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This document describes the effects that the implementation of the recommendations of the National Commission on Fiscal Responsibility and Reform would have on the benefits to which federal employees and retirees are entitled. It will focus on federal employee and retiree benefits and not Social Security (though the Commission proposed some changes in that area too). Some of the effects can be easily computed, but others are speculative.

Recommendation 1.8 – "Unleash agencies to begin identifying savings". The image of hundreds of federal agencies being "unleashed" is either frightening or amusing. This recommendation calls for the establishment of a two-year window where agencies would be able to conduct buyouts. No mention is made of the amount of the buyouts, which leads one to believe that the buyouts would be the usual; that is, the lesser of $25,000 or the amount of severance pay the employee would be entitled to receive. It also calls for giving agencies "expanded latitude for personnel realignment". No examples of this latitude are given.

What will this mean to employees? This is one of those recommendations where the effects are speculative. Many employees will not be affected at all. Of those that will be affected, some will welcome the opportunity to leave federal service with a little extra money in their pockets. Others will dread the thought of being subject to a reduction-in-force in an economy where unemployment is still high.

Employees should take what steps they can to improve their career prospects. Updating résumés and applications should be on every employee's to do list for 2011. Employees should also take stock of their financial situation (e.g., could they live comfortably on a pension reduced by early retirement; is their emergency fund big enough to cover several months worth of expenses, etc.)

Recommendation 1.10.3 – "Impose a three-year pay freeze on federal workers and Defense Department civilians". Here's an example: If an employee were making $100,000 at the beginning of the "freeze period", they would still be receiving $100,000 at the end of three years. If they had received pay increases of 1.5% per year, they would have made $101,150 at the end of one year, $103,022 at the end of two years, and $104,567 at the end of three years. Assuming that some type of pay increases resume after three years, the salary gap of $4,567 would slowly increase as pay increases are applied. For example, if a 1.5% pay increase were granted in the fourth year, the "frozen" employee would receive $101,150 (an increase of $1,150) in year four and the "unfrozen" employee would receive $106,135 (an increase of $1,568).

Let's use the fourth year salaries to compute a retirement annuity that was based on "high-three" salaries of $101,150 and $106,135. The "frozen" employee who had a high-three of $101,150 and had worked 30 years would have a CSRS annuity of $57,093 and a FERS annuity (1% factor) of $30,450. The "unfrozen" employee with a high-three of $106,135 and had worked for 30 years would have a CSRS annuity of $59,700 ($2,607 more) and a FERS annuity (1% factor) of $31,950 ($1,500 more). COLAs added to these amounts after retirement (after age 62 in most FERS situations) would increase the discrepancy.

Of course, we already have a two-year pay freeze. We can only hope that the two-year freeze will eliminate the need for the Commission's proposed three-year freeze. A two or three year pay freeze will have a harsher effect on federal annuities than would another of the Commission's recommendations; going to a high-five salary instead of a high-three for annuity computation (see recommendation 4.1).

Recommendation 1.10.4 – "Reduce the size of the federal workforce through attrition". This recommendation calls for a reduction of 10% (roughly 200,000 employees) in the total federal workforce. No guidance is given, other that it should be through attrition. Questions that will need to be answered are:

- Will there be only a government-wide goal, or will each agency have a target reduction?
- Will there be exemptions for hard-to-fill positions, positions in national security or positions that require special skills?
- How will this tie in with "unleashing" the agencies to identify savings? Can agencies target certain groups of employees and use Reductions In Force to cause attrition?

The suggestions made at the end of recommendation 1.8 would apply here as well.

Recommendation 2.1 – This deals with changes to the tax code. One "example" cited by the Commission as an area for potential savings is "consolidating retirement accounts and capping tax-advantaged contributions to the lower of $20,000 or 20% of income. This would limit the ability of federal employees to fund their TSP accounts with pre-tax dollars. Currently, a federal employee who is age 50 or over has the opportunity to set aside $22,000 in pre-tax contributions to the TSP. This change would result in the loss of favorable tax treatment for $2,000 in TSP contributions.

The above does not take into account that an individual 50 or older could also lose favorable tax treatment for $6,000 in pre-tax contributions to a traditional deductible IRA (assuming they meet the IRA's income requirements). Even an employee under the age of 50 can currently set aside $21,500 in pre-tax dollars ($16,500 in the TSP and $5,000 in a traditional deductible IRA).

Of course, once the TSP introduces a Roth account (currently planned for January 2012) that will make this a moot issue for federal employees who elect the Roth option. Employees who elect the Roth option are likely to be younger than those who will stay with the traditional TSP.

This change would not affect all federal employees, as many of them cannot afford to max out in their TSP as it is. It would, however, affect higher income feds.

Recommendation 3.3.13 – Pilot premium support through FEHB program. This recommendation calls for changing the Federal Employee Health Benefits Program (FEHBP) from its current design to a "…defined contribution premium support plan that offers federal employees a fixed subsidy that grows by no more than GDP (Gross Domestic Product) plus 1% each year". This would put all federal employees who purchase health insurance on an equal footing, where there would be a subsidy of a fixed amount for self-only plans and another for self-and-family plans. The theory behind this is that, if more of the cost of higher priced insurance plans was borne by the employee/retiree, they would be likely to reduce their expenditures on health insurance.

A wild card is the level at which premium support will be initially set. We might benefit by the fact that Representatives and Senators also participate in FEHBP and might set the initial support level high for their own benefit.

Recommendation 4.1 – "Review and reform federal workforce retirement programs". This recommendation calls for the establishment of a "federal workforce entitlement task force". The Commission states that the task force needs to consider the following items:

- Change the computation of federal annuities from using a "high-three" to a "high-five". Let's assume a prospective retiree is making $100,000 five years before retirement and receives annual raises of 1.5%. Under a high-three formula (using as a high-three the salary of the fourth of five years), a CSRS retiree would receive a pension of $58,818 and a FERS retiree (1% factor) would receive $31,370. With a high-five formula substituted (using as a high-five the salary of the third of five years), the CSRS pension would be $57,949 ($869 less) and the FERS pension (1% factor) would be $30,906 ($464 less). COLAs would compound the difference over time. Of course, combining a pay freeze and a change in the computation formula would multiply the effect.
- Defer retiree cost of living adjustments until age 62 for all retirees. This will not affect COLAs for most FERS retirees, but will affect the COLAs for CSRS/CSRS Offset retirees and special category FERS retirees, (e.g., law enforcement, firefighter, etc.). The proposal as written would grant retirees who are currently entitled to pre age 62 COLAs an age 62 adjustment. The change would grant no colas between retirement and age 62, but when the retiree reaches 62, the amount of the annuity would be adjusted to where it would have been if COLAs had been applied from the time of retirement. This could result in some FERS retirees going twelve or more years without receiving a cost of living adjustment. This would cause many potential retirees to consider working longer.
- Adjusting the ratio of contributions to pension plans so that employees and the government are paying the same percentage of costs. This will not affect straight CSRS employees, as they are contributing 7% of their salary and Uncle is contributing an equal 7%. It would, however, affect the payroll deductions of FERS and CSRS Offset employees. Currently CSRS Offset and FERS employees contribute .8% of their salary, while the government contributes 7.5%. If contribution rates were equalized, both employees and the government would be contributing 4.15%. This would result in close to an 80% increase (from .8% to 4.15%) in pension withholding for affected employees.

Recommendation 6.1 – "Switch to a more accurate measure of inflation for indexed provisions". This is similar to recommendation 5.7, "Adopt improved measure of CPI", which would affect Social Security COLAs. The proposal calls for switching from the current Consumer Price Index for Urban Wage-earners (CPI-W) to the Chained Consumer Price Index for all Urban Consumers (C-CPI-U). The National Active and Retired Federal Employees Association (NARFE) reported that if the C-CPI-U had been used over the last ten years, annuities would be roughly 3% less today.

What separates the different indexes is the substitution effect. CPI-W assumes that you will not make a substitution if prices rise (e.g., if the price of steak increases, you will continue to purchase steak), while the C-CPI-U assumes you will make a substitution (e.g., you will purchase poultry if the price of steak increases).

None of the above suggestions are good news for federal employees. This is especially true as the Commission's recommendations did not receive a super-majority vote from the Commission members. A vote of 14 of the 18 members was necessary to move the entire series of recommendations to Congress for an up-or-down vote without amendments being allowed. Even though 11 of the 18 members support the recommendations, it is likely that the recommendations will be taken up piecemeal by Congress. This is not good for federal employees and retirees as, even though there are over 4 million of us, we are a relatively small constituency and do not have a lot of lobbying strength.

Another unknown is how the recommendations will be implemented:

- Will they all be prospective, offering extensive "grandfathering"?
- Will they be totally retroactive, affecting those who might have already retired?
- Will current benefits be frozen, but all benefits earned beyond a specific date will be computed at the new "rates".

It is in the best interest of the federal employee to pay close attention to these changes so that he/she can make their voices heard and take proactive action.

Federal Career Experts is a small business that incorporated in late 1996. Previously known as Chicago Management and Career Consultants, FCE has been providing quality training and consulting solutions to agencies and individuals since March of 1997.

John Grobe, President of Federal Career Experts, has had close to 40 years of experience with federal issues; first as an employee and manager and later as a consultant. He has written three books (two of which have sold over 20,000 copies) and is a frequent contributor to the **fedsmith** newsletter. He is an accomplished trainer and consultant.