The Social Security old age, survivor, and disability programs are projected to expand rapidly through 1987, increasing both in dollar terms--to $237.6 billion--and as a proportion of all income security programs. Social Security's share of income security is projected to rise from 60.6 percent in 1983 to 62.7 percent in 1987. The retirement portion is projected to grow by 39.4 percent between 1983 and 1987--a faster pace than the 17.6 percent rate for Social Security disability. Much of this estimated growth will arise from the COLA adjustments, although the expansion in the number of older Americans and higher average wages of new retirees will continue to contribute to increases in Social Security outlays. The disability caseload, however, is expected to decline.

Only federal housing assistance programs are projected to increase at a more rapid rate than Social Security. These programs are projected to account for $16 billion in federal outlays by 1987. This figure assumes that additional households will receive aid each year, increasing at the same rate as the growth in recipient households in 1982. Veterans' compensation and nutrition programs other than food stamps are also projected to rise substantially over the next five years, each increasing by about 35 percent.

Rates of growth are projected to be much slower for the means-tested cash assistance programs. It is estimated that SSI benefits will rise to $10.6 billion--a 16.5 percent increase. According to this projection, benefits per capita will rise more rapidly but will be offset by a decline in the number of beneficiaries. Similarly, veterans' pensions are expected to remain constant in nominal terms at $3.5 billion, partly as a result of more restrictive eligibility standards for new cases. AFDC's relatively low projected growth rate through 1987 reflects fairly stable numbers of participants and per capita benefit increases that will lag behind those programs with automatic COLAs.

## BUDGET STRATEGIES

In view of the magnitude of this budget function, income security seems certain to be a prime area for future benefit reductions. Because of the size of the social insurance portion, the options described here focus on Social Security and veterans' programs. Potential changes in the means-tested programs are also discussed and compared. The options detailed here illustrate some of the issues and tradeoffs that might arise from additional budget reductions; they do not, however, represent an exhaustive enumeration of possible cuts.

In evaluating examples of specific strategies for reductions in the income security area, several broad issues are appropriate to consider, specifically:

- o The differences among programs with regard to state and local government responsibility;
- o The interrelationships among income security programs; and
- o The tradeoffs between budget reductions and desirable incentives for recipients.

Income security programs differ considerably in terms of federal, state, and local government responsibilities. Social Security and the veterans' programs provide uniform national coverage and are usually considered outside the bounds of state and local responsibilities. State and local participation is of concern for the means-tested programs, however, since the states currently administer--and in some cases, share the costs of--several of these programs. A shifting of responsibility through unrestricted block grants for some means-tested programs might reduce paperwork at the federal level and enhance states' flexibility in tailoring programs to meet local needs. These grants would not yield major federal outlay savings, however, unless federal support for benefits were concurrently reduced. Such reductions would disproportionately affect areas with greater percentages of low-income families--areas likely to have lower fiscal capacity as well--and might result in even greater disparities in benefit levels among states than currently exist.

Achieving major reductions in outlays is complicated by the interrelationships among many of the income security programs. Any savings from benefit reductions in one program may be partially offset elsewhere. For example, a reduction in Social Security benefits may increase eligibility and payments to the elderly from SSI. Moreover, in this particular case, new SSI participants are likely to become eligible for Medicaid and food stamps as well. Additional cuts in AFDC benefits would in most cases generate offsets of more than 50 percent through increased federal outlays for food stamps and housing assistance. On the other hand, some changes may lead to a compounding of reductions to beneficiaries, where total payments may fall more rapidly than they would appear to if only one program is considered. For instance, some earners who participate in both AFDC and Medicaid are subject, after four months of employment, to a loss of benefits that would considerably exceed their total earnings.

Important tradeoffs between budget reductions and desirable incentives for beneficiaries are likely to occur. For example, evidence suggests that the behavior of families and individuals is sensitive to the amount of earned income they are allowed to keep while participating in income security programs. If the rules are very restrictive, savings in outlays must be balanced against the disincentives for beneficiaries to work. Moreover, if the penalties are too severe, outlays could actually increase as fewer participants are employed. In such a case, short-run savings would occur at the expense of both long-run budget savings and work incentives.

## Changes in Social Security

During 1982, 59.4 percent of all income security outlays will be devoted to Social Security payments. Consequently, in order to achieve major reductions in income security, changes in Social Security may be necessary.

The short-term financial crisis facing the Social Security system gives particular urgency to consideration of cuts in this program. According to CBO's most recent projection, the combined balance in the three Social Security trust funds may fall to a level that is too low to ensure timely payment of all benefits. Specifically, CBO projects that, unless corrective measures are taken, Social Security trust fund levels could drop to 13.4 percent of annual outlays by the end of fiscal year 1983, and they could be as low as 7.6 percent by the end of 1984. Though there is no consensus about an acceptable minimum level of trust fund reserves, a year-end figure of 12 percent of the coming year's anticipated outlays falls roughly in the middle of the range of levels that various analysts regard as adequate to guarantee that all benefits can be paid on time. In fact, if economic conditions are more adverse than are now anticipated, the depletion of the trust funds could occur even sooner. Changes in either the benefits or revenues will be required within the next two years to guarantee uninterrupted payments to beneficiaries.

A wide range of policy options could generate savings in Social Security. Very large and prompt savings could come from a change in the Social Security COLA. Other outlay savings could arise from reducing or eliminating benefits to particular groups or from changing the retirement age. Because Social Security is funded directly by a payroll tax, the system's financial position could also be improved by changes in the tax structure or the characteristics of the population covered. Payroll taxes could be raised, or additional workers--such as federal employees--could be added to the system to increase revenues (see Appendix B-600-d). Finally, some portion of Social Security benefits could be taxed and the proceeds allocated to the trust funds (see Appendix B-600-c).

Some of these options would affect all beneficiaries, while others would reduce benefits for particular groups of current or future beneficiaries. Limiting reductions to future Social Security recipients would ensure that current beneficiaries lose no real benefits. On the other hand, current retirees are projected to receive much higher rates of return on their contributions than are future beneficiaries. A single male worker retiring at age 65 in 1980 who had earned the average wage since age 22 could expect to receive about 5.6 times as much in lifetime benefits as taxes paid (based only on employee contributions). Under current law, that proportion will drop to 2.2 for a similar worker retiring in the year 2000. Moreover, confining reductions in Social Security benefits to future retirees would postpone outlay savings because few persons would be affected initially. Options that involve a large number of beneficiaries could achieve the same total savings with less sacrifice by each affected recipient.

Another important issue in designing Social Security reductions is the speed of implementation and the tradeoff between the magnitude of short-run savings and the ability of beneficiaries to adjust to the changes. The sooner changes are implemented, the larger the initial savings and the greater the contribution to solving the financial problems of the trust funds. These advantages must, however, be weighed against the ability of Social Security recipients to respond to sudden, unexpected changes in the program. For example, the tradeoffs for options affecting retirement age are particularly acute. Since many workers plan for retirement long in advance, an extended phase-in period would be necessary to allow people to adjust their financial plans.

<u>Changing the Indexing Methods</u>. A large reduction in outlays in the short run could be generated by some change in the Social Security COLA, which is used to alter benefits each July 1. Such a

change would affect almost all beneficiaries by the same proportional amount and would require no phase-in period. 4/ Consequently, current retirees, who have relatively high rates of return to their contributions, would be included in the benefit modifications. Moreover, a reduction in the COLA, with its immediate impact on outlays, would be particularly effective in alleviating the projected crisis in the trust funds.

Automatic cost-of-living adjustments based on the CPI have led to much of the growth in Social Security benefits since 1975. Moreover, many observers believe that Social Security benefits have been overindexed in the recent past, because of a now-corrected technical flaw in the benefit formula and the way in which the CPI treats homeownership costs. 5/ If so, Social Security beneficiaries have received increasing real benefits at a time when other sources of income have not kept pace with inflation. For example, prices have risen faster than average wages over the last three years, so that workers' real earnings have fallen while Social Security benefits have been fully protected (and perhaps overprotected) against inflation.

On the other hand, large reductions in the COLA could create substantial hardships for those among the elderly with relatively low benefits and little other income. The oldest among the beneficiaries rely heavily on Social Security and have little ability to adjust to such changes. (SSI benefits could offset this loss for some recipients, unless that program were also subjected to COLA restrictions.)

A number of approaches could be used to alter the degree to which benefits are indexed. Such changes include:

- Reducing the COLA to two-thirds of the CPI;

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4. Only student beneficiaries, whose benefits are no longer indexed and are being phased out, would not be affected.

5. Critics argue that the CPI currently uses a flawed treatment of homeownership. Rising building costs and record mortgage interest rates are cited as major reasons for the overstatement of inflation. Beginning in 1983, the CPI will use rental costs for the housing component. Over the long run, this may or may not affect the rate of change in the CPI and hence the cost-of-living adjustments.

- o Delaying COLAs by three months; and

- o Changing the indexing of the "bend points" in the benefit computation formula over the next five years.

The first two approaches could be instituted immediately, yielding large reductions in outlays through 1987 (see Appendix A-600-c and A-600-b). The third (see Appendix A-600-f) would reduce benefits by changing the formula through which average indexed monthly earnings (AIME) are translated into a primary insurance amount. This option, which would affect only new beneficiaries, would be phased in over a five-year period.

The first approach would automatically increase benefits in July of each year by only two-thirds of the rise in the CPI. Nominal benefits to all recipients would rise each year (if inflation continues) but by a proportionately smaller amount than under the current adjustment formula. In times of less budget stringency, the Congress could, at its discretion, increase the adjustment. Outlay savings could total $76 billion by 1987 if the reduction starts with the July 1982 COLA, but only if the Congress avoids discretionary supplements above the two-thirds limit. This very large potential saving illustrates the impact of indexing on the growth of Social Security outlays.

As a second example, a permanent delay in the COLA from July 1 to October 1 would implicitly reduce benefits to Social Security recipients for three months each year as compared to current practice. As benefits are now projected, this would result in outlay reductions of more than $16 billion over the next five years. Again, all beneficiaries would be affected.

Finally, a less direct indexing adjustment would change the "bend points" of the benefit computation formula. Using a three-bracket formula, benefits are computed as percentages of AIME. These percentages decline at discrete bend points, which are currently indexed to rise over time with the increase in average covered wages in order to keep replacement rates roughly constant. If the adjustment were constrained to rise at only 50 percent of the wage increase, benefits for new retirees would fall as a proportion of their past earnings, as compared to the current formula. This option would differ from the other two changes, in that it would affect only new retirees, with the largest relative declines experienced by persons with the highest covered earnings. Savings from this approach would be small in the beginning but would grow in later years--in fact, this change alone could offset most of the projected long-term shortfall in the Social Security trust funds. Through 1987, five-year cumulative savings would total $3.6 billion.

Reducing or Eliminating Benefits. Options for reducing or eliminating Social Security benefits would affect a smaller proportion of all beneficiaries than would the indexing options. The two approaches discussed here affect auxiliary benefits rather than basic coverage for retirement or disability. The justification for these modifications is to improve the targeting of Social Security benefits to people who are most in need. At present, Social Security benefits are available to the wealthiest people in the United States as well as the poorest. Consequently, changes in auxiliary benefits may be able to reduce expenditures without affecting the social insurance protection offered by Social Security to the needy elderly and disabled.

On the other hand, restricting program eligibility or eliminating certain types of coverage might change the nature of Social Security. For example, adding a means-testing provision could move the program away from social insurance. Moreover, elimination of even small portions of Social Security might substantially reduce certain participants' incomes, with many unable to replace these lost benefits with income from other sources.

Options for reducing Social Security benefit coverage include:

- Means-testing auxiliary benefits; and

- A five-year postponement in eliminating the earnings test for beneficiaries aged 70 and 71.

Making receipt of auxiliary (dependents') Social Security benefits conditional on income would significantly alter the character of the program. For example, benefits could be reduced to families with incomes above $10,000 from sources other than Social Security. 6/ Workers' benefits would not be affected by this proposal.

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6. Estimates of the savings from such an option are not supplied here because of the lack of necessary data and the complexity of the details of the option that would be required. Savings, however, would be large.

Since auxiliary Social Security payments are supplements to workers' benefits designed to provide additional support to extra family members, limiting dependents' benefits to families below a given income level might improve the targeting of benefits to the most needy. Such a change could also help reduce the inequities in benefits among individuals with equal contributions but unequal family size. On the other hand, a long-standing principle behind Social Security is that it provides social insurance, and many would oppose the application of a means test to dependents' benefits on philosophical grounds.

A second change would retain the earnings test for beneficiaries aged 70 and 71 through 1987 or later (see Appendix A-600-g), rather than dropping it in 1983 as is now planned. Consequently, retirees under age 72 would continue to experience benefit reductions if they earned wages in excess of an exempt amount. This option would yield savings of about $2.9 billion through 1987 and would have only a minor effect on work incentives, since few people remain in the labor force past age 70. On the other hand, some observers argue that government policies should encourage--not discourage--employment among the elderly.

Raising the Retirement Age. The final Social Security options to be discussed would raise the age of retirement either directly or indirectly. Such changes would reflect the long-run implications of improved health and life expectancy of older Americans, which may in themselves lead to later retirement. These options, which would only affect future retirees, include:

- Raising the age at which regular and early-retirement benefits are paid; and

- Increasing the number of labor-force years included in the benefit computation period.

Raising the regular retirement age for full benefits from age 65 to 68 and providing reduced benefits beginning at 65 would lower future Social Security outlays substantially. The phase-in period for such a proposal would be critical in determining both the stream of savings that would be generated and the ability of new retirees to adjust to such a major change in policy. Though a long phase-in period would avoid disruptions in retirement plans and result in substantial savings in the future, it would provide little budgetary relief in the mid-1980s. For example, an option with a relatively short nine-year phase-in would save about $500 million in 1983.

Supporters of such a change argue that future generations of retirees will remain in the labor force longer. A higher retirement age may be particularly appropriate when the post-World War II baby boom generation reaches age 65 after the turn of the century. Moreover, because the change would affect only new retirees, persons currently receiving benefits would not face reduced payments.

This approach would create hardships for those persons forced out of work before age 65 by ill health (who would not be eligible for Social Security disability benefits) or by a job-related problem such as being laid off, however. Income security coverage would be eliminated for these persons unless they become eligible for means-tested programs. Currently, about two-thirds of Social Security awards for retired workers are reduced for early retirement, so many workers could potentially be affected.

The second option in this category--a change in the AIME computation period--would affect retirees by requiring them to include more low-earnings years in benefit calculations (see Appendix A-600-a). Those who retire at 65 or later would generally have more labor-force years from which to choose for calculating benefits, although they too would be affected under this option if they left the labor force for extended periods during any part of their working lives. This option would, for example, lower the primary insurance amount (PIA) for many women who stop or suspend employment to have children. Total savings under this proposal would be about $1 billion through 1987.

## Changes in Veterans' Programs

The income security programs for military veterans--pensions and disability compensation--are potential sources of appreciable outlay savings. The overriding issue for these programs is the extent to which veterans are to be extended preferential treatment. Both programs, administered by the Veterans Administration, provide services also available from other federal sources for disabled or low-income persons; but individuals who qualify for veterans' benefits receive higher amounts of cash assistance. For example, the veterans' pension program now guarantees a veteran without other resources $413 per month, compared to $265 in monthly federal benefits from SSI. 7/ Changes in veterans' programs could restrict benefits to the more needy, however.

Eliminating Veterans' Pensions. Veterans' pensions provide means-tested benefits to low-income war veterans who are at least age 65 or have total and permanent disabilities, to their dependents, and to needy survivors of war veterans. Just under 1 million veterans, 1.1 million survivors, and nearly 1 million dependent beneficiaries currently receive such pensions. These programs overlap other means-tested income security programs, particularly SSI. (The SSI program also aids the aged, blind, and otherwise disabled, although with less generous benefits than veterans' pensions.)

Gross savings from elimination of veterans' pensions would amount to nearly $3.5 billion in 1983. This amount, however, would be offset by approximately $1.1 billion in increased SSI costs, and smaller rises in food stamps, AFDC, and Medicaid, as former pension recipients become eligible for those programs. Since the income eligibility limits for veterans' pensions are higher than under SSI, current pensioners would experience a drop in benefits, and a few--mostly veterans--would have incomes too high to qualify for assistance under SSI at all.

Although other veterans' disability benefits are generally designed to compensate for some loss resulting from military service, pensions are not granted under this rationale. The requirement for disability pensions does not relate to service-connected disabilities, but rather to disabilities incurred after discharge. (Veterans aged 65 and older also qualify for veterans' pensions.) Furthermore, there is no reason to believe that the low incomes of VA pensioners are related to their military service, since veterans

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7. Many states supplement the SSI benefits, reducing the differential. In 1980, for example, the average supplement to those receiving supplements was $85 per month, but across all SSI recipients the average was only $19 per month. If these benefit guarantees were adjusted to include food stamp eligibility as well, the SSI beneficiary (with no state supplement) would gain $6 relative to the veteran, reducing the disparity in guarantees to $142. Finally, treatment of earned income for determining benefit levels varies between the two programs, so that a veteran with some earnings might not be worse off under SSI.

as a group have higher median incomes than nonveterans of the same age. This option would make benefits to this group of the population consistent with income security payments to other groups.

Defenders of veterans' pensions point out that many current beneficiaries would be ineligible for SSI or AFDC. Since these pension benefits are aimed at war veterans and their survivors, they may be entitled to uniquely high levels of protection.

This option could be modified by phasing out veterans' pensions rather than eliminating them altogether so that persons already on the rolls, particularly aged recipients, would not suffer severe hardships. For example, veterans' pensions could be eliminated for new recipients and phased out for current beneficiaries. Savings under such an option would be considerably lower.

Ending Veterans' Compensation to Persons with Limited Disability. Veterans' disability compensation provides benefits to persons with service-connected disabilities, regardless of financial need. The amount of compensation is based on the degree of impairment; payments are made to veterans with as little as 10 percent disability. Additional allowances are also paid for dependents, but only if the veteran has disabilities rated at 30 percent or more. Of the 2.3 million veterans now receiving compensation, 56 percent have total disabilities rated below 30 percent.

Veterans' compensation could be limited to those with disability ratings above 30 percent. This option would reduce federal outlays by about $1.2 billion in fiscal year 1983. Some of the nearly 1.3 million persons who would lose their benefits might be eligible for other income security programs. It is likely, however, that most of these veterans would no longer receive government support.

Veterans' disability ratings were originally designed to compensate on the basis of an average loss of earning power. With the improvements in reconstructive and rehabilitative medicine, combined with the sharp decline in the portion of the workforce performing manual labor, however, impairments of less than 30 percent may not significantly reduce an individual's ability to work. Many people with these lesser impairments, therefore, may not have reduced incomes as a result of their disabilities. This fact is already recognized to some degree by the exclusion of these individuals from entitlement to dependents' allowances.

On the other hand, if these payments are viewed as compensation for injuries incurred in service to the country, it may be irrelevant whether the recipients are able to support themselves or whether their earning ability is reduced. Under these circumstances, subjecting veterans' compensation to the same standards as other income security programs may be inappropriate.

A more modest version of the restriction on veterans' disability compensation would end payments to persons with less than 20 percent disability (see Appendix A-700-a). The arguments remain essentially the same; persons with 10 percent disability are even less likely to experience any income loss. In fact, in a small number of cases, veterans with zero disability ratings still receive compensation--albeit at very low levels. Savings from this option would total $640 million in 1983.

## Changes in Other Income Security Programs

The means-tested programs are much smaller than the social insurance portions of income security. Food Stamps is the largest means-tested program, with projected 1982 outlays of $11.5 billion, or about 7 percent of Social Security retirement and disability, for example. 8/ Consequently, even large reductions in these programs would yield smaller outlay savings than many of the social insurance changes discussed above. The examples presented here focus on changing the way in which housing assistance is provided and on shifting some of the responsibility for food and nutrition programs to the states. Such changes would be less likely to affect work incentives for program beneficiaries than would direct reductions in eligibility or benefits.

Providing Rent Vouchers for Housing Assistance. Shifting all future housing assistance to rent vouchers that lower-income persons could use to reduce their housing costs in dwellings of their own choosing could reduce future subsidized housing outlays. This option could generate savings while serving the same number of households as could be aided under current programs, because

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8. Altogether, the means-tested programs discussed in this chapter should total $47.1 billion in outlays in 1982. The remaining social insurance programs are also small, with the exception of federal civil service retirement and disability, which is considered in Chapter XI.

assistance recipients would be housed in less-costly existing dwellings rather than in newly built projects, as they are under most present programs. Annual savings in moving to a voucher program could exceed $15 million for each 10,000 households assisted.

Since vouchers would be valid only for physically standard dwellings, this change would be likely to encourage maintenance of existing dwellings, although such a shift would diminish the direct federal role in promoting new residential construction. As is the case with current housing assistance programs, vouchers would be available to only a small proportion of all households qualifying on the basis of income. Local housing agencies would thus have to ration vouchers as they now ration aid under similar programs.

Requiring State Contributions to Food Stamps. Food stamps currently provide no more than $233 per month in benefits for a family of four and are limited to those with incomes below 130 percent of the poverty threshold. Benefit amounts are determined by the "thrifty food plan," designed to reflect a minimum nutritionally adequate diet. Federal outlays could be reduced further by requiring states to contribute 20 percent of the program's benefit costs. About $2.2 billion could be saved in federal outlays in 1983.

Since the states currently administer food stamps--although all benefit funding is federal--states would have a greater incentive to hold down expenditures if they were liable for at least part of the costs. Such a treatment of food stamps would be consistent with other means-tested programs (such as Medicaid or AFDC) in which states bear some of the costs of providing services. Shifting additional burdens to the states would not substantially reduce the actual total costs of the program, however, unless states were allowed to reduce benefits. In addition, poorer states tend to have greater proportions of their populations receiving food stamps, so this option would place the heaviest burden on the states least able to provide benefits--that is, those states with relatively low average per capita income.

Creating Block Grants for Child Nutrition. Funding child nutrition programs with a block grant instead of the current array of nine programs could reduce federal outlays by $5.8 billion over five years if, at the same time, the federal contribution were cut by 25 percent (see Appendix A-600-o). Although such a block grant could simplify administration and enhance state and local flexibility, it would also shift more of the burden of child nutrition programs to the state or local level. This change might result in fewer nonpoor children receiving school lunches, but that change alone would not create enough savings to compensate for the 25 percent cut.

## CONCLUDING COMMENTS

From the items listed above, the largest potential source of immediate outlay reductions in the income security area is a change in the formula for automatically indexing benefits to the cost of living. If such a change were applied to Social Security, $76 billion in savings could be generated through 1987 by limiting the COLA to two-thirds of the CPI. Similarly, large savings could be generated in many other programs by delaying or reducing the automatic escalation of benefits. For example, a one-percentage-point reduction in the 1982 COLA for the Social Security, SSI, veterans' pensions, railroad retirement, and federal employee retirement and disability programs would reduce 1983 outlays by about $1.8 billion. Such changes would affect all program beneficiaries, ensuring that large outlay savings could be generated without severely restricting any one beneficiary's payments, although many SSI recipients would then have incomes even further below the poverty line.

The other major reduction strategy discussed here would eliminate benefits for groups of the recipient population least in need of federal income security. In general, these changes would affect fewer people and would generate lower outlay savings, even though each affected recipient would experience a greater loss.

The options discussed in this chapter would generate 1983-1987 savings ranging from $1 billion for changing the AIME computation period in Social Security to $76 billion for reducing the COLA to two-thirds of the increase in the CPI. These options do not represent a comprehensive list of all possible reductions in income security programs; some additional changes not mentioned here are presented as appendix items. Nonetheless, these changes illustrate some of the tradeoffs within the income security area, since nearly every option would reduce federal benefits to a particular segment of the population.

## CHAPTER XI. COMPENSATION FOR THE FEDERAL CIVILIAN WORKFORCE

In fiscal year 1981, the federal government spent $72 billion to compensate the federal civilian workforce. Of that sum, roughly 90 percent went to pay some 2.1 million active employees and to disburse pensions for about 1.8 million annuitants; the remainder covered the costs of health and life insurance and workers' compensation. Outlays for pay and retirement benefits affect different portions of the federal budget; outlays for the Civil Service Retirement (CSR) system appear in the income security accounts of the budget (function 600), and payroll expenditures are distributed among the separate accounts of each federal agency. These various outlays are combined in this chapter in order to present a unified review of the compensation costs that the government, as an employer, pays, and to illustrate the relationships between federal pay and retirement and the possibilities for budgetary reductions in this area. Because the number of employees inevitably influences compensation outlays, the size and composition of the federal civilian workforce is also considered.

### BUDGET HISTORY AND PROJECTIONS

Outlays for federal civilian pay and retirement have grown some 175 percent during the past decade--increasing from $24.0 billion in 1970 to $66.1 billion in 1981. If current policy is continued, these expenditures will reach $102.4 billion in 1987 (see Table XI-1). The major cause of past and future increases in compensation costs is inflation.

#### Historical Trends, 1970-1981

Federal Pay. During the 1970-1981 period, the federal civilian payroll increased from $21.3 billion to $48.4 billion. This growth represents an average annual increase of 7.6 percent. The number of civilian employees has decreased slightly; annual pay raises therefore account for almost all of the payroll growth. 1/

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1. Although federal civilian employment has remained quite stable, its distribution between defense and nondefense agencies has shifted somewhat, in line with changing emphases in national priorities. Throughout the 1970s, reductions in civilian employment in Department of Defense programs have offset a 230,000 workforce increase in nondefense agencies.

TABLE XI-1. FEDERAL COMPENSATION OUTLAYS FOR CIVILIAN PAY AND RETIREMENT (In billions of dollars)

| Major Programs | Actual 1970 | Actual 1981 | Estimated 1982 | Baseline Projection 1983 | Baseline Projection 1987 |
|---|---|---|---|---|---|
| Federal Civilian Pay | 21.3 | 48.4 | 50.9 | 55.1 | 70.8 |
| Civil Service Retirement | 2.7 | 17.7 | 19.8 | 22.0 | 31.6 |
| Total | 24.0 | 66.1 | 70.7 | 77.1 | 102.4 |

Over the years, career advances have also been reflected in higher wages and salaries, as have changes in government occupations; but to a far greater degree, the growth has been caused by annual government-wide pay adjustments that mainly reflect increases in the cost of living. Between 1970 and 1981, average federal pay raises did not keep up with changes in the cost of living, which rose at an average annual rate of 7.9 percent as measured by changes in the Consumer Price Index (CPI). After 1972, most of the annual pay adjustments were below increases in the cost of living.

The pay of federal employees is adjusted government-wide every year by procedures that compare federal salaries and wages with those paid for similar work in the private sector. 2/ The President and the Congress, however, are not bound by the comparability comparisons; and in six of the 14 cost-of-living adjustments (COLAs) since July 1969, they have adopted lower increases--all comparability pay increases for federal blue- and white-collar employees having been reduced each year since 1977. Alternative plans to pay increases have often been proposed to achieve budgetary and economic objectives and to set an example of wage restraint for the private sector.

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2. Civilian federal pay adjustments for white-collar workers occur each October on a nationwide basis and at different times of the year for blue-collar workers on a local area basis.

Contrary to a widely held misconception, the federal civilian workforce decreased slightly between 1970 and 1981--from 2.23 million to about 2.12 million. Although this change had little effect on total payroll expenditures, the responsibilities and size of the federal workforce continue to be a matter of public interest. In 1981, about 43 percent of the federal civilian workforce was employed by the Department of Defense, excluding the U.S. Army Corps of Engineers. In the same year, about one-sixth of the federal workforce provided direct nondefense services in health, transportation, and other areas. Significant numbers of federal workers were also employed in various other domestic programs that provided benefits to individuals (7 percent of total) and in natural resource management (10 percent of total). Activities slated for a reduced federal role employed relatively small numbers. About 5 percent of the workforce administered federal regulatory programs; less than 2 percent administered programs assisting state and local governments (see Table XI-2).

Federal Retirement. The CSR system, which predates and remains independent of Social Security, is intended to provide annuities that substitute for the combination of private employers' pensions and Social Security benefits. External income for the program comes from employee contributions (a withholding tax set by law at 7 percent of salary for most workers) and from payments from the U.S. Postal Service (USPS) and other off-budget agencies. The CSR fund also receives income from employing agencies, interest paid by the U.S. Treasury, and substantial federal payments appropriated directly to CSR. (Income from these sources represents internal budgetary transactions that do not affect program outlays.) The annual out-of-pocket federal cost for CSR represents program outlays that are not offset by receipts from external sources--that is, employee contributions and payments from the off-budget federal agencies. The $17.7 billion CSR outlay for 1981, for example, was partly offset by some $5.4 billion in receipts from employees and off-budget agencies, leaving a federal cost of $12.3 billion.

Between 1970 and 1981, the annual federal cost of CSR rose from $0.9 billion to $12.3 billion. During this same period, outlays for CSR increased at an average annual rate of 18.2 percent, climbing from $2.7 billion to $17.7 billion. About half (51 percent) of this growth resulted from COLAs in CSR pensions; other growth (21 percent) was caused by the net increase in the number of

TABLE XI-2. ESTIMATED DISTRIBUTION OF FEDERAL CIVILIAN WORKFORCE BY GOVERNMENTAL ACTIVITY (As of January 1, 1981)

| Activity | Primary Governmental Role | Numbers of Employees | Percent of Total |
|---|---|---|---|
| National Security | Civilian employees of the U.S. Department of Defense | 938,000 | 43.4 |
| International Affairs | Includes the Foreign Service and other employees of the State Department and agencies administering foreign aid, information, and other programs | 39,000 | 1.8 |
| Internal Revenue and Customs | Covers all activities of IRS and the U.S. Customs Service | 100,000 | 4.6 |
| Administration of Justice and Law Enforcement | Includes the Federal Bureau of Investigation, Secret Service, administration of immigration and naturalization, and federal prisons | 61,000 | 2.8 |
| Regulatory Activities | More than half administer food, health, safety, and environmental regulations. About another quarter serve on boards and commissions that regulate other aspects of the economy | 101,000 | 4.7 |
| Social Insurance and Benefit Programs | About three-fourths administer Social Security, health-care payments, veterans benefits (other than health services), and public aid. Most of the remainder administer urban and rural housing programs and loans to small businesses | 147,000 | 6.8 |

(continued)

TABLE XI-2. (Continued)

| Activity | Primary Governmental Role | Numbers of Employees | Percent of Total |
|---|---|---|---|
| Natural Resource Management and Related Public Enterprises | Includes the U.S. Army Corps of Engineers, the Tennessee Valley Authority, and agencies responsible for federal land and resource management | 214,000 | 9.9 |
| Assistance to State and Local Governments | More than two-thirds administer federal housing and community development aid, community health, and job training programs | 32,000 | 1.5 |
| Direct Federal Services | Three-fifths administer veterans' health services. The remainder includes air traffic control, Indian services, the census, and other statistical or information programs | 361,000 | 16.7 |
| Research and Development | Nearly two-thirds handle research and development for agriculture, health, and aeronautics and space | 75,000 | 3.5 |
| Departmental Direction and Management and Government-Wide Support a/ | Includes budget, audit, Inspector General, legal, management, and personnel functions. Government-wide support includes fiscal, property, records, and personnel administration | 93,000 | 4.3 |
| Total | | 2,161,000 | 100.0 |

SOURCE: Derived by CBO from Senate Committee on Governmental Affairs, Organization of Federal Executive Departments and Agencies.

a/ Includes activities performed under various management categories as reported by individual agencies.

CSR annuitants; a somewhat greater portion (28 percent) was brought about by increases in the size of initial benefits. 3/

The 1982 Budget Decisions

Actions on the 1982 budget denied comparability pay adjustments to federal civilian employees, reduced the frequency of retirement COLAs, shifted more workers from nondefense to defense-related jobs, and trimmed the overall size of the civilian workforce.

Pay Adjustments. Procedures for adjusting federal pay government-wide have been criticized for various technical reasons and for not taking into account the value of retirement and other fringe benefits. In lieu of enacting new standards and mechanisms for determining pay increases, the 1981 reconciliation act capped the 1982 pay adjustments at 4.8 percent for federal blue-collar and most white-collar employees. (If 1982 pay raises had not been capped, a 15.1 percent average comparability adjustment would have been implemented for white-collar employees.) This limitation follows a practice that has now capped government-wide pay raises for the last four years. 4/

Civil Service Retirement. Although the reconciliation act did not address the level of federal retirement benefits, it did decrease the frequency of COLAs from twice to once a year. The act eliminated the September adjustment, beginning in 1981, but it stipulated an annual adjustment each March that will recover 100 percent of the yearly increase in prices. This action will reduce CSR expenditures in 1982 by an estimated $0.5 billion because of the longer interval between COLAs.

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3. Benefits for new annuitants have steadily increased because of changes in wage histories, the occupational composition of the federal workforce, as well as a revised statutory formula for computing benefits on the basis of average salary for the highest three years, rather than the highest five years.

4. In the past, the Congress has also frozen salaries of top-level officials. The 1982 budget increased the federal pay ceiling from $50,100 to $57,500 for General Schedule employees and to $58,500 for employees under the Senior Executive Service. Had these ceilings not been in effect, salaries for some federal executives would exceed $75,000.