~~18083~~
115209

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

MAY 13, 1981

B-202999

115209

The Honorable Donald J. Devine
Director, Office of Personnel
Management

Dear Dr. Devine:

Subject: Cost-Of-Living Allowances for Federal Employees in Nonforeign Areas Should Be Based on Spendable Income (FPCD-81-48)

We wish to bring to your attention an issue warranting action by the Office of Personnel Management (OPM). The cost-of-living allowance (COLA) which is paid to civilian employees in nonforeign areas outside the continental United States should be based on spendable income rather than base pay. Spendable income is base pay less retirement contributions, life insurance premiums, income taxes, charitable contributions, and savings. In other words, spendable income is the money an individual has available for purchasing goods and services. This change will make the COLA in nonforeign areas consistent with COLA programs administered by the Departments of State and Defense, eliminate allowances for expenses which are not related to place of employment, and save at least $23.2 million annually.

We recommended this change previously to the Chairman, Civil Service Commission (now OPM), in our February 1976 report, "Policy of Paying Cost-of-Living Allowances to Federal Employees in Nonforeign Areas Should Be Changed" (FPCD-75-161). That same report also recommended that the Congress enact legislation to repeal the COLA program for Federal civilian employees in nonforeign areas because the program conflicted with Government pay policies established in 1962.

(963147)

216875

In following up on that report, we reviewed features of the COLA programs administered by your Office and by the Departments of State and Defense to determine whether the programs, which have a similar purpose, treat civilian employees and uniformed members consistently. We did our work in the Washington, D.C., area. We interviewed personnel responsible for administering the COLA programs and collected and analyzed information describing their purpose and features.

In a May 1979 report to the President, OPM recognized the reasons for adopting spendable income as the base for COLA but did not propose this change; instead, it favored eliminating the program.

In June 1979, President Jimmy Carter proposed locality pay rates as part of his pay reform proposal for all General Schedule employees. This proposal would have replaced the COLA program with locality pay rates, but the proposed legislation expired when the 96th Congress adjourned without acting on it. On March 31, 1981, President Ronald W. Reagan's pay reform proposal (S. 838) was introduced in the Senate. This bill would empower the President to designate pay areas and establish locality rates of pay for General Schedule employees. The bill would also eliminate the nonforeign area COLA program.

The purpose of COLA is to enable a Federal employee in a nonforeign area to maintain purchasing power similar to that of a comparable Federal employee in Washington, D.C. The COLA rate is computed from a comparison of the cost for a market basket of goods and services in the nonforeign area with the cost of a similar market basket in Washington, D.C. By applying the COLA rate to base pay, employees are compensated for items that are not in the market basket--income taxes, retirement, life insurance, savings, and charitable contributions. These are not included in the market basket costs because Federal employees receiving the same base pay incur essentially the same cost for these items, regardless of their place of employment. Thus, paying COLA as a percentage of base pay overcompensates employees in the nonforeign areas by about $41.4 million annually.

Although we have estimated the overcompensation at about $41.4 million annually at current salary levels, adopting spendable income as a base may not save all of that money. In Alaska, private sector salaries are substantially higher than salaries in the 48 contiguous States, and the Government already pays special higher rates to a few occupation groups to recruit and retain well-qualified personnel. Adopting spendable income as the base for COLA would reduce COLA payments in Alaska by about $18.2 million annually; however, that money may have to be added to special pay rates for all or nearly all employees in Alaska to recruit and retain personnel. This problem should not arise in the other nonforeign areas, because Federal salaries there generally are competitive with private sector pay. Even if it is necessary to increase special pay in Alaska by the amount of the COLA reduction, we estimate that basing COLA on spendable income will save about $23.2 million annually (at current pay rates) in other nonforeign areas.

We believe OPM should immediately adopt spendable income as the basis for COLA payments. We recognize that legislation has been introduced in the present Congress to eliminate COLA; however, neither our Office nor OPM can forecast when the Congress may pass such legislation. As long as the nonforeign area COLA remains in effect, we continue to believe it should be paid as a percentage of spendable income rather than base salary.

We therefore recommend that the Director, OPM, base COLA payments on a percentage of spendable income, recognizing the number of dependents and salary level of the employees affected.

- - - -

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations. This written statement must be sent to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report. A written statement must also be sent to the House and Senate Committees on Appropriations with an agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; and to the Chairmen, Senate Committee on Governmental Affairs and House Committee on Government Operations, House and Senate Committees on Appropriations, and House Committee on Post Office and Civil Service.

Sincerely yours,

Clifford I. Gould

Clifford I. Gould
Director