GAO

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General Government Division

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February 27, 1986

The Honorable Mary Rose Oakar
Chair, Subcommittee on Compensation
and Employee Benefits
Committee on Post Office and Civil Service
House of Representatives

Dear Madam Chair:

Enclosed is a fact sheet which is provided in response to your February 12, 1986, request for information on the effect of the fiscal year 1987 budget proposals recommending changes to civil service retirement benefits. As you suggested, we calculated the effects on retirement benefits for a typical employee retiring at age 61 after 30 years of service with a life expectancy of age 80 and a beginning annuity of $15,000 per year. We also assumed future pay raises of 3 percent and an inflation rate of 5 percent. We first calculated the annuity reductions resulting from the change from high-three to high-five and the pre-age 62 reduction. We then compared lifetime benefits assuming no changes to the beginning annuity and 5 percent per year cost-of-living adjustments with the reduced annuity and 3 percent per year cost-of-living adjustments.

The fact sheet shows that the overall effect of the three proposed benefit reductions (high-three to high-five, 2 percent per year pre-age 62 reduction and cost-of-living adjustment limitation) would be a loss of $111,767 over the lifetime of the typical retiree. Furthermore, the typical current employee will be required to contribute an additional $11,751 over the remainder of his/her career because of the proposal to increase retirement contributions from 7 to 9 percent.

As arranged with your office, we will send copies of this fact sheet to the Director, Office of Management and Budget, and to others who have an interest in this subject.

Sincerely yours,

Rosslyn S. Kleeman

Rosslyn S. Kleeman
Associate Director

Effects of Proposed Reductions on Retirement Benefits

The following example illustrates the effects of the proposed changes on a typical employee retiring at age 61 with 30 years of service who receives an annual benefit of $15,000.

1. High-Three to High-Five

The proposal to go from a high-three to a high-five average salary for benefit computation purposes results in a lower salary base and therefore a lower annuity. Assuming that an employee's salary is increasing by 3 percent a year over the last five years of the employee's career, a person with a $15,000 annuity would, under the high-five rule, suffer a benefit loss of $428 per year.

2. Two percent Per Year Pre-Age 62 Reduction

The proposal to penalize early retirees requires a two percent benefit reduction for each year a person is under age 62 at the time of retirement. In the example, retirement at age 61 means a cut of 2 percent or $300 in annual benefits.

3. COLA Limitation

The proposal would limit future COLA to the increase in the consumer price index (CPI) minus 2 percentage points. Assuming a 5-percent inflation rate, the first year's COLA would be reduced by $300.

The overall effect of the three proposed benefit reductions would be a loss of $111,767 over the lifetime (life expectancy-age 80) of the typical retiree.

Furthermore, another proposed change would require current employees to contribute more towards these reduced benefits. A typical employee earns $27,000 per year and has 14 years of service. It is proposed that this employee's retirement contributions be increased from 7 to 9 percent. Assuming a 3 percent pay raise each year, the employee's contributions would increase by $11,751 over the remainder of his/her career.

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