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FEDERAL EMPLOYMENT

Impact of the President's Budget on Federal Employees

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IMPACT OF THE PRESIDENT'S
BUDGET ON FEDERAL EMPLOYEES

Summary of Statement by
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In large part, the proposals in the President's budget affecting federal employees represent efforts to address the challenges created by the deficit problem. The proposal to limit the 1995 pay raise to 1.6 percent is a further short-term compromise of the reforms enacted in the Federal Employees Pay Comparability Act of 1990 to make federal employees' pay once again competitive with nonfederal pay. Given the challenges facing the government to resolve the deficit problem, federal employees may again have to make sacrifices like the proposed pay limitation. But, significant challenges exist as well in recruiting and retaining quality employees. GAO continues to believe that serious attention should be paid to restoring pay comparability as soon as possible.

GAO supports efforts to move to a smaller, more efficient government wherever possible. However, any staff reductions must be based on well-considered strategic and workforce planning, and good communications, to ensure that critical skills are not lost and surviving employees remain productive. GAO's ongoing work to examine downsizing strategies in the nonfederal sector emphasizes the importance of these points.

The budget's proposal to charge agencies the full government share of accruing costs of the Civil Service Retirement System does not affect the deficit, but is an important step toward the objective of identifying the full costs of government programs. According to OPM projections, the retirement fund will continue to grow and have enough assets to cover retirement benefit payments in the future under the current financing arrangements. The proposed higher agency contributions might cause the financing arrangements to be changed, but they do not appear to be needed to enable the retirement system to honor its commitments to employees and retirees. Rather, the objective is to ensure that accruing costs are properly recognized and charged to agency programs.

Madam Chair and Members of the Subcommittee:

We are pleased to be here this morning to assist the Subcommittee in its consideration of the President's budget proposals affecting federal employees. Specifically, these proposals are to limit the 1995 pay increase, reduce federal employment levels, and charge federal agencies the government's full share of the accruing costs of the Civil Service Retirement System.

LIMITATION OF FEDERAL PAY INCREASE

The President proposes to limit the 1995 pay raise to 1.6 percent. This would further delay full implementation of the 1990 federal pay reform law.[1]

Although the exact amount has not yet been determined, full implementation of the pay reform law would result in a substantially larger federal pay increase in 1995. The national pay increase, based on the Employment Cost Index (ECI), would be 2.6 percent. Added to that would be various locality pay adjustments which in 1994 averaged just under 4 percent. Assuming the remaining pay gaps stayed constant, the average 1995 locality adjustments would be around 2 percent and, combined with the ECI pay adjustment, yield a total average pay increase of about 4.6 percent.

We appreciate the importance of reducing the budget deficit and realigning spending and taxing priorities to meet urgent social and economic needs. At the same time, we remain very concerned about the government's need to attract and retain employees of the highest caliber. Indeed, a recent survey we made of new college graduates and placement officials showed that federal employment is still too often not the career choice of the best and brightest. Substandard pay continues to be cited as a major reason most new graduates do not see the government as a desirable career choice.

Given the challenges facing the government to resolve the deficit problem, federal employees may again have to make sacrifices like the proposed pay limitation. But, significant challenges exist in recruiting and retaining quality employees, and we hope that serious attention can be paid to restoring pay comparability as soon as possible.

FEDERAL PERSONNEL REDUCTIONS

The budget proposes to reduce the number of federal personnel by 118,000 through the end of 1995 and by an additional 134,000 through 1999, for a total reduction of 252,000.

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[1]Federal Employees Pay Comparability Act of 1990 (Public Law 101-509, Nov. 5, 1990).

These proposed reductions are based on the conclusion by the National Performance Review (NPR) that the various "reinventions" of government operations it proposed could result in a 12 percent reduction in the number of federal workers, or 252,000 positions.

The NPR report did not specify how it derived its estimate of the number of excess employees or how the determination was made that agencies had more employees than they need to effectively accomplish their missions. However, the report expressed the view that employment reductions could be achieved by taking steps to encourage federal employees to become managers of their own work. The report maintained that cuts in the number of supervisory personnel were possible by "reducing the power of headquarters vis-a-vis field operations", freeing agencies from over-regulation, and eliminating "systems control" staff. The NPR called for agency heads to set goals for increasing the span of control for every federal manager as part of an overall federal government objective of doubling the managerial span of control in coming years.

We support efforts to move to a smaller, more efficient government wherever possible. However, any staff reductions must be made in a strategic, well-thought out manner. Equal, across-the-board reductions for all agencies and functions should be avoided. Such an approach does not distinguish between efficient and wasteful activities and can seriously diminish agencies' capabilities to manage their resources and deliver services to the public.

Workforce restructuring and downsizing efforts have been fairly common among large nonfederal employers in recent years. To better understand the approaches and techniques these employers used, we are visiting some of them and seeing if lessons can be learned from their experiences. This work is not complete, but some themes are emerging thus far that we believe are relevant to the federal situation.

For the most part, the private employers we visited did not start with reduction targets in mind or even the assumption that employee headcounts had to be reduced. Rather, they often examined the worth and contributions of functional units and targeted reductions to those units found to contribute least to corporate efficiency. For example, one company used what it called a "3Rs strategy"--(1) rethink, (2) reshape, and (3) resize. Under this strategy, the company assigned values to its various groups and categorized them into core and noncore units. It then focused its reduction efforts on the noncore units. Another company asked the managers of all departments to examine their work processes and identify opportunities for reducing headcounts and expenses. The company also sought to increase its managers' span of control through targeted examinations of all cases in which managers supervised three or fewer employees.

This examination resulted in a number of managers being demoted, reassigned, or separated, and when completed, caused the average managerial span of control to increase from an average of four employees for each manager to an average of six employees for each manager.

We believe it is important to recognize that there are many legitimate factors that determine what an appropriate level of supervision should be for an organization or function. Our work in the private sector suggests that detailed examinations are generally used in making decisions on appropriate staffing levels. The private companies' experiences confirm our long-held position that sound workforce planning must be an integral part of decisionmaking on staffing levels in the government.

PROPER ACCOUNTING FOR RETIREMENT COSTS

The budget proposes to charge agencies the full government share of accruing costs of the Civil Service Retirement System. We support the objective of this change.

The proposal is consistent with a long-standing recommendation we first made back in the 1970s. In reports on retirement system funding practices, we pointed out that the real cost of providing retirement benefits to federal employees was not being recognized.[2] At the time, the Military Retirement System was funded entirely on a "pay-as-you-go" basis, with no recognition or funding of the costs of future benefits being accrued by active military personnel. Some of the accruing costs of the Civil Service Retirement System--the largest retirement program for civilian employees--were being recognized and funded, but a significant portion of the system's costs was ignored in the actuarial valuations. We recommended that all the government's retirement systems adopt actuarial valuation methods and funding provisions that reflected the full cost of accruing retirement benefits and charge to agency operations all costs not covered by employee contributions.

The requirement to fully fund accruing retirement costs was subsequently adopted for the military system and the Federal Employees Retirement System (FERS) that covers most civilian employees first hired after December 31, 1983. However, it was not adopted for the civil service system that continues to cover employees hired before January 1, 1984. As we understand it, the budget proposal is intended to correct that oversight.

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[2]See, for example, Need for Overall Policy and Coordinated Management of Federal Retirement Systems, FPCD-78-49, December 29, 1978.

In general, employees covered by the civil service system and their employing agencies are each required by law to contribute 7 percent of pay to the retirement fund.[3] However, these contributions do not cover the accruing costs of the system. According to the latest actuarial valuation, the system may cost twice as much as employees and agencies are now contributing.

This disparity occurs because employee and agency contribution amounts do not reflect the cost of two expensive features of the retirement system. Each time employees receive pay increases, the retirement benefits they will eventually receive also increase since benefit amounts are related to salary levels. Once retired, employees receive cost-of-living adjustments based on increases in the Consumer Price Index. The retirement costs created by employee pay raises and retiree cost-of-living adjustments are not covered by employee and agency contributions.

Under the statutory financing arrangements for the civil service system, the added retirement liabilities created by employee pay raises are amortized in 30-year installments. For the most part, these costs are included in amounts appropriated annually to the Office of Personnel Management (OPM) for deposit into the retirement fund. Other agencies' budgets are not charged for any portion of these amortization payments. A major exception to this is the legal requirement that the U.S. Postal Service fund the retirement liabilities created by pay increases it negotiates with its employees by making amortization payments direct to the retirement fund. Similarly, the law requires the Postal Service to amortize the liabilities created by its retirees' cost-of-living adjustments. However, amortization payments are not required to fund the added liabilities created by cost-of-living adjustments for nonpostal retirees. These adjustments add dollar-for-dollar to the retirement system's unfunded liability.

The current lack of full recognition of accruing civil service retirement costs in agency budgets results in the understatement of the cost of government programs. Sound decisionmaking on whether and to what extent the various programs should be authorized or continued is inhibited if the true costs are not known. Providing employee retirement is clearly part of the cost of agency operations and should be fully reflected in agency budgets.

The budget proposal gives no details on how the change to full retirement cost recognition would be made. There are a number of

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[3]Higher contributions are required for some covered employees. Members of Congress contribute 8 percent of pay, and congressional employees and certain law enforcement and firefighter personnel contribute 7.5 percent of pay. The employing organizations match the employee contributions.

ways it could be done. When the necessary legislation to implement the change is proposed, the specifics can be evaluated at that time. We would be pleased to make such an evaluation if you desire.

It is important to note that, as the budget acknowledges, increasing agency civil service retirement contributions will not change the budget deficit. Also, according to OPM projections, the statutory financing arrangements for the civil service and FERS systems are sufficient to enable the retirement fund to continue to grow and have enough assets to cover retirement benefit payments in the future. Therefore, although the proposed higher agency contributions for the civil service system might change the current financing arrangements, the increased contributions do not appear to be needed to enable the retirement system to honor its commitments to employees and retirees. Rather, the objective is to ensure that accruing costs are properly recognized and charged to agency operations.

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This concludes my prepared statement. I will be pleased to answer any questions you or the Members of the Subcommittee may have.

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