CBO TESTIMONY

Statement of
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before the
Subcommittee on Compensation and Employee Benefits
Committee on Post Office and Civil Service
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NOTICE

This statement is not available for public release until it is delivered at 2:00 p.m. (EDT), Tuesday, October 19, 1993.

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Madam Chair and Members of the Subcommittee, I appreciate this opportunity to discuss H.R. 3218, the Federal Workforce Restructuring Act of 1993. My testimony today will review:

- The costs to the federal government of the proposed legislation;

- The contribution the legislation might make to meeting the Administration's announced goal of reducing federal employment by about 252,000 through 1999; and

- Some findings of the Congressional Budget Office (CBO) regarding the use of cash incentives at the Department of Defense and the U.S. Postal Service.

THE COSTS TO THE FEDERAL GOVERNMENT OF H.R. 3218

H.R. 3218 would allow civilian agencies of the federal government to establish programs that would offer separation payments to encourage employees in the civil service to retire or resign in fiscal year 1994. The amount of the separation payment per employee would be the lesser of $25,000 or the amount of severance pay the employee would qualify for under involuntary separation. Employees who accept the incentive and wish to retire must qualify under current rules for voluntary retirement. We assume that the executive branch agencies will request and that the Office of Personnel Management will grant widespread use of authority for voluntary early retirement, as available under existing law, in conjunction with the use of separation incentives. H.R. 3218 has implications both for the direct spending scorecard under the pay-as-you-go system and for appropriations that are enforced by discretionary caps.

Direct Spending

Direct spending would increase under the bill because some employees who retire after taking the incentive would receive their annuities earlier than under current law. CBO estimates that the costs of the additional annuity payments would accumulate to $792 million through 1998 (see Table 1). Throughout the federal government (except for the Department of Defense, the Central Intelligence Agency, and the General Accounting Office, which already have the authority to provide separation payments), about 250,000 employees will be eligible to retire or retire early in 1994. Our cost estimate assumes that 35 percent of employees eligible to retire under regular voluntary rules and 20 percent of employees eligible to take early retirement under reduced age and service requirements would accept the incentive and retire. These rates of

TABLE 1. EFFECTS OF H.R. 3218 ON DIRECT SPENDING, 1994-1998
(By fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998	Cumulative Five-Year
Annuity Payments	248	443	137	-18	-18	792
Agency Payment of 9 Percent	-127	-13	-14	-58	-61	-273
Total	121	430	123	-76	-79	519

SOURCE: Congressional Budget Office.

acceptance are based on experience at both the Department of Defense (DoD) and the U.S. Postal Service (USPS) and assume some targeting by agencies in the future.

Based on results from a program at the USPS, we expect that 65 percent of regular retirees and 40 percent of early retirees who take the incentive and retire would have retired at the same time anyway, without the incentive. The incentive payments therefore would induce approximately 29,000 employees to retire earlier than they would have otherwise. The benefits paid to these retirees constitute the increase in direct spending. We assume that these people would retire one or two years earlier. As a result, initial spending for retirement benefits under the incentive program would exceed the baseline. Beginning in 1997, however, savings would result because people who retire early accept an annuity that is lower than the one they would have had in the absence of an incentive.

This proposal would also require agencies to contribute to the retirement trust fund a total of 9 percent of the salary at the time of retirement of all future involuntary and voluntary early retirees in the Civil Service Retirement System. This requirement would extend beyond the limited period during which agencies can make incentive payments. Receipt of this payment into the trust fund offsets direct spending. The purpose of the 9 percent payment is to fully reimburse the retirement system for the cost of early retirement. Under present law, the 2 percent reduction in annuities for each year before age 55 for early retirees is not sufficient to cover the cost of early retirement.

Amounts Authorized for Appropriation

The government also would incur costs that would be funded by appropriations. These costs accumulate to $2 billion through 1998 (see Table 2). The largest component of this cost is the incentive payments, which total an estimated $1.7 billion in 1994. We assume that all retirees, more than 60,000 in total, would receive a $25,000 separation incentive and that more than 24,000 resignees would accept an average separation incentive of $7,500.

TABLE 2. EFFECTS OF H.R. 3218 ON OUTLAYS, 1994-1998
(By fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998	Cumulative Five-Year
Incentive Payments	1,703	0	0	0	0	1,703
Agency Payment of 9 Percent	127	13	14	58	61	273
Payment for Unused Leave	265	-133	-133	0	0	0
Total	2,095	-120	-119	58	61	1,975

SOURCE: Congressional Budget Office.

The cost of agencies' payments to the retirement trust fund of 9 percent of final salary for all early retirees would be an estimated $127 million in 1994, $13 million in 1995, $14 million in 1996, $58 million in 1997, and $61 million in 1998. These estimates assume an average of about 3,000 early retirements annually in 1995 and 1996 and about 12,000 annually in 1997 and 1998.

The payout for unused annual leave would be $265 million in 1994. The average payment for unused leave is assumed to be $3,800 for retirees and $1,400 for resignees. These payouts are offset in later years when separating workers would have retired anyway.

I would like to point out that the proposed legislation could result in substantial savings in personnel costs. Over the long run, those savings could total many times the estimated cost. For example, assuming an average salary for separated workers of $35,000, payroll savings for the 85,000 workers CBO assumes would leave government could total about $3 billion per year--summing to $15 billion over five years. CBO does not include these pay and other savings in the cost estimate, however, because the proposed legislation does not contain a provision to ensure that appropriations to agencies would actually be reduced. In effect, most if not all of these savings will be needed to stay within the appropriation limits set by the Omnibus Budget Reconciliation Act of 1993.

MEETING THE ADMINISTRATION'S EMPLOYMENT REDUCTION GOAL

The National Performance Review (NPR) proposes reducing the federal government's civilian, nonpostal work force by 252,000, or 12 percent of the current level, through 1999. Assuming, consistent with the President's budget, that a reduction of about 10,000 will be accomplished in 1993, then 242,000 reductions would have to be made in 1994 through 1999.

Many factors will determine the ability of the proposed early-retirement and incentive program to achieve the targeted reduction, including how fast the incentives are carried out and how concentrated the reductions are by occupation and geographic location. Generally, the more evenly reductions are spread over time and place, the easier it would be to achieve them without layoffs and other major disruptions in the work force. More definitive analysis of the possibility of success for the employment reduction efforts will have to wait until detailed agency plans are available in December of this year.

Based on information currently available, however, it would appear that the Administration may be able to achieve the required level of reductions without too much difficulty. Budget and other information from DoD suggests that reductions planned there will total 160,000 over the 1994-1999 period. That means that civilian agencies would have to make only 82,000 reductions to meet the goal of 242,000 through 1999. If CBO's estimate that about 85,000 workers would leave civilian agencies under the proposed legislation is accurate, then total separations for that period would reach about 245,000, exceeding the level targeted by the NPR for the same years. Even if civilian agencies replaced half of the 85,000 employees that CBO estimates would leave, total civilian agency and defense reductions would still reach about 200,000, which is a substantial step toward the goal. Remaining reductions could easily be achieved through a freeze on hiring.

Moreover, even a reduction in employment of 85,000 could also probably be achieved with a partial freeze on hiring. If the drop in employment were spread evenly over the six years from 1994 through 1999, needed annual reductions would amount to about 14,000. Assuming that 5 percent of the work force voluntarily separated each year, which is a conservative estimate, the government could meet its target by filling only about three of every four vacancies that occur. But if the reductions are concentrated in particular agencies or are not spread evenly over the five to six years, the incentive payments authorized by H.R. 3218 would provide a useful tool for achieving the reductions without major disruptions in service.

Of course, the overall number of workers who leave is only one consideration. The success of efforts to reduce employment without significantly disrupting the work force will also depend on the ability of agencies to separate employees they can afford to lose and not replace. Otherwise, efforts to reduce employment would have to be accompanied by concerted efforts to retrain and relocate workers, some layoffs, and potentially some costly rehiring of new personnel to fill any resulting gaps in skills. As described below, agencies have had varying degrees of success in targeting incentive offers toward the right employees.

EXPERIENCE WITH SEPARATION INCENTIVES AT THE U.S. POSTAL SERVICE AND THE DEPARTMENT OF DEFENSE

The USPS and DoD have had experience with separation incentives. These two agencies have managed to achieve reductions with differing degrees of disruption to their work forces and differing costs. We drew upon their experience in preparing our cost estimate for H.R. 3218.

The USPS carried out an ambitious restructuring of its work force in the fall of 1992. To abolish 30,000 positions, the USPS offered an incentive of six months' salary to all employees eligible for early or regular retirement. Because the offer was made generally and was not targeted, the USPS made incentive payments to 48,000 employees. The plan therefore provided more than enough separations to meet reduction goals and avoid layoffs.

The data also suggest that the USPS offer increased the number of workers who took regular and early retirement. In other words, not all of those employees would have left if the incentive had not been offered. For example, the number taking regular retirement was several thousand higher than normal. This increase reflects the fact that the percentage of those who were eligible to retire, and did so, exceeded normal rates.

The success the USPS achieved in encouraging separations, however, meant that it paid incentives to almost two-thirds more employees than it had positions to abolish. These extra payments are part of the reason that an incentive program can be much more expensive than other methods of separating workers, such as a hiring freeze or layoffs. The USPS estimates that the bonuses cost some $860 million. In addition, only about 13,000 of the workers who left were in jobs the USPS hoped to abolish. To vacate the remaining positions, the USPS was forced to move incumbents into other jobs, which involved the cost and disruption associated with downgrading, relocating, and retraining. With such efforts, only a few employees now remain in jobs the agency hoped to abolish. Thus, the USPS was able to achieve many separations, but not without some disruption to its work force. In addition, most of the decrease in positions has been offset by an increase in temporary workers and overtime hours.

At DoD, the Secretary of Defense, under authority granted by the Defense Authorization Act of 1993, may offer cash incentives to employees as a way of avoiding layoffs. These incentives supplement efforts to reduce employment by means of a hiring freeze that has been in operation at the agency since 1990.

DoD's experience with its incentive program offers both parallels and contrasts to that of the USPS. Like the USPS, DoD has succeeded in attracting a significant number of employees to take incentives and leave government service. In 1993, about 40,000 employees were offered incentives, 30,000 of whom accepted them. These incentives will cost DoD over $600 million this year. DoD has managed to use its incentive program, as intended, to avoid many layoffs. In the absence of incentives, CBO estimates that DoD would have experienced a total of 16,300 layoffs over two years--6,500 in 1993 and 9,800 in 1994. For the first three-quarters of 1993, layoffs totaled only about 2,000.

Moreover, DoD's efforts to target incentives toward specific groups have probably helped to ensure that the workers who separated actually vacated an abolished job. At DoD, commanding officers in organizations facing layoffs can limit incentives to employees in particular occupations. If the number of employees accepting incentives exceeds the number of jobs to be abolished, DoD limits acceptances based on seniority. Although the results are not yet in, DoD's efforts to target incentives appear to help to ensure that the workers taking the incentives are those the agency would like most to separate, thus reducing the kind of relocation and other disruptions experienced at the USPS.

On the downside, DoD, like the USPS, has had to pay many incentives to accomplish the stated objective of the program--avoiding layoffs. According to CBO estimates, the 30,000 incentives paid would help to avoid the much smaller number of layoffs that would otherwise have been made. In addition, DoD may have been even less successful than the USPS in avoiding paying workers who already planned to leave. Although data suggest that retirements in 1993 were over 40 percent higher than the normal level, resignations occurred at about normal levels. One of the problems in DoD's plan is that the prospect of separation payments may make separation rates low because employees know that DoD has authority to offer incentives for five years. Under H.R. 3218, that is less likely to happen as long as the Congress makes it clear that incentives will not be offered again.

CONCLUSION

Experience at DoD and the USPS suggests that incentives can be used effectively as a tool to reduce the federal civilian work force. Such efforts will have costs that are likely to be far higher than relying on other methods. Depending on how well agencies plan their employment reductions, their efforts could also involve a great deal of reorganization, retraining, and other activities to achieve the planned reductions. But over the long term, savings from reduced personnel costs more than offset any short-term costs. CBO's analysis suggests that these savings will total many times any costs--provided that the reduction in employment is permanent and agencies do not rehire.