# FEDERAL PAY:

# ITS BUDGETARY IMPLICATIONS

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## PREFACE

Federal Pay--Its Budgetary Implications provides background information and analysis on the issue of pay for the federal work force. This paper provides documentation supporting the material on federal pay included in CBO's Annual Report. The paper was prepared by Earl A. Armbrust and David M. Delquadro of CBO's Management Programs Division under the direction of Howard M. Messner and Seymour D. Greenstone.

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March 10, 1976

# SUMMARY

## The Setting

Pay for the federal work force is a topic of increasing public awareness and concern. Over 13 percent, or $49.3 billion, of the federal budget is devoted to civilian and military pay. Under present policy, over the next five years $324.3 billion will be spent on all types of federal pay. In terms of impact on the federal budget, the General Schedule (GS) is the most significant system since it determines the rates for nearly 77 percent ($26.9 billion) of civilian pay and directly affects military pay which is linked to the GS schedule. The 2.1 million active military personnel and members of the reserve components have an annual payroll of about $22.4 billion. Because each 1 percent change in GS pay rates could increase or decrease the federal budget by $493 million a year, several alternatives to the present system for determining federal pay rates have been suggested.

## Issues

The current system for determining pay rates on an annual basis dates back to the relatively recent Federal Pay Comparability Act of 1970, although the principles underlying federal pay go back many years. The term "comparability" has come to mean many things to each of the active participants in the federal pay process--the Office of Management and Budget and the Civil Service Commission, the employees and the employee unions, the President, and the Congress. Broadly defined, comparability means that federal salaries should be commensurate with private enterprise salaries for similar types of work at the same level of responsibility.

The two basic public policy issues are: (1) whether determining federal pay on the basis of comparability to commensurate private sector pay is a viable approach for the future, and (2) if comparability is a viable approach, what measurable elements constitute comparability.

To achieve full comparability under the present system, GS pay rates would increase by 12 percent in 1977. This amount includes a 3.7 percent "catch-up" due to the 5 percent "cap" imposed in the previous year. Annual increases over the period 1977-1981 would average 8.6 percent at a cumulative cost of $77.8 billion beyond the payroll base for the five years.

## Alternative Approaches to Determining Federal Pay and Their Budgetary Implications

The budgetary impact of federal pay over the next few years can be illustrated by describing the possible range of effects under two versions of the current pay-setting system and four alternative approaches.

Three alternatives have been suggested that would raise federal pay:

- A system of indexation would provide automatic cost-of-living increases based on changes in one or more independent economic indicators. This approach could cost an additional $2.2 billion in fiscal year 1977 and could add a cumulative $10.8 billion to the federal budget through fiscal year 1981.

- Extending collective bargaining in the federal government to include compensation would be a far-reaching change but it would move the federal government closer to practices observed in the private and nonfederal public sectors of the economy. This alternative would not lead to higher budget costs in fiscal year 1977, but could add a cumulative cost of $20.5 billion by fiscal year 1981.

- There are changes possible in the criteria determining pay under the current system which would increase the amount of pay adjustments. These criteria relate to the measurement of pay at each grade, the percentage difference between grades, the size of private establishments covered in the salary survey, the time lag between the survey date and the effective date of the pay adjustment, and inclusion of the length of the private sector work week in the computations. This approach could cost an additional $1.7 billion in fiscal year 1977 and could add a cumulative $34 billion to the federal budget through fiscal year 1981.

Three alternatives have been suggested that would reduce budget costs due to pay:

- A two-year moratorium on pay raises could save $5.92 billion in fiscal year 1977 and $54.2 billion through fiscal year 1981 as against continuation of present policy.

- Retention of the 5 percent "cap" for two additional years could save $3.45 billion in fiscal year 1977 and $29.0 billion through fiscal year 1981.

- Finally, there are changes possible in the criteria determining pay under the current system which would decrease the amount of pay adjustments. These changes are the inclusion of the secretarial and computer operator occupations in the pay survey and weighting the survey results for composition of the federal work force. This alternative could save $2.7 billion in fiscal year 1977 and $16.0 billion by fiscal year 1981.

## The Rockefeller Panel and a Total Compensation Approach

It is difficult to assess the effect that any of the different pay-setting approaches would have on the quality of the federal work force, i.e., attracting and retaining high caliber personnel. Data presently available do not provide a basis for firm judgments. However, the report of the President's Panel on Federal Compensation (Rockefeller Panel) issued in December, 1975, concludes that "a serious problem of pay compression has developed at senior levels of the General Schedule, the Foreign Service, and the Department of Medicine and Surgery" and that a situation has been created "in which key executives, scientists, engineers, and diplomats are resigning or opting for premature retirement at an alarming rate."

The Rockefeller Panel made some major recommendations which provide a broad outline of the possibilities for achieving significant changes to the overall system of compensating federal employees. They include:

- The principle of comparability with the private sector should be reaffirmed as the basis for federal pay setting.

- The principle of comparability should be extended to include benefits as well as pay. Development and testing should take place over the next two years to determine the best approach to implementation.

- The present General Schedule, which covers white-collar employees, should be replaced by a Clerical/Technical Service and a Professional/Administrative/Managerial/Executive Service.

- The Clerical/Technical Service should be paid local or other geographical rates.

A departure from the current procedure of dealing with adjustments to salary and "fringe" benefits separately has been characterized as a "total compensation" approach. The $7.4 billion in employee benefits now account for 21 percent of total civilian compensation (excluding postal) and--depending on the method used for calculating retirement costs--could run as high as 33 percent.

The treatment of the major benefit elements to be included in a total compensation approach would be complicated and controversial. For instance, the present employer contribution to the retirement system, set by law at 7 percent of pay, does not include the cost of indexation or present unfunded liabilities. It is unlikely that the employee unions would support a system which would allow basic pay to be traded off against employee benefits. A management viewpoint, however, argues that pay and benefits are all part of the employee's compensation and should be considered together.

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## CHAPTER I

## FEDERAL PAY IN PERSPECTIVE

### Introduction

The executive branch of the federal government employs about 1.9 million full-time civilian workers (other than postal employees) at an annual cost of about $35.5 billion (including premium pay and benefits). Assuming no change in federal employment or the present policies and procedures which tie pay to private sector rates, it is estimated that annual civilian costs will reach $53.5 billion by 1981.

In terms of impact on the federal budget, the General Schedule (GS) is the most significant system since it determines the rates for nearly 77 percent ($26.9 billion) of civilian pay and directly affects military pay which is linked to the GS schedule. The 2.1 million active military personnel and the members of the reserve forces have an annual payroll of about $22.4 billion. Decisions on the GS system thus have a combined civilian and military annual cost of $49.3 billion. Consequently, each 1 percent change in average GS pay rates could increase or decrease the federal budget by $493 million per year.[1]

In addition to being a significant element in determining the level of future federal expenditures, the method of setting GS pay rates has come under increasing criticism for a variety of reasons. In the last three years the Comptroller General has issued five reports to the Congress dealing with the compensation of federal employees;[2] and in June, 1975, the

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1. Since there are basic differences in the funding of civilian and military retirement, the economic costs of amortization of increased retirement liability are not included.

2. Comptroller General of the United States: Improvements Needed in the Survey of Non-Federal Salaries Used as Basis for Adjusting Federal White-Collar Salaries, B-167266 (May 11, 1973); letter to Honorable Roy L. Ash and Honorable Robert E. Hampton, B-167266 (July 12, 1974); Need for a Comparability Policy for Both Pay and Benefits of Federal Civilian Employees, FPCD-75-62 (July 1, 1975); Federal White-Collar Pay Systems Need Fundamental Changes, FPCD-76-9 (October 30, 1975); Classification of Federal White-Collar Jobs Should Be Better Controlled, FPCD-75-173 (December 4, 1975).



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President appointed a special panel of executive branch officials under the chairmanship of the Vice President to undertake a policy review of federal compensation. Federal employee unions and the public also have expressed criticism of the present approach to determining GS pay rates.

The current system for determining pay rates on an annual basis dates from the relatively recent Federal Pay Comparability Act of 1970, although the principles underlying federal pay go back many years. The term "comparability" has come to mean many things to each of the active participants in the federal pay process--the Office of Management and Budget and the Civil Service Commission, the employees and the employee unions, the President, and the Congress. Broadly defined, comparability means that federal salaries should be commensurate with private enterprise salaries for similar types of work at the same level of responsibility.

The two basic public policy issues are: (1) whether determining federal pay on the basis of comparability to commensurate private sector pay is a viable approach for the future, and (2) if comparability is a viable approach, what measurable elements constitute comparability. Problems include the establishment of relevant criteria and valid statistical measurements to determine comparability.

## The Current System

### The 1970 Act

In the federal government pay and benefits are determined separately. Pay rates are adjusted annually under policies and procedures established by the Federal Pay Comparability Act of 1970. Benefits such as leave and retirement are determined independently through enactment of separate legislation on an ad hoc basis.

The 1970 Act reaffirmed the previous statutory tenets of the General Schedule:

- Federal pay rates should be comparable with private enterprise pay rates for the same levels of work.
- There should be equal pay for substantially equal work.
- Pay distinctions should be maintained in keeping with work and performance distinctions.

The principle of comparability is intended to provide a standard which reflects the relevant factors influencing the level of pay in the private sector--cost of living, standard of living, productivity, supply of and demand for specific skills, and organization of labor markets. The principles of equal pay for equal work and recognition of work and performance distinctions are intended to maintain jobs in appropriate alignment. With comparability and job alignment the resulting pay level is expected to enable the federal government to compete fairly with private firms in attracting and retaining a well-qualified work force.

## The Role and Impact of the Principal Actors

- The Office of Management and Budget and the Civil Service Commission (OMB/CSC), designated by the President as his "pay agent," are responsible for: (a) developing criteria for determining comparability to be incorporated into the design of the annual survey of private enterprise salary data--known as the National Survey of Professional, Administrative, Technical, and Clerical Pay (PATC); and (b) translating annual survey data into specific GS rate proposals.

OMB/CSC usually have been the dominant force in determining the actual adjustments under the criteria for determining comparability. In four of the six adjustments under the 1970 Act, the OMB/CSC recommendation was ultimately adopted. The first exception occurred in January, 1972, when amendments to the Economic Stablization Act limited the pay increase to 5.5 percent rather than the 6.6 percent comparability increase recommended by OMB/CSC. The second departure came with the October, 1975, increase in which Congress approved the President's alternative plan which reduced the 8.66 percent increase recommended by OMB/CSC to 5 percent.

- The Federal Employees Pay Council (FEPC) consists of five representatives of federal employee unions. The FEPC has an advisory role but must be consulted by OMB/CSC concerning both the criteria for comparability and the development of annual rate proposals. By law, the Council's recommendations must be included in the annual OMB/CSC report to the President.

The employee unions, through the FEPC, have recommended increases averaging 2.7 percentage points above the OMB/CSC level. The FEPC proposals also have argued for a significantly different distribution of increases from that of the OMB/CSC staff recommendations.

. The Advisory Committee on Federal Pay consists of three members appointed by the President who are not otherwise employed by the federal government. The Advisory Committee provides the President with independent third-party advice on the analysis and pay proposals presented in the annual report to the President, taking into consideration the recommendations of OMB/CSC and the Federal Pay Council.

With the exception of the October, 1975, increase on which the employee unions and the OMB/CSC reached a final compromise of 8.66 percent, the Committee has recommended increases somewhere between the OMB/CSC and union proposals. In contrast to the impact of the OMB/CSC recommendations, the Advisory Committee appears to have had little or no influence on the four adjustments for which it submitted reports to the President. He has yet to adopt a recommendation by the Advisory Committee.

. The President, after considering the recommendations of OMB/CSC, the Federal Employees Pay Council, and the Advisory Committee on Federal Pay, must either adjust GS salary rates to achieve comparability or submit an alternative plan to the Congress. An alternative plan may be submitted if the President considers a comparability adjustment to be inappropriate because of "national emergency or economic conditions affecting the general welfare."[3]

With the exception of the first increase in January, 1971, the President has sought to defer or reduce the adjustments recommended by OMB/CSC. Successive efforts to delay the four increases between January, 1972, and October, 1974, were defeated by the Congress or reversed in the courts. In the recent October, 1975, increase the President's proposal to reduce the 8.66 percent increase recommended by the OMB/CSC to 5 percent was upheld by the Congress.

. The Congress retains veto power over any alternative plan submitted by the President. If no action is taken within 30 days, the President's alternative becomes effective. If the plan is disapproved by a simple majority of either House, the comparability rates become effective.

Under the concept of comparability the average pay of GS employees increased by 31.6 percent between January, 1971, and October, 1975, while the Consumer Price Index increased by

3. Federal Pay Comparability Act of 1970, 5 USC 5301(c)(1).

38 percent. In the most recent October, 1975, increase, the 5 percent "cap" had the effect of reducing real income by 2.6 percent below that of a year earlier.

# CHAPTER II

## ALTERNATIVE APPROACHES TO DETERMINING PAY AND THEIR BUDGETARY IMPLICATIONS

The budgetary impact of federal pay over the next few years can be illustrated by describing the possible range of effects under five different pay-setting approaches, including the current system.

Option 1 - Retain the present comparability system with or without modifications.

Option 2 - Establish a system of collective bargaining and arbitration.

Option 3 - Index the level of total changes in compensation to one or more independent economic indicators.

Option 4 - Continue the 5 percent "cap" on the size of annual adjustments for fiscal years 1977 and 1978.

Option 5 - Place a two-year moratorium on pay increases.

These options do not represent all possible alternatives nor do they take into account economies which could be realized by reductions in the size of the federal work force. Also, the relative desirability of each option is not measured solely on the basis of costs involved. Many of the modifications possible within the present system can be initiated administratively. The collective bargaining and indexation approaches are fundamental departures from the current system which would require legislative authorization. Options 4 and 5 come within the President's authority to submit an alternative plan to the Congress because of "national emergency or economic conditions affecting the general welfare."

These pay alternatives result in additional five-year cumulative outlays beyond the payroll base for the five years ranging between $23.6 billion and $111.8 billion.

The estimated five-year costs of these options are shown in the following table:

Impact of Pay Increase Alternatives on Payroll Base[1]
($ in billions)

| | Cumulative 5-Year Increases[2] Current Policy Base ($) | Increase(+) Decrease(-) ($) | Total ($) | Percentage Increase 1977 (%) | 1978 (%) | 1979 (%) | 1980 (%) | 1981 (%) | Average Annual Increase 1977-1981 (%) |
|---|---|---|---|---|---|---|---|---|---|
| Present System 3 | $77.8 | -- | $77.8 | 12.0 | 8.8 | 8.3 | 6.9 | 6.9 | 8.6 |
| Option 1: Modifications to Present System | | | | | | | | | |
| High (changes increasing compensation) | 77.8 | +34.0 | 111.8 | 15.5 | 12.3 | 11.8 | 10.4 | 10.4 | 12.1 |
| Low (changes decreasing compensation) | 77.8 | -16.0 | 61.8 | 6.5 | 8.8 | 8.3 | 6.9 | 6.9 | 7.5 |
| Option 2: Collective Bargaining 4 | 77.8 | +20.5 | 98.3 | 12.0 | 11.9 | ,11.4 | 10.0 | 10.0 | 11.1 |
| Option 3: Indexation 5 | 77.8 | +10.8 | 88.6 | 16.4 | 13.6 | 7.6 | 6.9 | 6.9 | 9.3 |
| Option 4: Retain 5 % "Cap" 6 | 77.8 | -29.0 | 48.8 | 5.0 | 5.0 | 8.3 | 6.9 | 6.9 | 6.4 |
| Option 5: Two-year moratorium 6 | 77.8 | -54.2 | 23.6 | -0- | -0- | 8.3 | 6.9 | 6.9 | 4.4 |

1. Assumes changes in military pay rates which continue to be linked to General Schedule pay adjustments.
2. Projections used 1976 civilian GS and military annualized payroll base of $49.3 billion.
3. Percentage increases are consistent with CBO 5-year economic projections (path B).
4. The collective bargaining estimates were developed on the basis of assuming that full comparability under existing criteria would be achieved in 1977 and that the net effect of all Option A modifications would be phased-in evenly over the period 1978-1981. The average annual increase of 11.1% is slightly less than the 11.5% experienced by the U.S. Postal Service under collective bargaining.
5. Percentage increases are based on projection of the Index of Average Hourly Earnings in the Private Non-Farm Economy.
6. The percentage increases under Options 4 and 5 for 1979-1981 do not include any catch-up amounts for prior years. Legislative action may be required to authorize such an approach. In 1979 average pay under Options 4 and 5 would be 10.8 and 20.8 percent, respectively, below the result under the present system.

## The Present System With or Without Modifications

Under the present system pay would increase 12 percent in 1977 to achieve full comparability.[4] Annual increases over the entire 1977-1981 period would average 8.6 percent at a cumulative cost of $77.8 billion beyond the payroll base for

4. The 12 percent increase for fiscal year 1977 includes a 3.7 percent "catch-up" due to the 5 percent "cap" imposed in the previous year.

the five years. The basis for the present system option consists of the criteria used in the OMB/CSC pay comparability recommendations for the October, 1975, adjustment.

The criteria used to compare federal pay rates with analogous rates in the private sector allow considerable latitude for judgment in their application. These criteria relate primarily to the design of the Professional, Administrative, Technical, and Clerical Pay (PATC) Survey used in the comparison and to the interpretation of data included therein. Some of the modifications to the criteria within the present system which could be initiated administratively and which would influence the level of pay significantly include:

First-Year Impact of Changes in Criteria
(Civilian and Military Pay)

| Criterion | Percentage Impact | Cost ($ in billions) |
|---|---|---|
| Changes Increasing Compensation | | |
| 1. Adopting the employee union proposal to use the fourth pay step of a grade as reference point and a constant percentage differential between grades | +3.3 | +1.6 |
| 2. Increasing the minimum size of establishments surveyed from 250 to 2,500 employees | +8.2 | +4.0 |
| 3. Eliminating or reducing the 6-month time lag between the survey date and the effective date of the adjustment | +4.4 | +2.2 |
| 4. Reflecting private sector shorter work week in the computations[1] | +1.8 | +0.9 |
| | +17.7 | +8.7 |
| Change Decreasing Compensation | | |
| 5. Incorporating the secretarial and computer operator occupations in the survey and weighting the survey results for composition of the federal work force[1] | -5.5 | -2.7 |

1. The basic data for these computations was provided by the Civil Service Commission. The computations represent one set of assumptions; different combinations would produce different results; e.g., including employees of state and local governments and nonprofit organizations or reflecting some of the basic structural changes recommended by the President's Panel on Federal Compensation (December, 1975).

When compared to the present system, these options could increase five-year additional cumulative outlays beyond the payroll base by as much as $34.0 billion or reduce them by as much as $16.0 billion.

## Employee Union Proposal

Existing pay of the GS work force is measured now by determining the mean salary at each grade. This is in contrast to the previous method which was to use the fourth step of a grade as the representative step. The practical effect of the change was to reduce the size of the pay adjustment needed to achieve comparability. OMB/CSC strongly support continuation of the current mean salary reference point as the most valid statistical method for comparing GS and private sector rates. They point out that the need for changing to the new criteria and the specific methodology employed have been endorsed both by the Advisory Committee on Federal Pay and the General Accounting Office.

The PATC Survey produces salary rates for comparison with federal counterparts on the General Schedule. An ordered hierarchial federal pay system is then arranged by construction of two paylines (smooth curves that follow the trends of the salary data) which compare PATC and GS pay. The construction of the paylines is critical to determining levels of federal pay; underlying assumptions can significantly alter both the pay rates of individual GS grades and the size of overall increases.

During the past several years the employee unions have taken strong exception to the present criteria for the reference point, the intergrade differential, and the fit of the payline. They would prefer a payline based on a step 4 reference point, a constant intergrade differential, and a special adjustment in fitting the payline to the lower grades (e.g., GS-1 through GS-4) for which the step 4 reference point is considered unrepresentative. If the employee union position had been used in the October, 1975, adjustment, the overall increase would have been 3.29 percentage points ($1.6 billion) greater, averaging 11.95 percent compared to the recommended 8.66 percent. Within this average, the increase would be greatest at the grade employing the most people; i.e., GS-5 pay would increase by 18.69 percent.

## Establishment Size

The impact of establishment size criteria on PATC Survey results is considerable. Other things being equal, larger establishments tend to pay higher rates than small establishments. Approximately one-third of the white-collar workers excluded from the PATC Survey are within the industrial scope of the survey but are employed by establishments below the minimum size criteria; i.e., 250 employees for manufacturing and retail trade and 100 employees in the other industry groups.[5]

If the survey for the October 1975 pay adjustment had used a minimum establishment size of 2,500 employees, the OMB/CSC proposal to the President would have been 16.88 percent rather than 8.66 percent. The impact of establishment size would be greater at the lower grades which are influenced by local rather than national job markets. The average weighted increase for GS-1 through GS-5 would have been 18.57 percent.

The present policy of using the smallest feasible establishment size reflects a belief that conceptually the PATC Survey should include all establishments since the federal government as an employer must compete with all employers in the economy. Agency field offices often are equated to "small establishments" in the private sector. The employee unions, on the other hand, believe that establishment size in the PATC Survey should be increased to reflect trends toward collective bargaining at the industry level. The argument proceeds that the federal government in a collective bargaining mode would behave like a giant corporation in the private sector.

## Hours of Work

The average workweek for employees in the PATC Survey is slightly over 39.3 hours compared to the 40-hour workweek for federal employees. The private sector average is reduced by shorter hours for employees in the New York metropolitan area and in the finance, insurance, and real estate industries nationwide. If the comparison criteria in the PATC Survey were adjusted to reflect shorter hours in the private sector, average GS pay would increase about 1.8 percent.

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5. Comptroller General, Improvements Needed in the Survey of Non-Federal Salaries, B-167266, page 27.

Timeliness of Adjustment

Any pay adjustment occurring on an annual basis has an inherent time lag. The annual PATC Survey uses March as a reference point for compiling salary data from the private and federal sectors. Consequently, the effect of pay changes occurring between March and the October effective date is not accounted for until the following year.

The OMB/CSC recognize the desirability of developing a "feasible and acceptable" method for moving the March reference month closer to the October effective date. The Federal Employee Pay Council favors changes that would eliminate or reduce the lag between the effective date and the reference month. This could be achieved by: (a) making the increase retroactive to the reference month, or (b) supplementing the annual PATC Survey pay adjustment by a formula. Elimination of the six-month time lag would result in an additional first-year increase of 4.4 percent ($2.2 billion).

Occupational Representativeness and Weighting

An important question to be resolved in determining pay is "which and how many" jobs should represent given work levels in comparing pay with the private sector. Statistical weighting then associates relative and appropriate importance to the specific jobs selected.

While standards have been established to determine which job "matches" (GS work force and private sector counterparts) qualify for inclusion in the PATC Survey,[6] there are no criteria for selecting the number and mix of the eligible matches. The lack of such criteria allows considerable latitude in selection and produces results which are vulnerable from a statistical standpoint. This is particularly critical in those grades where there are more than two PATC occupational categories.[7] For example, the 1975 PATC Survey

6. The criteria for including a job in the PATC Survey are that the job: (1) consists of work which is essentially the same in private enterprise as in the government, (2) is numerically important in both sectors, (3) is surveyable by the job matching technique, (4) is covered by a published Civil Service Commission classification standard, and (5) must exist across industry lines.

7. PATC categories are professional, administrative, technical, and clerical.

included nine job matches at the GS-5 work level--four professional, three technical, one for clerical, and one for administrative. Each of the job matches is given an equal weight in determining the average salary. This masks the composition of the GS-5 work force.

Of the March, 1975, federal employment of 153,712 at the GS-5 level, only 2.6 percent (3,954) were in professional jobs while 72.2 percent (110,971) were employed in clerical positions. Yet, of the 6,801 GS-5 positions for which a 1975 PATC job match existed, only 358 or 5.3 percent were clerical. The clerical positions were represented by one job match, which is less than 5 percent of all GS-5 clerical jobs. The professional category was represented by four job matches, with 51 percent of all professional jobs at the GS-5 level represented in the survey.

While the absence of selection criteria has the most obvious effects in the clerical category of the GS-5 level, the wide latitude now permitted affects the entire pay structure at all work levels. Changes in the number and mix of job matches can influence the magnitude and distribution of the annual pay increase significantly. OMB/CSC and the Federal Employees Pay Council have been discussing the addition of two job match categories; computer operator (technical category) and secretary (clerical category).

The weighting method currently used in the PATC pay process assigns equal weight to both salary variation and work force composition (e.g., salary and number of engineers versus salary and number of secretaries). Equal weighting is appealing because of its simplicity. However, if representation of the clerical work force were expanded to include the secretary and computer operator occupations and the results weighted by federal employment composition, the recommended increase would be reduced by 5.5 percentage points ($2.7 billion).

## Collective Bargaining

Collective bargaining is a primary force influencing employee wages and benefits in the private sector. In view of continuing changes in the occupational mix of the labor force, union efforts to recruit white-collar workers have intensified. Between 1972 and 1974, white-collar membership (public and private sectors) in national unions and employee associations continued its long-term, upward trend, increasing by 673 thousand to almost 5.9 million workers or 24.3 percent of total membership. Most of this growth has taken place in state and local government employment.[8]

By late 1974, formal collective bargaining was required or permitted by statute in 29 states for state and local employees. Membership in state and local government employee unions and organizations increased from 2.5 million in 1968 to 3.9 million in 1974. According to the Census Bureau, 4.3 million (50.4 percent) of the state and local government work force were represented in negotiations in 1972 by employee unions or organizations. The creation of the Postal Service as an "independent establishment" of the executive branch in 1970 resulted in one-fourth of the federal civilian work force having its pay levels established under collective bargaining.

Extending collective bargaining in the federal government beyond conditions of employment would facilitate comprehensive consideration of salary and "fringe" benefits through the customary processes followed in collective bargaining. This would result in a "total compensation" approach and would move the federal government closer to practices observed in the private and nonfederal public sectors of the economy. However, such an extension of the collective bargaining process would alter basic legal and management authorities significantly.

The collective bargaining alternative increases the $77.8 billion in projected five-year cumulative outlays beyond the payroll base under the present system by $20.5 billion. This collective bargaining formulation is a hypothetical one that would have to be tested in actual operation.

## Indexation

This approach would relate the amount of pay adjustment to one or more independent economic indicators--such as the Index of Average Hourly Earnings for the Private Non-Farm Economy. This Bureau of Labor Statistics (BLS) index exhibits a very close statistical relationship to the Professional, Administrative, Technical, and Clerical Survey results currently used to compare federal and private sector salaries

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8. U.S. Department of Labor, Bureau of Labor Statistics, Directory of National Unions and Employee Associations (1973), page 76, Table 12; and News Release of August 12, 1975.

and is being considered for developing estimates of federal pay raises.[9] The BLS is developing another measure of "wages and salaries" known as the Employment Cost Index (ECI). This series is expected to provide an even better index of comparability and may be expanded later to include supplemental benefits.

Indexation would remove much of the judgment factor from determining the size of the adjustment, thereby avoiding some of the criticisms now directed toward the survey approach. It would eliminate or reduce the six-month lag between the March survey date and the October effective date of the adjustment; but would leave the distribution of the increase among GS grades still to be determined. In the absence of such distribution, external and internal pay relationships among various occupations, worklevels, and GS grades would become distorted over a period of time. Consequently, job survey data would still be needed at some appropriate interval (e.g., every second, third, or fifth year).

The indexation alternative increases the $77.8 billion in projected five-year cumulative outlays beyond the payroll base under the present system by $10.8 billion, based on projected increases in the Index of Average Hourly Earnings for the Private Non-Farm Economy and elimination of the time lag. The annual costs of indexation without reducing the time lag would be the same as those under the present system.

## A Five Percent "Cap" for Two Years

This option would continue the 5 percent limit imposed on GS and military pay adjustments in fiscal year 1976 through fiscal year 1978. The two-year period of the "cap" would allow time to develop a "total compensation" approach for adjusting federal pay that would equate to private sector compensation. The adjustments after fiscal year 1978 would be comparable to the rate <u>changes</u> experienced in the private sector. However, the 1978 salary schedule would become the base for rate changes in succeeding years. Legislative action may be required to authorize such an approach.

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9. The percentage change in average PATC Survey pay rates equals .07 + .90 x (percentage change in Average Hourly Earnings). See discussion in <u>Federal Pay Raise Projections</u>, Office of Management and Budget Technical Staff Paper, BRD/FAB 75-3 (July 30, 1975).

This alternative could decrease the $77.8 billion in projected five-year cumulative outlays beyond the payroll base under the present system by $29.0 billion.

## Two-Year Moratorium on Pay Increases

This option is even more severe than the 5 percent "cap." The rationale for such an alternative probably would be derived from a Congressional determination based on circumstances in the economy and budget priorities. This alternative could decrease the $77.8 billion in projected five-year cumulative outlays beyond the payroll base under the present system by $54.2 billion.

## Rockefeller Panel Recommendations

It is difficult to assess the effect that any of these options would have on the quality of the federal work force, i.e., attracting and retaining high caliber personnel. Data presently available do not provide a basis for firm judgments. However, the report of the President's Panel on Federal Compensation (Rockefeller Panel) issued in December, 1975, concludes that "a serious problem of pay compression has developed at senior levels of the General Schedule, the Foreign Service, and the Department of Medicine and Surgery" and that a situation has been created "in which key executives, scientists, engineers, and diplomats are resigning or opting for premature retirement at an alarming rate."

The following are some of the Rockefeller Panel's major recommendations dealing with the areas discussed in this paper:

- The many separate federal civilian pay systems should be reviewed, and combined with other pay systems or eliminated if no longer needed.

- The principle of comparability with the private sector should be reaffirmed as the basis for federal pay-setting.

- Consideration should be given to conducting major federal pay surveys less frequently than once a year, with interim adjustments based on an appropriate statistical indicator.

- The principle of comparability should be extended to include benefits as well as pay. Development and testing should take place over the next two years to determine the best approach to implementation.

- The present General Schedule, which covers white-collar employees, should be replaced by a Clerical/Technical Service and a Professional/Administrative/Managerial/Executive Service.

- The Clerical/Technical Service should be paid local or other geographical rates.

- Merit, rather than length of service, should be the principal basis for within-grade pay advancement for employees in the Professional/Administrative/Managerial/Executive Service.

- Federal pay laws should be amended to permit the inclusion of state and local governments in federal pay surveys when needed.

- The President's Agent should continue its efforts to improve the statistical techniques used in the white-collar survey design and pay rate determination processes.

## CHAPTER III

## TOTAL COMPENSATION--A DIFFERENT PERSPECTIVE

### The Framework

A departure from the current procedure of dealing with adjustments to salary and "fringe" benefits separately has been characterized as a "total compensation" approach. The $7.4 billion in employee benefits now account for 21 percent of total civilian compensation (excluding postal) and--depending on the method used for calculating retirement costs--could run as high as 33 percent. Vacations, holidays, and other leave account for more than 44 percent of the employee benefit package with retirement being the next most significant single benefit.

CIVILIAN BENEFITS (Excluding Postal)
Fiscal Year 1975

| | Dollars in Billions | Distribution of Benefits | Percent of Total Employee Compensation of $35.1 Billion |
|---|---|---|---|
| Retirement (agency contributions) | $1.9 | 25.7% | 5.4% |
| Health and insurance programs (including sick leave) | 1.7 | 23.0% | 4.8% |
| Pay for leave time (vacations, holidays, and other ) | 3.3 | 44.6% | 9.4% |
| Other benefits | .5 | 6.7% | 1.4% |
| Total | $7.4 | 100.0% | 21.0% |

Source: Office of Management and Budget, Work-Years and Personnel Costs, Executive Branch, U.S. Government, Fiscal Year 1975, (December 18, 1975).

In the private sector it is common for collective bargaining agreements to cover both pay and benefits. As noted recently by the Comptroller General, "There is no standard or method for assessing the adequacy of Federal employee benefit programs. Benefits are considered and adjusted by law on a piecemeal basis." In its July, 1975, report the General Accounting Office called for a policy of total compensation comparability for determining federal employee pay and benefits. The report observed that as early as 1962 the President's Panel on Federal Pay Systems recommended that benefits be considered along with basic pay in evaluating compensation for federal employees and that a President's Cabinet committee recommended in 1966 that "the comparability principle should be applied to both pay and benefits to insure equity for federal employees with their equals throughout the economy."[10]

In 1973 the Civil Service Commission requested and obtained a supplemental appropriation to fund, among other projects, a feasibility study for developing a total compensation system which would include pay and benefits alike. The Rockefeller Panel report "endorses the principle of pay and benefits comparability for all federal employees" and recommends that "within the next two years, development and testing of alternatives should be completed and experiments conducted to determine the manner and extent to which the principle of total comparability of pay and benefits can be implemented."[11]

The selection of the major benefit elements to be included in any comparison is a difficult task. For instance, the Rockefeller Panel report endorses the inclusion of data on bonuses. In the past, bonuses have not been included but continue to be an issue between OMB/CSC and the employee unions. The cost impact of including "nonproduction cash bonuses" in the pay adjustment process is not considered significant; it has been estimated at 0.5 percent of annual salaries. However, this estimate is based on unpublished data exhibiting large sampling errors and a high nonresponse rate. Employee union estimates have been four to five times as great.

Employee representatives have no strong objection to the principle of having federal employee benefits comparable with those of their nonfederal counterparts. However, the employee unions are reluctant to extend the present pay-setting mechanism to fringe benefits given the fact-finding differences they have had in the last five years with OMB/CSC and the alternatives proposed by the President in the submission of alternative pay plans. It is unlikely that the unions would support a system which would allow basic pay to be traded off against employee benefits. A management viewpoint, however, argues that pay and benefits are all part of the employee's compensation and should be considered together.

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10. Comptroller General, Need for a Comparability Policy, FPCD-75-62, pages 4-6.

11. Report to the President of the President's Panel on Federal Compensation (December, 1975), page 7.

## Retirement Benefits

The method used to calculate federal employee retirement can alter the amount of consideration accorded the size of the benefit package significantly and the level of total compensation. Depending on the assumptions used, the effective annual economic cost to the government for employee retirement may range from 7 percent to as much as 60 percent of pay.

The present employer contribution, set by law at *1* percent of pay, does not include: (a) the cost of indexation[12] or (b) present unfunded liabilities--either created since 1969 or assumed when the existing system of financing was established. There is disagreement concerning the inclusion and treatment of these additional cost factors. Their potential cost impact, however, can be determined from data in the most recent Board of Actuaries Report, which includes actuarial valuation data as of June 30, 1972.

If indexation alone were included, the effective annual cost to the government would be 21.7 percent of pay.[3] If the cost to amortize increased liabilities created since 1969 also were included, the effective cost would increase to 24.9 percent of pay. Finally, if all liabilities--including those created prior to 1969--were counted, the government's effective cost would range between 40 percent and 60 percent of pay, depending on the method of calculation used.

The statutory formula for adjusting civilian retirement includes a 1.0 percent "kicker" which represents an extra percentage point added to each cost-of-living adjustment. Annuities are increased whenever the Consumer Price Index (CPI) increases by 3 percent for three consecutive months. The "kicker" is intended to compensate for the lag between changes in the CPI and the effective date of the annuity increase. Other federal programs which are indexed for price changes do not provide for such frequent adjustments or have a "catch-up" feature. Social security adjusts once a year

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12. The present contribution rates are based on the normal actuarial cost for new entrants under static assumptions which do not reflect the impact of inflation on income from pay and interest or benefit payments which are indexed to the cost of living.

13. The estimate is based on a conservative assumption of 4 percent annual CPI increase.

with a five-month lag; food stamps are indexed twice a year with a five-month lag; and white-collar civilian and military pay are adjusted once a year with a six-month lag.

Legislative changes in the present statutory formula for indexing civilian retirement would have a significant budgetary impact. If the 1.0 percent "kicker" were eliminated, annual outlay reductions would start at $93 million beginning in 1977 and reach $791 million in 1981--resulting in a cumulative five-year reduction of $2.1 billion below the present system.[14]

14. Calculations are consistent with CBO five-year economic projections (path B).