FEDERAL-POSTAL COALITION

STATEMENT BY
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ON BEHALF OF THE MEMBER ORGANIZATIONS OF THE FEDERAL-POSTAL COALITION:

American Federation of Government Employees (AFGE)
American Federation of State, County and Municipal Employees (AFSCME)
American Foreign Service Association (AFSA)
American Postal Workers Union (APWU)
FAA Managers Association (FAAMA)
Federally Employed Women (FEW)
Federal Managers Association (FMA)
International Association of Fire Fighters (IAFF)
International Association of Machinists and Aerospace Workers
International Federation of Professional and Technical Engineers (IFPTE)
Laborers' International Union of North America (LIUNA)
National Active and Retired Federal Employees Association (NARFE)
National Air Traffic Controllers Association (NATCA)
National Association of Assistant United States Attorneys
National Association of Government Employees (NAGE)
National Association of Letter Carriers (NALC)
National Association of Postal Supervisors (NAPS)
National Association of Postmasters of the U.S. (NAPUS)
National Council of Social Security Management Associations (NCSSMA)
National Federation of Federal Employees (NFFE)
National League of Postmasters
National Postal Mail Handlers Union (NPMHU)
National Rural Letter Carriers Association (NRLCA)
National Treasury Employees Union (NTEU)
Organization of Professional Employees of the U.S. Department of Agriculture (OPEDA)
Professional Aviation Safety Specialists (PASS)
Professional Managers Association (PMA)
Senior Executives Association (SEA)

BEFORE THE SUBCOMMITTEE ON THE FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY, COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM, UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON FEDERAL EMPLOYEES' RETIREMENT SECURITY

JANUARY 25, 2012

Chairman Ross, Ranking Member Lynch and Members of the Subcommittee, thank you for inviting me to testify on behalf of the nearly five million federal and postal workers and annuitants represented by the national member organizations of the Federal-Postal Coalition. I appreciate the opportunity to discuss the retirement income security the federal government provides to those who dedicate their careers to public service.

The individuals we represent perform a diverse array of important jobs, from providing medical care for our veterans and delivering our mail to producing the intelligence needed to thwart terrorism and keep our airways safe. They did not enter public service to become rich, but they do face the same economic challenges as everyone else, including the need to prepare for retirement. Although they are paid, on average, 26 percent less than their private-sector counterparts according to impartial, nonpartisan experts,[1] a fair, but modest, retirement package helps to make up for part of that lower pay by helping to provide reasonable income security in their later years. With a median annuity under the Federal Employees Retirement System (FERS) of $720 per month ($8,640 annually), federal employees are not retiring rich.[2]

Unfortunately, recent legislative proposals have sought to unravel this basic bargain, unfairly singling out middle class federal employees for disproportionate sacrifice. Last month, the House passed legislation (H.R. 3630) that would use cuts to federal retirement compensation of middle class federal and postal workers to pay for a payroll tax *holiday*. It would offset over half of the cost of the holiday ($65 billion over ten years out of a $121 billion cost[3]) on the backs of less than 2 percent of the nation's workforce.[4] This would add financial strain on top of the prospect of job loss through the sequestration process mandated by the debt ceiling agreement and the more than $60 billion that the federal government has already saved by freezing federal employee pay for the past two years, which itself has permanently diminished long-term annuities for recent retirees.

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[1] *Recommendations for Locality Pay in 2013*, Federal Salary Council, p. 2, http://www.opm.gov/oca/fsc/recommendation11.pdf (finding a 26.3 percent gap between comparable private sector jobs and federal jobs).

[2] *Statistical Abstracts for Fiscal Year 2010*, Federal Employee Benefits Programs, Office of Personnel Management, Exhibit R9.

[3] The Congressional Budget Office (CBO) estimates that the bill's changes to federal retirement programs would reduce the deficit by $38.5 billion over ten years, and the reduction in discretionary spending associated with the one-year extension of the two-year federal pay freeze would reduce the deficit by $26.2 billion over ten years. In addition to the $121 billion cost of the payroll tax holiday extension, the bill includes other provisions that increase the budget deficit. *See Letter from the Congressional Budget Office to the Honorable Dave Camp, Chairman, Committee on Ways and Means, House of Representatives*, December 9, 2011, http://www.cbo.gov/ftpdocs/126xx/doc12609/hr3630.pdf.

[4] The Bureau of Labor Statistics estimated that the December 2011 labor force numbered about 154 million people. Employment Situation Summary – December 2011, http://www.bls.gov/news.release/empsit.nr0.htm. There are about 2.0 million non-postal federal employees and 575,000 postal employees. *See* Bureau of Labor Statistics Fact Sheet on Federal Employment, http://www.bls.gov/oco/cg/cgs041.htm; Postal Service Fact Sheet, http://about.usps.com/who-we-are/postal-facts/welcome.htm.

Federal families are no more immune from the challenges that come with tough economic times than any other working American family. They, too, have been experiencing declining home values and diminished savings, rising health insurance costs, escalating tuition for their children's education, spouses who have lost jobs and grown children unable to find jobs after college. Cuts to federal retirement benefits and further pay freezes harm hardworking federal employees and their families, who are struggling with these challenges just like their private sector counterparts.

Apart from the personal toll these cuts take on the dedicated civil servants I am here to represent, these actions undermine the federal government's ability to attract and retain the talent this nation needs to deal with the challenges we all face as a country. Shared sacrifice is fair, but singling out federal employees and retirees for disparate treatment threatens to do permanent harm to a federal civil service critical to meeting the increasingly complex and deeply important tasks of government. At a time when more is being asked of our government, the American public deserves an engaged and efficient workforce; not one Members of Congress paint as the source of our country's problems.

Attacks Based on Misguided Assumptions

The legislative attacks on federal employee retirement compensation seem to derive from: (i) the misguided assumption that most private sector 401(k) retirement plans provide adequate retirement income security – they do not; (ii) the related assumption that federal retirement benefits are overly generous – they are not; and (iii) the questionable opinion that instead of pursuing policies that would improve private sector retirement income security, Congress should pursue policies that diminish federal retirement income security – it should not.

The attacks also seem to derive substantially from the erroneous belief that federal employees are over-compensated compared to their private sector counterparts. The facts support the opposite conclusion. When comparing similar jobs, including levels of skill, experience and education, federal employees are paid less. I will discuss these issues later in my testimony.

What Constitutes Adequate Retirement Income?

Retirement plans are designed to provide income security in retirement to ensure that retirees do not suffer a significant decline in their standard of living. According to the RETIRE Project at Georgia State University, which has been calculating required retirement replacement rates for income for decades, a household with earnings of $50,000 or more needs about 80 percent of pre-retirement earnings to maintain the same level of consumption after retirement.[5] Individuals

[5] *See* Munnell, Alicia, et. al., "How Much to Save For a Secure Retirement," Center for Retirement Research at Boston College, November 2011, Number 11-13, p. 2, available at http://crr.bc.edu/images/stories/Briefs/IB_11-13.pdf (summarizing and citing Palmer, Bruce A. 2008. "2008 GSU/AON RETIRE Project Report." Research Report Series No. 08-01 (Jun). Atlanta, GA: J. Mack Robinson College of Business, Georgia State University, available at http://rmictr.gsu.edu/Papers/RR08-1.pdf).

need less money because: (i) they pay less in taxes because they no longer pay Social Security and Medicare payroll taxes, and they pay lower federal income taxes because – at most – only a portion of their Social Security benefits are taxable; (ii) they are no longer saving for retirement; and (iii) most pay off their mortgage before they retire, or soon thereafter.[6]

Both private sector and public sector retirement plans should strive to meet this goal of adequate retirement income. According to a February 19, 2011, article in *The Wall Street Journal*, the median household headed by a person age 60 to 62 with a 401(k) account had less than one-quarter of what is needed in that account to maintain its pre-retirement standard of living.[7] Clearly, Social Security benefits and 401(k) accounts are not providing the retirement security Americans deserve. Instead of pursuing legislation that eliminates or reduces the defined benefit portion of the federal retirement plan, Congress should explore policy options to encourage better private sector retirement plans and/or greater savings rates across the private sector.

Federal Retirement Benefit Programs – Adequate, Not Overly Generous

Federal retirement programs can provide an adequate, but not overly generous, retirement income. Rather than looking to dismantle the program, Congress should view FERS as a model for private sector reforms.

Civil Service Retirement System (CSRS)

Federal and postal employees who began their service prior to 1984 are covered by the Civil Service Retirement System (CSRS). Employees contribute 7 percent of their pay to the Civil Service Retirement and Disability Fund (CSRDF), from which benefits are paid. CSRS annuities are equal to the average of the highest three consecutive years of pay *multiplied by* years of service *multiplied by* an accrual rate of 1.5 percent for each of the first five years of service, 1.75 percent for the 6^{th} through 10^{th} years of service, and 2 percent for each year of service after the 10^{th}. The annuity is also protected from inflation by periodic cost-of-living adjustments, based on increases in the Consumer Price Index.

CSRS service is not covered by Social Security, and CSRS employees receive no matching contributions to their Thrift Savings Plan (TSP) accounts, though they are entitled to make tax-deferred contributions if they choose to contribute to the TSP. For career employees under CSRS, the annuity is their sole source of retirement income. As a group, these retirees collect a

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[6] Munnell, p. 1.

[7] E.S. Browning, "Retiring Boomers Find 401(k) Plans Fall Short," Wall Street Journal, February 19, 2011, available at: http://online.wsj.com/article/SB10001424052748703959604576152792748707356.html.

mean monthly annuity of $3,191 ($38,292 annually) after an average of 32 years of service.[8] The maximum benefit is limited to 80 percent of the average of the high-three years of salary.

That means that CSRS retirement annuities explicitly are limited to providing no more than what is considered the amount needed to prevent a significant decline in standard of living in retirement. However, that level assumes individuals will pay less in taxes because a significant portion of Social Security benefits are not taxable.[9] While a portion of CSRS annuities are paid tax-free, because taxes were paid on the initial employee contribution, CSRS annuities receive less favorable tax treatment than Social Security benefits.

The disparate treatment does not end there. CSRS retirees who have worked at least 10 years in private sector employment, but fewer than 30 years, see their Social Security benefit reduced by up to $374 per month through the Windfall Elimination Provision (WEP). In order to comport with the progressive nature of the Social Security system, the provision reduces the replacement rate of income on the first $749 of average indexed monthly earnings to prevent middle and higher income earners from obtaining a replacement rate on their Social Security covered earnings similar to that afforded to lower income earners. Unfortunately, the provision goes too far, often unfairly reducing replacement rates for Social Security earnings income below what workers with similar income but not subject to WEP receive.

Furthermore, the Government Pension Offset (GPO) reduces the Social Security spousal benefit that a CSRS retiree would otherwise receive by two-thirds of the retiree's CSRS pension. This offset is intended to approximate Social Security's "dual entitlement rule," through which a spouse's Social Security earnings reduce the spousal benefit. But the GPO goes too far by assuming that two-thirds of a government employees' pension is equivalent to what he or she would have received through Social Security with a similar income. This overestimate causes an unfair reduction in the retirement benefit.

Finally, around one half-million current CSRS covered employees[10] have not benefitted at all from the recent payroll tax holiday, as they are not covered by Social Security. Yet while all other Social Security participants receive a reduction in payroll taxes of 2 percent, H.R. 3630

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[8] *Statistical Abstracts for Fiscal Year 2010*, Federal Employee Benefits Programs, Office of Personnel Management, Exhibit R8.

[9] If combined income is between $32,000 and $44,000 for a joint return or between $25,000 and $34,000 for an individual return, income tax may be payable on up to 50 percent of Social Security benefits. If combined income is more than $44,000 for a joint return or more than $34,000 for an individual return, up to 85 percent of benefits may be taxable. Combined income is defined as adjusted gross income plus nontaxable interest plus half of the Social Security benefit. Taxes and your Social Security Benefit, Social Security Administration, http://www.ssa.gov/planners/taxes.htm.

[10] *Statistical Abstracts for Fiscal Year 2010*, Federal Employee Benefits Programs, Office of Personnel Management, p. 2 (estimating that about 16 percent of the approximately 2.7 million covered employees are covered by CSRS).

would effectively tax the pay of CSRS participants by another 1.5 percent through an increase in retirement contributions.

Federal Employees Retirement System (FERS) – A Model for Reform

Federal and postal employees who began their service on or after January 1, 1987, are covered by FERS. Signed into law by President Ronald Reagan, the creation of FERS was motivated by changes in law that placed new federal hires under Social Security, and it was designed to provide retirement benefits roughly equivalent to CSRS, but with greater job mobility. Today, FERS covers about 84 percent of active federal employees.[11] It provides a three-legged stool of benefits: (i) a basic defined benefit, which is significantly lower than the CSRS benefit; (ii) Social Security coverage; and (iii) the Thrift Savings Plan. Both Social Security benefits and Thrift Savings Plan (TSP) balances are portable to private-sector jobs.

The FERS basic defined benefit annuity is equal to the average of the highest three consecutive years of pay *multiplied by* years of service *multiplied by* an accrual rate of 1 percent if the employee has less than 20 years of service and retires prior to age 62 or 1.1 percent if the employee has 20 or more years of service and retires after age 62. While this annuity receives some inflation protection, it does not always receive the full amount of the increase in the Consumer Price Index as a cost-of-living adjustment.[12]

FERS employees contribute a total of 7 percent of pay to Social Security (6.2 percent without the payroll tax holiday) and to the CSRDF (0.8 percent). Agencies contribute an automatic 1 percent of salary into FERS employees' TSP accounts. Employees may receive an additional 4 percent of salary in matching contributions from their agency. Employee TSP contributions are tax-deferred; in effect, TSP is the federal employees' 401(k).

As part of the transition from CSRS to FERS, Congress also included a temporary supplemental benefit for FERS employees who retiree before age 62 with at least 30 years of service. The "FERS annuity supplement" is equal to the estimated Social Security benefit that the individual earned while employed by the federal government and it is only paid until age 62.

Rather than looking to eliminate FERS or reduce its benefits, members of Congress should look to the system as a model for private sector reforms. Pension experts as diverse as David John, senior research fellow at the Heritage Foundation; Norma Stein, pension consultant and professor at Drexel University; and Leigh Snell of the National Council on Teacher Retirement have referred to FERS as a model.[13] The basic benefit it provides is modest – a median of $720 per month ($8,640 annually), and replaces only 1 to 1.1 percent of the average of the highest-

[11] *Id.*

[12] If the increase in the consumer price index (CPI) is 2 percent to 3 percent, FERS annuitants only receive a 2 percent cost of living adjustment. If the CPI is above 3 percent, FERS annuitants receive the CPI minus 1 percent.

[13] Diane Rehm Show, NPR, 10/8/10.

three years of salary. This provides modest retirement income security that is not overly generous.

The major motivation for private sector firms moving away from defined benefit plans does not apply to FERS. Enhanced funding requirements and the instability of market returns led many private employers to alter their retirement plan structures. On the other hand, agencies fund the full normal cost of FERS benefits annually, as required by law. This means that the FERS system is financially sound and 100 percent pre-funded, with no unfunded liability. According to the Congressional Research Service, "[a]ctuarial projections indicate that the CSRDF will be able to meet its financial obligations in perpetuity."[14] In fact, the creation of FERS helped to shore up both the CSRDF and the Social Security system.

Legislative Proposals to Cut Federal Retirement Benefits Undermine Their Adequacy

H.R. 3630

H.R. 3630 would substantially reduce the retirement income security provided by FERS and effectively provide a pay cut for already underpaid federal employees (covered by both FERS and CSRS) who have experienced a pay freeze for the last two years. New employees (those with less than five years of service) would experience a 41 percent reduction in their deferred compensation because the bill would create a new system of retirement that would base retirement annuities on (i) the average of the highest five years of consecutive service instead of the highest three years, and (ii) reduce the accrual rate by more than 36 percent, to 0.7 percent. The resulting 41 percent reduction in FERS annuities would result in a new mean annuity of only \$425 per month (\$5,098 annually). That is barely over a third of what a minimum wage earner would make per year (\$15,080), working 40 hours per week for \$7.25 per hour.

New employees would also face a 3.2 percent increase in retirement contributions, while other current employees (covered by both CSRS and FERS) would face a 1.5 percent increase in retirement contributions over three years. While the tax holiday provides take-home pay increases for one year, federal employees get permanent pay cuts.

Additionally, H.R. 3630 eliminates the FERS annuity supplement, starting in 2013. This provision would result in a substantial reduction in early-retirement pay for federal employees who have dedicated their entire careers to public service and relied on receiving this supplement as part of their retirement compensation.

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[14] CRS Report, *Federal Employees' Retirement System: Benefits and Financing*, by Katelin P. Isaacs, January 5, 2011, at 12.

President's Proposal

Unlike H.R. 3630, President Obama has only proposed changes to federal retirement programs as part of a larger shared sacrifice to reduce deficits. The President has not proposed it as an offset for an extension of the payroll tax holiday. Specifically, the President has proposed increasing retirement contributions by 1.2 percent over three years and eliminating the FERS annuity supplement for new employees only, which avoids harming long-serving employees who have planned for retirement relying on the promise of the annuity supplement.

Federal Employees Are Already Undercompensated

While federal retirement benefits provide a fair balance between current and deferred compensation, independent studies suggest that the overall compensation package that federal employees receive is below that of comparable private sector employees. Cutting retirement benefits or increasing retirement contributions would exacerbate the situation. Data collected by the Bureau of Labor Statistics (BLS) shows that federal workers are paid approximately 26 percent less, on average, than their private-sector counterparts.[15] The BLS makes apples-to-apples comparisons that account for differences in occupation, education, experience, skill level, scope of responsibility, length of service, age, geographic location and special requirements such as exposure to personal danger.

In other words, the BLS distinguishes between workers such as a teenage Dairy Queen's cashier in a rural town and an experienced attorney in New York City; and even between a junior attorney who writes pro forma wills and a senior attorney leading billion-dollar litigation. In general, the federal workforce consists of more professionals and managers, and federal employees have more education, are older, have more experience and perform jobs that require more skill and have more responsibility than the average private-sector worker.

We do recognize that the BLS data does not include retirement benefits; however, the cost to federal agencies of providing the FERS annuity is 11.7 percent of pay per year.[16] The cost to the government of providing the CSRS annuity is 18.8 percent of pay per year.[17] These amounts do not bridge the 26 percent gap. Furthermore, the private-sector compensation used as a comparison would need to be increased upwards by the cost of retirement benefits to similarly-

[15] *Recommendations for Locality Pay in 2013*, Federal Salary Council, p. 2, http://www.opm.gov/oca/fsc/recommendation11.pdf (finding a 26.3 percent gap between comparable private sector jobs and federal jobs).

[16] CRS Report, *Federal Employees' Retirement System: Benefits and Financing*, by Katelin P. Isaacs, January 5, 2011, at 11.

[17] *Id*.

situated private-sector employers.[18] According to the National Compensation Survey, 86 percent of private-sector employers with 500 or more workers offered access to a retirement plan in addition to Social Security.[19] Every Fortune 100 company offered access to a retirement plan.[20] Furthermore, private sector companies have the ability to offer forms of profit-sharing, such as stock options. This is additional compensation that federal employees cannot receive. Also, it represents the prospect of substantial financial reward, which the federal government will never be able to provide.

Maintaining a Qualified Workforce

American citizens need a competent, efficient federal workforce. While there may be ideological disagreements regarding the scope of government, those disagreements should not endanger the quality of the federal workforce, regardless of its size. Veteran's Administration doctors and nurses, Department of Justice prosecutors and Federal Court judges, NASA engineers and NIH scientists, high-qualified intelligence officers and diplomats, and senior executives all require adequate compensation. The federal government underpays these individuals, but provides a modicum of security through its benefits package. Many of these individuals forego the prospect of riches in the private sector to engage in public service, whether by caring for veterans or preventing terrorism or otherwise. By undermining their compensation, we risk hindering our ability to recruit and retain the best and the brightest.

Conclusion

Federal retirement programs provide a fair balance between salary and retirement benefits, an adequate mix of guaranteed income through defined benefit annuities and individual flexibility through defined contribution savings. Instead of making them a target for cuts, they should provide a model for other retirement programs.

Federal employees ensure that the food we eat and the water we drink are safe; they protect our borders and our airways; they provide us Social Security benefits and deliver our mail; they take criminals off our streets and keep them behind bars; they care for our veterans and provide the intelligence needed to thwart terrorism; day after day, they perform the tasks needed to maintain the stability and security of our country.

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[18] On average, about 5 percent. *See Employer Costs for Employee Compensation – September 2011*, Bureau of Labor Statistics News Release, Table A, available at http://www.bls.gov/news.release/pdf/ecec.pdf (ratio of 3.6 to 70.5 = 5 percent). But again, it is important to compare benefits for similar jobs.

[19] *Employee Benefits in the United States – March 2011*, Bureau of Labor Statistics News Release, Table 1, available at: http://www.bls.gov/news.release/pdf/ebs2.pdf.

[20] *See* Towers Watson, "Prevalence of Retirement Plan by Type in the Fortune 100," June 2010, available at: http://www.towerswatson.com/united-states/research/2106.

Federal employees do not ask for much, as they demonstrate their willingness to sacrifice every day on the job. As much as anyone, our nation's civil servants understand the constraints of the federal budget and the gravity of the nation's fiscal responsibilities. But we do not believe it is fair to be singled out for sacrifice to pay for a tax holiday that some of us do not even receive.

Thank you again for the opportunity to share our views with you and I am happy to answer any questions you may have.