percent. This cost would be 2 to 7 percent of pay lower than the cost of current CSR provisions, depending on the particular method, data, and assumptions used in the comparison (see Table 5). 9/

The 7 percent differential shown in the table derives from an OPM illustration of a private pension plan that includes COLA provisions recovering 25 percent of the increases in the CPI. 10/ The lower differential of 2 percent is based largely on analyses prepared for CBO by Hay Associates using different actuarial techniques. The estimate also assumes that private pension COLAs would average 30 percent of CPI changes. Both the high and low differentials use the same economic assumptions supplied by the CSR Board of Actuaries, cost estimates for Social Security, and the estimated advantage from the tax-exempt status of Social Security income. To express the comparison between CSR and private-sector retirement costs another way, the CSR employee withholding rate could be increased from 7 to at least 9 percent of pay without creating a disadvantage in the value of retirement benefits not paid by federal employees.

If the costs to the federal government of the CSR system are regarded as excessive, there are only two ways to decrease them: either reduce benefit levels, or increase employee contributions. Both approaches are described in the following chapter.

9/ Previous CBO papers have compared CSR and private-sector retirement benefits and indicated the difficulty of quantifying such comparisons. See Options for Federal Civil Service Retirement (December 1978); Federal White Collar Employees (April 1979); and Compensation Reform for Federal White-Collar Employees (May 1980).

10/ The 7 percent differential could be even higher if other cost assumptions now being considered by OPM were used, particularly those concerning Social Security and related tax considerations.

CHAPTER III. ALTERNATIVE CONTRIBUTION RATES AND BENEFIT PROVISIONS

In considering what if any action to take with regard to Civil Service Retirement, the Congress will want to weigh several factors. The goals that could be achieved by changing the present mechanisms of CSR--particularly by altering contribution rates--include improving the system's accountability in federal agency operations, lowering CSR's overall cost to the government, and bringing federal retirement closer to the practices that prevail in the private sector.

As the following discussion of various options makes clear, these objectives need not be mutually exclusive. Several goals could be met by taking the same course of action. Or, as is always the case, the Congress could decide that the present system is satisfactory, or at least optimal, in which case, a continuation of current law (Option I) would be the obvious course. The alternatives, all of which would involve Congressional amendments of current CSR authorizing legislation, focus either on improving cost accountability (Option II) or on reducing federal costs (Options III and IV). The changes entailed in the alternatives to current law would be brought about by:

- Increasing agency contributions to CSR to reflect the system's full federal costs (Option II),

- Increasing employees' and employing agencies' contributions (Option III), or

- Maintaining present contribution rates but limiting benefits for early retirement and cost-of-living adjustments (Option IV).

The following table summarizes the major financing provisions of each option. 1/ The changes in Options II and III include a new basis for annual appropriations to CSR from the general fund of the Treasury.

1/ Appendix D displays the distribution of income to the CSR system under the various options.

TABLE 6. SUMMARY OF MAJOR FINANCING PROVISIONS OF OPTIONS

	Employee Withholding Rate as a Percent of Pay	Employing Agency Contribution Rate as a Percent of Pay	Appropriations from U.S. Treasury
Option I	7	7	Continues reimbursements for costs associated with military service, federal pay raises, and lower interest earnings
Option II	7	29.5	Limits reimbursements to costs associated with past pay raises and amortizes unfunded liability a/
Option III	9 (phased in over 4 years)	27.5 (phased in over 4 years)	Same as Option II
Option IV	7	7	Same as Option I except that reduced benefits will decrease reimbursements for military service and lower interest earnings

SOURCE: Congressional Budget Office.

a/ Under Options II and III, the annual general fund appropriations will amortize CSR unfunded liability at 7 percent over a 75-year period, the unfunded liability being calculated as of September 30, 1981 and to include the impact of future COLAs for existing annuitants.

OPTION I. CONTINUE CURRENT LAW

Analysis of OPM's projections of CSR fund income and outgo over the next 50 years indicates that fund reserves, though declining under present financing, would still have a margin of about 1.6 times annual outlays by the year 2030. The cost to the government, however, would continue to be excessive in comparison with private-sector practices. If benefit levels, the tax-free status of Social Security income, and employee contributions are considered together, the present CSR cost to the government might be 1.9 to 6.8 percent of pay greater than private-sector practices. Thus, continuing current law both would retain the relative advantage of federal retirees and the more expensive associated costs to the government.

Opponents of the present system note that the existing contribution rates do not bring the true cost of federal retirement to light in agency operations, and thus they conceal part of federal personnel costs. Other critics, who assess CSR in terms of private pension plans, also point out that current financing is actuarially inadequate according to measures of unfunded liability (see Chapter II).

Advocates of current financing provisions note that CSR, unlike most private pension plans, operates on a pay-as-you-go basis. Calculations of unfunded liability are considered an artificial and inappropriate basis for determining the CSR fund's financial condition. They also point out that the taxing power of the federal government--not the condition of the CSR fund--ultimately assures that future CSR obligations will be met.

OPTION II. INCREASE AGENCY CONTRIBUTION RATES TO REFLECT THE FULL COST TO THE GOVERNMENT

Both the CSR Board of Actuaries and GAO have made recommendations that would effectively increase most agency contributions from 7 percent to about 29.5 percent of payroll. 2/ The new rate

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2/ General Accounting Office, Federal Retirement Systems: Unrecognized Costs, Inadequate Funding, Inconsistent Benefits (August 1977). The Board of Actuaries of the Civil Service Retirement System, 57th Annual Report (November 1979). For further discussion on cost accounting, see CBO, Retirement Accounting Changes: Budget and Policy Impacts (April 1977).

would represent the difference between the full actuarial cost, which includes the impact of future COLAs and annual pay increases, and the present employee contribution rate. GAO believes this alternative would improve management decisions about the costs and nature of federal programs. It would not, however, change present CSR benefit provisions or employee withholding rates.

This option would improve cost accounting and thus, the basis for agencies' programmatic and budgetary decisions. Consistent with current regulations concerning contracting for certain services, Option II would require that agency operating budgets recognize the full federal cost of retirement for active employees.

Because of the increased agency contributions, Option II would eliminate needs to reimburse the fund for benefit costs attributable to military service and to amortize CSR costs associated with future federal pay raises. In addition, general fund appropriations would amortize unfunded liability rather than compensate the CSR fund for interest. 3/ Option II's financing changes would increase annual income to the retirement fund by a net amount of $55.4 billion in 1986, including $17.6 billion in agency contributions (including $4.0 billion from off-budget agencies) and $17.0 billion in federal payments appropriated from the general fund. The additional income during the first five years (1982-1986) would increase accumulated reserves by $230.6 billion, reaching 12.5 times outlays in 1986. In light of the buildup of reserves, lowering the general fund appropriations could be considered.

Increasing the agency contribution rate from 7 percent of pay to 29.5 percent would reduce CSR's annual costs to the government because of the additional receipts from off-budget agencies. The extra income, mainly from the U.S. Postal Service, would begin at $3.2 billion in 1982 and accumulate to $17.8 billion through 1986 (see Table 7). The higher agency contribution rate would eliminate present indirect CSR subsidies to off-budget enterprises, but the costs would eventually be reflected in higher postage rates and other government charges. These consequences could be avoided by enacting corresponding increases in direct federal payments to off-budget agencies, but doing so would cancel out the reduction in federal costs.

3/ A 75-year amortization of unfunded liability (estimated at $480 billion for September 30, 1981) would require annual federal payments of $33.8 billion. Annual payments of $3.3 billion for amortization of past pay raises would continue.

TABLE 7. PROJECTED CSR COST TO THE GOVERNMENT a/ UNDER OPTIONS: 1982-1986, IN BILLIONS OF DOLLARS

	Option I	Option II	Option III	Option IV
1982				
Level	14.0	10.8	13.0	13.2
Decrease from current law	--	3.2	1.0	0.8
1983				
Level	16.2	12.9	14.1	14.8
Decrease from current law	--	3.3	2.1	1.4
1984				
Level	18.4	15.1	15.1	16.3
Decrease from current law	--	3.3	3.3	2.1
1985				
Level	20.2	16.2	15.1	17.4
Decrease from current law	--	4.0	5.1	2.8
1986				
Level	22.2	18.2	17.0	18.8
Decrease from current law	--	4.0	5.2	3.4
Five-year Cumulative Decrease from Current Law	--	17.8	16.7	10.5

SOURCE: Estimates prepared by Congressional Budget Office.

a/ Outlays not covered by employee and off-budget agency contributions.

OPTION III. INCREASE AGENCY AND EMPLOYEE CONTRIBUTION RATES

This option would use essentially the same CSR funding provisions as those outlined in Option II, but it would increase employee contributions as well. Under this alternative, federal employees would shoulder some of the CSR rate adjustment, with their payroll withholdings eventually rising from 7 to 9 percent of pay. The CSR employee contribution rate has been adjusted only twice during the past 25 years. In 1956, the rate increased from 6 to 6.5 percent of pay and again in 1969 to the present 7 percent of pay. The agency contribution rate, in contrast, would rise from 7 to 27.5 percent of pay. Both increases would be phased in by equal installments over the next four years.

The higher employee withholdings, together with existing retirement benefits, would bring CSR costs more into line with prevailing private-sector retirement practices. The increase in the CSR employee withholding rate from 7 to 9 percent of pay would make up approximately half of the cost for the difference between CSR COLAs (100 percent of CPI increases) and COLAs estimated under private-sector standards (70 percent of CPI increases). Thus, federal employees would continue to be better protected against inflation; but while working, they would pay part of the extra cost. The higher employee contribution rate would also bring the long-term costs to the government closer to private-sector standards (based on the combination of a private pension plan plus Social Security).

The higher employee contributions would substantially increase receipts to the government. Increased annual receipts from employee contributions and off-budget agencies could reach $1.0 billion in 1982 and as much as $5.2 billion in 1986. Over the five-year period, cumulative receipts could increase by $16.7 billion. About $11.6 billion of this amount would come from off-budget agencies and would be nullified if direct federal payments to such enterprises were adjusted to cover the additional costs.

Proponents of Option III might argue that economic conditions have changed significantly since the last CSR employee rate increase and that a further increase is now in order. They point out that, from 1970 to 1980, CSR unfunded liability rose from $52.8 billion to $166.4 billion, and that CSR's annual cost to the government rose from $949 million to $9.5 billion. During the same period, employee contributions to Social Security (excluding the Health Insurance portion) increased markedly--from a rate of

4.2 percent applied to the first $7,800 of pay to a 5.08 percent applied to the first $25,900 of pay. Social Security withholding rates and the taxable maximum of earnings went up again at the start of 1981.

Employee organizations would strongly oppose a mandatory increase in withholding rates because most private plans, albeit providing less generous benefits, require no employee contributions at all. Moreover, an increase in the CSR withholding rate would widen an existing disparity in take-home pay between many federal workers and their nonfederal counterparts.

OPTION IV. RETAIN CURRENT CONTRIBUTION RATES BUT LIMIT EARLY RETIREMENT BENEFITS AND COST-OF-LIVING ADJUSTMENTS

The costs to the government of CSR could be lowered by reducing certain benefit provisions while leaving contribution rates and other sources of financing unchanged. Specifically, this option would limit the size and frequency of CSR cost-of-living adjustments; and gradually, it would reduce initial benefits for persons who choose to retire before age 65. These changes would affect features of CSR that are very costly over the long run and that are much more generous than retirement practices in the private sector. New benefit provisions would reduce CSR's cost to the government by a total of some $10.5 billion through 1986.

Of the present two yearly cost-of-living adjustments, the October one would be eliminated, effective in fiscal year 1982. The remaining March adjustment would be limited to 70 percent of the change in the CPI, based on the preceding year's December-to-December CPI computation.

In addition, the reduction in annuities for persons younger than age 65 would be phased in over 20 years for specified age groups in order to prevent a sudden increase in CSR retirements. Without this gradual phase-in, many persons might elect early retirement before implementation of the change. When fully implemented, pension reductions for early retirement would progress toward 10 percent for retirement at age 60 and 20 percent for retirement at age 55. The 20 percent maximum reduction, averaging 2 percent per year, would still be less severe than annuity reductions required under private-sector practice. Many private plans reduce benefits by about 4 percent for each year that retirement occurs before age 65, and Social Security reduces benefits by 6.66 percent for each year down to age 62.

The substantial savings in costs to the government could be applied either to reducing the federal budget or to funding a greater increase in federal pay for active workers. For example, potential decreases in CSR outlays in 1982 would yield savings adequate to provide federal employees with a 1.2 percent pay raise in addition to the pay increases assumed in the Administration's budget for 1982. The cumulative additional pay increases would total 4.6 percent over the five-year period 1982-1986.

Proponents of this option--those who regard CSR COLA and early retirements as too generous and too costly to the government--believe that the government should provide retirement benefits comparable to those available in the private sector. Opponents, in contrast, would argue that the government, as a model employer, has a responsibility fully to protect its retired employees against inflation--especially at a time of rapid increases in the cost of living. The fact that most private plans do not provide such protection is considered a defect that should not be incorporated in federal retirement policy, too. Moreover, current CSR benefits have been viewed as fair recompense for pay limitations affecting active workers and for the taxation of civil service retirement income.

APPENDIX A: CHARACTERISTICS OF CSR ANNUITANTS

TABLE A-1. AGE DISTRIBUTION OF CSR ANNUITANTS AT THE END OF 1980, IN PERCENTS

Age Group	Employee Retirees		Survivors	
	On the Rolls	New Adds	On the Rolls	New Adds
29 and Under	a/	0.3	12.4	23.1
30 - 39	0.6	1.6	1.1	2.2
40 - 49	2.0	5.2	3.1	6.3
50 - 54	3.8	9.5	4.6	7.5
55 - 59	14.0	37.0	8.7	12.1
60 - 64	21.6	34.0	11.1	12.3
65 - 69	21.6	11.2	13.0	11.9
70 - 74	16.3	1.2	13.6	10.0
75 - 79	9.6	0.1	13.1	8.3
80 and Over	10.4	a/	19.3	6.3

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

a/ Less than 0.05 percent.

TABLE A-2. DISTRIBUTION OF CSR RETIREES BY TYPE OF PENSION, AT THE END OF 1980

	On the Rolls		New Adds	
	Number (in thousands)	Percent	Number (in thousands)	Percent
Voluntary Retirement for Age and Length of Service	699.6	56.1	69.6	68.3
Involuntary Retirement	128.3	10.3	5.8	5.7
Disability	343.3	27.5	23.2	22.8
Delayed Pensions for Persons, Age 62 and Over, Who Had Left Government Service Before Retiring	76.8	6.2	3.3	3.2
Total	1,247.9		102.0	

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

TABLE A-3. INCOME DISTRIBUTION OF CSR ANNUITANTS ON THE ROLES AT THE END OF 1980, IN PERCENTS

Bracket of Benefit Income (in dollars)	Retirees	Survivors
Under 6,000	22.6	74.7
6,000 - 8,399	18.0	14.1
8,400 - 9,599	8.0	3.6
9,600 - 10,799	8.4	2.3
10,800 - 11,999	8.2	1.5
12,000 - 23,999	29.1	3.6
24,000 - 35,999	4.9	0.1
36,000 and Over	0.8	a/
Total	100.0	100.0

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

a/ Less than 0.05 percent.

APPENDIX B. COMPARISON OF AGE OF RETIREMENT UNDER CSR AND PRIVATE SECTOR PRACTICES

Approximately 80 percent of male retirements under private plans occur at age 62 or later, as compared with 36 percent of male civil servants. Nearly half of all male civil service retirements occur before age 60, as compared with less than 10 percent of the male workforce covered by a company pension and Social Security (see below).

TABLE B-1. DISTRIBUTION OF MALE CIVIL SERVICE AND PRIVATE SECTOR RETIREES BY AGE AT RETIREMENT, 1976: IN PERCENTS

Age at Retirement	Civil Service a/	Private Sector b/
Under 55	9.5	1.1
55 - 59	39.6	6.3
60 - 61	14.5	12.6
62 - 64	18.1	42.1
65 and Over	18.3	37.9

SOURCE: CBO, Options for Federal and Civil Service Retirement: An Analysis of Costs and Benefit Provisions (December 1978), p. 10.

a/ Calculated from data on men who retired under civil service during fiscal year 1976, excluding those who were disabled or who received deferred pensions.

b/ Age at which private pension was first received by men awarded Social Security retirement benefits in fiscal year 1970. (Data include some individuals who also received civil service benefits.) Social Security Administration, Office of Research and Statistics, Research Report No. 47, Table 12.4, p. 172.

APPENDIX C. INFORMATION ON COST-OF-LIVING ADJUSTMENTS IN THE PRIVATE SECTOR

Recent surveys have collected data on cost-of-living adjustments (COLA) available to private-sector retirees. Summaries of these surveys follow.

Hay-Huggins Noncash Compensation Survey, 1977, Section IV, pp. 18-22.

The Hay-Huggins data are summarized in CBO, Options for Civil Service Retirement (December 1978), pp. 16-20. The data show that 37 percent of the private pension plans analyzed do not grant cost-of-living increases of any kind. In addition, only 3 percent have an explicit COLA provision, and even in these, the adjustments average 85 percent of increase in the CPI.

The analysis covered 448 companies that together employed a total of 5 million workers. The companies were included in the data base only if they met both the minimum size and the industrial classification criteria used to determine annual pay adjustments for federal white-collar employees.

Hay-Huggins Noncash Compensation Comparison, 1980, Section V, pp. V19-V23.

Out of the 549 organizations surveyed in the spring of 1980, 43 percent provide no cost-of-living increases and 49 percent provide increases on an ad hoc basis. The remaining plans (8 percent) provide formal post-retirement adjustments provisions. These plans provide increases according to changes in CPI, but most include a limitation on annual increases, ranging from 2 percent to 5 percent and averaging 3.2 percent. Unlike the 1977 survey, the 1980 data was not edited for CBO analysis.

Social Security Administration Retirement History Survey

Private pension annuitants received periodic increases on an ad hoc basis recovering about 44 percent of the annual increase in the cost-of-living between 1972 and 1974. Specifically, the median private pension increased 7.3 percent, as compared with a 16.9 percent increase in the cost of living during the two-year period.

This information was derived by CBO from the Social Security Administration's Retirement History Survey, a 10-year longitudinal study of persons aged 58-63 in 1969. The sample consists of men in all marital status categories and women who were not married at the time of sample selection. The analysis was limited to those persons who: received a private pension in both 1972 and 1974; did not earn any money in either 1972 and 1974; and were aged 65-66 in 1972 and 67-68 in 1974. The Retirement History Survey is based on the same sampling frame that is used by the Bureau of Census for its Current Population Survey.

Towers, Perrin, Foster and Crosby Analysis

From January 1, 1975 through December 31, 1979, annual COLA increases for 100 private-sector pension plans averaged one-third of the change in the CPI. Specifically, the average annual increase (weighted for plan size) was 2.7 percent, compared to an annual inflation rate of 8.1 percent. The TPF & C study, conducted for the Office of Personnel Management, analyzed 100 private pension plans that covered over 2 million employees.

Bankers Trust Corporate Pension Plan Study 1980, Section 2, pp. 52-55.

The Bankers Trust Study of 325 pension plans covering more than 8 million employees found that only 13 plans (4 percent) provided cost-of-living adjustments based on changes in the Consumer Price Index. In nine of these plans, changes were made automatically on an annual basis, but increases were limited to no more than 4 percent per year. Another 32 percent provided post-retirement adjustments, mainly unscheduled, on some base other than changes in CPI.

For the plans that granted post-retirement increases of any kind during the six year period (1975-1980), none granted increases every year: 45 percent of the plans gave one increase, 35 percent gave 2 increases, 5 percent gave 3 increases, and 5 percent gave 4 increases, and 10 percent gave 5 increases.

APPENDIX D. SOURCES OF FUNDING FOR CSR

TABLE D-1. PROJECTED CSR FINANCING UNDER OPTIONS: 1982-1986, IN BILLIONS OF DOLLARS

	1982	1983	1984	1985	1986
Option I					
Employee withholdings	4.3	4.5	4.8	5.3	5.6
Employing agency contributions	3.3	3.5	3.7	4.0	4.3
Payments from off-budget agencies a/	1.8	1.9	2.0	2.2	2.3
General fund appropriations	14.2	15.6	17.2	18.6	20.1
Interest earned on investments and other	7.1	8.4	9.8	11.1	10.6
Total income	30.7	33.9	37.5	41.2	42.9
Option II					
Employee withholdings	4.3	4.5	4.8	5.3	5.6
Employing agency contributions	13.8	14.7	15.7	16.8	17.9
Payments from off-budget agencies a/	5.0	5.2	5.3	6.2	6.3
General fund appropriations	37.1	37.1	37.1	37.1	37.1
Interest earned on investments and other	9.5	14.3	19.4	25.2	31.3
Total income	69.7	75.8	82.3	90.6	98.2
Option III					
Employee withholdings	4.6	5.2	5.8	6.8	7.2
Employing agency contributions	5.7	8.6	11.9	15.7	16.7
Payments from off-budget agencies a/	2.5	3.3	4.2	5.8	5.9
General fund appropriations	37.1	37.1	37.1	37.1	37.1
Interest earned on investments and other	9.0	12.9	17.4	22.8	28.7
Total income	58.9	67.1	76.4	88.2	95.6
Option IV					
Employee withholdings	4.3	4.5	4.8	5.3	5.6
Employing agency contributions	3.3	3.5	3.7	4.0	4.3
Payments from off-budget agencies a/	1.8	1.9	2.0	2.2	2.3
General fund appropriations	13.2	14.2	15.3	16.3	17.2
Interest earned on investments and other	7.5	8.9	10.2	11.7	13.1
Total income	30.1	33.0	36.0	39.5	42.5

SOURCE: Congressional Budget Office.

a/ Includes off-budget agency contributions and amortization payments from the U.S. Postal Service.