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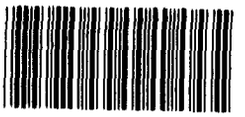

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Locality Pay for Federal Employees

Statement of
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Subcommittee on Employment and Housing
House Government Operations Committee

LOCALITY PAY FOR FEDERAL EMPLOYEES

Summary of Statement by
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The General Schedule pay system--the primary pay system for federal white-collar employees--applies nationwide. Any particular job is paid the same regardless of location.

The process for setting General Schedule pay rates needs to be reformed. Because of limitations on pay increases imposed each year since 1977, private sector pay rates average about 22 percent more than federal pay rates for comparable jobs. The government cannot continue to attract and retain the good people it needs with such uncompetitive pay rates.

GAO believes any plan to reform the federal pay-setting process must include the consideration of geographic differences through some form of locality pay. The national pay scale may have little relevance to private sector rates paid in any locality, and differences in the cost of living across geographic areas can cause significant differences in federal employees' purchasing power from one area to another.

GAO presents two models or types of locality pay systems the government could adopt--one based on cost-of-living and one based on local labor markets. GAO notes that each system is currently being used to set pay for certain federal employees, but points out that these systems cover only a small portion of the federal white-collar workforce. GAO also provides data it obtained showing that the cost-of-living and private sector pay rates vary widely among different geographic areas of the country. Finally, GAO notes that federal employees' rates of voluntary separations from the government are higher in high cost-of-living areas than in low cost-of-living areas.

Mr. Chairman and Members of the Committee:

I am pleased to be here to discuss the subject of locality pay for federal employees.

Locality pay has recently been a hotly discussed topic in federal personnel management circles, particularly in the wake of the Volcker Commission's recommendations on ways to improve the public service. Although "horror stories" abound concerning the difficulty agencies have had hiring and keeping quality personnel in certain areas, little empirical data has been reported on the need for locality pay or the effect it might have on recruitment and retention. We at GAO are currently in the process of collecting and analyzing that information. What I would like to do today is describe some of the data which seems to indicate the need for locality pay and present some locality pay options.

Before getting into the specifics of the locality pay issue, though, it might be informative if I briefly reviewed the recent history of federal pay setting as a background to why federal pay reform has become such a serious topic.

BACKGROUND

Since 1962, the law has required that federal white-collar employee pay rates be set and adjusted on the basis of overall

comparability with the private sector. The comparability principle holds that the private sector, through collective bargaining, cost-of-living considerations, pay surveys, and other factors private employers use in pay setting, determines the "going rates" for jobs comparable to those found in the government. The government then is to pay the national average rates paid in the private sector for similar levels of work. In concept, pay comparability was designed to assure federal employees that they are paid fairly for the work they do and assure the nation's taxpayers that federal pay rates are reasonable in comparison to what others in the country make for doing similar work.

The comparability process worked fairly well for many years. There were often disagreements over how pay comparability should be measured, what jobs should be surveyed, and how small or large the employers in the survey should be, but the process was continually refined and, as a rule, federal pay was kept comparable to the private sector average.

Beginning in 1978 and each year since then, however, Presidents have proposed and Congress has agreed to grant federal pay raises at lesser amounts than required to achieve comparability with the private sector. Such "alternative plans" are allowed by the pay comparability law when the President believes smaller pay raises are justified by a "national emergency or economic conditions

affecting the general welfare." As a result of these alternative plans, a gap between federal and private sector pay for comparable jobs gradually developed, growing each year until it now stands at about 22 percent.

The results of federal white-collar pay setting since 1977 are graphically demonstrated in Appendix I, which shows how the federal-private sector pay gap has grown each year that full comparability was not achieved. Appendix II shows the median rates now being paid for selected jobs in the private and federal sectors. As you can see, median federal pay for certain jobs currently lags far behind median private sector pay. Thus, it is apparent that the pay comparability adjustment process is not working. The government is unlikely to be able to attract and retain the good people it needs with such uncompetitive pay rates.

Another problem with the administration of the comparability principle is its assumption that private sector pay rates are similar in different parts of the country. The General Schedule or "GS" pay system--the primary federal white-collar pay system--applies nationwide, with every particular job paid the same regardless of location. An entry-level secretary in New York is paid the same as an entry-level secretary in Denver or San Antonio.

In fact, as we will demonstrate, private sector pay rates for the same job and local costs of living vary substantially across the country. The national average pay used in the comparability process often has little relevance to private sector rates paid in a locality or the compensation needs of federal employees. Currently, the only systematic way federal white-collar pay rates can vary by occupation or locality is if the Office of Personnel Management approves "special rates" to counteract recruitment and retention problems caused by higher private sector pay. Employing agencies must certify that they have sufficient funds to pay the higher amounts before special rates will be approved. The Office of Personnel Management recently testified that the special rate program is unable to adequately address the need for variances from the General Schedule.

We believe that the current uniform GS pay system can have at least two negative effects on the federal workforce. Differences in the cost of living across geographic areas can cause significant differences in federal employees' purchasing power from one area to another. A dollar paid to an employee in a high-cost area just does not go as far as that same dollar in a low-cost area. Thus, it can be argued that the current uniform GS pay system does not equitably compensate employees doing the same work in different locations.

Second, the disparities in private sector pay rates for particular occupations across localities result in differences in the degree to which the federal government is competitive in local job markets. Because of local pay differences, the government may pay more than the market in some areas for certain jobs, even with the 22 percent average pay gap. In other areas, the federal government pays much less than its competitors for the same jobs.

Given the pay gap and the problems of inequitable and uncompetitive pay from one area to another, it is not surprising that the Volcker Commission and others report that the federal government is experiencing recruitment and retention problems. Federal employees in some high cost areas, although they may desire to serve the public, may find it difficult to support their families. Job applicants in areas where federal pay falls significantly behind the private sector will have to be willing to accept less than they could get from other employers in order to become federal employees. Therefore, we believe any plan to reform the federal white-collar pay-setting process must include the consideration of geographic compensation differences through some form of locality pay.

TYPES OF LOCALITY PAY SYSTEMS

There are essentially two separate models or types of locality pay systems the federal government could use--one based on cost of living and one based on the local labor market. Cost of living-based locality pay focuses on equalizing employee purchasing power throughout the country, and would adjust pay for all federal white-collar employees in the specified areas. Labor market-based locality pay is primarily concerned with keeping the federal government competitive with other employers, and would provide pay adjustments in those areas only for those employees in occupations where federal pay is lower than the private sector rate. Because either model would vary pay adjustments by area, adoption of locality pay could be a less expensive way to address the recruitment and retention problem than attempting to close the pay gap through nationwide adjustments.

Both types of locality pay already exist in the federal government. For example, the Federal Deposit Insurance Corporation, which has certain pay-setting autonomy not available to other federal agencies, adds cost-of-living differentials to General Schedule rates for its employees in high cost-of-living locations. One such location is San Francisco, where FDIC employees get a 19.4 percent pay differential--the highest in the country. In another cost of living-based program, civilian

employees in nonforeign areas outside the continental United States, such as Alaska, Hawaii, and Puerto Rico, receive cost-of-living allowances (COLAs) of up to 25 percent of base pay. The COLAs are intended to equalize the purchasing power of these employees with the purchasing power of employees in Washington, D.C.

The Federal Wage System (FWS) for blue-collar workers is an example of a market-based locality pay system. In the FWS, wage fixing authorities in each of 135 designated areas throughout the country survey private sector employers in their localities to determine the prevailing wage rates for blue-collar jobs comparable to those in the government. Each of the 135 FWS wage areas adjusts its pay structure annually to reflect the average private sector wage rates in the area. The differences in federal pay for the same job across the wage areas are substantial. For example, in FY1988, federal blue-collar employees at grade 10 step 2 were paid $9.06 an hour in Columbus-Aberdeen, Mississippi and $13.46 an hour in San Francisco-- a 49 percent difference.

Nevertheless, the FWS system does not perfectly mirror private sector pay. Through appropriation limitations imposed by Congress during the past several years, pay increases for FWS employees have been limited to no more than the percentage pay raises granted to white-collar employees. Thus, FWS rates in

many areas are now well below the prevailing private sector rates. For example, federal blue-collar workers at grade 10 step 2 in San Francisco were paid 15.75 percent less than their private sector counterparts in FY1988.

The special rate program is also a form of market-based locality pay in that it uses private sector pay rates as one factor in setting pay for selected white-collar federal employees. However, the program does not always permit special rates high enough to match private sector pay rates for particular occupations and may not be awarded at all if the agency is unwilling or unable to absorb the cost of the increase. Although the special rate program and other locality or market-based pay initiatives are significant attempts to make white-collar pay more flexible and market sensitive, they cover only a portion of the federal white-collar workforce. The argument for locality pay for all white-collar workers can perhaps best be made through evidence of cost of living differences and differences in private sector pay rates by locality.

COST OF LIVING DIFFERENCES BY LOCALITY

One of the problems in establishing a cost of living-based locality pay system is the development of reliable measures of cost of living differences among areas. Because of budget cuts, the Bureau of Labor Statistics stopped collecting such data in

1981. Consumer Price Index (CPI) measures, while valuable in calculating changes in living costs in a particular area over time, cannot be used for intercity comparisons because different items are used to calculate the CPI in different locales.

Because no government cost-of-living data across areas are available, we contracted with Runzheimer International, a management consulting firm that specializes in compiling cost-of-living information. Runzheimer data are used by over 300 of the Fortune 500 companies and by the General Services Administration in its determination of federal travel allowances. Runzheimer's calculations of cost of living include taxes, transportation, housing, goods and services, and other expenses. The company provides separate measures of living costs for different employee profiles based on income, family size, and whether employees own or rent their homes. For homeowners, Runzheimer determines living costs for persons buying a house today, 3 years, and 6 years ago. Runzheimer calculates living costs for each employee profile in a "standard" city (a median cost city) and uses the standard city costs to construct cost-of-living indexes that allow comparisons of living costs from one city to another.

We obtained comparative cost-of-living data from Runzheimer for each of the 28 metropolitan statistical areas (MSAs) that had at least 10,000 GS or GS-equivalent employees as of September 30, 1988. Over 750,000 GS or GS-equivalent employees worked in the

28 MSAs at that time--about half of the federal white-collar workforce. We specified a profile of an "average" GS employee--a homeowner, family of four, earning $30,000 a year.

Appendix III shows the Runzheimer cost-of-living indexes for the 28 MSAs as of April 1989. As you can see, there are wide variations in the total annual cost of living across the MSAs. For the profiled GS employee buying a house today, the most expensive MSA was New York, which was 46.8 percent more expensive than standard city. The next most expensive MSAs were San Francisco and Boston, each about 33 percent more expensive than standard city. The least expensive MSAs were San Antonio (11.5 percent below standard city), Houston (8.7 percent below standard city), and Oklahoma City (8.1 percent below standard city). Thus, for the average GS employee buying a house now, the cost of living difference from the highest- to the lowest-cost MSAs is 58.3 percent.

For employees who bought their homes 3 and 6 years ago, the differences in living costs are less substantial but still significant. For 3-year homeowners, New York is still the most expensive of the 28 MSAs (31.6 percent above standard city), while Huntsville, Alabama, is least expensive (7.8 percent below standard city). Thus, the difference in cost of living from high to low MSA for this group is 39.4 percent--nearly 20 percentage points less than for employees who are buying homes now. For 6-

year homeowners, the highest to lowest (New York-Huntsville) cost of living differential is 33.7 percent. New York is 24.4 percent above standard city and Huntsville is 9.3 percent below standard city.

Housing Costs

The largest single determinant of cost of living is housing. Runzheimer data indicate that market values for the same house vary widely across the 28 MSAs. The highest priced houses are in San Francisco, where the standard house for the profiled family (1,400 square feet, 3 bedrooms, 1.5 baths) currently costs $193,600. Three years ago the same house in San Francisco cost $137,300, or 41 percent less than current market values. The area with the lowest home market values is San Antonio, where the standard house currently costs $57,900--less than 30 percent of the cost of the same house in San Francisco. Interestingly, home market values in San Antonio, Houston, and Oklahoma City have actually declined over the past 3 and 6 year periods.

In terms of total housing expenses (mortgage principal and interest, insurance, property taxes, etc), New York is the most expensive MSA due primarily to higher real estate taxes in New York than in San Francisco. New York is 103 percent above standard city, and San Francisco is 87 percent above standard city. On the other end of the scale, Oklahoma City has the

lowest housing expenses--more than 28 percent below standard city. Thus, the range from highest- to lowest- cost area in the 28 MSAs (New York to Oklahoma City) on the housing cost dimension was about 131 percent.

Income Adjustments

Runzheimer also calculates the adjustments to income for the profiled employee that would be necessary in each location to compensate for the differences in cost of living from standard city. For example, the profiled $30,000 employee with a 3-year old mortgage would need a $9,477 a year adjustment to remain "whole" in New York when compared to a similar employee in standard city. That same employee would need approximately a $6,000 a year adjustment in Los Angeles, Honolulu, or San Francisco. Conversely, employees with 3-year old mortgages in Huntsville would need $2,344 a year less than employees in standard city; employees in San Antonio would need nearly $1,900 less. That decrease in relative salary would not need to be accomplished by cutting anyone's pay. Rather, it could involve slowing the rate of any future pay increases.

Federal Retention and Cost of Living

One underlying question in any discussion of cost of living and locality pay is whether recruitment is more difficult or turnover

is more prevalent in high cost-of-living cities than in low cost-of-living cities. While our analysis is not complete, preliminary information does indicate a cost of living and retention relationship.

We obtained data from the Office of Personnel Management on quit rates (voluntary separations from the federal government, excluding retirements, transfers, and other separations) in 1987 for full-time white-collar federal employees in 17 of the 28 MSAs for which we had cost-of-living data. Quit rates for those MSAs are shown in Appendix IV. There were substantial differences in the quit rates across the MSAs, and quit rates generally were higher in high-cost areas. For example, the quit rate for all white-collar federal employees in Boston in 1987 was 9.96; in Oklahoma City the quit rate was 2.59. Overall, the high-cost areas for which we had data had quit rates that were more than twice as high as quit rates in the low-cost areas. I should emphasize at this point, though, that we cannot conclude that the relatively higher cost of living caused these employees to quit. We will be attempting to get accurate data on the relationship in the near future.

WHITE-COLLAR PAY DIFFERENCES BY LOCALITY

The other type of locality pay system--market-based pay--is founded on differences in pay rates across areas for particular

occupations. However, little publicly available data exists on locality- and occupation-specific private sector pay rates for white-collar jobs. The Bureau of Labor Statistics' annual survey of private sector salary rates used to set federal white-collar pay rates is made on a national basis. It does not determine salary rates by locality.

We are in the process of contracting with a private company to compile and analyze locality- and occupation-specific private sector pay information. We are also obtaining locality and occupation-specific information on federal rates of pay. Until that work is completed, we cannot comment in detail on federal-private sector pay differentials in any particular area. However, other data suggest that private sector white-collar salary rates for the same job vary widely by geographic area.

Occupational Group Pay Relatives

In its area wage survey program, the Bureau of Labor Statistics gathers earnings data for certain occupations within each of 61 metropolitan areas each year. To demonstrate inter-area pay differences, BLS calculates area "pay relatives" for general occupational groupings such as "office clerical" or "electronic data processing" workers. A pay relative of "100" is calculated to equal the average for all areas, and each area is compared separately to the overall average.

The data indicate significant differences in private sector pay rates across the 61 areas. For example, the 1987 "office clerical" pay relative for all industries in San Francisco was 120, highest of the 61 areas surveyed that year. At the other end of the spectrum was Northeast Pennsylvania, whose pay relative of 83 meant it was 17 percent below the national average.. San Francisco and Northeast Pennsylvania were also the highest and lowest paying areas for the "electronic data processing" occupational group, with pay relatives of 116 and 87, respectively. Put another way, private-sector employers in San Francisco paid 44.6 percent more than employers in Northeast Pennsylvania to office clerical workers and 33.3 percent more to electronic data processing workers. The pay relatives for the highest and lowest paying of the 61 areas are shown in Appendix V.

Occupation Specific Comparisons

The differences in pay from one area to another are even more dramatic when looking at specific occupations in the 1987 area wage survey rather than general occupational groups. Data for some of the occupations surveyed are presented in Appendix VI.

There are wide variations in the average rates of pay for the same occupation across the 61 areas. For example, "Secretaries"

average weekly earnings ranged from a high of $484 in Detroit, Michigan, to a low of $314 in Northeastern Pennsylvania--a 54 percent difference in average pay for the same occupation. The smallest geographic pay range within an occupation was for "Registered Industrial Nurses" (31 percent) and the largest range was for "Drafters" (94 percent). The average geographic pay range across all the occupations was 59.9 percent.

These wide variations in private sector pay rates for the same white-collar jobs across areas leads us to suspect that federal pay within particular localities is uncompetitive in some areas and more than it needs to be in others. However, implementation of locality pay would not necessarily mean reducing employees' pay in low-cost or low-pay areas. Locality pay could be achieved through a slower increase in pay in those areas until the proper pay differentials are established.

That completes my prepared statement. I would be pleased to try and answer any questions the Subcommittee may have.

APPENDIX I

HISTORY OF GENERAL SCHEDULE PAY ADJUSTMENTS (1978 TO 1989)

Month/Year	Pay Agent[1] Determination	Increase Provided	Pay Gap
October 1978	8.40%	5.50%	2.90%
October 1979	10.41%	7.00%	3.41%
October 1980	13.46%	9.10%	4.36%
October 1981	15.10%	4.80%	10.30%
October 1982	18.47%	4.00%	14.47%
January 1984	21.51%	4.00%	17.51%
January 1985	18.28%	3.50%	14.78%
January 1986	19.15%	0.00%	19.15%
January 1987	23.79%	3.00%	20.79%
January 1988	23.74%	2.00%	21.74%
January 1989	26.28%	4.10%	22.18%

[1]The President's Pay Agent (currently the Secretary of Labor and the Directors of the Office of Management and Budget and the Office of Personnel Management) determines and reports annually to the President the pay adjustments necessary to maintain pay comparability based on surveys of private sector pay by the Bureau of Labor Statistics.

PAY COMPARISON OF SELECTED FEDERAL AND PRIVATE SECTOR OCCUPATIONS[2] (1988)

Occupation	Median Private Sector Pay	Median Federal Pay[3]
Key Entry Operator I	$13,311	$11,970
Key Entry Operator II	$17,185	$13,241
Computer Operator I	$14,722	$14,863
Computer Operator V	$31,022	$22,812
Stenographer I	$22,462	$13,241
Stenographer II	$23,528	$14,863
Buyer I	$21,266	$16,630
Buyer IV	$42,533	$30,488
Chemist I	$25,694	$16,630
Chemist VII	$77,062	$51,347
Systems Analyst I	$30,770	$25,199
Systems Analyst VI	$76,382	$60,397
Attorney I	$31,987	$25,199
Attorney VI	$107,207	$60,397

[2]Source: Annual Report of the President's Pay Agent, August 1988.

[3]Median federal pay was calculated using step 4 of the FY1988 pay grade specified for that occupation by the President's Pay Agent.

TOTAL ANNUAL COST OF LIVING IN MSAs WITH AT LEAST 10,000 GS OR GS EQUIVALENT EMPLOYEES (April 1989)

MSA	Index Comparisons[4] A	B	C
New York, NY	146.8	131.6	124.4
San Francisco, CA	133.3	120.0	118.1
Boston, MA	132.8	116.3	109.5
Los Angeles, CA	130.5	120.3	118.5
Oakland, CA	124.8	114.2	112.2
Honolulu, HI	121.7	120.0	119.2
San Diego, CA	118.1	114.0	114.0
Washington, DC	114.4	109.1	108.6
Philadelphia, PA	114.4	109.2	108.2
Chicago, IL	113.7	109.3	108.4
Sacramento, CA	109.1	106.3	105.0
Baltimore, MD	108.9	107.5	106.5
Detroit, MI	105.5	103.9	103.7
Atlanta, GA	102.5	101.7	101.2
Seattle, WA	102.1	100.1	102.1
Salt Lake City, UT	100.6	101.6	102.7
St. Louis, MO	100.2	99.6	100.2
STANDARD CITY, USA	**100.0**	**100.0**	**100.0**
Norfolk, VA	99.8	101.4	99.8
Kansas City, MO	98.4	99.9	100.3
Harrisburg, PA	98.2	96.9	96.4
Dallas, TX	97.4	100.2	100.2
Denver, CO	96.5	99.0	99.1
Indianapolis, IN	96.2	96.3	96.8
Dayton, OH	93.7	95.3	96.2
Huntsville, AL	93.3	92.2	90.7
Oklahoma City, OK	91.9	96.5	100.0
Houston, TX	91.3	95.2	98.7
San Antonio, TX	88.5	93.7	95.3

[4]The index comparisons denote the combined cost of housing, taxation, transportation, goods and services, and other expenses in each MSA for the profiled employee as compared to the cost of the same items in a median or "standard" city. The three columns indicate whether the employee is currently buying a house (A), bought a house 3 years ago (B), or bought a house 6 years ago (C).

QUIT RATES FOR FULL-TIME PERMANENT WHITE-COLLAR FEDERAL EMPLOYEES IN SELECTED MSAs BY HIGH, MEDIUM, AND LOW COST OF LIVING AREAS (FY1987)

MSA	Quit Rate[5]
High-Cost Areas	
Boston, MA	9.96
New York, NY	8.64
Los Angeles, CA	7.37
San Francisco, CA	5.90
Chicago, IL	5.04
Washington, DC	4.44
Average	**6.89**
Medium-Cost Areas	
Atlanta, GA	8.35
Seattle, WA	5.51
Baltimore, MD	4.49
Detroit, MI	4.14
Salt Lake City, UT	3.85
St. Louis, MO	2.77
Average	**4.85**
Low-Cost Areas	
Denver, CO	4.01
Harrisburg, PA	3.53
Norfolk, VA	3.38
San Antonio, TX	3.14
Oklahoma City, OK	2.59
Average	**3.33**

[5]"Quit rate" is the number of voluntary separations from the government each year per 100 employees, and does not include other separations such as retirements, transfers, deaths, etc.

PRIVATE SECTOR PAY RELATIVES FOR SELECTED AREAS AND OCCUPATIONAL GROUPS[6] (1987)

OFFICE CLERICAL		ELECTRONIC DATA PROCESSING	
High Pay Areas			
San Francisco, CA	120	San Francisco, CA	116
Davenport-Rock Island-Moline, IA-IL	115	San Jose, CA	114
Los Angeles-Long Beach, CA	114	Houston, TX	112
San Jose, CA	114	Miami-Hialeah, FL	111
Low Pay Areas			
Northeast PA	83	Jackson, MS	85
St. Cloud, MN	84	Elkhart-Goshen, IN	87
Tampa-St. Petersburg-Clearwater, FL	85	Memphis, TN-AR-MS	87
Jackson, MS	90	Northeast PA	87
Memphis, TN-AR-MS	90	South Bend, IN	87

[6]Source: Bureau of Labor Statistics, "Wage Differences Among Metropolitan Areas, 1987," Summary 88-6, July 1988.

AVERAGE WEEKLY EARNINGS OF HIGH/LOW PAYING AREAS FOR SELECTED OCCUPATIONS[7] (1987)

Occupation	High/Low Areas and Weekly Earnings		High/Low Differential
Secretary	Detroit, MI	$484.00	54%
	Northeast PA	$314.00	
Key Entry Operator	San Jose, CA	$369.00	62%
	Louisville, KY	$228.00	
Accounting Clerk	San Francisco, CA	$412.00	71%
	Northeast PA	$241.00	
Computer Systems Analyst	Danbury, CT	$822.00	68%
	Billings, MT	$490.00	
Computer Programmer	San Francisco, CA	$682.00	57%
	Elkhart-Goshen, IN	$435.00	
Computer Operator	Detroit, MI	$453.00	54%
	Billings, MT	$294.00	
Drafter	Detroit, MI	$577.00	94%
	San Angelo, TX	$298.00	
Electronics Technician	San Francisco, CA	$628.50	48%
	Elkhart-Goshen, IN	$423.50	
Registered Industrial Nurse	Detroit, MI	$624.50	31%
	Nassau/Suffolk, NY	$476.00	

[7]Source: Bureau of Labor Statistics, Area Wage Surveys: Selected Metropolitan Areas, 1987, Bulletin 3040-62.