. We selected two large agencies, one military and one civilian. Both employed a large number of civilian employees and had numerous field activities widely dispersed throughout the country. However, because we did not randomly select the agencies or their field locations, the information we obtained could not be projected to portray the implementation of FERS throughout the Army, Veterans Administration, or the government.

- Employees planned to make the federal government their career and believed that CSRS provided greater benefits for career employees than FERS.
- Employees did not trust various aspects of the design or stability of FERS, including the viability of the Social Security system and potential for future changes in FERS benefit levels.

In contemplating the relevance of employees' 1987 reasoning for a new open season, it is worth noting that much has changed in the past decade. For instance, although the number of FERS retirees is still small relative to CSRS retirees, FERS is no longer an unknown or fledgling retirement program. The benefits available from participation in FERS likely are better understood today than in 1987 when the program was created. Of particular importance may be a general improvement in public understanding of 401(k) plans and the role that they now play in retirement savings. Although the growth of these plans may be due in part to their popularity with employers, the plans also enjoy increased employee popularity because they are seen as an important element of retirement income and as having the advantage of portability. Also, notwithstanding the recent volatility of stock markets worldwide, sustained economic growth has boosted plan earnings and increased total assets substantially over the past decade, including those of the TSP C fund. On the other hand, should the U.S. economy falter or market gains abate or turn to losses, TSP might seem less attractive to those employees who are considering whether to change their retirement coverage.

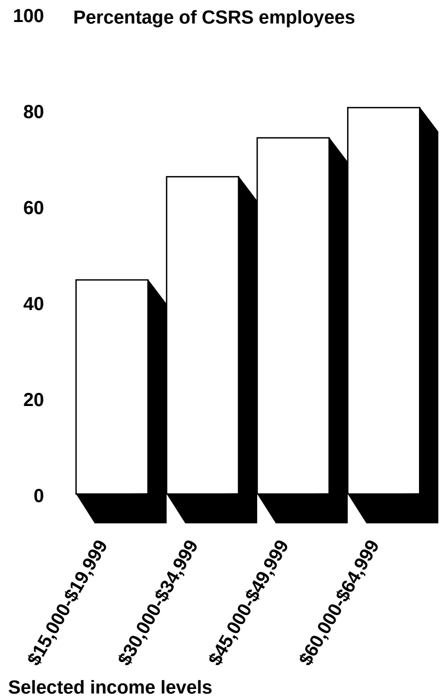
As to the TSP affordability issue cited by employees, CSRS participants—who are allowed to contribute up to 5 percent of pay on a tax-deferred basis to their own TSP accounts—are doing so in large numbers. In 1996, more than half of the CSRS-covered employees in civilian agencies contributed to TSP. Participation rates ranged from a low of about 42 percent at the Postal Service to a high of about 75 percent at the Education Department. Also, more than 70 percent of CSRS employees who were contributing to TSP in 1996 contributed the maximum allowed.

In part, because 10 years have elapsed since the last open season, individual employees' personal circumstances could be considerably different. In general, more CSRS employees would be closer to retirement eligibility, many may have moved to higher salary levels, and still others' family responsibilities may have changed—either by increasing or decreasing.

It is reasonable to expect that such economic considerations would play an important role in employees' decisions about transferring to FERS. Given such changes, some employees might find a financial advantage in changing their retirement coverage now who did not in 1987. For example, some economic incentives to switch include the following:

- Changes in personal circumstances such as advancing to higher salary levels could be contributing to the increased CSRS employee participation in TSP. For example, as shown in figure 1, about 80 percent of CSRS employees earning between $60,000 and $65,000 contributed the maximum 5 percent of their salaries into TSP. Some of these employees might be attracted to FERS to take advantage of the opportunity to put up to 10 percent of their salaries, which would result in a 5-percent contribution by the government.
- After a 5-year period of FERS participation, any CSRS employee who switched would become eligible upon retirement for the full spousal benefit provided under Social Security. CSRS retirees have these benefits partially or entirely offset by their CSRS pensions.
- The approximately 4,000 CSRS employees who have worked long enough to qualify for the maximum retirement benefit of 80 percent of their high-3 average salary could earn greater retirement benefits by transferring to FERS, because they would qualify for agency matching contributions to TSP, Social Security, and other benefits. The pensions that they would receive as transferees would include the maximum allowable CSRS benefit, plus the additional FERS annuity.
- Lower-salaried employees may fare well under FERS, because Social Security benefits are weighted toward lower income workers. Although employees who participate in CSRS do not receive Social Security benefits from their federal service, those participants who transfer to FERS would receive pensions combining CSRS and FERS benefits, and they would be eligible to receive Social Security benefits from their federal service. However, this advantage to low wage earners could be considerably reduced by the Windfall Elimination provision, which would significantly reduce Social Security benefits for transferees who do not have at least 21 years of substantial Social Security coverage.

Figure 1: Percent of CSRS Participants Who Contributed 5 Percent of Income in 1996, by Selected Salary Brackets



Source: Federal Retirement Thrift Investment Board data.

On the other hand, concerns about economic risks or uncertainty could dissuade some employees from transferring. As noted above, concern about the reliability of Social Security benefits was an important factor in employee decisions during the first open enrollment season. Current opinion polls suggest that many Americans remain concerned about whether these benefits will be a reliable source of retirement income. Our review of the last open season also suggests that factors such as the perceived complexity of the FERS program and its attendant risks also can play important roles in employees' decisions. For example, some employees have less than 40 years of service and thus have not reached the maximum CSRS benefit. These employees might not want to exchange the larger annuities that additional CSRS service would provide for smaller FERS annuities that are coupled with the risk of losses from TSP investments that could result an overall lower retirement income.[12]

[12]The amount of the reduction in annuity benefits would depend on the number of years of FERS service that would be applied to the employee's eventual annuity calculation.

Finally, although economic factors logically would play an important role in employee decisions, noneconomic considerations could also play a significant role. Choices about when is the right time to retire are very personal and reflect individual values and circumstances as well as economic considerations. Thus, these decisions could be based on factors that are hard, if not impossible, to quantify. Upon transferring to FERS, for example, employees would need to work an additional 5 years to avoid the public pension offset rules that apply to CSRS employees. However, working the additional 5 years might take some individuals beyond the date at which they had planned to retire, and the trade-off between additional retirement income and a shorter retirement would be a difficult personal decision. In the final analysis, much like employee decisions to take or forego recent early-out opportunities, it may be possible to estimate who would benefit from a FERS open season transfer on economic grounds, but the deciding factors might in fact be known only to the employees.

Agency Retirement Cost Increases Would Depend on the Number and Salary Levels of Employees Who Transfer

Given the difficulty of predicting the number and characteristics of the employees who ultimately might transfer to FERS, we developed two sets of examples to illustrate the range of increases in retirement costs that agencies could face following a new FERS open season. Using two different sets of assumptions, we calculated the increase in agency retirement costs if 1, 5, and 10 percent of the eligible employees transferred to FERS. For the first set of calculations, we assumed that the distribution of transferring employees for each GS pay grade matched their actual distribution, governmentwide. That is, if 2.2 percent of the eligible CSRS employees were in grade GS-4, then 2.2 percent of the employees included in the 1-, 5-, and 10-percent calculations would also be in grade GS-4. For the second set of calculations, we assumed that a larger proportion of the transferring employees would be earning salaries at higher GS grades. This assumption helps to illustrate the sensitivity of the agency retirement cost increases to the salary level of transferring employees and may be especially pertinent if employees nearing the end of their careers, or those who wish to take advantage of the FERS TSP higher maximum contribution rate are most likely to transfer.

Table 3 illustrates the potential increases in agency retirement costs if 1, 5, and 10 percent of the eligible employees covered by CSRS transferred to FERS, assuming that the transfer rates across the GS grades would match the current distribution of employees by grade and step. As the table shows, under these assumptions the increase in agency costs for the full calendar year 1997 would have ranged from about $24 million more if 1 percent of the employees transferred to about $244 million more if 10 percent transferred. Our results for CSRS Offset plan participants ranged from less than $1 million to about $8 million and are presented in appendix I.

Table 3: Comparison of the Estimated Increase in Agency Costs for General Schedule Employees Covered by CSRS

	Total cost of selected rates of transfer		
Grades	**1 percent**	**5 percent**	**10 percent**
GS-1	$133[a]	$663	$1,326
GS-2	2,694	13,472	26,944
GS-3	39,971	199,856	399,711
GS-4	268,896	1,344,478	2,688,957
GS-5	850,251	4,251,255	8,502,510
GS-6	806,650	4,033,250	8,066,499
GS-7	1,389,418	6,947,090	13,894,179
GS-8	687,775	3,438,877	6,877,753
GS-9	2,017,484	10,087,421	20,174,842
GS-10	319,857	1,599,285	3,198,569
GS-11	4,321,219	21,606,095	43,212,189
GS-12	6,483,941	32,419,705	64,839,410
GS-13	4,273,407	21,367,034	42,734,067
GS-14	1,985,738	9,928,692	19,857,384
GS-15	945,820	4,729,099	9,458,198
Total	**$24,395,340**	**$121,965,721**	**$243,931,442**

Note 1: For this table, we estimated the total costs associated with each selected rate of transfer by assuming that the proportion of CSRS employees who transfer would match the actual distribution of these employees across GS grades governmentwide.

Note 2: Due to rounding, totals may not equal the transfer rate percentages shown above.

[a]Because only seven of the CSRS employees whom we included in our analyses were in grade GS-1, 1 percent of these seven represents the cost difference for less than one person.

Source: GAO analysis of OPM data.

Table 4 shows the increase in agency costs if 1, 5, or 10 percent of the eligible employees covered under CSRS transferred to FERS under the different assumption that transfer rates would be higher for employees in grades GS-13 through GS-15. Following this logic, the calculations assume that 75 percent of the total number of employees who would transfer would be in grades GS-13 through GS-15, and the remaining 25 percent of the transferring employees would be in grades GS-1 through GS-12. Under these assumptions, the 1 year agency costs would range from a low of about $32 million if 1 percent of the employees transferred to a high of $320 million if 10 percent transferred. Our results for CSRS Offset plan participants ranged from about $1 million to about $13 million and are presented in appendix I.

Table 4. Comparison of the Estimated Increase in Agencies' Costs for General Schedule Employees Covered by CSRS If the Concentration of Those Transferring to FERS Were at the Higher Grade Levels.

	Total cost of selected rates of transfer		
Grades	**1 percent**	**5 percent**	**10 percent**
GS-1 to GS-12	$ 5,393,886	$ 26,964,573	$ 53,934,002
GS-13 to GS-15	26,585,497	132,919,510	265,831,044
Total	**$31,979,383**	**$159,884,083**	**$ 319,765,046**

Note 1: For this table, we estimated the total costs associated with each selected rate of transfer by assuming that 75 percent of CSRS employees who transfer would be in grades GS-13 through GS-15, and 25 percent of the employees would be in grades GS-1 through GS-12.

Note 2: Due to rounding, totals may not equal the transfer rate shown.

Source: GAO analysis of OPM data.

Agencies Might Have to Pay Any Additional Retirement Without Additional Resources

Regardless of the size of the increase in agencies' retirement costs may be, the way in which agencies' budget resources are controlled under the current budget process suggests that agencies might have to absorb any increase. Agency spending to pay retirement costs is discretionary spending. Under the current process, discretionary spending is subject to fixed-dollar caps that are implemented through the budget and appropriations processes.[13] As a consequence, unless Congress chose to provide additional resources to fund the added retirement costs that agencies could be charged, agencies would need to absorb any increases, within the limits of their annual appropriations.[14]

Given the uncertainty regarding how many employees might transfer to FERS during an open season, it is correspondingly difficult to estimate

[13]In particular, as noted in Budget Policy: Issues in Capping Mandatory Spending (GAO/AIMD-94-155, July 18, 1994), congressional budget resolutions set totals by budget function and accompanying statements to the conference reports allocate funds to the appropriations committees for discretionary programs. House and Senate appropriations committees subsequently allocate these totals among their subcommittees. OMB keeps score by tracking congressional actions, and Congress has established spending levels in each congressional budget resolution. Should appropriations exceed the discretionary cap, the Budget Enforcement Act provides for eliminating the overage through the sequestration of discretionary spending. Policymakers vote annually on these discretionary program appropriations.

[14]To provide additional appropriations for this purpose would likely require an increase in the discretionary caps.

whether agencies would have a difficult time absorbing such an increase. By one measure—the percentage that the increase in retirement costs might be of agencies' total expenditures for salaries and benefits—the increased retirement costs do not look imposing. For example, our highest estimate of increased governmentwide costs, about $332 million, would represent approximately 1 percent increase in expenditures for salaries and benefits for the employees used in our analysis, based on fiscal year 1997 figures. Of course, depending on how "personnel-intensive" specific agencies' operations may be or what other cost increases may arise from other sources, even such a small overall percentage increase could be difficult to absorb in certain situations, and might, for example, result in reductions in staff levels or capital spending. Finally, agencies would be affected differently, depending on their particular grade structure. For example, an agency with a relatively larger share of highly salaried employees who opt to transfer would experience larger increases in its retirement costs compared to an agency with a smaller share, assuming that both agencies experienced the same transfer rates.

That concludes my prepared statement. I would be pleased to answer any questions you or other Members of the Committee may have.

Table I.1. Comparison of Agency Cost Increases for Each CSRS Offset Employee Who Transfers to FERS, by Grade and Step

	Steps									
Grades	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
GS-1	785	812	838	864	890	905	931	957	958	982
GS-2	883	904	933	958	969	997	1,026	1,054	1,083	1,112
GS-3	964	996	1,028	1,060	1,092	1,124	1,156	1,188	1,221	1,253
GS-4	1,082	1,118	1,154	1,190	1,226	1,262	1,298	1,334	1,370	1,406
GS-5	1,210	1,251	1,291	1,331	1,372	1,412	1,452	1,493	1,533	1,573
GS-6	1,349	1,394	1,439	1,484	1,529	1,574	1,619	1,664	1,709	1,754
GS-7	1,499	1,549	1,599	1,649	1,699	1,749	1,799	1,849	1,899	1,949
GS-8	1,660	1,716	1,771	1,826	1,882	1,937	1,992	2,048	2,103	2,158
GS-9	1,834	1,895	1,956	2,017	2,078	2,139	2,201	2,262	2,323	2,384
GS-10	2,019	2,087	2,154	2,221	2,289	2,356	2,423	2,491	2,558	2,625
GS-11	2,219	2,293	2,367	2,441	2,515	2,589	2,663	2,736	2,810	2,884
GS-12	2,659	2,748	2,837	2,925	3,014	3,102	3,191	3,280	3,368	3,457
GS-13	3,162	3,268	3,373	3,478	3,584	3,689	3,795	3,900	4,005	4,111
GS-14	3,737	3,861	3,986	4,110	4,235	4,360	4,484	4,609	4,733	4,858
GS-15	4,395	4,542	4,688	4,835	4,981	5,128	5,274	5,421	5,567	5,714

Source: GAO analysis of OPM data.

Table I.2. Comparison of the Estimated Increase in Agency Costs for General Schedule Employees Covered by the CSRS Offset Plan

	Total cost of selected rates of transfer		
Grades	**1 percent**	**5 percent**	**10 percent**
GS-1[a]	$0	$0	$0
GS-2	156	779	1,558
GS-3	4,310	21,550	43,101
GS-4	29,292	146,459	292,919
GS-5	76,991	384,957	769,914
GS-6	68,269	341,346	682,692
GS-7	91,249	456,245	912,491
GS-8	32,855	164,273	328,547
GS-9	77,874	389,370	778,741
GS-10	8,232	41,160	82,321
GS-11	118,355	591,774	1,183,547
GS-12	144,041	720,203	1,440,406
GS-13	92,328	461,639	923,277
GS-14	39,548	197,742	395,484
GS-15	22,982	114,910	229,820
Total	**$806,661**	**$4,033,305**	**$8,064,370**

Note 1: For this table, we estimated the total costs associated with each selected rate of transfer by assuming that the proportion of CSRS Offset employees who transfer would match the actual distribution of these employees across GS grades governmentwide. That is, because 6.1 percent of the eligible CSRS employees were in grade GS-4, 6.1 percent of the CSRS Offset employees included in the 1-, 5-, and 10-percent cost estimates were also in grade GS-4.

Note 2: Due to rounding, totals may not equal the transfer rate percentages shown above.

[a]Because no CSRS Offset employees were in grade 1, the cost difference is $0.

Source: GAO analysis of OPM data.

Table I.3. Comparison of the Increase in Agency Costs for General Schedule Employees Covered by the CSRS Offset Plan If the Concentration of Those Transferring to FERS Were at the Higher Grade Levels

	Total cost of selected rates of transfer		
Grades	**1 percent**	**5 percent**	**10 percent**
GS-1 to GS-12	$182,590	$912,951	$1,825,901
GS-13 to GS-15	1,079,569	5,397,844	10,791,690
Total	**$1,262,159**	**$6,310,795**	**12,617,591**

Note 1: For this table, we estimated the total costs associated with each selected rate of transfer by assuming that 75 percent of CSRS Offset employees who transfer would be in grades GS-13 through GS-15, and 25 percent of the employees would be in grades GS-1 through GS-12.

Note 2: Due to rounding, totals may not equal the transfer rate percentages shown.

Source: GAO analysis of OPM data.

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