COST OF POTENTIAL LAYOFFS UNDER THE ADMINISTRATION'S FEDERAL EMPLOYMENT REDUCTION PROGRAM

A Staff Working Paper

July 1981

Congressional Budget Office
Office of Intergovernmental Relations

PREFACE

This working paper, prepared at the request of the House Committee on Post Office and Civil Service, examines the costs of employee layoffs caused by the Administration's program to reduce federal civilian employment in nondefense agencies. As noted in the paper, the estimates are based on current information and are subject to considerable change because of uncertainty about the number of employees who may be laid off and about their ages, salaries, and length of government service.

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July 1981

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SUMMARY

In preparing its employment reduction program for fiscal years 1981 and 1982, the Administration assumed that most job cuts could be achieved primarily through attrition--that is, by not filling existing and upcoming vacant positions--rather than by laying off large numbers of employees. Relative to the January Budget, the program is expected to cut 79,000 workyears throughout the two fiscal years and to generate associated federal savings of some $2.0 billion. Recent reports suggest, however, that the program may cause as many as 15,550 permanent full-time workers to be laid off by December 31, 1981.

If the projected layoffs should occur, the two-year savings estimated by the Administration would decline by as much as $0.34 billion because of costs for various entitlement benefits to laid off federal workers--namely severance pay, unemployment compensation, refunds for retirement contributions and unused leave, and pensions for involuntary retirees. Some layoffs have occurred already, and more are anticipated. Almost one-third of the costs are distributed over the accounts of employing agencies and will thus most likely be absorbed within existing budget limitations, although cutbacks in other activities might also result. The remaining portion, mainly unemployment compensation and refunds of retirement contributions, is funded in two central government accounts. (The estimated budgetary impact of federal layoffs is subject to great uncertainty because of data limitations concerning the numbers, and timing, and the characteristics of workers who might be affected.) The cost of entitlement benefits for laid-off federal workers, basically a one-time expense, might be viewed as a necessary price for cutting back nondefense employment and achieving associated savings in domestic programs. (This paper focuses solely on the potential costs of layoffs and does not examine other budgetary effects of employment reductions or program cuts.)

Overall, the Administration's planned employment control efforts will alter the composition of the federal civilian workforce more than its total size. The size of the federal civilian workforce remains about the same, but contrary to past trends, the portion employed by the Department of Defense will increase while the nondefense portion shrinks accordingly.

The Congressional Budget Office's analysis of government-wide data shows that the combined 79,000 workyear reductions for fiscal years 1981 and 1982 equate numerically to elimination of jobs that would have been added to a straightline projection of employment as of December 31, 1980. Within the government-wide totals, however, employment in particular programs will be cut below the December 1980 level.

In future years, federal employment reductions may also result from agencies' deciding that it is more economical to have various federal functions, comparable to certain commercial and industrial types of activities in the private sector, performed by government contractors. Employment cutbacks accompanying a shift to more contracting out could rival the fiscal year 1981-1982 reductions that largely reflect lower program levels and redefined federal responsibilities. Any savings that could result from more contracting out would diminish initially, however, if the personnel reductions were achieved by laying off staff rather than by attrition.

SECTION I. INTRODUCTION

Early this year, President Reagan announced a hiring freeze on federal civilian employment and later set employment ceilings for agencies in the Executive Branch. Personnel ceilings, essentially matters of administrative decision, emerge in the budgetary process. Relative to the employment levels estimated in the January 1981 Budget, the Administration expects its program to cut nondefense agency employment by 17,000 workyears (1.4 percent) in fiscal year 1981 and 62,000 workyears (5.1 percent) in fiscal year 1982. 1/ The Administration estimates assume that agencies will be able to achieve their employment reductions primarily by attrition (that is, not filling existing and upcoming vacant positions) rather than by large numbers of layoffs, and that these cutbacks will generate federal outlay savings of some $2.0 billion over the two fiscal years. 2/ Costs for federal layoffs were not considered.

1/ Workyears, for purposes of this paper, disregard overtime, and thus the term may be used interchangeably with full-time equivalent employment, which measures the size of the workforce in terms of the number of scheduled work hours (2,080 hours representing one work year). Estimates for nondefense agencies include civil functions of the Department of Defense, mainly carried out by the Army Corps of Engineers. Appendix A provides workyear estimates related to the Administration's employment controls.

2/ Office of Management and Budget, Fiscal Year 1982 Budget Revisions: Additional Details on Budget Savings, April 1981, p. 390. The Administration estimates may slightly overstate savings from employment cutbacks. CBO calculations, also disregarding layoff costs, show a two-year savings of $1.9 billion rather than $2.0 billion. The difference reflects a lower assumed average annual compensation cost per workyear and adjustment for the lag in fund disbursement.

Recent reports suggest, however, that employee layoffs may be much more numerous than was initially anticipated. The reported layoffs reflect decisions to cut back particular programs rather than across-the-board percent reductions in agency totals. Thus in many instances assumptions about agency-wide attrition rates are not relevant. If the projected layoffs materialize, the estimated savings might be eroded by as much as $0.3 billion because of offsetting outlays for layoff benefits to which federal employees are legally entitled. Because of such entitlements, layoffs cost a good deal more than shrinking the workforce by attrition.

This study analyzes costs associated with laying off federal employees in the Executive Branch. (Because of data limitations, the paper does not address the budgetary impact of employment ceilings on voluntary retirements, overtime, service contracts, and administrative/legal activities; nor does it assess the budgetary effects of program changes.) The remainder of this section describes how federal employment controls operate and gives an overview of past and current efforts to control the size of the federal workforce. The next section describes the Administration's employment reduction plan, the costs of federal layoffs, and possible budgetary effects. The third section identifies contracting out as a major source of federal employment reductions in future years.

HOW EMPLOYMENT CONTROLS OPERATE

Throughout the last two decades, federal civilian employment has been controlled on an agency-by-agency basis through personnel ceilings established by the Office of Management and Budget (OMB). The ceilings are customarily developed in the preparation of budget estimates, and they reflect decisions about program levels and resource allocations. Agencies may request adjustments in their ceilings throughout the year, or revisions may be initiated by OMB. For the most part, agencies have wide discretion in setting internal ceilings, within the overall allocations, for various programs and component organizational units.

Traditionally, employment ceilings have specified the number of employees who can be on an agency's payroll as of a particular date, usually the end of a fiscal year. There are usually two ceilings for each agency: one for its total workforce and another specifically for its full-time permanent staff--mainly career employees appointed for regular work on a 40-hour week. When end-of-year ceilings apply to total employment, agencies can conform to them by freezing vacancies or by reducing part-time, temporary, or intermittent employment near the date of compliance. When controls are limited to full-time permanent staff, on the other hand, the number of part-time and other nonpermanent employees may increase. The General Accounting Office (GAO) has repeatedly criticized the use of end-of-year ceilings as ineffective and as an inferior substitute for effective management. 3/

3/ General Accounting Office, Personnel Ceilings--A Barrier to Effective Manpower Management (June 2, 1977), and Federal Workforce Planning: Time For Renewed Emphasis (December 30, 1980).

The OMB hopes to improve federal personnel management through a revised system that translates part-time and intermittent employment into the equivalent of full-time workyears. The new system bases agency personnel ceilings on scheduled work hours, using a measure called "full-time equivalent" (FTE) employment. This approach, in effect, averages employment levels throughout the year and provides a common denominator for monitoring and comparing employment under full-time permanent and other work schedules. Measuring FTE employment leaves less room for end-of-year manipulations and serves as a more useful means of evaluating the workforce in the course of programmatic and budgetary decision-making.

The new system for controlling employment is expected to become fully operational throughout the Executive Branch for fiscal year 1982, but it applies to eight major agencies in fiscal year 1981. These eight include the departments of Agriculture; Education; Health and Human Services; Housing and Urban Development; and Treasury; the Environmental Protection Agency; the General Services Administration; and the Veterans Administration.

Agency personnel ceilings based on FTE employment introduce time as a new factor in controlling the size of the workforce. As cutbacks are delayed, more positions may be affected. For example, reducing an agency's workforce by one FTE unit would require the loss of one job if effected at the beginning of the year, but it would cost four jobs if the cut were not taken until the beginning of the last quarter. In addition, reductions in part-time or intermittent jobs will only reflect their respective contribution to the agency's total workyears. For example, considering part-time employees who work a 20-hour week, the agency would need to cut two positions for 12 months to reduce its rolls by the equivalent of one workyear.

Information on federal workyears is subject to several limitations, including lack of detailed historical data, possible inconsistencies among various governmental reports, and technical changes in the definition of full-time permanent work. In addition, most agencies are now in the process of developing systems for monitoring FTE employment, and thus, reporting problems are to be expected during the first few years.

Employment Ceilings and Contracting Out

Under policies of the current and past Administrations, agencies are not supposed to contract for services solely to circumvent personnel ceilings. Agency decisions to perform work--similar to commercial and industrial types of activities in the private sector--either in-house by federal employees or outside under contract must be based on an objective determination of the most cost-effective method. Changes to perform more work in-house or more under contract may be accompanied by administrative adjustments in agency personnel ceilings either in connection with OMB's budget review process or at other times throughout the year.

There is no present basis for estimating the extent to which current personnel ceilings might cause an increase in contracting out. (Reporting lags and lack of data on reasons for purchasing services now impede drawing any firm conclusions.) The GAO contends that, in practice, many agencies have used contracting-out as a means to by-pass personnel ceilings, though not necessarily because contracting was determined to be more economical. GAO has found that many services supporting federal programs could be performed by government contractors and, conversely, that some agencies currently contract out for work that should be done in-house, because it involves basic management decisions. 4/ GAO is examining the volume of services the government purchases under contract as well as agencies' compliance with present reporting requirements. The last section of this paper describes in greater detail the future prospects of contracting out as a means of reducing federal employment.

PAST AND PRESENT EFFORTS TO REDUCE FEDERAL EMPLOYMENT—AN OVERVIEW

The present Administration's employment control plans would change the composition of the federal civilian workforce more than its total size. Contrary to a widespread misconception, total federal civilian employment has remained relatively stable over the past decade. Throughout this period, reductions in civilian employment in Department of Defense (DOD) programs have offset increases of about 230,000 workyears in nondefense agencies.

4/ General Accounting Office, Civil Servants and Contract Employees: Who Should Do What for the Federal Government? (June 19, 1981).

Consistent with its general priorities, the present Administration has slated DOD for a sizable manpower increase and the nondefense agencies for concommitant decreases. Thus, the size of the federal civilian workforce will remain roughly constant, but a greater portion will be employed by DOD--thus reversing past trends. Relative to fiscal year 1980, the civilian workforce for nondefense agencies will decline by 3.4 percent through September 30, 1982, but the civilian workforce for DOD will increase by 1.5 percent. Because of these changes the proportion of the total civilian workforce employed by DOD will increase slightly during the two-year period (see Table 1).

TABLE 1. PROJECTED FEDERAL CIVILIAN WORKFORCE: IN FISCAL YEARS 1980-1982, FULL-TIME EQUIVALENT EMPLOYMENT IN THOUSANDS

	1980 Actual	Administration Budget: 1981 Estimate	Administration Budget: 1982 Estimate	1980-1982 Change: In Numbers	1980-1982 Change: In Percents
Department of Defense (military functions)	924	929	938	14	1.5
Nondefense Agencies	1,204	1,191	1,163	-41	-3.4
Total	2,128	2,120	2,101	-27	-1.3
DOD as percent of total	43.4	43.8	44.6	NA	NA

SOURCE: Derived by the Congressional Budget Office from budget materials prepared by the Office of Management Budget; see Appendix A. Details may not add to totals because of rounding.

NOTE: Minus figure denotes a decrease.

SECTION II. THE ADMINISTRATION'S EMPLOYMENT REDUCTION PROGRAM

More than four-fifths of the Administration's proposed workforce reductions in nondefense agencies are targeted for full-time permanent employees (see Table 2). More important, the aggregate reductions are numerically equivalent to stopping growth in the workforce for nondefense agencies. Analysis of government-wide employment data shows that the combined reduction of 79,000 workyears for fiscal years 1981 and 1982 equates to elimination of workyears that otherwise would have been added over a straight line projection of the December 31, 1980 level for the remainder of this and the next fiscal year. Within the government-wide totals, however, the employment reductions in particular agency programs include personnel cutbacks below the December 1980 level.

POSSIBLE LAYOFFS

Contrary to initial expectations, the cutbacks are leading to noticeable numbers of layoffs. Many layoff notices have already been issued, and more are expected in the months ahead. The total numbers of layoffs are very difficult to estimate. The number and particular people affected will depend, in large part, on agency decisions concerning how to comply with their employment ceilings and on Congressional decisions concerning the allocation of resources among programs and subsidiary agency organizations. According to data collected by the Federal Government Service Task Force, employee layoffs could be much more numerous than the

TABLE 2. PROJECTED REDUCTION IN WORKYEARS FOR FEDERAL NONDEFENSE AGENCIES: FISCAL YEARS 1981 AND 1982, IN THOUSANDS

	1981 Projection from December 1980 Level a/	1981		1982		Combined Reductions for 1981 and 1982
		January Budget	Revised Estimates	January Budget	Revised Estimate	
Full-Time Permanent	972 b/	1,015	999	1,024	975	65
Other	167 b/	194	193	201	188	14
Total	1,139	1,209	1,192	1,225	1,163	79

SOURCE: Derived by the Congressional Budget Office from Administration budget materials. See Appendix A.

a/ The Congressional Budget Office estimates 1,139,400 workyears for civilians employed by nondefense agencies in fiscal year 1981, if employment remained at the December 31, 1980 level for the remaining 9 months of the fiscal year. This estimate includes 285,200 workyears for the first quarter and 854,100 workyears projected for the last three quarters, based on a straight line projection from the December 31, 1980 level . The calculations assume that the average employee who is not under a full-time permanent work schedule accounts for 0.7049 of a workyear (based on data for fiscal year 1979).

b/ Estimates include 31,000 workyears for DOD civil functions (27,000 under full-time permanent work schedules and 4,000 under other work schedules).

Administration originally anticipated. 5/ The survey, which bases its findings on information from agency responses to survey questions and on follow-up interviews with Task Force staff, found that as many as 15,550 full-time permanent employees may be laid off by December 31, 1981.

On an annual basis, the projected layoffs represent nearly a quarter of the proposed cutback in full-time permanent workyears for fiscal years 1981 and 1982. The survey data do not specify how many of the layoffs are associated with employment reductions for each fiscal year, but most will occur during the remaining three months of fiscal year 1981. (A substantial number of additional layoffs are expected during the balance of fiscal year 1982 and beyond.) The Task Force projects that a little under half of the layoffs will occur in the Department of Health and Human Services (HHS) and almost a quarter in the departments of Commerce, Interior, and Transportation (see Table 3). A large majority of the HHS layoffs will result from closing most of the 37 hospitals and clinics now run by the Public Health Service. 6/

5/ The Federal Government Service Task Force, which began operation in January 1981 under the chairmanship of Representative Michael D. Barnes (D.-Md.), serves as a bipartisan Congressional clearing house for information on issues affecting federal civilian employees (nondefense) and anuitants. Task Force membership, subject to periodic change, currently consists of Senator Paul Sarbanes (D.-Md.), Senator John W. Warner (R.-Va.), and 32 members of the House of Representatives.

6/ It should be kept in mind that this staff working paper focuses on the compensation costs of laying off federal employees and does not address larger issues concerning the budgetary costs and benefits of program changes.

TABLE 3. LAYOFFS PROJECTED BY THE GOVERNMENT SERVICE TASK FORCE, BY AGENCY: DECEMBER 31, 1980

Agency	Number of Layoffs
Department of Health and Human Services	7,000
Department of Interior	1,350
Department of Transportation	1,200
Department of Commerce	1,100
Community Services Administration	950
Department of Energy	750
Department of Housing and Urban Development	550
Department of Justice	450
Department of the Treasury	450
Department of Labor	350
Others Combined a/	1,400
Total	15,550

SOURCE: Derived from Government Service Task Force Survey data released by Congressman Michael D. Barnes, May 28, 1981, and updated through July 1, 1981.

NOTE: The total projected layoffs, rounded to the nearest 50 excludes 350 layoffs of temporary employees recorded for the Department of Education. Thus, the remaining layoffs are believed to consist almost entirely of employees working full-time permanent schedules.

a/ Includes agencies with fewer than 350 layoffs.

By the end of December, the actual number of layoffs could be below or above the current Task Force estimates. In some cases, the number might decline, because the Administration could revise personnel ceilings for individual agencies, or because more reductions might be achieved through attrition. In other cases, the number of layoffs could increase because of problems not reported by some agencies responding to the Task Force survey.

POSSIBLE OUTLAYS FOR GOVERNMENT-WIDE LAYOFFS

This section describes the entitlement benefits and related outlays for federal workers who are laid off and offers an estimate of the potential budgetary impact. The conclusions are based on the number of layoffs reported to the Federal Government Service Task Force (discussed above).

Entitlement Layoff Benefits

When employment reductions cause layoffs, savings can be significantly reduced or eliminated in the short run by substantial one-time costs associated with entitlements for severance pay, federal unemployment compensation, lump-sum payments for employee retirement contributions and unused leave, and pensions for involuntary retirement. A brief description of these entitlements follows. 7/

7/ The benefits available to laid-off federal workers and related eligibility provisions are described in more detail in Fed Facts 22, prepared by the Office of Personnel Management and in the Federal Employees Almanac 1981, 28th annual edition, Joseph Young, editor.

Severance Pay. Generally, federal workers who are laid off after being employed for at least one year may receive severance pay. The number of years employed determines the severance period covered: one week's pay at the employee's final salary for each of the first 10 years of service, and two week's final pay for each year of the next 21 years of service. If, for example, a federal employee with 10 years of service and final salary of $22,000 were laid off, the 10 weeks' severance pay would come to about $4,230. In addition, severance payments are increased by 10 percent for each year the employee is over age 40. The maximum payment may not exceed one full year's salary, however. The payments are disbursed by the employing agency every two weeks as though the person were still on the active payroll. 8/

Unemployment Compensation. Unemployment insurance benefits are available to federal employees who are laid off, but they vary according to the geographic location of the work site. The unemployment program is administered by state agencies based on their own standards for determining eligibility, the size of payments, and length of time benefits may be received. Below certain dollar maximum levels, payments usually vary according to earnings; maximum weekly benefits currently range from $84 to $184. State

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8/ Except for unemployment compensation, severance pay and other cash benefits received by laid-off workers are subject to federal and other income taxes (the retirement contributions having been taxed at the time they were withheld from employee pay). Unemployment compensation is taxable only when taxable income from all sources exceeds $25,000 (married filing a joint return).

agencies are reimbursed for federal unemployment compensation costs out of funds appropriated to the U.S. Department of Labor.

Payments for Unused Vacation. Federal employees who are laid off receive payment in lieu of earned "annual leave" (vacation) time that has not been used. For example, a federal employee with an annual salary of $22,000 and three weeks of unused earned leave would receive a lump-sum payment of some $1,270. Such payments are normally disbursed by the employing federal agency and are drawn from its operating budget.

Refunds for Employee Retirement Contributions. Most federal civilian employees are required to contribute 7 percent of their gross salaries to the Civil Service Retirement (CSR) system. Any employee leaving government service, including one who is laid off, may receive a refund of his accumulated contributions to the CSR system. Employees with five or more years of federal service may leave their contribution with the federal government and thus retain their right to a CSR pension upon reaching age 62. Contribution refunds are administered by the Office of Personnel Management (OPM), and the cost impact on CSR trust fund outlays can be substantial. For example, an employee with a salary of $22,000 and 10 years' service, could receive a refund, without interest, of some $11,700 for retirement contributions made while employed. 9/

9/ CSR refunds can include interest, depending on length and period of federal service. Interest may be paid if the laid-off employee had at least one but less than five years of service or, for contributions made prior to 1957, if the employee had five or more years of service.

Involuntary Retirement. Federal employees who are forced to leave the government for reasons other than misconduct or delinquency may receive an immediate pension, though they forfeit other layoff benefits, provided they meet certain requirements. The present eligibility requirements are a total of 20 years of service, whether consecutive or interrupted, at age 50 and over, or simply 25 years of service, whether consecutive or broken, at any age. At present, involuntary retirements may be granted if a person's job is abolished or transferred to a location outside the current commuting area. 10/

As under voluntary retirement, the size of an involuntary retirement pension is based on salary and length of service, but it is reduced by 2 percent for each year the retiring employee is under age 55. For example, an employee involuntarily retired at age 50 with 20 years of service would receive a pension equal to 32.6 percent of his average salary for the three years at his highest earnings. As with voluntary retirement, the pensions would be further reduced if the ex-employee elected survivor coverage for a spouse or other dependent. The retirement benefits are administered by OPM and the costs are paid from the CSR trust fund.

10/ The Office of Personnel Management may grant benefits similar to those for involuntary retirement to employees who elect to retire when their agency is undergoing a reorganization, transfer of functions, or reduction in employment. OPM has recently tightened the requirements for such voluntary early retirement. This authority does not apply to laid-off employees and the associated costs are not addressed in this paper.

Budgetary Impacts

If the actual number of layoffs should come close to the 15,550 suggested by the Task Force survey, outlays for related entitlements in the first 12 months could reach $0.34 billion. More than half of this amount would cover lump-sum refunds of employee contributions to the CSR trust fund (see Table 4).

The outlay estimates in this paper are limited to layoff entitlements. Employment reductions, however, also generate other federal expenses that cannot be readily estimated. Such expenses, albeit in unknown amounts, include increased workload in personnel administration and appeal processes, relocation, training replacements for persons who elected to retire voluntarily, and job placement and counseling programs run by the employing agencies, the Department of Labor, and OPM. 11/ When employment reductions occur, they may also be accompanied by increased numbers of voluntary retirements because of encouragement by supervisors, solidarity with employees who might otherwise be laid off, reexamination of personnel circumstances, or early eligibility granted by OPM (see note on page 15). As previously noted, the impact of current employment reductions on voluntary retirement cannot be determined.

11/ The staff of the Federal Government Service Task Force further note that some layoffs may increase federal costs for Social Security, Medicaid, and other federal entitlements as well as increase costs of various public programs run by state and local governments.

TABLE 4. OUTLAYS FOR LAYOFF BENEFITS PROJECTED BY FEDERAL GOVERNMENT SERVICE TASK FORCE: FIRST TWELVE MONTHS, IN MILLIONS OF DOLLARS

Benefit	Source of Funding	Costs	Percent of Total Layoff Costs
Severance Pay a/	Employing Agency	85	25
Unemployment Compensation b/	State Agencies Reimbursed by U.S. Department of Labor	20	6
Refunds for Unused Annual Leave c/	Employing Agency	20	6
Refunds for Retirement Contributions d/	Civil Service Retirement Trust Fund	200	59
Pensions for Involuntary Retirement e/	Civil Service Retirement Trust Fund	15	4
Total Cost		340	100

SOURCE: Congressional Budget Office.

NOTE: Estimates, rounded to the nearest $5 million, reflect fiscal year 1981 prices.

a/ Estimate assumes 14,000 of the laid-off employees would receive average payments of $6,160.

b/ Estimate assumes some 12,900 of the laid-off employees would receive benefits averaging $102 per week for an average of 15.9 weeks.

c/ Estimate assumes 15,550 laid-off employees would receive average refunds of $1,400.

d/ Estimate assumes 14,000 of the laid-off employees would receive average refunds of $14,190.

e/ Estimate assumes 1,550 of the laid-off employees would receive involuntary retirement pensions averaging $8,400 each.

Any estimate of the budgetary impact of layoff entitlements that will result from the Administration's budget reduction program is subject to great uncertainty. No single information source exists to determine the number of employees affected or when the layoffs will occur. Equally important, information is not readily available on the salaries, ages, and years of service of employees who may be laid off. Without solid information on either the numbers or characteristics of affected workers, layoff cost estimates are highly subjective. The estimates in this study are based on a set of "average" characteristics constructed to reflect the employees of major agencies and weighted to reflect the relative number of projected layoffs for each agency. The government-wide composite assumes the laid-off employee is age 37, worked some 11 years for the federal government, has three weeks of unused leave, and an annual salary of about $24,000. These assumptions may be conservative; some analysts believe most laid-off employees have higher salaries and more years of federal service.

The cost of entitlements for laid-off federal workers might be viewed as a necessary price for cutting back federal employment government-wide and achieving the associated long-run savings. In many agencies, workforce reductions are apparently being achieved using layoffs as a last resort and as an exception to general practice. Nonetheless, the $0.34 billion in benefit expenses for layoffs noticeably reduces the Administration's initial government-wide savings estimates of $0.4 billion in fiscal year 1981 and $1.6 billion in 1982. Even with layoffs, however, most of the savings would continue to be realized in subsequent years, because most of the entitlements are essentially one-time costs.

Budget Control

Almost a third of the total cost of entitlements for laid-off federal workers may be distributed among the accounts of individual employing agencies. Thus, costs of refunds for unused leave and severance pay may well be covered by appropriated funds. Such cost absorption would, of course, reduce resources that otherwise would have been available for other agency activities. In some instances, for smaller agencies in particular, requests for supplemental funds might later be transmitted to the Congress.

Costs for unemployment compensation, pensions for involuntary retirement, and refunds of employees' retirement contributions—representing the remaining portion of estimated entitlements—are funded in two central accounts: the CSR Trust Fund, administered by OPM; and the Federal Unemployment Benefits and Allowances account, administered by the Department of Labor.

SECTION III. CONTRACTING OUT--A MAJOR PROSPECT FOR REDUCING FEDERAL EMPLOYMENT

In 1983 and subsequent fiscal years, large reductions in federal employment may also result from agencies' deciding that it is more economical to have certain activities performed by private contractors than by workers hired directly onto the federal roles. This rationale for cutting back federal civilian employment would contrast with current reduction efforts, which largely reflect reduced program levels and federal responsibilities.

Contracting out to reduce costs is a common practice in private industry. Similarly, the Administration believes that in many cases, certain federal activities of a commercial and industrial nature might be performed at less cost by private contractors because of more efficient operations, lower overhead, and lower pay and outlays for fringe benefits. Reviews by GAO and OMB indicate that the potential for cost savings through contracting out federal work could be more actively pursued by many agencies. Future reductions in the size of the federal workforce caused by increased use of private contractors could rival the employment reductions currently planned for fiscal year 1982. Initial savings from shifts to contracting out, however, would diminish if the associated federal personnel reductions were achieved by laying off employees rather than relying mainly on attrition.

Some observers, including organizations representing public employees, express skepticism about claims that contracting out federal work brings about legitimate economies. In their view, some private contractors might initially offer low bids to obtain government work and then try to increase prices at the time of contract renewal. In other situations, contractors might provide their employees with inferior pay, retirement, and other fringe benefits. It should be pointed out that the Administration's three-year plan to reduce federal compensation (pay and fringe benefits combined) below levels for comparable work in the private sector could lower compensation differentials that may exist between contract and federal employees and likewise the potential savings available to the government from shifts to contract work.

Under current law, agency mode-of-performance decisions (in-house versus contracting out) are subject to policies and procedures set forth in the revised OMB Circular A-76. In order to emphasize relative cost as a major criterion for future contracting-out decisions, bids from potential contractors must be compared against the estimated cost of in-house performance. Agencies will be required to compare in-house and contractor costs according to detailed and comprehensive guidelines, which include federal cost factors such as: fringe benefits and paid time off, specified at 44 percent of wages and salaries; a 10 percent capital investment cost; and depreciation. The guidelines also require contractor costs to be reduced by estimated federal income taxes.

The revised OMB regulation will be fully implemented after an initial three-year review cycle, scheduled to end in March 1982. Full implementation could noticeably shift more work to government contractors and would thus reduce future federal employment levels. The aggregate effect cannot be projected because of the comprehensive nature of the new guidelines and the large volume of individual federal activities that are subject to review for contracting out. Even so, considerable potential exists for reducing the cost of particular government operations through expanded use of government contracts. OMB believes full implementation of Circular A-76 could generate average annual savings of as much as $0.6 billion, assuming contract costs would average 20 percent less than in-house costs. 12/

The prospect of achieving savings from further contracting out is illustrated by activities OMB has identified in four agencies: the departments of Defense and Health and Human Services, the General Services Administration, and the Veterans Administration. The identified areas--affecting an estimated 95,800 federal workers--include custodial and maintenance services, food preparation, commissary and supply operations, and other commercial and industrial sorts of activities (See Table 5). If, hypothetically,

12/ Office of Management and Budget staff, memorandum to Edwin Harper, Deputy Director of the Office of Management and Budget, February 27, 1981, used by GAO, Civil Servants and Contract Employees, p. 16.

cost comparisons resulted in half of the work performed by these employees shifting to service contracts, then annual full-year outlay savings in fiscal year 1983 prices could exceed $90 million and might reach $185 million. 13/ OMB has asked these four agencies to give special attention to review of the specified activities and to complete cost studies by March 1982.

TABLE 5. EMPLOYMENT IN AREAS IDENTIFIED BY THE OFFICE OF MANAGEMENT AND BUDGET FOR EXAMINATION OF CONTRACTING OUT ECONOMIES

Department or Agency	Building Maintenance and Custodial Services	Food Preparation	Supply and Commissary	Other a/	Total
Defense	15,000	—	33,000	4,000	52,000
Health and Human Services	900	—	—	7,100	8,000
General Services Administration	9,000	—	—	4,000	13,000
Veterans Administration	11,900	10,900	—	—	22,800
Total	36,800	10,900	33,000	15,100	95,800

SOURCE: Letters from Edwin L. Harper, Deputy Director, Office of Management and Budget, April 8, 1981.

a/ Includes delivery, guard, data processing, and audio-visual services.

13/ The hypothetical savings estimates assume current compensation for the 47,900 affected positions would average $19,300 in fiscal year 1983, and that 10 to 20 percent of this cost might be saved through contracting out.

Areas not specifically identified by OMB may also offer potential savings from contracting out. Decisions to change the mode of performance in these areas could affect budgetary requests for fiscal year 1983 and could lead to further reductions in federal civilian employment.

APPENDIX. SUMMARY DATA ON FEDERAL CIVILIAN WORKFORCE

The following table compares federal civilian employment by fiscal year, by budget plan, and by type of agency (defense and nondefense). The estimates measure the workforce on the basis of FTE employment (workyears), including employees under full-time permanent work schedules.

TABLE A-1. SUMMARY DATA ON FEDERAL CIVILIAN WORKFORCE: IN THOUSANDS OF FTE WORKYEARS, FISCAL YEARS 1980-1982

	1980 Actual	1981 Estimate January Budget	1981 Estimate Revised Budget	1982 Estimate January Budget	1982 Estimate Revised Budget
	(Full-time Permanent Employment) a/				
Defense b/	880	865	870	865	879
Nondefense c/	1,002	1,015	999	1,024	975
Total	1,882	1,880	1,868	1,889	1,854
	(Total Employment) d/				
Defense b/	924	924	929 e/	916	938 e/
Nondefense c/	1,204	1,209	1,192	1,225	1,163
Total	2,128	2,133	2,120	2,141	2,101

SOURCE: Derived by the Congressional Budget Office from data supplied by the Office of Management and Budget.

NOTES: For comparative purposes, the estimates do not reflect the impact of technical changes caused by conversion to the FTE system of monitoring federal employment. OMB indicates a decrease of about 25,000 will occur for the DOD, military functions. Details may not add to totals because of rounding.

a/ Derived from Fiscal Year 1982 Budget Revisions, March 1981, Table 26, p. 133.

b/ Estimates limited to Department of Defense military functions; employment for civil functions are included under nondefense.

c/ Represents the difference between employment for DOD military functions and total employment in the Executive Branch, excluding the U.S. Postal Service.

d/ Includes employment not covered by full-time permanent work schedules. Data derived from Special Analysis, Budget of the U.S. Government, Fiscal Year 1982, January 15, 1981 p. 278; Fiscal Year 1982 Budget Revisions, Additional Details on Budget Savings, April 1981, p. 391; and supplemental data provided by OMB staff.

e/ Derived from Listing of Employment of Executive Branch, Office of Management and Budget, March 26, 1981, p. 1.