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Federal White Collar Employees—Their Pay and Fringe Benefits

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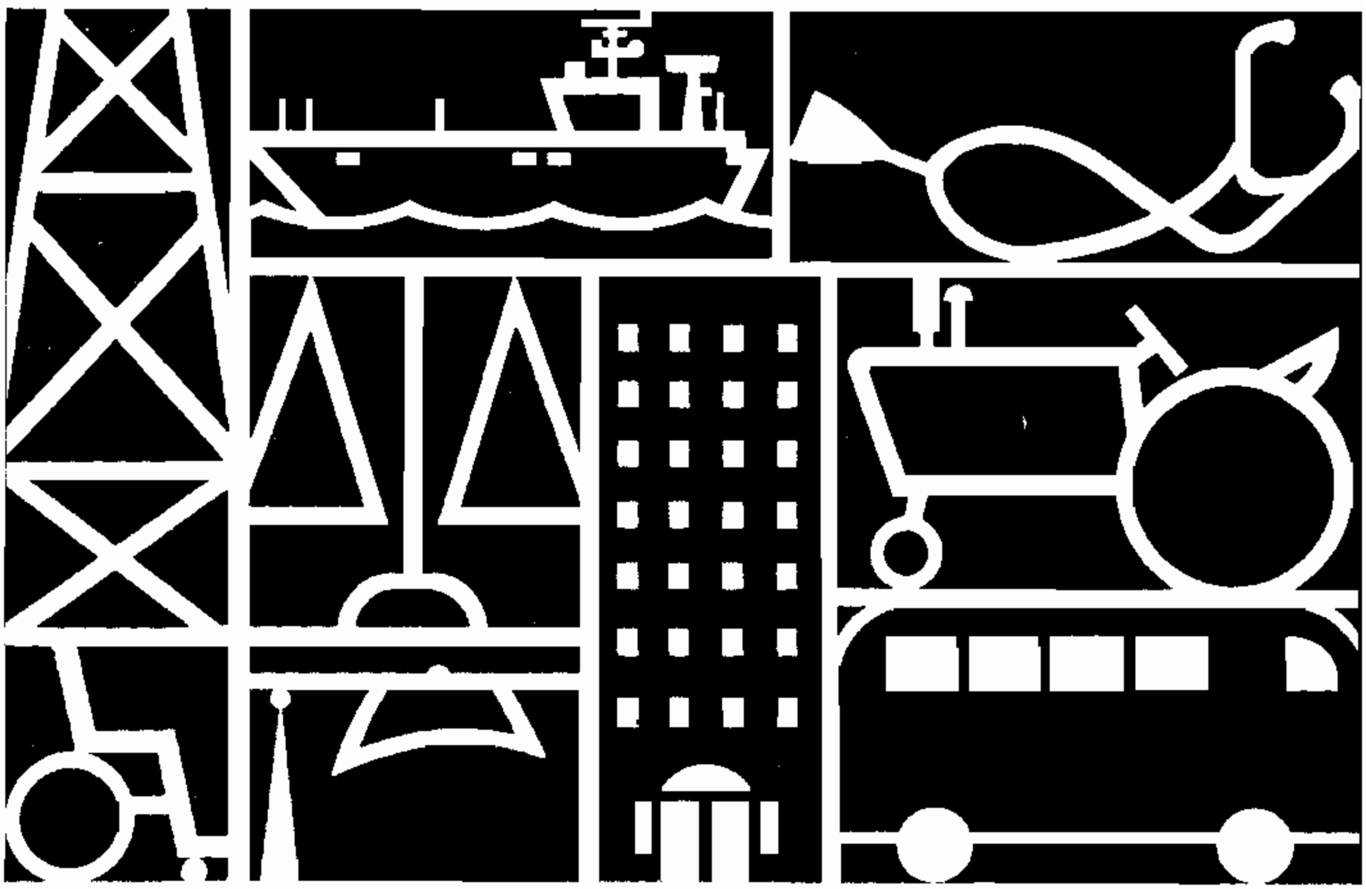

Congressional Budget Office
Congress of the United States

FEDERAL WHITE COLLAR EMPLOYEES--
THEIR PAY AND FRINGE BENEFITS

ERRATA

Regrettably, two errors occurred in the production of this paper. The date on the cover should read

April
1979

and page 18 of the text was omitted. The missing page carries the following portion of a paragraph.

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classified, the federal payroll would be reduced by an estimated $385 million--approximately 1.5 percent below its current level. Since provisions were included in the Civil Service Reform Act of 1978 to protect the pay of federal employees now occupying jobs that might be reclassified, savings from any major effort to correct classification errors would not be realized for several years.

FEDERAL WHITE COLLAR EMPLOYEES-- THEIR PAY AND FRINGE BENEFITS

The Congress of the United States
Congressional Budget Office

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NOTES

The term "federal employees" as used in this paper identifies persons who belong to the U.S. Civil Service, and most are employed in the Executive Branch. In this system, white collar jobs are ranked numerically according to the General Schedule (GS). This paper deals with full-time workers in jobs rated from one through 15 on the General Schedule.

Unless otherwise indicated, all years referred to in this paper are fiscal years.

PREFACE

This report, which was prepared at the request of the House Budget Committee, is intended to provide the Congress with an analytical basis for assessing the total compensation of federal white collar employees. It complements earlier CBO analyses of federal pay and retirement benefits. The forms and costs of compensation now provided to General Schedule employees are compared with those that would result if the federal government were to adopt common private sector practices. This issue is currently of special interest because of various federal pay and benefit reforms under consideration by the Administration.

The report was prepared by Earl A. Armbrust and David M. Delquadro of the General Government Management staff of CBO's Office of Intergovernmental Relations, under the general supervision of Stanley L. Greigg. The authors gratefully acknowledge the special assistance provided by Sherri Kaplan and Susan Leverone. Johanna Zacharias edited the paper, and Norma Leake typed the various drafts and prepared the paper for publication.

Alice M. Rivlin
Director

April 1979

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SUMMARY

The current annual cost to the federal government of compensating its 1.4 million white collar employees is estimated at \$34.2 billion--\$25.65 billion for actual pay and \$8.58 billion for the following fringe benefits: paid leisure time, cash awards, health coverage, and pensions. This paper compares the forms and costs of compensation now provided to General Schedule (GS) employees with the forms and costs of compensation that would result if common private sector practices were adopted. This hypothetical approach is a logical extension of the current federal policy that government salaries be comparable with those in private industry.

FRINGE BENEFITS

Altogether, GS employees now receive more compensation in the form of fringe benefits than they would if the common practices of the private sector were adopted. Adopting private sector practices would reduce the annual cost to the government by the equivalent of some \$637 million (based on current payroll).

If private sector practices were adopted benefit by benefit, there would be a change in both the overall level of compensation and the forms in which it would be received. For GS employees as a group, the following major changes would occur:

- Pension benefits would diminish because of reduced retirement annuities, lower early retirement benefits, and smaller cost-of-living adjustments;

- Employee contributions for pensions and health coverage would be reduced from 9.8 percent of payroll to 6.4 percent--representing a 3.4 percent increase in take-home pay;

- Unused sick leave would be forfeited and thus no longer credited toward retirement;

- Cash awards would increase to about 1 percent of payroll;
- Two additional days of paid leisure time would be granted, increasing the average amount of time off per employee to about 32 days per year.

ALTERNATIVES FOR ADJUSTING COMPENSATION

In analyzing the cost to the government of compensating its employees, a total compensation approach would take into account both pay and benefits. Within this concept there are many possibilities for adjusting compensation. To illustrate the various approaches and their cost implications, four options are considered in this paper. Raising federal pay to private sector levels, but leaving fringe benefits as they now stand, could result in a total compensation cost to the government of $37.8 billion in fiscal year 1980. This sum is the baseline against which the four options are measured. It includes outlays and actuarial costs, and should not be confused with annual budgetary impacts. If any of the alternatives discussed were adopted, the overall increase in compensation costs would drop by something between $0.7 and $1.7 billion. Under Options I and II, however, the annual cost to the government would be comparable to adopting private sector practices for both pay and benefits. The other two options would depart from comparability altogether and generate still greater savings (see Summary Table 1).

Option I. Establish a Total Compensation System

This alternative would include both pay and benefits in future federal compensation adjustments. According to this approach, the annual cost to the government would be the same as if federal compensation were comparable with common private sector practices. Although this system could take many forms, the cost estimates for Option I assume comparability on a benefit-by-benefit basis. In order to allow time for implementation, federal compensation presumably would conform to private practices in fiscal year 1981. Changes in federal compensation for fiscal year 1980 would be limited to a 7.6 percent pay increase, based on changes in average hourly earnings in the

SUMMARY TABLE 1. ESTIMATED REDUCTIONS IN ANNUAL COST TO THE GOVERNMENT UNDER ALTERNATIVE APPROACHES TO FEDERAL COMPENSATION a/: IN BILLIONS OF DOLLARS

Options	Pay	Benefits	Total Compensation	Government Savings Compared with Pay Comparability and Existing Benefits b/
I. Establish a Total Compensation System Based on Comparability	28.35	8.78	37.1	0.7
II. Achieve Comparability by Adjusting Federal Pay	27.85	9.28	37.1	0.7
III. Index Pay and Modify Retirement	27.60	8.50	36.1	1.7
IV. Continue to Cap Pay Raises (President's Plan for 1980)	27.06	9.02	36.1	1.7

a/ For the purpose of comparing costs, it is assumed that all of the alternatives would be implemented in 1980. The estimates of annual cost to the government are based on outlays and actuarial costs and should not be confused with annual disbursements.

b/ The cost to the federal government if emloyees' pay were adjusted to match private sector rates but fringe benefits were not changed is $37.8 billion; that sum is composed of $28.35 billion for pay and $9.45 billion for fringe benefits.

private sector. If adopted in 1980, Option I would reduce the annual cost to the government by some $0.7 billion.

Option II. Achieve Comparability by Adjusting Federal Pay

Option II is being considered by the Administration as the first phase of a total compensation system. It differs from Option I in that federal pay alone would be adjusted to achieve comparability in the total level of compensation. On this basis, the 1980 pay increase would be about 8.6 percent rather than 10.5 percent under full comparability. Similarly, fringe benefits received during employees' years of active work would remain below private sector benefit levels. Pension benefits, on the other hand, would continue to be more generous than pensions in the private sector. If adopted in 1980, Option II would have the same impact on annual cost to the government as would Option I--that is, it would yield a savings of $0.7 billion.

Option III. Adjust Pay According to Economic Indexes and Modify Retirement

Option III would adjust federal pay according to annual changes in average hourly earnings in the private sector. In addition, cost-of-living adjustments for both present and future retirees would be matched to those given in the private sector, which combine Social Security and a company-paid pension. This alternative would not yield a catch-up from the fiscal 1979 pay raise cap of 5.5 percent. Thus the 1980 adjustment would be limited to 7.6 percent. The change in cost-of-living adjustments for existing and new retirees would have the following two effects:

- o Limit the size of adjustment to 70 percent of the rises in the Consumer Price Index; and
- o Decrease the number of adjustments from twice a year to once a year, consistent with Social Security practices.

Option IV. Continue to Cap Pay Raises

Option IV represents the greatest departure from comparability with private sector practices. For budgetary and economic reasons, the 1980 federal pay increase would be capped at 5.5

percent, as the President has proposed. No catch-up would be provided in subsequent pay adjustments, nor would benefits change.

By adopting a pay cap for the second consecutive year, Option IV does not address major differences between Civil Service and private sector practices. Pay would be 4.8 percent below comparability, but the cost to the government for pensions would be higher by 6.2 percent of pay. The annual aggregate cost to the government for pay, pensions, and other fringe benefits would be about $1.7 billion below the cost of pay comparability without a change in benefits.

BUDGETARY REDUCTIONS

The future budgetary effects of the four options differ from the estimated changes in cost to the government. Since pensions are a deferred form of compensation, changes in the annual cost of retirement may not effect the budget for several years. The budgetary effect of alternatives reflects changes in both outlays and revenues from employee contributions. With the exception of Option I, the four alternatives would result in substantial budgetary reductions over the next five years--cumulative reductions ranging from about $3.0 billion to $8.3 billion. The total compensation system under Option I would increase the budget during the first three years of implementation (1981-1983) because of decreased income from employee contributions for health and retirement benefits. Beginning in 1984, the reduction in employee contributions would be more than offset by lower outlays, resulting in a net savings of some $230 million. Estimates of the five-year budgetary effects of the compensation alternatives are set forth in Summary Table 2.

SUMMARY TABLE 2. PROJECTED BUDGETARY REDUCTIONS RESULTING FROM ALTERNATIVES TO PAY COMPARABILITY AND EXISTING FEDERAL BENEFITS: FISCAL YEARS 1980-1984, IN MILLIONS OF DOLLARS a/

	1980	1981	1982	1983	1984	Cumulative Reduction for First Five Years
Option I: Establish a Total Compensation System Based on Comparability	759	-1,013	-531	-170	228	-727
Option II: Achieve Comparability by Adjusting Federal Pay	508	548	600	656	713	3,025
Option III: Index Pay and Modify Retirement	888	1,340	1,656	2,008	2,380	8,272
Option IV: Continue to Cap Pay (President's Plan for 1980)	1,302	1,405	1,530	1,669	1,810	7,716

a/ The budgetary reductions for Option I represent the net effect of changes in outlays and income from employee contributions. The budgetary reductions for Options II, III, and IV do not include any changes in employee contributions and are thus limited to changes in outlays.

CHAPTER I. INTRODUCTION AND METHOD OF ANALYSIS

The present basis for determining the pay of the federal government's 1.4 million white collar employees is comparability with the private sector--that is, equivalent pay for equivalent work. Fringe benefits, on the other hand--including pay for leisure time, cash awards, medical insurance and sick leave, and pensions--are determined irrespective of pay and on an ad hoc basis that is not tied to comparability. 1/ Fringe benefits are nonetheless an important part of federal compensation and, together with pay, are often referred to as "total compensation."

The Administration is currently considering applying the principle of comparability to federal employees' benefits as well as to their pay. This approach is consistent with the federal policy that government salaries be comparable with those in the private sector.

The concept of total compensation has been supported since the pay comparability process was established in 1962. Since then, several studies have endorsed broadening the comparability principle to include employee's fringe benefits. 2/

1/ These benefits were selected for analysis because of their cost significance, their prevalence among private employers, and the availability of comparative data on them. The paper does not analyze other benefits such as health coverage for retirees; stock options and thrift plans; and free or subsidized meals, parking, or transportation. Nor does it address the tax implications of various compensation practices. Since Civil Service retirement is the most expensive and complex employee benefit, it is analyzed separately in CBO, Options for Federal Civil Service Retirement: An Analysis of Costs and Benefit Provisions, December 1978.

2/ The following studies concluded that, because benefits represent a significant part of employee compensation, the comparability principle should be broadened to include benefits as well as pay: see Cabinet Committee on Federal Staff Retirement Systems report of February 1966; General Accounting Office, Need for a Comparability Policy, July 1975; President's Panel on Federal Compensation report of December 1975; Federal Personnel Management Project, Job Evaluation Pay and Benefit Systems, October 1977.

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The purpose of this paper is to provide an analytical basis for assessing the total compensation of federal white collar General Schedule (GS) employees as a group. 3/ In the remaining sections of this paper, the following topics are taken up:

- o A comparison of current federal pay and benefits to representative practices in the private sector as determined by survey; and
- o Alternative approaches to compensation, including the President's proposed plan to cap the 1980 pay increase at 5.5 percent.

The costs and forms of compensation are also compared with those that would result if the federal government adopted representative private sector practices. The paper does not purport to compare the compensation received by particular individuals on the basis of occupation or income level.

A primary measure for assessing the compensation of the federal white collar workforce is the cost to the government as employer. 4/ This cost is the difference between the total cost of compensation and the amount paid through employee contributions. For comparative purposes, fringe benefit costs are calculated as a level percent of payroll and reflect the age, sex, income, and marital status of the present generation of federal white collar employees. 5/

The comparison of Civil Service and private sector benefits is based primarily on survey data and analysis from Hay Associates. 6/ Civil Service benefits are based on current law

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3/ See the note on page ii.

4/ The cost to the government is based on the combination of outlays and actuarial costs and thus should not be confused with cash disbursements or income for a given period of time.

5/ The cost of deferred or future compensation, such as pension benefits, is estimated as a level percent of payroll over the work careers of GS employees.

6/ Hay Associates, an actuarial firm retained for this study by CBO, conducts an annual survey of non-cash compensation in the private sector. A total of 468 companies participated in the 1977 survey. In order to meet minimum size and industrial classification criteria, 20 companies were excluded as of October 1977. Private sector benefits are based on the practices of 448 companies that participated in the 1977 Hay survey. All the companies met both the minimum size and the industrial classification criteria used for determining annual adjustments for federal white collar employees. Based on the survey data, Hay Associates developed representative plans for each major fringe benefit--that is pensions, health care, and paid leisure time. Bonuses are considered in this paper on the basis of data provided by the U.S. Department of Labor, Bureau of Labor Statistics.

The provisions of the representative plans were analyzed from two perspectives. First, average and median practices of all 448 companies were determined regardless of how many persons each company employed. A second analysis determined average and median practices after weighting plan provisions by the respective number of salaried employees working in the United States. 7/ Although there is little difference between weighted and unweighted results, the weighted plan provisions were selected for use in this analysis since they take into account the relative size of each company and more closely reflect practices for white collar private employees. The representative plans resulting from this approach are a composite of practices followed in the private sector, rather than the provisions of any particular company.

All 448 companies in the Hay survey provided their employees private pensions, health benefits, and paid leisure time. Many companies not represented in the Hay survey have employees who do not receive such benefits. Roughly half of all private sector workers have no company pension plan to supplement Social Security and 20 percent are without employer-provided health insurance. If the survey had included companies that do not provide fringe benefits, the composite picture mentioned above would be quite different. The overall effect of including companies that offer no fringe benefits would be a lower level of benefits in the private sector and, correspondingly, a greater comparative advantage for federal employees.

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from the edited data base prepared for CBO. Appendix A lists the 448 companies by industrial code and employment levels. Details concerning benefit provisions will be provided in a forthcoming CBO technical paper.

7/ Of the 5.0 million people employed altogether by the 448 companies in 1977, approximately 1.1 million were salaried employees not eligible for overtime pay.

Collective Bargaining--A Different Perspective

According to the U.S. Bureau of the Census, labor agreements covered some 28 percent of the state and local government workforce in 1976. In addition, roughly one fifth of the federal civilian workforce (mainly employees of the U.S. Postal Service, the Tennessee Valley Authority, and certain employees of the Government Printing Office) already have their pay determined through collective bargaining. Another 44 percent of federal civilian employees are organized, but only for dealing with grievances and conditions of employment. Unions and employee organizations argue that collective bargaining would move federal compensation practices closer to those of the private sector. To expand collective bargaining to include pay and benefits, however, the government would need to address complex decisions regarding recognition of bargaining units, the roles of the Executive and Legislative branches, and the scope of future labor agreements.

CHAPTER II. COMPARISON OF FEDERAL AND PRIVATE SECTOR COMPENSATION

EMPLOYEE BENEFITS

Altogether, federal white collar employees currently receive more compensation in the form of fringe benefits than they would under the private sector plans represented in the Hay Associates analysis. If federal provisions for paid leisure time, cash awards, health care, and pensions had been matched with those of private companies, the fiscal year 1979 cost to the government would have decreased by nearly $640 million. This reduction would have derived from a $1.59 billion decrease in the cost of pension benefits simultaneous with a $951 million increase for paid leisure time, cash awards, and health coverage (see Table 1).

TABLE 1. COST IMPACT OF FEDERAL ADOPTION OF PRIVATE SECTOR BENEFIT PRACTICES: IN BILLIONS OF DOLLARS, FISCAL YEAR 1979

Benefit	Current Civil Service Provisions	If Private Sector Practices Adopted	Savings (-) or Costs (+)
Paid Leisure Time	2.929	3.138	+0.209
Bonuses and Cash Awards	0.026	0.256	+0.230
Health Coverage	1.619	2.131	+0.512
Pensions	4.007	2.419	-1.588
TOTAL	8.581	7.944	-0.637

SOURCES: Estimates are based on the GS payroll for fiscal year 1979 and Hay Associates survey results

Although there are a number of ways in which comparability in the total level of compensation could be achieved, a benefit-by-benefit comparison provides a reference point for analyzing current federal and private compensation practices. If private sector practices had been in effect in 1979, the total cost of federal benefits would have been reduced from $8.58 billion to $7.94 billion. In addition, the distribution of costs among benefits would have changed: employees would have received more compensation during their active years of employment and less later on, in the form of pension benefits. Thus, based on the Hay data, pensions would account for about 30 percent of the government's cost for fringe benefits, as against 47 percent under current Civil Service provisions.

As mentioned in Chapter I, the fringe benefits selected for study in this paper fall into four categories:

- <u>Leisure time</u>, which includes paid time off resulting from a shorter work day, holidays, and vacations;

- <u>Bonuses and cash awards</u>, both of which are independent of a company's level of production;

- <u>Health coverage</u>, which includes medical insurance and sick leave or short-term disability pay; and

- <u>Pension benefits</u>, which cover age retirement, long-term disability, and payments (including life insurance) to survivors.

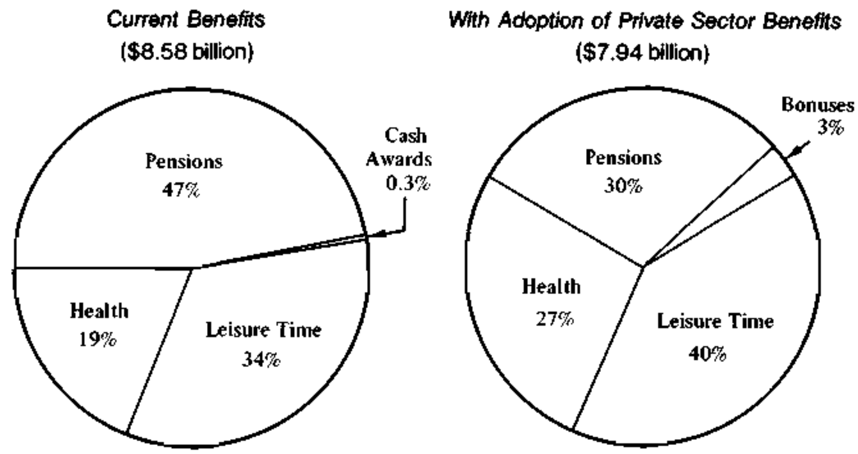
Figure 1 summarizes the comparative costs of existing federal fringe benefits to those that would occur if private sector practices were adopted.

Paid Leisure Time

On average, current federal employees take 29.7 days per year for vacations and holidays with pay. If private sector practices were adopted, annual paid time off would go up to roughly 31.8 days. The estimated increase of 2.1 days results from the net effect of a shorter private sector work day and more holiday time offset by reduced annual leave for vacations. The work week for federal white collar employees averages 40 hours, compared with an average of 39.3 hours for white collar employees

Figure 1.

Breakdown of Federal Fringe Benefits Under Current Practice and With Adoption of Private Sector Practices: Fiscal Year 1979



NOTE: Estimates are based on the GS payroll for fiscal year 1979 and Hay Associates survey.

in the private sector. 1/ Taken together, these changes would increase the payroll cost to the government--for additional time not worked--by 0.81 percent of pay (see Table 2).

An average of 10.4 annual holidays are granted by employers in the private sector as compared with an average of 9.2 days under Civil Service. The larger amount of holiday time in the private sector reflects a wide range of company practices, which allow time off for state holidays, the worker's birthday, half days for Christmas or New Year's Eve, or other occasions. Although less time is granted for vacations in the private sector, some companies distinguish between annual leave used for vacations and that used for personal business on an ad hoc basis. Thus, the 31.8 days of annual time off under private sector practices is an underestimate insofar as personal leave is not charged against vacation time. 2/

1/ The private sector average reflects shorter hours worked by employees in the New York metropolitan area and by employees nationwide in the finance, insurance, and real estate industries. See CBO, Federal Pay: Its Budgetary Implications, March 1976, p. 10.

2/ It is not possible to estimate the prevalence and impact of time off that may be granted for personal business, since it generally occurs on an informal basis and is not recorded.

TABLE 2. PAID LEAVE UNDER CIVIL SERVICE COMPARED WITH PRIVATE SECTOR PRACTICES

Type of Leave	Current Civil Service Provisions	If Private Sector Practices Adopted	Amount More (+) or Less (-)
(Days Per Year Per Employee)			
Shorter Work Week	— a/	3.86 b/	+3.86
Holidays	9.22	10.45	+1.23
Vacations	20.47 c/	17.50	-2.97
TOTAL	29.69	31.81	+2.12
(Cost to Government as a Level Percent of Payroll)			
Shorter Work Week	—	1.48	+1.48
Holidays	3.55	4.02	+0.47
Vacations	7.87	6.73	-1.14
TOTAL	11.42	12.23	+0.81

a/ The payroll for federal employees is based on a 40-hour work week.

b/ The 3.86 days per year represents the difference between a federal work week of 40 hours and the private sector average of 39.3 hours.

c/ The estimate for paid annual leave (vacations) is based on annual average days used by GS and other non-postal civilian employees during the five-year period, fiscal years 1972-1976. See Office of Personnel Management (formerly the Civil Service Commission) annual reports, Work-Years and Personnel Costs, Executive Branch, U.S. Government.

Bonuses and Cash Awards

For the period 1966 through 1976, federal white collar employees received annual cash awards averaging 0.1 percent of pay. During this same period, non-production bonuses for private sector white collar employees averaged some 1.0 percent of pay per year. While the magnitude and extent of private sector bonuses are affected by the financial condition of particular companies, there is little year-to-year variation nationwide in the amount spent on bonuses. In the decade 1966-1976, private sector bonuses ranged from 0.9 percent of pay per year to 1.1 percent. 3/ If federal cash awards were increased to reflect bonuses provided in the private sector, the annual cost to the government would increase by an estimated 0.9 percent. 4/

Health Coverage

The current cost to the government for Civil Service health-care benefits is estimated to be 6.3 percent of payroll. This includes some 2.4 percent of payroll for medical insurance and 3.9 percent of payroll for paid sick leave. 5/ If private sector practices were adopted, the cost to the government would go up to roughly 8.3 percent of payroll (see Table 3). The increased health-care cost to the government reflects the following factors:

3/ Estimates of private non-production bonuses and federal cash awards to white collar employees are based on data provided by the Bureau of Labor Statistics (BLS).

4/ As part of the March 1976 pay comparability survey, the BLS attempted to collect bonus data for private sector white collar employees based on occupation and skill level. The data were not published by BLS because of large sampling errors and a low response rate. There is no ongoing effort to refine the data collection or to utilize bonus data from other BLS sources.

5/ The estimated 3.9 percent of pay for sick leave includes 0.18 percent for unused sick leave credited toward retirement and 3.69 percent for sick leave used. Sick leave is often granted in the private sector in the form of short-term disability benefits.

TABLE 3. FEDERAL HEALTH-CARE COSTS UNDER CIVIL SERVICE COMPARED WITH PRIVATE SECTOR PRACTICES a/

Cost Factors	Current Civil Service Provisions	If Private Sector Practices Adopted	Amount More (+) or Less (-)
(Combined Benefits)			
Medical Insurance	2.45	4.49	+2.04
Sick Leave	3.86	3.82	-0.04
TOTAL Cost to Government	6.31	8.31	+2.00
(Detail for Medical Insurance)			
Total Cost	4.33	5.08	+0.75
Less Employee Contributions	1.88	0.59	-1.29
TOTAL Cost to Government	2.45	4.49 b/	+2.04

a/ Medical insurance and sick leave, as a level percent of payroll.

b/ The cost to the government for adopting private sector medical insurance practices assumes an increase in the GS employee participation rate from about 85 to 100 percent.

- o Continuation of the present level of medical insurance benefits;

- o Full employee participation in medical insurance plans because a larger share of costs would be paid by the government; and

- o Discontinuing the retirement credit for unused sick leave (discussed below) but providing more protection against extended periods of sickness in any given year.

If private sector medical insurance practices were adopted, the level of benefits offered federal employees would not change appreciably from the current level. There would, however, be a significant change in the allocation of costs between employer and employee. Under the present system, federal employees pay about 43 percent of their medical insurance premiums and the government, as employer, pays the remaining 57 percent. According to the Hay data, the allocation of payment for medical insurance coverage in the private sector averages 88 percent from the employer and 12 percent from the employee. If this ratio were adopted for federal employees, the cost to the government for employees' health insurance would be some 4.5 percent of pay--increasing the cost from $0.63 billion to $1.15 billion. This estimated increase reflects both the change in the allocation of premium costs between employer and employee as well as the associated increase in employee participation.

Altogether, federal employees earn an average of 12.6 days of paid sick leave per year and use about 9.6 days. The unused days are not forfeited; retirement credit is given for the accumulation of sick leave not used. 6/ In the private sector, sick leave is granted on an annual basis, increases with seniority, and is forfeited if not used. Based on Hay data, a representative sick leave plan would incorporate a 10-week waiting period and a leave schedule based on years of service that provides two to 26 weeks of full pay and six to 11 weeks of half pay. If these provisions were adopted by the federal government, the estimated actuarial cost would be 3.8 percent of pay, the equivalent of $980 million. This cost reflects the elimination of retirement credit for unused sick leave but more protection in a given year.

6/ In calculating their retirement benefits, federal employees may include the accumulation of unused sick leave as additional federal service.

Pension Benefits

The total cost of current federal pension benefits is estimated to be 23.5 percent of payroll, with the government paying 15.6 percent and employees paying 7.9 percent of payroll. Adoption of private sector pension practices would reduce the cost to the government by about 6.2 percent of payroll (see Table 4). The following major changes would result if representative private sector pension practices were adopted in combination with Social Security:

- Reduction in the size and number of cost-of-living adjustments; 7/

- Reduction in the level of retirement benefits for most Civil Service retirees; credit for military service limited to social security; and deferred pensions after 10 rather than five years of service;

- Reduction in benefits for retirement prior to age 65;

- Tighter eligibility standards but increased benefits for long-term disability; and

- Reduction of employee contributions from 7.9 percent of payroll to about 5.8 percent.

COMBINING PAY AND BENEFITS

The current annual cost to the federal government of compensating its GS employees is estimated to be $34.2 billion--$25.65 billion for pay and $8.58 billion for fringe benefits (outlays and actuarial costs). The cost of fringe benefits is affected by the level of pay. If private sector benefits, as determined by the Hay data, had been adopted--along with the 5.5 percent pay raise cap--in fiscal year 1979, the cost of benefits would be reduced by approximately $640 million. If, on the other hand, private benefits and the pay comparability increase (8.4 percent) had been adopted, outlays for pay would go up about $700 million; the cost of benefits, meanwhile, would drop by some $420 million (see Table 5).

7/ Cost-of-living adjustments would be reduced from 100 to 70 percent of increases in the Consumer Price Index; occur annually, consistent with Social Security provisions; and be prorated, as recommended by the General Accounting Office.

TABLE 4. FEDERAL RETIREMENT COSTS UNDER CIVIL SERVICE COMPARED WITH PRIVATE SECTOR PRACTICES a/

Cost Factors	Current Civil Service Provisions	If Private Sector Practices Adopted	Amount More (+) or Less (-)
Total Cost	23.5	15.2	-8.3
Less Employee Contributions	7.9	5.8	-2.1
Cost to the Government as Employer	15.6	9.4	-6.2

TABLE 4A. DETAIL FOR CIVIL SERVICE AND PRIVATE SECTOR PROVISIONS

	Age Retirement	Dis-ability	Survivors Insurance c/	Total
Benefits				
Civil service	15.0	4.6	3.8	23.5
Private sector b/	8.0	5.8	1.3	15.2
Less Employee Contributions				
Civil service	4.8	1.5	1.6	7.9
Private sector	2.8	2.6	0.4	5.8
Net Cost to Employer				
Civil service	10.2	3.1	2.2	15.6
Private sector	5.2	3.2	0.9	9.4

a/ As a level percent of payroll.

b/ Includes provisions for both Social Security and a representative private pension plan. For a detailed discussion of provisions and their budgetary implications, see CBO Options for Federal Civil Service Retirement, December 1978.

c/ Including life insurance.

TABLE 5. CURRENT TOTAL CIVIL SERVICE COMPENSATION COSTS COMPARED WITH PRIVATE SECTOR PRACTICES: IN BILLIONS OF DOLLARS, FISCAL YEAR 1979

	Existing Benefits	If Private Sector Practices Adopted	
	Current Pay a/	Current Pay a/	Comparability Increase b/
Total Compensation			
Payroll	25.65	25.65	26.35
Benefits	8.58	7.94	8.16
TOTAL	34.23	33.59	34.51
Impact of Adopting Private Practices: c/			
Payroll	—	—	+0.70
Benefits	—	-0.64	-0.42

TABLE 5A. DETAIL FOR FRINGE BENEFITS

	Existing Benefits	If Private Sector Practices Adopted	
Fringe Benefit	Current Pay a/	Current Pay a/	Comparability Increase b/
Paid Leisure Time	2.93	3.14	3.22
Bonuses and Cash Awards	0.02	0.25	0.26
Health Coverage	1.62	2.13	2.19
Pensions	4.01	2.42	2.49
TOTAL	8.58	7.94	8.16

a/ GS payroll for fiscal year 1979, based on the 5.5 percent pay increase.

b/ GS payroll for fiscal year 1979 if the full comparability pay increase of 8.4 percent had been received.

c/ The impact represents the difference between existing pay and benefits and adoption of private sector pay or benefits.

FEDERAL PAY

As stated above, the federal government currently spends an estimated $25.65 billion per year in salaries for its white collar employees. By means of an annual survey, GS salaries are compared with salaries paid in the private sector. In determining annual adjustments in GS pay, the Administration exercises considerable latitude both in the design of the comparability survey, and in alternative approaches that limit, or "cap," federal pay in response to general economic conditions.

Earlier CBO papers have analyzed the extent to which pay comparability determinations are influenced by judgments concerning such factors as occupations, size of establishment, geographical differences in pay rates, and techniques of comparison. 8/ One feature under consideration by the Administration in its deliberations about revising federal compensation is a proposal that would result in geographical variations in GS employees' pay.

Because of economic conditions affecting the nation's general welfare, the President may propose an alternative to the annual comparability adjustment. Such an alternative takes effect unless overruled by either House of Congress. Of the nine pay increases between January 1971 and October 1978, three alternatives pay plans were allowed by the Congress. The most recent alternative to comparability was the October 1978 increase, which was capped at 5.5 percent. If the comparability adjustment had gone into effect, the increase would have been 8.4 percent. The 5.5 percent cap thus restrained rising GS payroll costs by approximately 2.9 percent, or $700 million. In fiscal year 1980, the Administration again plans to cap pay raises at 5.5 percent, rather than allow a comparability increase of some 10.5 percent.

Ideally, all the factors that influence the level of salaries in the federal government and the private sector should be considered when reviewing federal pay. Two areas that affect the size of the GS payroll--job security and discrepancies in the classification of federal jobs--are discussed below.

8/ For a detailed discussion of the current comparability process see CBO, The Federal Government's Pay Systems, February 1977, pp. 7-16; and CBO, Federal Pay: Its Budgetary Considerations, March 1976, pp. 7-12.

Job Security

Federal employment is generally more stable than employment in the private sector, because the government is less affected by economic fluctuations. From calendar year 1969 through 1978, the national unemployment rate averaged 6.0 percent, with 3.5 percent for white collar employees. During the same period, the average unemployment rate for all federal employees--blue and white collar--was 3.2 percent (see Figure 2). It is reasonable to assume that the federal white collar rate is below 3.2 percent, since blue collar workers generally have higher rates of unemployment. Thus the average federal white collar unemployment rate for the past decade is estimated to be 2.4 percent--some 1.1 percent below the national rate for white collar employees. 9/ Greater GS job security, however, also benefits the federal government as an employer by increasing productivity and lowering costs associated with personnel turnover (the costs of which include severance pay, recruitment, and training).

Job Classification

The incorrect classification of jobs is a management problem that affects a limited number of employees at any given time. A recent study by the Civil Service Commission (now the Office of Personnel Management) concluded that about 11.5 percent of white collar GS jobs were classified higher than they should have been and 3.3 percent were underclassified. 10/ Although this problem is not unique to the federal government, there are no available data to determine the extent to which incorrect classification occurs in the private sector.

Although incorrect job classification is not directly related to pay comparability, it is an area in which payroll costs could be reduced. If all white collar GS jobs were correctly

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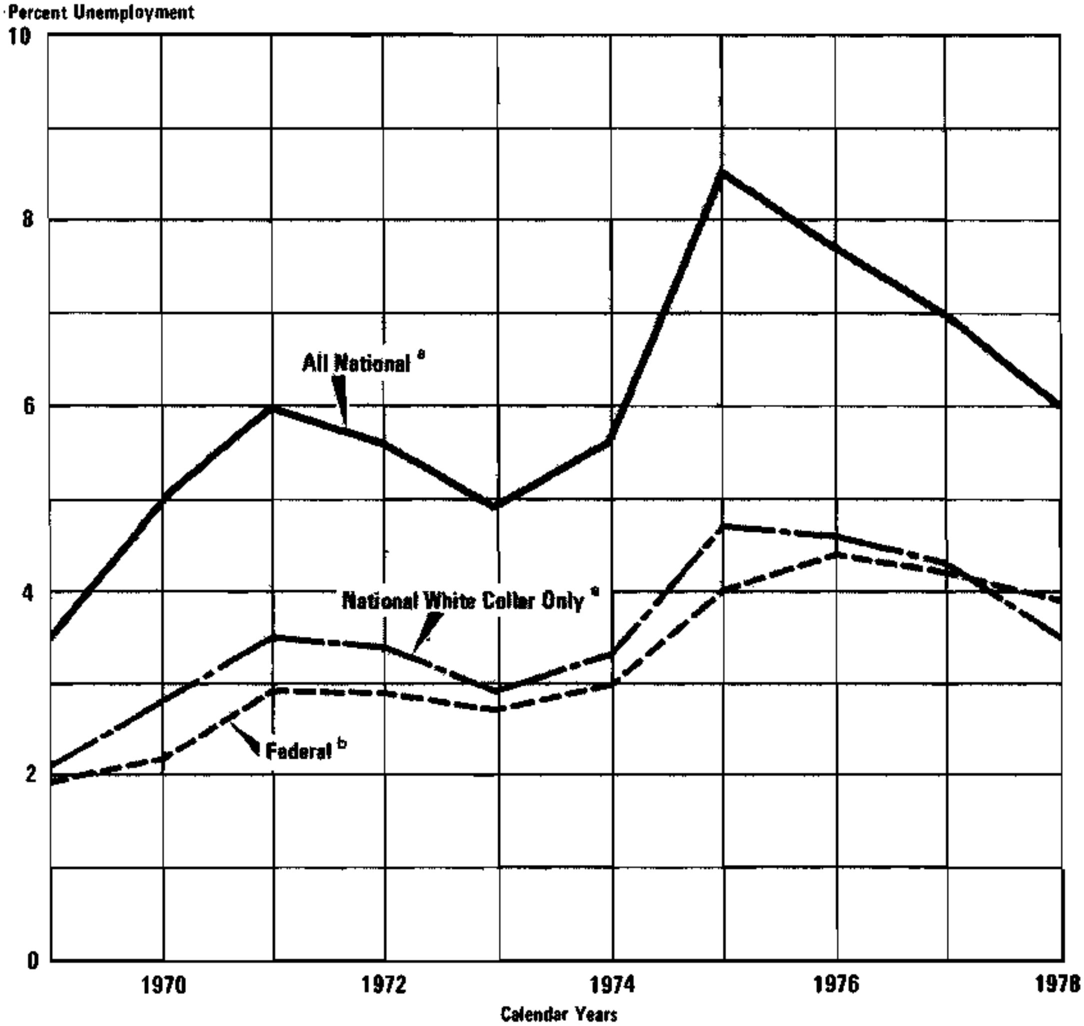
9/ There are no data on which to base a precise estimate of the unemployment rate for federal GS employees. The estimate used in this paper assumes that the relative difference between the national unemployment rate and that for employees who are white collar would be the same in the federal sector.

10/ Civil Service Commission, Study of Position Classification Accuracy in Executive Branch Occupations Under the General Schedule, November 1978.

Figure 2.

Unemployment Rates of Federal and Private Sector Workers: Calendar Years 1969-1978



[a] Includes both Federal and private sector workers.

[b] Includes Federal blue and white collar and postal workers.

NOTE: Average unemployment rates for the period 1969-1978 were:

National—6.0%
White Collar—3.5%
Federal—3.2%

CHAPTER III. ALTERNATIVES FOR ADJUSTING COMPENSATION

In analyzing the cost to the government of taking a "total compensation" approach, both pay and benefits would have to be considered. Within such an approach there are many possibilities for adjustment. To illustrate the possible approaches and their cost implications, four alternatives are considered here. If these alternatives were adopted in 1980, they would lower costs from something between $700 million and $1.7 billion below the $37.8 billion that would be required if pay were increased to private sector levels and federal benefits were not changed. Under Options I and II, total compensation would be comparable to adoption of private sector practices for both pay and benefits. The remaining options would depart from comparability in order to generate greater savings. The four options are:

Option I. Establish a total compensation system;

Option II. Achieve comparability by adjusting federal pay;

Option III. Adjust pay according to economic indexes, and modify retirement;

Option IV. Cap pay raises in 1980 at 5.5 percent.

The cost effects of these alternatives are analyzed by comparing the following two factors:

- The annual cost to the government if pay and benefit changes were in effect as of fiscal year 1980; 1/ and

- The cumulative net budgetary impact for 1980 through 1984 (meaning the combined effect of changes in both outlays and income from employee contributions).

1/ The cost to the government--that is, total cost less employee contributions--is the combination of outlays and actuarial costs. It should not be confused with budgetary outlays, which measure cash disbursements for a given period of time. For comparative purposes, the annual cost to the government is estimated as if all options were implemented simultaneously in fiscal year 1980.

Using these two measures, each of the alternatives is compared to the costs that would occur if, under the existing comparability process, pay were increased to private sector levels and benefits were not changed. On this basis, the annual cost to the government in 1980 is estimated at $37.8 billion. By adopting the alternatives presented here, this cost could be reduced by at least $0.7 billion (Options I and II) or by as much as $1.7 billion (Options III and IV). Table 6 compares the annual cost of the government for federal pay and benefits under each of the compensation alternatives.

Under Options I and II, the annual cost to the government would be comparable to adoption of private sector practices. The other alternatives, which are not based on comparability, would generate significant budgetary savings in the first five years. Table 7 presents the budgetary effects that all four options would have over the next five years. Any of the options, as the table shows, yields some amount of annual budgetary reduction in 1984. With the exception of Option IV, all alternatives would require new legislation.

OPTION I. ESTABLISH A TOTAL COMPENSATION SYSTEM

Under a total compensation system, the annual cost to the government would be the same as if federal compensation--both pay and benefits--were based entirely on comparability with private sector practices. Within this cost framework, a number of alternatives could be considered--that is, changes could be made both in salaries or in certain benefits. If private sector practices were adopted on a benefit-by-benefit basis in 1980, however, the following major changes would occur:

- Salaries would rise an estimated 10.5 percent in order to reach levels comparable with the private sector;

- Pension benefits would be equivalent to Social Security and a representative private plan--resulting in a reduction of basic annuities, early retirement benefits, and cost-of-living adjustments; 2/

2/ For detailed information concerning changes in Civil Service retirement under Option I see CBO, Options for Federal Civil Service Retirement, December 1978, pp. 40-41.

TABLE 6. ESTIMATED REDUCTIONS IN ANNUAL COST TO THE GOVERNMENT UNDER ALTERNATIVE APPROACHES TO FEDERAL COMPENSATION a/: IN BILLIONS OF DOLLARS

Options	Pay	Benefits	Total Compensation	Government Savings Compared with Pay Comparability and Existing Benefits b/
I. Establish a Total Compensation System Based on Comparability	28.35	8.78	37.1	0.7
II. Achieve Comparability by Adjusting Federal Pay	27.85	9.28	37.1	0.7
III. Index Pay and Modify Retirement	27.60	8.50	36.1	1.7
IV. Continue to Cap Pay Raises (President's Plan for 1980)	27.06	9.02	36.1	1.7

a/ For the purpose of comparing costs, it is assumed that all of the alternatives would be implemented in fiscal year 1980. The estimates of annual cost to the government are based on outlays and actuarial costs and should not be confused with annual disbursements.

b/ The cost to the federal government if emloyees' pay were adjusted to match private sector rates but fringe benefits were not changed is $37.8 billion; that sum is composed of $28.35 billion for pay and $9.45 billion for fringe benefits.

TABLE 7. PROJECTED BUDGETARY REDUCTIONS RESULTING FROM ALTERNATIVES TO PAY COMPARABILITY AND EXISTING FEDERAL BENEFITS: FISCAL YEARS 1980-1984, IN MILLIONS OF DOLLARS a/

	1980	1981	1982	1983	1984	Cumulative Reduction for First Five Years
Option I: Establish a Total Compensation System Based on Comparability	759	-1,013	-531	-170	228	-727
Option II: Achieve Comparability by Adjusting Federal Pay	508	548	600	656	713	3,025
Option III: Index Pay and Modify Retirement	888	1,340	1,656	2,008	2,380	8,272
Option IV: Continue to Cap Pay (President's Plan for 1980)	1,302	1,405	1,530	1,669	1,810	7,716

a/ The budgetary reductions for Option I represent the net effect of changes in outlays and income from employee contributions. The budgetary reductions for Options II, III, and IV do not include any changes in employee contributions and are thus limited to changes in outlays.

- Employee contributions for pensions and health coverage would be reduced from 9.8 percent of payroll to 6.4 percent--resulting in a 3.4 percent increase in take-home pay;

- The employers' share of health insurance premium costs would increase from 57 to 88 percent;

- Retirement credit for unused sick leave would be discontinued;

- Cash awards would increase from 0.1 percent to 1.0 percent of payroll; and

- Two additional days of paid time off would be granted, increasing the average leave time per employee to about 32 days per year.

Option I assumes that the President would be required by law to submit to the Congress a total compensation plan based on pay and benefit comparability. Such a system would require extensive collection and evaluation of data. Annual surveys would therefore be impractical and comparability adjustments would be made periodically--say, once every three years. For interim years, adjustments could be based on changes in existing indexes of private sector compensation.

In order to allow time for implementing Option I, the only change in compensation during fiscal year 1980 would be a 7.6 percent increase in pay. 3/ In fiscal year 1981, federal pay and benefits would conform with private sector practices. Option I would reduce the annual cost to the government by an estimated $0.7 billion and, in 1984, result in a net budgetary savings of about $230 million. In the first three years of implementation of Option I, however, the budget would be increased to compensate for reduced income from employee contributions for health and retirement benefits.

3/ The estimated 1980 increase of 7.6 percent does not allow pay to catch up from the prior year's pay raise cap of 5.5 percent.

OPTION II. ACHIEVE COMPARABILITY BY ADJUSTING FEDERAL PAY

Option II is being considered by the Administration as the first phase of a total compensation system. In order to achieve comparability in the overall level of total compensation, the size of future pay increases would be reduced but benefits would not be changed. On this basis the 1980 pay increase would be about 8.6 percent rather than 10.5 percent, based on comparability as it is currently determined. Similarly, fringe benefits received during active employment (paid leisure time, cash awards, and health coverage) would remain below levels as defined in the representative private plans developed by Hay Associates. Pension benefits, on the other hand, would continue to be more generous than those in the private sector.

Option II would reduce the annual cost to the government by some $0.7 billion in 1980. The budgetary reduction in 1984 would be approximately $710 million as compared with $230 million under Option I. 4/ The cumulative five-year budgetary reduction would be about $3.0 billion.

OPTION III. ADJUST PAY ACCORDING TO ECONOMIC INDEXES AND MODIFY RETIREMENT

Option III would adjust federal pay based on changes in average hourly earnings in the private sector. In addition, cost-of-living adjustments for both existing and new retirees would be treated as follows. They would be limited to 70 percent of increases in the Consumer Price Index. 5/ They would occur once rather than twice a year, consistent with Social Security practices. And they would be prorated as recommended by the

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4/ The Administration plans to develop legislation for changing pay-setting procedures as part of its approach to total compensation. The CBO costs estimates do not take account of this initiative since major specifications are unknown at the time of publication of this paper.

5/ For a comparison of Civil Service and private sector cost-of-living adjustments provided retirees, see CBO Options for Federal Civil Service Retirement, December 1978, pp. 16-20.

General Accounting Office. 6/ The combined effect of these changes in both pay and retirement benefits would be a $1.7 billion reduction in annual cost to the government--some billion dollars more than the savings that would result from adoption of private practices as outlined for Option I.

The third option would not allow a catch-up from the 1979 pay raise cap of 5.5 percent; consequently, the 1980 pay adjustment is estimated to be the same as with Option I, namely 7.6 percent. Cost-of-living adjustments to Civil Service pensions would be equivalent to those that would occur under Social Security and a representative private pension plan. Since the formula for determining basic retirement benefits would not be affected, federal employees--as a group--would continue to receive more compensation in the form of retirement benefits than they would under private sector practices.

Option III could be fully implemented in fiscal year 1980 and, as a result, could reduce budgetary outlays by about $890 million. Cumulative outlay reductions over the first five years (1980 through 1984) are estimated to be $8.3 billion.

OPTION IV. CONTINUE TO CAP PAY

Option IV, the 1980 pay raise cap proposed by the President, represents the greatest departure from comparability with private sector practices. For budgetary and economic reasons, the October 1979 pay increase--like the October 1978 pay increase--would be limited to 5.5 percent, and no catch-up would be allowed in subsequent years.

Since Option IV would not change existing employee benefits, the annual cost-of-living adjustments for Civil Service retirees would not be affected. Thus, federal retirees would continue to receive greater protection from inflation than they would if

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6/ New retirees also benefit from cost-of-living increases occurring during the last few months before retirement. The General Accounting Office recommends that the law be changed to prorate the individual's first adjustment to reflect only cost-of-living increases occurring after the date of retirement. General Accounting Office, Cost-of-Living Adjustments for New Federal Retirees, November 17, 1977.

private sector practices were adopted. 7/ Conversely, benefits received during active employement would, like pay, lag further behind representative practices in the private sector.

By adopting a 5.5 percent cap for a second year, Option IV does not address major difference between Civil Service and private sector benefit provisions. In particular, pensions would continue to represent 47 percent of fringe benefit costs, as compared with 30 percent under full comparability (Option I). Under the fourth alternative, pay would be 4.8 percent below comparability, but the cost to the government for pensions would be 6.2 percent of pay above comparability. The annual cost to the government for pay, pensions, and other fringe benefits would be reduced by an estimated $1.7 billion. Similarly, outlays in fiscal year 1980 would be reduced by some $1.3 billion. Cumulative outlay reductions from 1980 through 1984 would reach an estimated $7.7 billion.

7/ See CBO, Options for Federal Civil Service Retirement, December 1978, p. 16-20.

APPENDIX A. PROFILE OF EDITED DATA BASE COMPANIES

The 448 companies included in the edited data base are distributed by standard industrial code (SIC) and employment levels. Employment levels are based on the 1977 Non-Cash Compensation Survey conducted by Hay Associates.

			Percents
1.	Total (All SIC Groups)		
	Number of Companies	448	(100)
	Number of Employees		
	Salaried	1,145,867	(100)
	Wage Earners a/	3,895,884	(100)
	Total	5,041,751	(100)
2.	SIC Group: Mining		
	Number of Companies	11	2.5
	Number of Employees		
	Salaried	13,694	1.2
	Wage Earners	40,880	1.0
	Total	54,574	1.1
3.	SIC Group: Construction		
	Number of Companies	9	2.0
	Number of Employees		
	Salaried	34,854	3.0
	Wage Earners	57,397	1.5
	Total	92,251	1.8
4.	SIC Group: Transportation and Utilities		
	Number of Companies	38	8.5
	Number of Employees		
	Salaried	96,078	8.4
	Wage Earners	366,889	9.4
	Total	462,967	9.2
5.	SIC Group: Wholesale Trade		
	Number of Companies	7	1.6
	Number of Employees		
	Salaried	13,627	1.2
	Wage Earners	32,140	0.8
	Total	45,767	0.9

a/ Includes all employees covered by the provisions of the Fair Labor Standards Act of 1938.

6. SIC Group: Retail Trade		
Number of Companies	15	3.3
Number of Employees		
Salaried	53,641	4.7
Wage Earners	616,650	15.8
Total	670,291	13.3
7. SIC Group: Banking		
Number of Companies	56	12.5
Number of Employees		
Salaried	50,744	4.4
Wage Earners	146,879	3.8
Total	197,623	3.9
8. SIC Group: Insurance		
Number of Companies	72	16.1
Number of Employees		
Salaried	115,474	10.1
Wage Earners	125,882	3.2
Total	241,356	4.8
9. SIC Group: Other Financial		
Number of Companies	17	3.8
Number of Employees		
Salaried	8,947	0.8
Wage Earners	12,526	0.3
Total	21,473	0.4
10. SIC Group: Services		
Number of Companies	21	4.7
Number of Employees		
Salaried	26,694	2.3
Wage Earners	63,555	1.6
Total	90,249	1.8
11. SIC Group: Manufacturing		
Number of Companies	202	45.1
Number of Employees		
Salaried	732,114	63.9
Wage Earners	2,433,086	62.5
Total	3,165,200	62.8