RETIREMENT TRUST FUND INVESTMENTS: ADEQUATE FOR LONG-TERM NEED?

HEARING

BEFORE THE

SUBCOMMITTEE ON
CIVIL SERVICE

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

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RETIREMENT TRUST FUND INVESTMENTS: ADEQUATE FOR LONG-TERM NEED?

WEDNESDAY, JUNE 28, 1995

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CIVIL SERVICE,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2154, Rayburn House Office Building, Hon. John L. Mica (chairman of the subcommittee) presiding.

Present: Representatives Mica, Bass, Burton, Morella, Moran, and Mascara.

Also present: Representatives Davis and Collins.

Staff present: George Nesterczuk, staff director; Dan Moll, professional staff member; Caroline Fiel, clerk; Bruce Gwinn, minority senior policy analyst; Cedric Hendricks, minority professional staff; and Elisabeth Campbell, minority staff.

Mr. MICA. Good morning, and welcome to the Subcommittee on Civil Service.

I would like to start this morning's proceeding by providing an opening statement, then I will defer to my colleagues on the panel.

Again, good morning and welcome. I see we have several of our Members who will be testifying. Every Member and every Federal employee who plans on retiring some day should be very concerned about the present financial condition of the system. It is my belief that if we take appropriate action today, we can ensure that every Federal employee can be assured of a funded Federal retirement tomorrow.

I want to extend a welcome to our witnesses who will be testifying, in addition to many Members of Congress. We have representatives of the administration, the Congressional Budget Office, and the General Accounting Office. We have asked our witnesses to testify regarding the financing of the Civil Service Retirement and Disability Fund, CSRDF, and on alternative proposals such as the one introduced by Representative Michael Bilirakis in H.R. 103, which would move the retirement fund to off budget.

The conference committee on the annual budget resolutions has just reached an agreement which includes changes in the Federal employee benefit package. The conference report includes a change in the formula used to compute retirement benefits, a move to high-five calculation by 1998 with an increase in employee contributions to the retirement system of one-quarter percent in 1996 and one-quarter percent in 1998. I believe that these are both reasonable, affordable, and measured increases, which I can support.

In addition, the Government's share of the premiums of the Federal Employee Health Benefit Plan would be based on a fixed dollar amount. The government contribution would be frozen to the 1995 level under the proposal with an inflationary increase based on the Consumer Price Index.

I have several questions relating to this proposal which I hope can be resolved in working with leadership and my colleagues, and I just spoke to the Speaker about some of my concerns about this second proposal. While some may view these changes as good news, the bad news is that if we have not made substantial progress in reducing the burden of the taxpayer for Federal retirement in future years, we are going to have some serious problems.

By not adequately funding retirement liabilities as they are incurred, we are essentially placing this inevitable responsibility on future Congresses and taxpayers. A great deal of misinformation has been circulated by various interest groups regarding this subcommittee's efforts to stabilize the retirement system for Federal employees and retirees.

As chairman of the Civil Service Subcommittee, it is incumbent upon me to confront the understated costs of the Federal retirement system. The CSRDF currently has assets of 300, and I use the term loosely, assets of $320 billion against obligations to current and future retirees of $860 billion. The practical effect of this $540 billion shortfall in assets or unfunded liability is to dramatically understate the cost to the taxpayer of Federal employees' retirement.

Some have contended that these numbers are irrelevant, just as some have argued that the public debt, now calculated at $4.640 trillion is not relevant. I disagree. CBO can testify today that there is no crisis in our Federal pension funds, and I may agree, but this year and in every future year Congress will continue to scramble to find general revenue funds to support current obligations and also to provide payments for debt service for these retirement plans.

There are additional pension problems on the horizon that this subcommittee and Congress must address. Those men and women who have served and are serving in the military are entitled to a pension benefit from the Military Retirement System, also known as MRS. Unfortunately the MRS, much like the CSRDF, also has a current understated liability of over half a trillion dollars.

CSRDF and MRS alone represent more than $1½ trillion the Federal Government is obligated to pay in future benefits. Less than one-third of this amount, about $450 billion, even shows up on the government accounting books or in the national debt.

The national debt represents debt incurred in this Congress for two World Wars and the Korean war, and the war in Vietnam, for the cost of maintaining an adequate defense through our four decades of the cold war, for infrastructure investments, for ports, for bridges, highways, mass transit, and hundreds of education, job, health, and welfare programs.

The unfunded liability for civil service retirement adds an additional 12 percent, or $540 billion to this debt. Unfunded liabilities for military retirement add another 11 percent, or another $510 billion to this debt. When liabilities are properly reflected, our pen-

sion system burdens the taxpayer by over $1½ trillion. That is 25 percent of our gross national debt, which includes Social Security and Medicare.

In the 1980's, Congress recognized the problem inherent in the Civil Service Retirement System, but enacted only a partial fix. When the Federal Employees Retirement System, or FERS, as it is also referred to, was created, Congress had the good sense to place the Thrift Savings Plan outside the budget and assure that its assets rest on real investments.

Congress also provided for the full funding of the basic annuity through employee and agency contributions but failed to back it with real assets in a real trust fund. I have asked the General Accounting Office to update its 1978 report on the financing and solvency of the nearly 40 different Federal retirement systems.

As the GAO stated in their 1978 report, "Full recognition of the accruing retirement cost is essential not only in determining and allocating the cost of government operations but also in determining the present and future financial condition of the United States."

Unpleasant as it may seem to some, failure to recognize the true cost of Federal retirement systems only pushes the burden of funding on to our grandchildren and future generations. I believe a thorough understanding of CSRDF financing is really fundamental to any consideration of long-term prospective reforms.

This hearing today will examine the amount of cash going into the system, the amount of money being paid out in annuities, and the status of CSRDF's assets. We will determine whether the $320 billion of so-called "assets" could be used to pay today's annuities and we will examine the amount of general revenues that will be required to pay annuities in the years 2015, 2025, and 2035.

I look forward to the testimony of our witnesses, and I hope that we can shed some light on the true nature of the retirement trust fund, its many obligations, and also on the reasons why pensions have received so much attention in the past, present, and, in all likelihood, future attempts to reduce our national budget deficit.

Those are my opening comments, and I will yield now to our ranking member on the panel, Mr. Moran from Virginia.

Mr. MORAN. Thank you, Mr. Chairman.

Well, I am glad we are having a hearing without having to be rushed into coming up with numbers to—or back in to savings numbers that came down from on high. This is the way we ought to do this, we ought to take our time and look at it in a careful, thoughtful way, and listen to experts.

We are going to have some experts talk to us today. I am particularly interested in the CBO analysis. As we said during the debate, the Federal retirement system is in very good shape. It needs to be recognized that the Federal retirement system is, in fact, different from private retirement systems. The Federal Government is not going to go out of business on one day and have all of its retirees seek their full retirement payment in one lump sum. We might have a problem if that happened. But that is not going to happen. That does happen in the private sector when businesses go bankrupt, but this is unique.

Where we are comparable to private sector retirement plans is that we use it as a tool to recruit the best people we can into the Federal Government to provide them security, to entice senior members at higher salaries oftentimes to be replaced by younger people at lower salaries. It is the result, what we have today, of many, many years, thousands of Members of Congress and thousands of people in the executive branch working together to come up with a system that makes sense.

We have that system today. It not only makes sense from employment policy, it also makes fiscal policy sense. If we were to invest privately, we would have to take these funds out of the Federal Government and invest them in some form other than where they are today. By doing it the way we do, there is no direct outlay. It is a fund transfer. It doesn't have to be scored as an outlay, and as a result it doesn't have any adverse implications in terms of our budget balancing objectives.

The numbers that I know we are going to see, because I have looked at them, that CRS has done, that OPM has, and that CBO has done show that if you look at the income to the retirement program, it more than covers any outgo requirements, particularly when you do it on a real dollar basis. In other words, you adjust for inflation as you would in any such analysis.

We are in very good shape. The 1986 plan, when it was put together, was done so in a thoughtful way. Everything that they anticipated would occur has occurred. As the CSRS plan phases out, the FERS plan phases in with less demands upon the retirement fund, Social Security is picking up more Federal employees' retirement needs, and the Thrift Savings Plan is working. So I think we ought to keep it the way it is. I have come to that conclusion after looking at all the numbers.

Essentially, the retirement fund is invested in much the same way that people invest their Thrift Savings Plan money when they decide to go with the safest type of investment, the G fund, the government securities. That is where the retirement fund is invested, in Federal Government securities, and it has the full faith and credit of the U.S. Government behind it.

So I am glad you have given us this opportunity to make this case because I know when we hear from the experts at CBO and CRS who have done very extensive analyses, it will confirm the expectation that the people who worked on it for 2 years back from 1984 to 1986 had, and confirm the fact that Federal employees have, an excellent retirement system that is safe, that is secure, and that makes a lot of common sense.

Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman, and I yield to the vice chairman of the subcommittee, Mr. Bass.

Mr. BASS. Thank you very much, Mr. Chairman.

I appreciate the fact that you are holding this important hearing to examine the financing, bookkeeping, and operation of the Civil Service Retirement and Disability Trust Fund. Clearly, there is a problem with the way the system is working when year after year Federal employees and retirees remain vulnerable to administration and congressional budget scrutiny, and I am pleased that we have this opportunity to take, as Mr. Moran mentioned, a careful

and thoughtful scrutiny of this system so that we can really get into the details and try to get some real concrete answers.

It has been a rushed process, perhaps necessarily, but still I think this is a great opportunity. In the past several months, as we know, a number of Members of Congress have indicated that they have concerns about the vulnerability of Federal workers and retirees, as well as what the moneys in the trust fund actually pay for. Some of them have been asked to testify today to share with us their thoughts and hopefully make suggestions on how we might address those concerns.

I look forward to the testimony of the Members today and hope they will share with us their ideas for prospective reforms. The major problem, as I see it, is the runaway cost of the retirement system. Money magazine reported on this significant and growing cost last October. According to Money magazine, "State governments on average spend 14.3 percent of payroll on pensions; for local governments, it is 16.5 percent; and at the Federal level, it is a beltway-sized 25 percent of payroll." And the magazine continues later on to say that despite the 1983 law intended to reform Federal pensions, the OPM expects that 25 percent to grow to 40 percent by the year 2020.

This huge and growing cost to the Federal retirement system worries me. I understand that Federal taxpayers in effect employ Federal employees, and as employers, are expected to shoulder their fair share of the retirement system, similar to the way any private company might, and for that matter State and municipal retirement systems. However, if the American taxpayer as an employer understood what the present costs were and how those costs are projected to skyrocket, he or she would do like any private company would do and take a good hard look at the way the system is financed.

I would like to take the opportunity to tell taxpayers as employers of Federal workers that the draw from their taxes, the General Treasury, was approximately $26 billion in fiscal year 1994. That figure is projected to grow to $44 billion by the year 2010 and will continue to explode into the hundreds of billions of dollars, as much as $1½ trillion by the year 2045. When Federal programs are allowed to go unchecked like this, it is no wonder that our annual deficit is too big and so disgraceful.

If you think the price Congress may be asking Federal employees to pay today is great, think about what these figures will mean a few years down the road. If we do not begin to correct the way we are financing the system, we will place an inescapable burden on future Congresses either to make draconian cuts in Federal benefits, which is something this Congress chose not to do, or to impose unacceptable taxes on ourselves and those who follow us. I might add that these decisions, if we do nothing now, will probably not be made by anybody here today, but by people who follow us.

I strongly believe that we in Congress have a responsibility to American taxpayers and to the Federal employees and retirees, the three groups involved, to begin addressing the current financial problems of the system, and that is why I have supported recent legislative proposals to get the way we fund this system back on track. Understanding that Congress is itself part of the problem, I

also support efforts to include us and our staffs in any proposal that would affect executive branch employees.

I commend the administration's actuaries for realizing and putting forth proposals to address some of the financing problems, one to deal with fully financing current and future CSRS benefits through agency contributions, and the other to pay off previously accrued CSRS unfunded liabilities. I am anxious to hear from the administration witness today regarding both of these proposals that were included this year in the President's budget submission.

Finally, I have some serious concerns about the way we are keeping the books for our Federal employees regarding their pensions. The majority of so-called "assets" in the fund which make the fund look like it is flush with cash are nothing but paper IOUs and represent spending authority for any number of government programs paid out of the General Treasury. This bookkeeping scheme misleads both taxpayers and the Federal workers and retirees into believing that we have reserved and invested actual funds into a special account.

In addition, the so-called "assets" of the fund are not invested in private sector funds but in non-negotiable government securities. Here again, there are no real monetary gains, merely entries on the books which become additional future draws on the Treasury. These bookkeeping practices underestimate the growing cost of the system and mask the real size of our Federal deficit by almost $26 billion in 1994 going up to $1½ trillion by the year 2045.

Our accounting is wrong, and I am not the only one who wants answers. Let me quote one of the letters that the committee received recently from Carol Goodyear, a Federal employee who wrote on June 2, to ask, "Where is all the money that is contributed to CSRS and why can't it be accounted for? Do private pension funds receive more protection from the Federal Government through the Pension Benefit Guaranty Corporation than do the pensions of its own Federal employees?"

I couldn't have asked the question better myself and I hope today that we will get some answers to this and other questions that I have raised.

I thank you, Mr. Chairman, for the opportunity to make this statement.

Mr. MICA. I thank the gentleman.

[The prepared statement of Hon. Charles F. Bass follows:]

PREPARED STATEMENT OF HON. CHARLES F. BASS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW HAMPSHIRE

Thank you, Mr. Chairman, for holding this important hearing to examine the financing, bookkeeping, and operation of the Civil Service Retirement and Disability Trust Fund (CSRDF). Clearly, there is a problem with the way the system is working when year after year Federal employees and retirees remain vulnerable to Administration and Congressional budget scrutiny.

In the past several months, a number of Members of Congress have indicated that they have concerns about the vulnerability of the federal workers and retirees, as well as what the monies in the trust fund actually pay for. Some of them have been asked to testify today to share with us their thoughts and hopefully make suggestions on how we might address those concerns.

I look forward to the testimony of the Members today and hope they will share with us their ideas for prospective reforms.

The major problem as I see it is the runaway cost of the retirement system. Money magazine reported on this significant and growing cost last October. According to Money:

> "State governments on average spend 14.3% of payroll on pensions; for local governments it's 16.5%, and at the federal level it's a Beltway-size 25% of payroll . . . [and, the magazine continued that] Despite a 1983 law intended to reform federal pensions, the OPM expects that 25% to grow to 40% by 2020." (Money's source was the OPM, the Office of Personnel Management.)

This huge and growing cost of the federal retirement system worries me. I understand that federal taxpayers in effect "employ" federal employees, and as employers, are expected to shoulder much of the cost of the retirement system—similar to the way a private company might. However, if the American taxpayer, as an employer, understood what the present costs were and how those costs are projected to skyrocket, he or she would do like any smart private company would do and take good hard look at the way the system is financed.

I'd like to take the opportunity to tell taxpayers as employers of federal workers, that the draw from their taxes—the general treasury—was approximately $26 billion in FY94. That figure is projected to grow to $44 billion in the year 2010, and will continue to explode into the $100's of billions in 2045. When federal programs are allowed to go unchecked like this, it is no wonder that our annual deficit is such a disgrace.

If you think the price Congress may be asking federal employees to pay TODAY is great, think about what these figures will mean a few years down the road. If we do not begin to correct the way we are financing this system, we are placing an inescapable burden on future Congresses either to make draconian cuts in federal benefits, (which is something this Congress chose NOT to do), or to impose outrageous taxes on ourselves and our children, or both.

I strongly believe that we in Congress have a responsibility to American taxpayers and to federal employees and retirees to begin addressing the current financial problems of this system, and that is why I support recent legislative proposals to get the way we fund this system back on track. Understanding that Congress too is part of the problem, I also support efforts to include us in any proposal that would affect Executive branch employees.

I commend the Administration's actuaries for realizing and putting forth proposals to address some of the financing problems: one to deal with fully financing current and future CSRS benefits through agency contributions; and the other to pay off previously accrued CSRS unfunded liabilities. I am anxious to hear from the Administration witness today regarding both of these proposals that were included this year in the President's budget submission.

Finally, I have some serious concerns about the way we are keeping the books for our federal employees regarding their pensions. The majority of so-called "assets" in the fund—which make the fund look like it's flush with cash—are nothing but paper IOUs, and represent spending authority for any number of government programs paid for out of the general treasury. This bookkeeping scheme misleads both taxpayers and federal workers and retirees into believing that we have reserved and invested actual funds into a special account.

In addition, the so-called "assets" of the fund are not invested in private sector funds, but in non-negotiable governmental securities. Here again, there are no real monetary gains, merely entries on the books which become additional future draws from the treasury. These bookkeeping practices horribly underestimate the growing cost of the system, and mask the real size of our federal deficit—by about $26 billion in fiscal 1994, and by $100's of billions by the year 2020.

Our accounting is wrong, and I'm not the only one who wants answers. Let me quote one of the letters the Committee received recently from Carol Goodyear, a federal employee, who wrote on June 2nd to ask:

> "Where is all the money that is contributed to CSRS, and why can't it be accounted for? Do private pension funds receive more protection from the Federal government (through the Pension Benefit Guaranty Corporation) than do the pensions of its own Federal employees?"

I couldn't have asked the question better myself, and I hope today we get some answers to this and other questions that I have raised.

Thank you, Mr. Chairman.

Mr. MICA. I yield to Mr. Mascara from Pennsylvania.

Mr. MASCARA. Good morning, Mr. Chairman. I thank you.

In my former life as an accountant and county commissioner and comptroller in Washington County, PA, I had the responsibility of administering a pension fund for the employees of Washington County. And when I left, it was 107 percent funded. We were required by law to make sure it was fully funded every year.

And I am a little confused as an accountant. I hear all of these numbers being thrown around and I am not sure what they mean. In fact, we just went through a BRAC commission hearing and closure, realignment, and it affected several bases in my district, and once we looked at the numbers, I was amazed at the inaccuracy, the flaws, the incorrect numbers that were being fed to us and that a decision was being made based upon information supplied by the Air Force and the Department of Defense and others. So you will excuse me if I am a little reluctant to accept anything at this point in time.

As a freshman Congressman, having been here only 6 months, I am totally amazed at how we throw numbers around. I have been here before, committee meetings and hearings, talking about this retirement. I thought the problem was solved in 1986 that after a 30-year glide path that we were going to be in good shape and that the fund did have, indeed, a surplus, this fiscal year a surplus of something over $350 billion. But there again, maybe it is not there. I don't know.

But I want to add that I must say that I am most pleased that we are finally going to get an opportunity to hear some of my Republican colleagues who share my views that we should not continually go after Federal workers and their retirement benefits. I have heard a hue and cry as a result of this move, just amazing the phone calls I get about this approach to go from high three to high five, and somehow pick the pockets of Federal employees by another 2.5 percent.

The various provisions included in the recently completed conference report on the Fiscal 1996 Budget Resolution which calls for increasing retirement fund contributions while cutting retirement benefits are nothing but a tax increase. The irony is that none, none of the $5.3 billion in savings these proposed cuts will allegedly generate will be going to shore up the retirement system which the chairman feels is broke. Instead, they will be falling into the black hole of deficit reduction and become part of the funds used to pay for the $245 billion tax cut that will largely benefit the wealthy.

I stand squarely with my Republican colleagues who will be testifying today in stating categorically that this is unfair. Perhaps most importantly, today's testimony from the Congressional Budget Office, the General Accounting Office, and Ms. Rivlin will help Members and the public better understand what the Federal retirement systems are and how they are funded. As the Congressional Budget Office will tell us, the Civil Service Retirement and Disability Fund is actually a ledger that is useful in measuring the cost and liabilities of the Federal retirement systems. The big news is the retirement does not face a financial crisis. It will explain that in fact the demand of the general fund to make up any shortfall actually declines in constant dollar terms after the year 2015. That

should be good news for my colleagues worried about the Nation's deficit.

Another important point that will be made is that the Civil Service Retirement and Disability Fund is a trust fund. Back where I come from if you violate the trust fund you go to jail, but that apparently isn't true on Capitol Hill. Just like Social Security and the myriad of other trust funds that abound in the Federal Government, any excess in the fund, which now stands at well over $300 billion, is invested as some who proceeded me said in non-negotiable Federal Government securities. The same thing happens with the Social Security Trust Funds.

It would have been nice back in Washington County if we could have just printed something that represented the dollars we collected from our employees. The government pays interest on these notes, and when additional funds are needed to pay benefits, this money comes out of the general revenues.

My friends on the other side of the aisle are not as quick to criticize such repayments to the Social Security Trust Funds as they are to the Civil Service fund. They are not as quick to discuss the much greater so-called "unfunded liability" the Social Security system faces in the next century. The reality is the same type of transactions occur in both systems and both should be held in the same high esteem. We have made commitments to both sets of retirees, and they should be kept.

While I understand there are budget implications surrounding Representative Bilirakis's proposal, I certainly share his view that the Civil Service Retirement and Disability Fund deserves the same kind of protection and respect afforded the Social Security Trust Fund. Hopefully this hearing will begin that long overdue process.

Thank you very much, Mr. Chairman.

[The prepared statement of Hon. Frank Mascara follows:]

PREPARED STATEMENT OF HON. FRANK MASCARA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Good morning Mr. Chairman. Thank you for calling this hearing.

Looking over the testimony, I think it is going to prove to be very interesting and enlightening. By the end, we will all have a better understanding of what is and isn't the Civil Service Retirement and Disability Fund. More importantly, we should walk away with a loud and clear message that the fund is financially sound, not standing on the edge of an abyss as some of my colleagues on the other side of the aisle would have us believe.

I must say that I most pleased that we are finally going to get an opportunity to hear from some of my Republican colleagues who share my view that we should not be continually going after Federal workers and their retirement benefits.

The various provisions included in the recently completed conference report on the fiscal 1996 budget resolution, which call for increasing retirement fund contributions while cutting retirement benefits, are nothing but a tax increase.

The irony is that none of the $5.3 billion in savings these proposed cuts will allegedly generate will be going to shore up retirement system, which Chairman Mica feels is broke. Instead they will be falling into the black hole of deficit reduction and become part of the funds used to pay for a $245 billion tax cut that will largely benefit the wealthy.

I stand squarely with my Republican colleagues who will be testifying today in stating unequivocally that this is unfair!

Perhaps most importantly, today's testimony from the Congressional Budget Office, the General Accounting Office and Ms. Rivlin, will help Members and the public better understand what the Federal retirement systems are and how they are funded.

As the Congressional Budget Office official will tell us, the Civil Service Retirement and Disability Fund is actually a ledger that is useful in measuring the costs and liabilities of the Federal retirement systems.

His big news is the retirement fund does not face a financial crisis. He will explain that in fact the demand on the general fund to make up any shortfall actually declines in constant dollar terms after 2015.

That should be good news for my colleagues worried about the Nation's deficit!

Another important point that will be made is that the Civil Service Retirement and Disability Fund is a trust fund—just like Social Security and the myriad of other trust funds that abound in the Federal Government.

Any excess in the fund—which now stands at well over $300 billion—is invested in non-negotiable Federal Government securities. The same thing happens with the Social Security Trust Funds.

The Government pays interest on these notes and when additional funds are needed to pay benefits, this money comes out of general revenues.

My friends on the other side of the aisle are not as quick to criticize such repayments to the Social Security Trust Funds as they are to the Civil Service fund. They are not as quick to discuss the much greater so-called unfunded liability the Social Security system faces in the next century.

The reality is it is the same type of transactions occur in both systems and both should be held in the same high esteem. We have made commitments to both sets of retirees and they should be kept.

While I understand there are budget implications surrounding Representative Bilirakis' proposal, I certainly share his view that the Civil Service Retirement and Disability Fund deserves the same kind of protection and respect afforded the Social Security Trust Funds.

Hopefully this hearing will begin that long overdue process.

Thank you Mr. Chairman.

Mr. MICA. I thank the gentleman. Now I will yield to Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman.

Mr. Chairman, I have a statement I would like to submit for the record and make some brief remarks because I want to get to my colleagues and listen to them.

Mr. MICA. Without objection.

Mr. BURTON. I don't want them to go to sleep out there listening to my statement.

I have voted, Mr. Chairman, for the revised approach to dealing with the pension plans for Federal employees, and it bothered me a lot. I think it caused a lot of us heartburn. I hope that we don't have to go back, and I don't think I will support going back and hitting them again. I think they have been hit enough.

I do believe that we need to look very seriously at changing the Federal retirement system for new people coming into the Federal work force, and that is something I hope this committee will take a look at in the future. I also think we need to consider creating a Federal retirement system that is fully funded, and that is separate from the Federal budget. ERISA requires private sector pensions to be fully funded, and I think that is a good idea and it should apply to the Federal pension system as well.

This is a very difficult and thorny issue. I hope we can come up with some solutions to the problem that won't cause any more pain for the Federal work force. We have a lot of fine people in the Federal work force, and they shouldn't be mistreated, and as I said before, it caused a lot of us heartburn to vote for the original plan that passed the House, and we shouldn't hit them again.

With that, Mr. Chairman, I yield back the balance of my time.

Mr. MICA. I thank the gentleman.

[The prepared statement of Hon. Dan Burton follows:]

PREPARED STATEMENT OF HON. DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. Chairman, I want to thank you for holding this hearing today. I think it is very important for this subcommittee to look closely at Federal retirement programs and how future retirement benefits will be financed.

All of us have heard from Federal employees back home who strongly oppose the Federal retirement changes contained in H.R. 1215 and in the budget resolution. They believe that Congress is breaking a contract it has made with them. Now, many Federal employees who are nearing retirement age, and have already made plans for retirement, are facing the possibility of reduced pensions. Federal employee contributions to their retirement will also be increased.

I reluctantly supported these changes when they were considered by the House because I believe it is urgent that Congress deal with the $540 billion unfunded liability in the Federal retirement fund. If we do nothing, the problem will only get worse, and then Congress will have to consider even harsher measures such as cutting COLAs.

Congress must meet the commitments it has made to current Federal employees and retirees. But I think that we need to look very seriously at changing the Federal retirement system for new persons hired in the future. It is very important that we protect the benefits that current Federal employees and retirees have earned, but we can and should change the system for new hires so that Congress is no longer faced with a continual shortfall in the retirement fund to pay for benefits.

I think we should consider creating a new Federal retirement system that is fully funded and that is separate from the Federal budget. ERISA requires private sector pensions to be fully funded and this is a good idea. A fully funded retirement system would guarantee that the money would be there to pay benefits to Federal retirees. That is not the case today. We have to use money from the general fund to help pay Federal retiree benefits because the retirement fund is underfunded. Secondly, by separating the new retirement system from the Federal budget we protect this money from being used by Congress for other purposes.

I will conclude by welcoming our witnesses who will appear before the subcommittee, and I look forward to your testimony. This is an important issue and we certainly need as much expert advice as possible.

Mr. MICA. Now I would like to yield to and apologize for not recognizing her earlier, the ranking minority member of the full committee, Mrs. Collins.

Mrs. COLLINS. No apology necessary, Mr. Chairman. I was more than happy to sit here and hear some of the opening statements.

Mr. Chairman, last week conferees cleared the way for the House and the Senate to consider the Republican budget proposal for fiscal year 1996. That budget, no matter how you look at it, hits the pay and benefits of Federal employees harder than any other proposal considered so far. The budget conference agreement cuts all three of the most important basic employee benefits—pay, health care, and retirement.

Under this proposal, Federal employees would have to give up $69 billion in future pay increases and $1.6 billion in retirement benefits over the next 7 years. During that same period of time, this budget will also force Federal employees to pay $14.7 billion more for their retirement and health benefits than they would pay under the current system.

Now, altogether, the budget snatches $85.3 billion out of the pockets of Federal employees and retirees. That is $85.3 billion in pay and benefits that the Federal Government has already made commitments to provide. Now this is money the Federal Government owes its employees and its retirees.

The majority is constantly saying the Federal Government should operate more like a private business. The budget proposal does just the opposite on retirement and health benefits. Large private employers in the United States pay virtually all the health

care costs for their employees, and under the Republican budget proposal over 78 percent of all Federal employees would pay more for their health insurance coverage than they do now.

The same is true for retirement benefits. Ninety-seven percent of all American employees in medium and large firms are in pension plans paid for entirely by their employers. However, about 25 percent of the cost of providing retirement benefits for Federal retirees last year was paid by the current employees.

So why does the Republican budget yank $85 billion away from middle-class Federal workers? They first said changes were needed because the unfunded liability of the Federal retirement system was rapidly growing to unacceptable levels; that, left alone, the civil service retirement fund would require steep increases in contributions from general revenues to avoid insolvency. However, the budget conference agreement actually contains less savings for the retirement system than the House has already passed. If insolvency is the problem, then this budget agreement does little to address it.

Furthermore, we heard from experts at the General Accounting Office and the Congressional Research Service that the retirement fund's unfunded liability is not even a problem that needs to be fixed. According to these experts, as well as other equally expert witnesses we will hear from today, Mr. Chairman, there is no danger now or in the future that the civil service retirement fund will be insolvent.

For this reason, members of our committee from both sides of the aisle were able to take a little more time to consider legislation implementing cuts in the Federal retirement program a few weeks ago. Later, however, the majority revealed their purpose more clearly when they included Federal retirement changes in their bill giving wealthy Americans a capital gains tax cut. To help pay for their $354 billion tax cut for the rich, the majority pushed through cuts in Federal employee retirement benefits and more than a 300 percent increase in the retirement withholding tax for many Federal employees.

Now, clearly many in the majority are more interested in giving a tax cut to the wealthy than in saving the retirement fund from insolvency. It is the tax cut and nothing more that has caused the majority to seek retirement cuts from the very beginning, and that continues to be the reason these cuts are still in the budget.

I have and will continue to strongly oppose cutting the retirement benefits of middle-class Federal employees in order to pay for a tax cut for rich folk.

I yield back the balance of my time.

Mr. MICA. I thank the gentlelady.

[The prepared statement of Hon. Cardiss Collins follows:]

PREPARED STATEMENT OF HON. CARDISS COLLINS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Chairman, last week conferees cleared the way for the House and the Senate to consider the Republican budget proposal for fiscal year 1996. That budget, no matter how you look at it, hits the pay and benefits of Federal employees harder than any other proposal considered so far.

The Budget Conference Agreement cuts all three of the most important basic employee benefits—pay, health care, and retirement.

Under the Republican proposal, Federal employees would have to give up $69 billion in future pay increases and $1.6 billion in retirement benefits over the next seven years (from enactment to the year 2000). During that time, this budget will also force Federal employees to pay $14.7 billion more for their retirement and health benefits than they would pay under the current system.

Altogether, the Republican budget takes $85.3 billion out of the pockets of Federal employees and retirees—$85.3 billion in pay and benefits that the Federal government has already made commitments to provide. This is money the Federal government owes its employees and retirees.

Republicans are constantly saying the Federal government should operate more like a private business. Yet, the Republican budget proposal does just the opposite on retirement and health benefits. Large private employers in the United States pay virtually all, I repeat all, the health care costs for their employers. Under the Republican budget proposal, over 78% of all Federal employees would pay more for their health insurance coverage than they do now.

The same is true for retirement benefits. Ninety-seven percent of all American employees in medium and large firms are in pension plans paid for entirely by their employers. However, about 25% of the cost of providing retirement benefits for Federal retirees last year was paid by current employees.

So, why does the Republican budget yank $85 billion away from middle class Federal workers? They first said changes were needed, because the "unfunded liability" of the Federal retirement system was rapidly growing to unacceptable levels; that, left alone, the civil service retirement fund would require steep increases in contributions from general revenues to avoid insolvency.

However, the Budget Conference Agreement actually contains less savings for the retirement system than the House has already passed. If insolvency is the problem, then this Budget Agreement does little to address it.

Furthermore, we heard from experts at the General Accounting Office and the Congressional Research Service who said the retirement fund's "unfunded liability" is not even a problem that needs to be fixed. According to these experts, as well as other equally expert witnesses we will hear from today Mr. Chairman, there is no danger now, or in the future, that the civil service retirement fund will be insolvent.

For this reason, Members of our Committee from both sides of the aisle were able to successfully block Committee approval of legislation implementing cuts in the Federal retirement program.

Later, however, the Republican Majority revealed their purposes more clearly when they included Federal retirement changes in their bill giving wealthy Americans a capital gains tax cut. To help pay for their $354 billion tax cut for the rich, the Republican Majority pushed through cuts in Federal employee retirement benefits and more than a 300% increase in the retirement withholding tax for many Federal workers.

Clearly, many in the Majority are more interested in giving a tax cut to the wealthy, than in saving the retirement fund from insolvency.

It is the tax cut, and nothing more, that has caused the Majority to seek retirement cuts from the very beginning and that continues to be the reason these cuts are still in the Republican budget. I have, and continue to, strongly oppose cutting retirement benefits for middle class workers in order to pay for a tax cut for the wealthy.

It is not only unfair to Federal workers who have participated in a retirement program based on commitments the government made, but these cuts also undermine efficiency and excellence in government. Extending the base salary period for retirement computation from three years to five years will have a devastating impact on efforts to downsize the Federal workforce.

These retirement changes will likely force many experienced Federal workers to retire earlier, thereby making it more difficult to retain skilled and experienced employees. These changes may also force many other workers to stay longer than they otherwise would in order to recoup lost benefits.

For example, officials at the Drug Enforcement Agency, one of the few agencies that has authority to hire, say they fear that retirement and other pay and benefit changes in the budget resolution will make it significantly more difficult to retain their most experienced agents, and still harder to hire experienced new ones.

The simple fact is that the changes in the budget resolution would mean that pay and other benefits for Federal employees will be far less competitive than comparable benefits in the private sector.

Mr. Chairman, I am very pleased, therefore, that you are holding this hearing. We will hear from Members of the Majority, who like myself, have concerns about both the fairness and the wisdom of the retirement changes being proposed. The

General Accounting Office and the Congressional Budget will also testify that the "unfunded liability," poses no threat to the retirement fund.

I look forward to their testimony, and I will continue to work to ensure that the Federal government lives up to the commitments it has made to its employees and to ensure that there is a competent and motivated workforce to do the people's business.

Mr. MICA. And now I would like to yield to the gentlelady from Maryland, Mrs. Morella.

Mrs. MORELLA. Thank you, Mr. Chairman.

I was going to be testifying, but I prefer to do it here as a member of this subcommittee, and so I want to reflect to all of you that the proposed revisions to the Federal retirement system have unearthed a number of very critical issues, and although you and I, Mr. Chairman, have divergent views on some of the issues, I do share your belief as outlined in your memorandum of June 23, that "an understanding of the financing of the Civil Service Retirement and Disability Fund is fundamental to any consideration of long-term, prospective reforms to the CSRDF."

I want to commend you, Mr. Chairman, for calling this hearing which is a crucial step in moving toward this understanding.

Is the retirement fund insolvent? Much has been made about the unfunded liability of the Federal retirement system, and yet both the Congressional Research Service and the General Accounting Office agree that, "the Federal retirement system's unfunded liability is not a problem that needs to be fixed." Both CRS and GAO have concluded that "there will always be sufficient assets in the retirement fund to cover benefit payments to all current and future retirees." In fact, the unfunded liability of the Social Security system is over $7 trillion, and no one seems concerned about that.

Who should finance the retirement system? In a CRS report entitled, "Federal Civil Service Retirement: Comparing the Generosity of Federal and Private Sector Retirement Systems," it was noted that virtually all private pensions, 97 percent, are funded entirely by the employer. The Military Retirement System operates under this principle, and yet Federal workers are preparing themselves for a slightly higher contribution and reduced benefits.

Now, I don't mean to suggest that Federal agencies and taxpayers, as employers, should pay the entire contribution to the Federal retirement system, which would be approximately 25 percent of salary. This would represent a significant cost to agencies which in these times would be problematic, to say the least. However, I am reserving judgment on the administration's proposal to fully fund the system, excluding the current employee contribution. At face value, this, too, seems problematic. But Mr. Flynn from OPM is here today, and he will hopefully outline the concepts of this idea.

Should the CSRDF be off budget? The intent of this idea is to protect the earned benefits of Federal workers. I support this. However, a number of individuals have expressed doubts that this idea would have this effect. Some feel the inverse is true, predicting increases in the deficit and current outlays while providing no real protection for current or future Federal retirees.

I am a cosponsor of Mr. Bilirakis's bill, H.R. 103, which would take the CSRDF off budget. I am glad that this subcommittee will afford Mr. Bilirakis an opportunity to discuss his bill and its finan-

cial implications. I also believe that Mr. Blum, Deputy Director of the CBO, will offer insight in this area.

What else should we be investigating? The importance of financing the Federal retirement system cannot be understated, but for me the quality of retirement life is the real issue. When a 33-year-old government worker is projected to receive around $3,100 a month when he or she retires at age 55, I wonder what kind of life he or she will have. In a letter to me from a sixth grade constituent she, too, raises a quality-of-life issue. "Some people would have fewer choices if they get less money and pension," she wrote.

Mr. Chairman, I don't think anyone on this subcommittee wants to see individuals having fewer choices in their golden years, so after we examine the financing of the system and we make needed changes, let's turn our attention to strategies that maximize pension investment opportunities for Federal workers. With plans to base Federal worker pensions on a high five, investments may be the difference between a Federal worker having a quality life in retirement or depending on someone else to take care of him or her.

I plan to introduce a bill that would amend the Federal Employee's Retirement System Act of 1986, and this bill would authorize a small capitalization stock index investment fund and an international stock index investment fund as part of the Thrift Savings Plan for Federal employees. These additions to the funds currently available will provide Federal workers sufficient financial options for diversifying their investment portfolios, but, Mr. Chairman, it will do more than that. This bill would empower Federal workers to take more personal responsibility for their retirement.

I would also, Mr. Chairman, like to submit for the record a statement by Helene A. Benson, president of the Professional Managers Association. Ms. Benson raises an interesting point in her statement. ERISA laws prohibit lowering benefits that private sector employees have already accrued. Following that logic, the high five provision would only apply to future years of accrual and not to the years employees have already accrued under the high three formula. If much of what we are planning to do to the Federal retirement system is modeled after the private sector, let us at least give Federal workers the same protections afforded private sector employees, so may I ask that her statement be included in the record, Mr. Chairman?

Mr. MICA. Without objection, so ordered.

Mrs. MORELLA. Again, thank you, Mr. Chairman, for calling this hearing. I look forward to hearing the witnesses.

Mr. MICA. I thank the gentlelady.

[The prepared statement of Hon. Constance A. Morella follows:]

PREPARED STATEMENT OF HON. CONSTANCE A. MORELLA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

The proposed revisions to the federal retirement system have unearthed a number of critical issues. And although the Chairman and I have divergent views on some of these issues, I share his belief, as outlined in his memorandum of June 23, that "an understanding of the financing of the Civil Service Retirement and Disability Fund (CSRDF) is fundamental to any consideration of long-term, prospective reforms to the CSRDF." Chairman Mica should be commended for calling this hearing, which is a crucial step in moving toward this understanding.

Is the retirement fund insolvent? Much has been made about the unfunded liability of the federal retirement system. Yet, both the Congressional Research Service

(CRS) and the General Accounting Office (GAO) agree that the "federal retirement system's unfunded liability is not a problem that needs to be fixed." Both CRS and GAO have concluded that "there will always be sufficient assets in the retirement fund to cover benefit payments to all current and future retirees." In fact, the unfunded liability of the Social Security system is over $7 trillion, and no one seems concerned about that.

Who should finance the retirement system? In a CRS report entitled, Federal Civil Service Retirement: Comparing the Generosity of Federal and Private-Sector Retirement Systems, it was noted that virtually all private pensions (97%) are funded entirely by the employer. The military retirement system operates under this principle. Yet, federal workers are preparing themselves for a slightly higher contribution and reduced benefits.

Now, I do not mean to suggest that federal agencies (and taxpayers), as employers, should pay the entire contribution to the federal retirement system, which would be approximately 25 percent of salary. This would represent a significant cost to agencies, which, in these times, would be problematic to say the least. However, I am reserving judgement on the Administration's proposal to fully fund the system, excluding the current employee contribution. At face value, this too seems problematic. But, Mr. Flynn from OPM is here today, and he will hopefully outline the concepts of this idea.

Should the CSRDF be off-budget? The intent of this idea is to protect the earned benefits of federal workers. I support this. However, a number of individuals have expressed doubts that this idea would have this effect. Some feel the inverse is true, predicting increases in the deficit and current outlays, while providing no real protection for current or future federal retirees. I am a cosponsor of Mr. Bilirakis' bill, HR 103, which would take the CSRDF "off-budget." I am glad that this Subcommittee will afford Mr. Bilirakis an opportunity to discuss his bill and its financial implications. I also believe that Mr. Blum, Deputy Director, CBO, will offer insight in this area.

What else should we be investigating? The importance of financing the federal retirement system cannot be understated, but for me, the quality of retirement life is the real issue. When a 33-year old government worker is projected to receive around $3,100 a month when he retires at age 55, I wonder what kind of life he will have. In a letter to me from a sixth grade constituent, she too raises the quality of life issue. "Some people . . . would have fewer choices if they get less money [pension]," she wrote.111Mr. Chairman, I do not think anyone on this Subcommittee wants to see individuals having "fewer choices" in their golden years. So after we examine the financing of the system and we make needed changes, let us turn our attention to strategies that maximize pension investment opportunities for federal workers. With plans to base federal worker pensions on a "high-five," investments may be the difference between a federal worker having a quality life in retirement or depending on someone else to take care him/her.

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I would also like to submit for the record a statement by Helene A. Benson, President, Professional Managers Association. Ms. Benson raises an interesting point in her statement. ERISA laws prohibit lowering benefits that private sector employees have already accrued. Following that logic, the "high-5" provision would only apply to future years of accrual and not to the years employees have already accrued under the "high-3" formula. If much of what we are planning to do to the federal retirement system is modeled after the private sector, let us at least give federal workers the same protections afforded private sector employees.

Again, thank you, Chairman Mica, for calling this hearing. I look forward to hearing the witnesses.

[The prepared statement of Ms. Benson follows:]

PREPARED STATEMENT OF HELENE A. BENSON, PRESIDENT, PROFESSIONAL MANAGERS ASSOCIATION

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to present the views of the Professional Managers Association on funding civil service retirement. The Professional Managers Association (PMA) represents the interests of career mid-level managers and management officials, Grade 13 through 15, in the Federal government. PMA is also a member of the Coalition for Effective Change, which consists of twenty-nine professional associations of Federal career executives, managers, and professionals.

I, like most Federal employees, am concerned and outraged over recent proposals to change various aspects of the Federal employee retirement plans.

I want to make one point before I go on to the others. And, that is that the benefits employees have already accrued simply cannot be tampered with, unless, to speak plainly, the Congress is willing to engage in outright stealing from Federal employees and, in addition, do to Federal employees what would be a violation of the Employee Retirement Income Security Act of 1974 (ERISA) in the private sector.

ERISA, which regulates private-sector employee retirement plans in Internal Revenue Code 411(d)(6) and section 204G of Title I in ERISA, prohibits lowering benefits that employees have already accrued (earned). Would you countenance expropriating employees' thrift savings accounts? Surely not. Lowering benefits employees have already accrued in a defined benefit pension plan (such as the Civil Service Retirement System (CSRS) and the annuity portion of the Federal Employees Retirement System (FERS)) is no different from taking away the amounts that have already been contributed to the thrift savings plan accounts of employees.

Accordingly, if the formula, such as the "high-3" formula, for computing benefits is changed to "high-5," the "high-5" formula cannot apply to past years, it can apply only to future years of accrual. So, if the "high-3" formula is changed to "high-5," all of the years employees have already accrued must be based on "high-3"—only their future years of service for which they have not yet accrued benefits can be based on "high-5."

If Congress, in dealing with Federal employees' retirement, does not abide by those simple protections given under Federal law to private-sector employees, it is allowing itself to strip Federal employees of rights and protections that private-sector employees in this country have long been protected from suffering at the hands of their employers. Not respecting benefits already accrued by employees would be more than breaking the Government's contract with us—it would be robbing us of benefits we have already earned. Remember, Congress recently promised to abide by the rules it imposes on the private sector.

For the Government to renege on any of its retirement promises to current Federal employees (even with respect to those benefits employees have not yet accrued) is to break faith with Federal employees and break the Government's contract with us. Such an action is akin to defaulting on paying interest on Treasury bonds. Federal employees' retirement is deferred compensation—it's an earned contractual benefit and part of employees' compensation package; it's not welfare or charity or an income transfer program. The Federal retirement system is a cost the Federal Government has as employer of more than 2 million employees. Federal employees have kept their part of the bargain by working—the Government, as their employer, must keep its part of the bargain and pay the benefits it has promised to pay them in exchange for that work. We cannot take back our work and years of service and the Government should not take its promises back.

Many employees are close to retirement and made retirement plans based on their contract with the Government. If Congress reneges on its promises, even with respect to benefits employees have not yet accrued but expect to accrue in the future in accordance with the promises made to them, it will cause the maximum hardship to those near retirement. I hope that Congress will abide by its promises. It's the right thing to do.

Any changes to Federal retirement programs should apply only to future employees. However, we see no reason for changes, even for future employees. It wasn't so long ago that FERS was enacted after much study and deliberation to cover employees hired after 1983. Nothing has happened since then to suggest that there are any real problems with or valid complaints about the Federal retirement system. So, we see no sensible reason for major changes. And, we think that, if changes are made (unless they are improvements that increase benefits), the Government will be seen as a less desirable and even frivolous and unstable employer unable to recruit and retain a competent workforce.

As the General Accounting Office testified, the combination of a defined benefit and a defined contribution component is quite common in the private-sector. There are problems in offering only a defined contribution plan. In a defined contribution plan the employee bears all the risk. The employee cannot count on a specified retirement benefit. Employees can be disadvantaged based on when they retire in a defined contribution plan if the economy is such that their account balance has gone

down at the time of their retirement, their pensions will reflect that. Moreover, CSRS and the annuity portion of FERS include protections for survivors of employees who die and for employees who become disabled. A defined contribution plan would not satisfactorily take care of those situations especially if those situations occur early in an employees' career.

The purpose of ERISA, which applies to private-sector retirement plans, is to see that retirement promises to employees are kept. The purpose of ERISA's funding rules is not to protect companies and their stockholders—it is to ensure that benefits will be there for employees even if the employer goes out of business and to ensure that the employer keeps its hands off money belonging to employees for their retirement. There is even insurance through the Pension Benefit Guaranty Corporation (PBGC) And, if the pension plan is in danger of not having the funds to pay the promised benefits, the employer is liable for up to a substantial portion of its assets.

The following should also be kept in mind.

1. Very few private-sector retirement plans require employee contributions whereas the CSRS requires employees to contribute 7 percent of their pay.

2. Some private-sector retirement plans and the majority of state government plans use a "high-3 year average" formula to compute benefits.

3. Many private-sector retirement plans and close to half of state retirement plans allow retirement without benefit reductions at age 55 or earlier, general with 30 years of service.

4. Changing the retirement system for incumbents will require most employees near retirement to delay their retirement in order to make up the money lost, and that creates a major problem for agencies mandated to downsize the workforce. After all, these employees cannot increase their savings for retirement retroactively.

5. In addition to Social Security cost-of-living adjustments (COLAs), private-sector retirees from the larger companies generally receive increases in their private-sector annuities periodically. See the Wyatt Company survey of retiree benefits of 50 large U.S. companies as of January 1994. That private-sector retirees are not yet GUARANTEED periodic COLAs is a defect in the private-sector retirement system that should not be emulated by the Federal Government in its retirement system.

6. COLAs do not increase annuities. They simply keep their purchasing power from being eroded by inflation. COLAs simply keep Federal retirees from becoming poorer as they age. Although private sector plans are not yet required to guarantee COLAs, that is often seen as a defect of the private-sector system that needs correction and should not be emulated by the Federal Government. Without COLA protection the Federal Government pays retirees in cheaper dollars and thus pays lower pensions to retirees.

7. Civil service annuities are fully taxable as ordinary income, unlike Social Security benefits.

8. While private-sector retirement plans supplement Social Security, Federal employees under CSRS are forced to forego the Social Security benefits (or the benefits are limited) to which they would otherwise be entitled because of the windfall elimination and public pension offset provisions enacted a few years ago.

9. As you know, the so-called "unfunded liability" issue is a red herring We all know that. If there is anyone who did not, the Congressional Research Service testimony of May 22 and its earlier memorandum of March 18, 1995, on whether there is a financing or funding problem, should have settled that issue, once and for all. As we all know, the "unfunded liability" is purely a bookkeeping artifice that represents the present value of the entire cost of retirement benefits for all current employees and retirees less the assets of the Civil Service Retirement and Disability Fund and the present value of future contributions to the fund. It is merely an accounting concept that indicates how much it would take to pay simultaneously the annuities for current and future retirees, minus the assets of the fund. The Civil Service Retirement and Disability Fund contained a surplus of almost $320 billion in 1993, according to the Office of Personnel Management's (OPM) Annual Report on the Fund (1994). The fund has nine times the reserves necessary to provide annuities as they become due, according to the OPM report.

10. Even if the so-called "unfunded liability" were a valid issue, it is the employer's (in this case the Government's) responsibility to see that it contributed sufficient funds to pay for its retirement obligations. In the private-sector, if a pension plan is in danger of not having the funds to pay the promised benefits, the employer is liable for up to a substantial portion of its assets. Remember, 95 percent of private-sector employees make no contributions to their retirement plan.

11. Federal retirement benefits are not overly generous. They are not out of line with plans in the private sector and with plans in state and local government, as the General Accounting Office has testified. Some of those plans are better than the

Federal plans No proposals to require Federal employees to work longer, pay more, or receive less should be considered. None of the proposed changes to the retirement systems covering Federal employees are really about making valid needed reforms or proper funding or equity. It is unconscionable to take promised benefits from employees to balance the budget or give tax-relief or pay for other programs.

12. Federal employees, as Federal employees, have done more than their share in the past few years for deficit reduction, as well as taking hits as citizens. That has not been fair. Suggesting that Federal employees, as such, bear additional burdens ignores the fact that cuts in Federal employee pay and benefits since 1981 have totaled approximately $170 billion. This continual beating up on Federal employees is distasteful. It would be inappropriate for the Government to engender disrespect from its own employees, but that is what will happen if the Government cavalierly breaks its retirement promises to incumbents, as has been proposed.

We will be happy to work with you on these issues and look forward to testifying in the future. Thank you for considering our views.

Mr. MICA. And before the witnesses in our panel die on the vine, we have one additional member of our full committee, the gentleman from Virginia, Mr. Davis, who also Chairs the D.C. Subcommittee. I recognize him now.

Mr. DAVIS. Mr. Chairman, thank you.

I was also offered to testify on the panel and knew that I would be able to speak first if I was up here with the subcommittee today, but thank you, Chairman Mica, for allowing me to join the subcommittee today to discuss a subject that is of great interest to me, the Federal retirement system.

I commend the subcommittee for holding this hearing. I look forward to more hearings in the near future to allow us to conduct responsible oversight of the Federal retirement system.

Now, Congress wears two hats when it turns its attention to the Federal retirement system. We must balance the twin goals of protecting the taxpayer from any wasteful spending, and we must maintain a secure retirement system that provides for a decent standard of living for our Federal retired workers, and encourages the recruitment and the retention of current Federal workers.

As we turn our attention to the detailed workings of the current retirement system, let's not forget that we are dealing with a major component of the Federal Government's compensation package that is relied upon by 2.3 million Federal workers and another 2.8 million—excuse me, 2.3 million retired workers and another 2.8 million active workers. The current system may have room for improvement, but let's remember that the main objective in providing a retirement plan is to better guarantee that the taxpayer gets government service from qualified professionals who are paid a decent wage with retirement security.

When Congress created the Federal retirement system in 1920, it was concerned that a growing Nation must attract talented professionals to provide the public with high quality government service. This goal is as important today as it was in 1920.

Before we hear from our excellent panels of witnesses today, let me briefly mention a few important facts about the Federal retirement system and about the people who depend on it.

The average Federal retiree receives about $17,000 in retirement payments a year, and since the CSRS system does not provide for any Social Security benefits, this $17,000 amounts to the entire annual budget for many Federal retirees. Approximately 80 percent of Federal retirees receive less than $25,000 in annual retirement

benefits from all sources, again without any Social Security benefits.

In conclusion, it is worth mentioning for the record that the financing system that we are discussing today is basically the same financing system used by Congress to operate the Military Retirement System and to some extent the Social Security program. Many of the issues we are discussing today cannot and should not be addressed in isolation. Nevertheless, as Americans live longer lives and as Congress works toward balancing the Federal budget, the entire range of Federal retirement programs must continue to be reviewed and safeguarded.

Today, Mr. Chairman, let's begin the long, honest dialog about the strengths and weaknesses of the current system, and let's remember what this is about. It is about recruiting and maintaining quality employees, protecting promises made, and ensuring that American taxpayers are getting their money's worth.

Thank you.

[The prepared statement of Hon. Thomas M. Davis follows:]

PREPARED STATEMENT OF HON. THOMAS M. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Thank you, Chairman Mica, for allowing me to join the Subcommittee today to discuss a subject that is of great interest to me—the federal retirement system. I commend the subcommittee for holding this hearing, and I look forward to more hearings in the near future to allow us to conduct responsible oversight of the federal retirement system.

Congress wears two hats when it turns its attention to the federal retirement system. We must balance the twin goals of protecting the taxpayer from any wasteful spending on federal retirement, and we must maintain a secure retirement system that provides for a decent standard of living for our retired federal workers and encourages the recruitment and retention of talented federal workers. As we turn our attention to the detailed workings of the current retirement system, let's not forget that we are dealing with a major component of the federal government's compensation package that is relied upon by 2.3 million retired workers and another 2.8 million active workers. The current system may have room for improvement, but let's remember that the main objective in providing a retirement plan is to better guarantee that the taxpayer gets government service from qualified professionals who are paid a decent wage with retirement security. When Congress created the federal retirement system in 1920, it was concerned that growing nation must attract talented professionals to provide the public with high quality government service. This goal is as important today as it was in 1920.

Before we hear from our excellent panels of witnesses today, let me briefly mention a few important facts about the federal retirement system and about the people who depend on it. The average federal retiree receives about $16,000 in retirement payments a year and, since the CSRS system does not provide for any social security benefits, this $16,000 amounts to the entire annual budget for the average federal retiree. Approximately 80% of federal retirees receive less than $25,000 in annual retirement benefits—again, without any social security benefits.

In conclusion, it is worth mentioning for the record that the financing system that we are discussing today is basically the same financing system used by Congress to operate the military retirement system and the Social Security program. Many of the issues we are discussing today should not be addressed in isolation. Nevertheless, as Americans live longer lives and as Congress works towards balancing the federal budget, the entire range of federal retirement programs must continue to be reviewed and safeguarded. Today, Mr. Chairman, let us begin a long, honest dialogue about the strengths and weaknesses of the current system. Let's remember what this is about—recruiting and maintaining quality employees, honoring promises made, and insuring that American taxpayers are getting their money's worth.

Mr. MICA. I thank the gentleman.

Now I would like to turn to our panel. As you can see, this matter has generated a great deal of interest and controversy, even

among panel members here, and everyone wants to be heard, so we appreciate your patience.

Following protocol, we will yield to Mr. Quillen first. I think he is senior. We will do this on a seniority basis. I now yield to you for your comments.

STATEMENT OF HON. JAMES H. QUILLEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. QUILLEN. Thank you, Mr. Chairman. I am delighted to be here today and witness the expertise of your committee and your members.

I congratulate you and your subcommittee for your efforts to educate the American public about our two Federal retirement systems, the Civil Service Retirement System, CSRS, and the Federal Employees Retirement System, FERS. However, I urge you to separate the debate over Members' pensions from informed discussions about the retirement system created for our postal and Federal workers. Should we decide to make changes to our own pension, so be it, but let's not shackle ourselves to our employees and drag them down with us.

As you consider retirement program revisions, I urge you to give significant weight to the independent analysis provided by both the Congressional Research Service and the General Accounting Office which conclude that the Civil Service Retirement Trust Fund is in financially good shape and its future obligations do not impact the budget. Furthermore, I urge you to appreciate that FERS is fully funded, resulting in fully accounted for liabilities.

I also caution you from being tempted to create a budget-driven proposal to completely redesign the existing Federal retirement system. We should not engage in this type of legislative effort just to prove that we can do it. In my view, Congress made a solemn promise to postal and Federal workers in 1984 when we reformed the Federal retirement system. Congress unequivocally stated that retirement benefits would no longer be subject to the ebb and flow of budgetary tinkering and political expedience.

FERS, the new retirement system, is fully funded, imposes a reduced COLA on its beneficiaries, and encourages employees to save for their own retirement. These are goals which Members of my own political party ought to embrace with open arms. For this reason, I am puzzled by current attempts to alter this decade-old retirement system, which even yet is not fully operational.

I would additionally like to speak about simple fairness. Many public employees whom I happen to represent thought they had an agreement with their employer, the Federal Government. Year after year these decent and committed Americans have been asked to make significant financial sacrifices in order to alleviate this Nation's budget problems. We, and I include myself in the we, have eliminated, reduced, and delayed cost-of-living adjustments to which postal and Federal retirees had been entitled. While I commend this subcommittee for not suggesting any annuity reductions to current retirees, I am very concerned about proposals to adversely affect earned retirement benefits that current employees will be entitled to during the retirement years. This is especially true for the countless postal and Federal workers approaching re-

tirement and who have made retirement decisions based upon the program as it stands today.

Finally, as I stated at the Rules Committee, I simply do not understand why the Postal Service workers should be impacted by CSRS or FERS reductions, as the Service fully pays for its retiree obligations—the result being no budget impact. Although I know that postal assessments are not under the jurisdiction of this subcommittee, I wanted to point out that hitting the Postal Service for supposed retiree obligations, as has been done over the years, is patently unfair. We all know that in the business world if a corporation is taxed, the consumer will be forced to absorb the cost and the product becomes less attractive. We should resist any attempt to manufacture a financial obligation for the Postal Service and simply credit it to the CSRS Trust Fund in the name of deficit reduction.

Mr. Chairman, the confidence of our workers and their families depends upon actions taken by this subcommittee and this Congress regarding the retirement system. So I implore you not to experiment with it, and if changes must be made, they should be prospective so as to protect the benefits of current employees.

Thank you, Mr. Chairman, and members of the committee for allowing me to share some of my concerns and thoughts with you.

One last thought. I don't think it is fair to these Federal employees and postal workers to pay for a tax reduction by imposing a considerable increase in what they have to pay the Government, which will be an increased tax on their earnings. I implore you to take a look, and the solution that you reach should not be based on anything other than the facts, and these Federal employees should receive the benefit of the agreement made in years past.

Thank you, Mr. Chairman.

Mr. MICA. I thank the gentleman from Tennessee for his testimony and his patience.

[The prepared statement of Hon. James H. Quillen follows:]

PREPARED STATEMENT OF HON. JAMES H. QUILLEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Thank you, Mr. Chairman. I congratulate you and your subcommittee for your efforts to educate the American public about our two Federal retirement systems—the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). However, I urge you to separate the debate over Members' pensions from informed discussion about the retirement system created for our postal and Federal workers. Should we decide to make changes to our own pension, so be it; but let's not shackle ourselves to our employees and drag them down with us.

As you consider retirement program revisions, I urge you to give significant weight to the independent analyses provided by both the Congressional Research Service and the General Accounting Office, which conclude that the Civil Service Retirement Trust Fund is in financially good shape and its future obligations do not impact the budget. Furthermore, I urge you to appreciate that FERS is fully-funded. Resulting in fully accounted for liabilities.

I also caution you from being tempted to craft a budget-driven proposal to completely redesign the existing Federal retirement system. We should not engage in this type of legislative effort just to prove that we can do it. In my view, Congress made a solemn promise to postal and Federal workers in 1984 when we reformed the Federal retirement system. Congress unequivocally stated that retirement benefits would no longer be subjected to the ebb and flow of budgetary tinkering and political expedience.

FERS, the new retirement system, is fully-funded, imposes a reduced COLA on its beneficiaries, and encourages employees to save for their own retirement. These are goals which Members of my own political party ought to embrace with open

arms. For this reason, I am puzzled by current attempts to alter this decade-old retirement system, which even yet is not fully operational.

I would additionally like to speak about simple fairness. Many loyal public employees, whom I happen to represent, thought they had an agreement with their employer—the Federal Government. Year after year, these decent and committed Americans have been asked to make significant financial sacrifices in order to help alleviate this Nation's budget problems. We—and I include myself in the "we"—have eliminated, reduced and delayed cost-of-living-adjustments to which postal and Federal retirees had been entitled. While I commend this subcommittee for not suggesting any annuity reductions to current retirees, I am very concerned about proposals to adversely effect earned-retirement benefits that current employees will be entitled to during their retirement years. This is especially true for the countless postal and Federal workers approaching retirement and who have made retirement decisions based upon the program as it stands today.

Finally, as I stated at the Rules Committee, I simply do not understand why the Postal Service's workers should be impacted by CSRS or FERS reductions, as the Service fully pays for its retiree obligations—the result being no budget impact. Although I know that postal assessments are not under the jurisdiction of this subcommittee, I wanted to point out that hitting the Postal Service for "supposed" retiree obligations, as has been done over the years, is patently unfair. We all know that in the business world, if a corporation is taxed, the consumer will be forced to absorb the cost and the product becomes less attractive. We should resist any attempt to "manufacture" a financial obligation for the Postal Service and simply credit it to the CSRS Trust Fund in the name of deficit reduction.

Mr. Chairman, the confidence of our workers and their families depends on actions taken by this subcommittee and the Congress regarding their retirement system. So, I implore you not to experiment with it, and if changes must be made, they should be prospective so as to protect the benefits of current employees.

Thank you, Mr. Chairman and members of the committee, for allowing me to share some of my concerns and thoughts with you.

Mr. MICA. Now I yield to the gentleman who has a large Federal work force contingency in his district from Virginia, Mr. Bateman.

STATEMENT OF HON. HERBERT H. BATEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. BATEMAN. Thank you very much, Mr. Chairman, members of the committee, I have a brief prepared statement which I would propose to read in view of the fact that if I sought to summarize it extemporaneously, the summary might be longer than the statement.

Mr. MICA. Proceed with the statement.

Mr. BATEMAN. Mr. Chairman, I appreciate the opportunity to be here today and add my testimony to the proceedings to investigate financing of the Civil Service Retirement System. As you have indicated, I represent Virginia's First Congressional District, which has one of the Nation's highest concentrations of Federal employees, and I am extremely concerned that budget cutting efforts relating to civil service retirement are misled attempts to balance the budget on the backs of Federal employees. As a Member who has consistently fought against efforts that unfairly target Federal employees, I believe it is extremely important that we understand all the facts in this matter before making any unwise decisions in the name of deficit reduction or reform.

As you know, civil service retirement, like most other employer-provided defined benefit plans, is financed significantly by the employer. In this case, the Federal Government. The private employers finance pensions from business income or revenues. The Federal Government also finances pensions primarily from revenues, tax revenues collected from the American people.

Many have argued that Federal employees should contribute a greater amount to their retirement, and proposals to increase employee contributions by 2.5 percent are included in both the tax package and the budget resolution passed by the House. However, neither the Civil Service Retirement System nor the Federal Employee Retirement System was ever intended to rely in large part on employee contributions for financing. In fact, employee contributions rarely pay for any significant portion of pension obligations. In the private sector, many employers finance 100 percent of their employees' pensions.

Increasing employee contributions translates to increasing taxes on all Federal employees. This is clearly an unfairly targeted deficit reduction effort that singles out Federal employees for tax increases. If an increase in employee contributions is required, it should be levied on workers coming into the civil service in the future, not on those who entered Federal employment based upon a reasonable reliance upon the system in place.

Another issue that has been raised is the unfunded liability of the Civil Service Retirement System. All private companies are required to have funds on hand to pay for pension obligations. This requirement was properly enacted to protect American workers in the event their company suddenly goes out of business and to protect the American taxpayers who ensure private pensions. The Federal Government will never go out of business and have to pay all pension obligations at once. Some of the amounts counted in the unfunded liability of the Federal Government will not come due for payment for a decade or more. So the unfunded liability of the civil service retirement plans should not be an issue.

Federal employees perform the daily functions of our government and deserve our gratitude and respect. Unfortunately, when they are most recognized is as a bull's eye for budget cutters. Like all Members of Congress, indeed like all Americans, I support efforts to cut Federal spending and reduce the deficit.

I voted for the balanced budget amendment and the House budget this year. However, I believe that such efforts should be well-conceived and should not unfairly target any one group. For my part, I will continue to fight against raising employee contributions of existing employees and annuity calculations designed to decrease employee pensions of those now in the Federal work force.

Again, thank you for providing me with this time.

Mr. MICA. I thank the gentleman again for his testimony and also for his patience.

I would now like to yield to my colleague from Florida, Mr. Bilirakis. Mr. Bilirakis has a proposal, I believe, to take the trust fund off budget, so Mr. Bilirakis, you are recognized.

Mr. BILIRAKIS. Mr. Chairman, my gratitude to you and to the subcommittee for the opportunity to be here this morning to discuss H.R. 103, which is the legislation you speak of, taking the Civil Service Retirement and Disability Trust Fund off budget.

As you know, and by now all of us know, the civil service retirement fund was created by the Civil Service Retirement Act of 1920. It was maintained as an independent trust fund until 1967, when President Johnson agreed to a recommendation that such trust funds should be made part of the unified budget.

Since that time, Mr. Chairman, the annuities of Federal retirees and in particular the cost-of-living adjustments have been highly vulnerable to cuts during our annual budget cycle. Most recently, the 1993 Omnibus Budget Reconciliation Act delayed COLAs for Federal retirees for 3 months in fiscal years 1994 through 1996. This delay resulted in $778 million in lost COLAs for Federal retirees.

Mr. Chairman, I might add that this $778 million is a part, a small part of the approximately $40 billion that Federal retirees have contributed during the last 12 years in the name of deficit reduction and canceled, delayed, and reduced cost-of-living adjustments, something I think we don't pay enough attention to.

In contrast, the Social Security Trust Fund was removed from the budget in a series of measures in the 1980's. Social security was removed from the unified budget so that cuts in benefits would have no effect on the Federal deficit, giving Social Security recipients special protection from budget cuts. The 1993 Omnibus Budget Reconciliation Act did not impact COLAs for Social Security recipients.

As part of that unified budget, the pensions of Federal retirees do not enjoy the same level of protection. This is why I introduced legislation to remove the Civil Service Retirement and Disability Fund from the budget. The idea of taking the Civil Service Trust Fund off budget was originated, as I know you remember, John, by a close friend of ours, former Representative Tom Lewis. Tom retired at the end of the last Congress, and I feel it is important to continue his efforts and therefore picked up this issue in this Congress.

Specifically, H.R. 103 removes receipts and disbursements of the trust fund from the President's budget request and from the congressional budget, and the Balanced Budget and Emergency Deficit Control Act of 1985. The bill simply seeks to achieve some measure of fairness—and that word has been thrown around here by other people testifying—for Federal retirees by putting the Civil Service Retirement and Disability Trust Fund on an equal budgetary status with Social Security.

While off-budget status does not guarantee, Mr. Chairman, absolute protection from cuts, it will make any cuts more visible and therefore more difficult to make. All retirees, whether they receive Social Security or some form of Federal annuity, I might add, including therein veteran retirees, military veteran retirees, should be treated equally.

My legislation has received widespread bipartisan support in the House. To date, 93 Members have cosponsored H.R. 103, including 13 members of the Government Reform and Oversight Subcommittee. My legislation is also supported by NARFE, the National Association of Retired Federal Employees.

Since taking the trust fund off budget raises some technical questions, God knows it does raise technical questions, and issues regarding budget rules, I felt it was best to introduce a very general piece of legislation with the anticipation that the bill would be amended as it moved through the legislative process. I hope that the Office of Personnel Management and the Congressional Budget

Office will be able to assist us in resolving these technical questions.

Mr. Chairman, in closing, I would like to remind my colleagues, all of us in this House and in this Congress, that Federal annuities are earned benefits, and so Federal retirees deserve to be treated, I think, at least equally with other retirees.

Mr. Chairman, I would also like to call to the attention of the committee the last line on page 16 of the prepared statement by CBO which goes on to say: "Moreover, placing the retirement fund into the off-budget category changes neither the pay-as-you-go financing of Federal retirement nor the budget totals." I am not really sure what is holding us back here. If we don't have really any sort of effect so far as dollars are concerned, I think we should just go ahead and do it so these people can feel less fear when it comes to budget time here in this Congress.

Again, I am grateful to the subcommittee for its consideration and look forward to working with all of you on this issue.

Thank you.

Mr. MICA. I thank the gentleman for his testimony. And also again his patience.

[The prepared statement of Hon. Michael Bilirakis follows:]

PREPARED STATEMENT OF HON. MICHAEL BILIRAKIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

I would like to thank you for the opportunity to be here this morning to discuss H.R. 103, legislation I introduced to take the Civil Service Retirement and Disability Trust Fund off-budget.

As you know, the Civil Service Retirement Fund was created by the Civil Service Retirement Act of 1920 (Public Law 66–215). It was maintained as an independent trust fund until 1967, when President Johnson agreed to a recommendation that such trust funds should be made part of the unified budget.

Since that time, the annuities of Federal retirees and, in particular, their cost-of-living adjustments (COLAs), have been highly vulnerable to cuts during our annual budget cycle. Most recently, the 1993 Omnibus Budget Reconciliation Act delayed COLAs for Federal retirees for three months in fiscal years 1994 through 1996. This delay resulted in $778 million in lost COLAs for Federal retirees.

In contrast, the Social Security Trust Fund was removed from the budget in a series of measures in the 1980s. Social Security was removed from the unified budget so that cuts in benefits would have no effect on the Federal deficit, giving Social Security recipients special protection from budget cuts. The 1993 Omnibus Budget Reconciliation Act did not impact COLAs for Social Security recipients.

As part of the unified budget, the pensions of Federal retirees do not enjoy the same level of protection. This is why I introduced legislation to remove the Civil Service Retirement and Disability Fund from the unified budget.

Specifically, H.R. 103 removes receipts and disbursements of the trust fund from the President's budget request, the congressional budget, and exempts the fund from sequestration under the Balanced Budget and Emergency Deficit Control Act of 1985. My bill simply seeks to achieve some measure of fairness for Federal retirees by putting the Civil Service Retirement and Disability Trust Fund on an equal budgetary status with Social Security.

While off-budget status does not guarantee absolute protection from cuts, it will make any cuts more visible and, therefore, more difficult to make. All retirees, whether they receive Social Security or some form of Federal annuity, should be treated equally.

My legislation has received widespread, bipartisan support in the House of Representatives. To date, 93 Members have cosponsored H.R. 103, including 13 members of the Government Reform and Oversight Committee. My legislation is also supported by the National Association of Retired Federal Employees (NARFE).

Since taking the trust fund off-budget raises some technical questions and issues regarding budget rules, I felt it was best to introduce a very general piece of legislation with the anticipation that the bill would be amended as it moved through the legislative process.

I hope that the Office of Personnel Management and the Congressional Budget Office will be able to assist us in resolving these technical questions.

In closing, I would like to remind my colleagues that Federal annuities are earned benefits. Federal retirees deserve to be treated equally with other retirees.

I am grateful to the subcommittee for its consideration of my legislation and look forward to working with you on this issue.

Mr. MICA. You have an interesting proposal, Mr. Bilirakis. There is only one problem with it. In advance reading of some of the testimony that is provided to us today, this whole exercise seems like a paperwork exercise, that there is no real money in any of these funds, that the whole system is predicated on a perpetual outflow from the General Treasury.

One of the problems that you would have if you instituted a trust fund such as you propose is the immediate replenishing of $320 billion in current assets to the trust fund. How would you propose to get that money?

Mr. BILIRAKIS. Well, first of all, with all due respect, I don't interpret it that way. It follows that this is the requirement that must take place. The unfunding, the lack of funding, if you will, of the current fund is a problem. We are all concerned about that. I am not sure that we are ever going to solve it with all of our deficits and that sort of thing, but that exists, as it now stands, just every bit as much and is every bit as critical as I think it would be if we went ahead and took this off budget. So I am not really sure.

Counsel is a lot more intelligent in this regard and probably every regard than I, and I am not really sure what counsel feels in that regard, but it doesn't follow, I don't think, that by taking this off budget that we are going to have to come up with an additional $300 billion or $500 billion, depending I guess on how you look at it.

As I understand, the unfunded liability's total is about $800 some billion and there is about $300 billion of assets in there, which is attributable mostly to FERS which would leave about $500 billion, so that is a problem that exists today and it is not going to exist anymore if we take it off budget.

What it will do if we take it off budget is basically allay these fears of the people who don't deserve to have these problems every time we tackle the budget.

Mr. MICA. Well, again, you have a system that has been created where you borrowed against all of the funds. Right now on the $320 billion that should be in the fund, there is no money there. There are non-negotiable certificates of indebtedness. I think 97 percent of the assets are in those notes, so you wouldn't replace that.

You propose just moving forward from this point, but having contributions go into the fund and not be used for any other purpose?

Mr. BILIRAKIS. Yes, I would say that certainly it is true. I mean, all we are talking about is paperwork entries being switched back and forth now anyhow. But, again, I don't mean to say that I don't think that there is any problem associated or any concerns should be associated with the fact that we have this great unfunded liability. We have it now. We should be every bit as concerned with it now. We apparently don't seem to be that concerned with it now, but if we put it off budget, we are going to be concerned with it.

It doesn't follow. I think the problem is there now every bit as much as it would be if we went off budget, so you are not changing anything so far as that area goes.

Mr. MICA. CSRS has an unfunded liability, I believe, of $538 billion. Current contributions from employees and employers are about 14 percent of payroll, while its true costs require contributions—I think Mr. Bass testified from the Money magazine article—of about 25 percent. Given the system's real cost, do you believe that in the past we have been overly generous in providing benefits at the Federal level?

Mr. BILIRAKIS. Well, again, Mr. Chairman, we are talking about paper transactions, and, you know, we are talking about $500 billion.

Mr. MICA. These really aren't paper now. This is 25 percent——

Mr. BILIRAKIS. But we are talking about a $500 billion unfunded liability. That is if Rebecca here, who is my staffer, were to retire today, which she isn't going to retire today, because she is not eligible for a pension. If she were to retire today, and were able to get all that she has earned and all the other people in her category, it would total out, as I understand, to that $500 billion. That isn't going to happen. So we are really talking about paper here.

Your question, I think, goes not to just whether we take it off budget, your question goes to the situation as it exists today.

Mr. MICA. Mr. Quillen, you have heard comments of your colleagues and also Mr. Bilirakis. One of the things you expressed was an interest in keeping our commitments to Federal employees and not jerking them around every time there is a budget proposal. Do you favor the proposal by Mr. Bilirakis or do you favor some means of independently securing these funds for retirees?

Mr. QUILLEN. Mr. Chairman, I feel like this, very sincerely and from the heart, that we should not give a tax decrease to the people of this country and at the same time give a tax increase, which that is what it is, to Federal employees who have a commitment from the Federal Government. When we really reworked the Federal retirement program a few years back, we promised that this system would not change. Now we prepare a tax decrease on one hand and a selective tax increase on the other. I haven't been able to resolve any difference in my mind to that concept.

Mr. MICA. Well, Mr. Quillen, politically I think we all, you know, would favor trying to provide as many benefits as we can to our constituencies, whether they are Federal employees or citizens, but the truth of the matter is that the way this system is now constructed, this entire Federal retirement benefits package is funded entirely out of current revenues. Not only are we funding the benefits out of—well, there are some employee contributions, let me correct that, but the largest portion of contributions are, in fact, coming out of the general revenue and General Treasury, and we can sit here and say that this money is going for a tax cut 1 year or for reducing the deficit in another year or if your agenda is more social programs, it is going to finance more social programs. Mr. Bilirakis has made a proposal to take this off budget. Do you feel that those funds should be secured for that purpose only?

Mr. QUILLEN. I think his proposal certainly has merit, take it off budget. You know, we have to look at it realistically.

Mr. BILIRAKIS. Mr. Chairman, I am sorry——

Mr. QUILLEN. Go ahead.

Mr. MICA. Mr. Bilirakis.

Mr. BILIRAKIS. I wasn't sure. I didn't mean to interrupt you, Mr. Chairman.

Again, a complicated subject. But as I understand it, there is an off-budget definition and there is an outside-the-budget definition, and with all due respect, I think you are probably thinking more and talking more in terms of outside the budget. We aren't suggesting that.

If we took it outside the budget and let it sit completely on its own the way our thrift savings program is concerned, then, yes, we would have to come up with all those dollars on the right-away basis, and I know that is impossible. That is not what we are talking about. We are talking about off budget, taking it off budget and in effect putting it into virtually the same category as Social Security is now.

There is no need under those kind of circumstances, as I see it, to reach out and try to pull in an additional $500 billion or whatever that shortfall would be. Outside budget, yes; off budget, no.

Mr. MICA. In conclusion, Mr. Bilirakis, even under your proposal, you would still have people coming up every year saying that this money, if there was some increase or when you increase this by a quarter percent employee contribution, that these funds were being, in fact, used for some other purpose or could be used for some other budget purpose.

Mr. BILIRAKIS. Well, I wonder if—the Social Security funds are kind of used back and forth, too, are they not? So I don't know that we have any kind of difference there. I think, again, we have got to understand clearly that with all due respect that distinction between off budget and outside budget. I know counsel understands this one heck of a lot better than I do.

Mr. MICA. I appreciate your comments. I yield now to——

Mr. QUILLEN. Mr. Chairman?

Mr. MICA. Yes.

Mr. QUILLEN. As I said in my statement, the analyses provided by both the Congressional Research Service and the General Accounting Office conclude that the Civil Service Retirement Trust Fund is in financially good shape and its future obligations do not impact the budget. Furthermore, I urge you to appreciate that FERS is fully funded, resulting in fully accounted for liabilities.

Mr. MICA. Well, FERS is fairly well funded. As I understand it, there is a $1.8 billion unfunded liability. Most of the unfunded liability is in CSRS, the old system.

The problem you have here, Mr. Quillen and Mr. Bilirakis, is that everything is funded out of current revenues. There is no real reserve in any of this. Even the money that is in the reserve, the $320 billion, last year we paid $25 billion in interest because we borrowed, we took all the money out of that. So it continues to reflect on annual budgets, and that is part of the problem we face.

I have taken more than my time, and I want to yield to our ranking member for questions. Mr. Moran.

Mr. MORAN. We are dealing with some data that really needs to be cleared up when we hear from GAO and CRS. I am really dis-

appointed with Money magazine. I used to read that rag, but in the interest of putting together what they consider to be a catchy story, they apparently deliberately misled the reader. For one thing, they must be talking about the dynamic cost of the retirement system versus payroll, which has actually gone down from 37 percent to 25 percent since 1979. So that figure is way out of context.

But when they talk about the State being, the States being 14 percent of payroll and local government, I think they said, what, 17 percent? It is in Mr. Bass' statement here, 16.5, 17 percent, 14 percent for State governments, and at the Federal level it is a beltway-sized 25 percent of payroll.

Well, they deliberately failed to mention the fact that the State government is understated because they have the Social Security system to back them up. That is the difference in these plans. CSRS is not dependent upon the Social Security system. It makes up for the whole Federal employees not having the Social Security retirement if they go into CSRS, and the reform that we put in in 1986 was that FERS would complement the Social Security system. That is why FERS is so differently funded and is in such good shape because you have the cost-of-living increases.

CSRS has a problem. Although it is going to be completely taken care of because CSRS, we are not getting new CSRS people, and the liability goes down as FERS takes over, and the reason for the reduction in the dynamic figure is that the numbers that they estimated in 1986 didn't materialize because we provided less cost-of-living increases.

The 1986 projection for CSRS assumed that we would give full cost-of-living increases each year and projected those cost-of-living increases at an inflation rate in the 1980's which was much higher than what we have realized in the 1990's, and so that is why the actual dynamic cost that would include a cost-of-living index built in has gone from 37 percent down to 25 percent of payroll, and a drastic reduction. You would never know that by reading the Money magazine article.

But just as importantly, to compare what they must know—is that Money magazine writers leaving? You didn't write this thing for Money magazine, no. But, you know, to be comparing apples with oranges here I think deliberately misleads the reader.

The State employees have Social Security in addition to their State retirement. That is why the State retirement is only 14. Local employees have Social Security in addition to their local retirement, and that is why theirs is only 17 percent.

The 25 percent figure they talked about is CSRS, which doesn't have Social Security as a complement to their retirement security. And as far as going from 25 to 40 percent, we have got to find out from OPM what they are talking about because I can't figure out where that number came from. So, so much for Money magazine.

But now, Mr. Bilirakis, let me ask you some questions about your proposal because not only do I like you, as you know, I like the concept of your proposal, but we have got some problems. The people that we look to for advice for their objective opinion on this—OMB, GAO, and CBO—all came out in opposition to it. OMB says it is going to increase the deficit by $28 billion annually, GAO says it would serve no purpose, and CBO says that it would not

necessarily insulate retirement benefits from cutbacks. Well, those are some major problems. Now we are going to hear from them later on. But is there any point you want to make in advance that you would like us to ask them when they explain these statements?

Mr. BILIRAKIS. Yes. First of all, yes, Social Security is not insulated from cutbacks just because it is an off-budget item. It is set up as, I understand, a separate category item as part of the unified budget which basically red flags it if we were to fool around with it, red flags it, and that is what we are asking insofar as our Federal retirees are concerned, the same treatment. So there is really no difference as far as that is concerned.

I don't know, I read the sentence, and I realize one sentence does not constitute a full 21-page report from CBO, but that one particular sentence basically tells me there is no change as far as pay-as-you-go financing nor budget totals, so that is from the CBO written report. I haven't, frankly, looked at the other reports.

There is a chart here which I guess is from CBO which talks about the transaction agency; this is, what difference does it make for the deficit if the funds are treated like Social Security and are placed off budget? Agency payment of an accrual charge? It says no effect, same as current accounting. Employee contributions? It says decreases, same as current accounting. Treasury interest payments? No, effect, same as current accounting. Annuitant benefit payments? Increases, same as current accounting. It looks like that sort of equals out to roughly zero. I realize it is not a zero, so again no effect as far as that is concerned.

Jim, I think, really we have got to maybe bend a little bit here if we really think that fairness should be a part of the equation. We are all concerned about budget deficits. I am chair of the Health and Environment Committee. I have got to come up with these $270 plus billion savings in Medicare, and the additional amount of Medicaid.

I represent one of the oldest districts in the country, so I have great concerns about that and great concerns about the budget. I certainly would not be a party to all this if I thought in my mind and my heart that we are going to have any great concerns budget wise. These other people are more expert than I, but they also don't have to answer to the constituents the way we do.

Mr. MORAN. Yes. Well, I appreciate the work that you are going to have to be doing on that. I don't know, it seems like an unsolvable problem. I am glad you are doing it and not us. I appreciate your response and the intent of your legislation, Mr. Bilirakis.

I am going to make the point, and I don't know that you even disagree with it in terms of the underlying rationale for the system that we have, but you know, we need to bear in mind we keep talking about what the private sector does. The private sector, 97 percent of the private sector pays in full for the retirement plans for their employees, and the Federal retirees pay 24 percent, on average, for their retirement.

As to whether we take it off budget or not, I think we probably ought to talk to the budget experts that come up, and I certainly appreciate your interest in this issue and your leadership, Mike.

Mr. BILIRAKIS. May I just very quickly, again with all indulgence, I was a Federal employee for a little while many years ago. I was

an engineer up here before I decided to go to law school, and I wish sometimes I had stayed as an engineer, but in any case, the point of the matter is that you can't really equate that, the salaries in the private sector, and I know that the Federal salaries have increased, but these people have been here all these years for a couple of reasons, and one is I think they are patriots and want to serve but the second reason is these benefits, and now we are talking about after all those promises, one, we are trying to reach out and pull them away from them conceivably, and that is damn wrong on our part.

Mr. MORAN. Thank you, Mr. Bilirakis.

Mr. MICA. I thank the gentleman and yield now to the vice chairman, Mr. Bass.

Mr. BASS. Thank you, Mr. Chairman.

I guess the gentleman from Virginia is correct. According to the Civil Service Retirement Disability Fund annual report by OPM, total expense money paid out, $12.6 billion; combined payroll, $47.4 billion; 1995, the total amount of money that is paid out is $37.6 billion for a combined payroll of $110.3 billion, and then in the year 2020, the total amount of money to be paid out, projected, is $140.6 billion, with a combined payroll projection of $346.4 billion, which is 40 percent.

I guess my question to you, Congressman Bilirakis, is on budget, off budget, so forth, do you think that we need to address the fact that we have an employee contribution in 1995 of $4.7 billion and a total expense of $37.6 billion, which is about a $34 billion total cash out on the Federal Government, and increasing over the years. Do we have a responsibility to address this question and try in as an imaginative fashion as possible, being sensitive to the interests of Federal employees and what they need and deserve and also what the taxpayers deserve to formulate some sort of solution?

Mr. BILIRAKIS. To paraphrase what Jim said to me about my problem, that is basically your responsibility to determine that. I am not in a category to do that. I have enough on my plate. First of all, I don't know; that has nothing to do directly with whether we take it off budget or not. The problem is still there whether we leave it alone now as it now stands or whether we take it off budget.

Certainly, I think that if everything—all the statistics basically bear out that you have got to have some kind of increases, certainly for new employees coming aboard. That has got to be considered. And I think that NARFE as well as the active Federal employee unions have to take all that into consideration.

The tough thing, of course, is changing horses in the middle of the stream for those who are now still working, and that is a tough decision on your part. But even those people I think would probably understand what has to be done in order to protect the program, sort of like what we are telling the Medicare beneficiaries now, we have got to preserve the program, and so we are going to have to take some hard lines and we don't know yet what those are, but we are working hard at it.

Mr. BASS. Thank you very much, Congressman Bilirakis. Thank you, Mr. Chairman.

Mr. MICA. I yield now to Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

I think one of the problems we have here is comparing apples to apples and oranges to oranges. It gets a little jumbled when we start throwing numbers around. I think the purpose of this hearing and the later dialog we will be having up here is to really arrive at where truth is in this.

For example, when you take the figure of $528 billion unfunded liability, my question then was what does that mean. If you looked at Social Security in the same light, what would be the unfunded liability then, and what do we do with it, and the answer I think that we have gotten is it is something like $7.6 trillion. When you start looking at numbers like that and trying to look at the fix, I think it puts it all in perspective about what we are trying to do.

I think, Mr. Bilirakis, you have ably presented that, that everything isn't coming due all at once, that it is done over a period of time. I am a cosponsor of your bill. I think it is a good bill. I think it doesn't do anything in terms of masking the deficit, which is one of the concerns that has been raised, and I hope that we can move forward with that this year.

I think the focus here, though, ought to be on the taxpayer as the employer. This point, the government basically representing the taxpayer as an employer, the question we have to ask ourselves is what kind of benefit package do we want to pay our employees so that we can have the best people who are qualified to be FBI agents and qualified people as cancer researchers and astronauts, who have the right background and those kind of issues, and yet you want qualified people at the window and on the phone when you call up the Social Security Administration or the Immigration Office. I think really we have to cast this whole debate in those terms. Then we can start talking about who pays what.

But you want to have an appropriate benefits package that is going to attract and maintain qualified people for government service so that we can get the job done at a time when we are asking fewer people to do more with less. It seems to me, I was in the private sector, those are issues that we have got to face.

Let me ask you, my understanding is that most defined benefit plans in the private sector, there is really no employee contribution. Do you have any thoughts on that?

Mr. BILIRAKIS. Well, they vary. You know as much about it as I do. I don't know what I can add to it. But they certainly vary. I have been—heck, I worked in the aerospace industry for a while as an engineer and as a lawyer back before my wife could go back to work and I could start a law practice, but we didn't have any kind of retirement plan back in those days. They instituted it sometime shortly after I left, and that is—so it really varies, the company that you are with and things of that nature. Those are all the things we take into consideration when we decide whether we want to accept a job with this company, this firm or the other firm, whatever, and the same thing is true with all of these people over the years. They made their decisions to stay with the Government for a number of reasons. One, as I said before, they wanted to serve their country in a way, but also, the benefits, which are the same reason that we tell people to stay in the military because they can

expect such and such after they retire and look what we are trying to do.

Mr. DAVIS. Or stay in Congress, as the case may be?

Mr. BILIRAKIS. That is right. I think basically the same thing applies. It really varies. Companies are coming up with good plans because they want to do exactly the thing that you are referring to and that is to attract good people and hope that good people will stay aboard.

Mr. DAVIS. The FERS system, of course, when we moved to the FERS system and we gave people a choice, there is no problem with the FERS system right now, any significant problem.

Mr. BILIRAKIS. Apparently, it is supposed to be a fully funded system, and the chairman made the comment about some sort of a shortfall there. I am sure counsel knows more about it than I do. But it is virtually fully funded.

Mr. DAVIS. I think we can get to the bottom of that in these hearings and take a look at it. It is clearly much more actuarially sound than the CSRS.

Mr. BILIRAKIS. They fall in the same category. If we are going to delay COLAs and things of that nature and hit the Federal retirees over the years, we are hitting the FERS people as well as the CSRS people.

Mr. DAVIS. I think the thing I like the most about your bill is the fact that for a while we have had a dichotomy between Social Security recipients and Federal retirees, and many Federal retirees who were employees get treated in an adverse way even though they don't get Social Security.

One thing your bill would do, I think, is to bring it into perspective and treat everybody the same. It seems to me you just don't go after your former employees and look to them for savings and for other people, give them a break. They ought to be treated equally. I think that is really what your legislation gets to. There may be years when there aren't COLA's for everybody, and that may be the right thing to do, but at least you have equality of treatment.

Anyway, I thank you for being here today. I appreciate your testimony, I know the chairman does. Thank you.

Mr. MICA. I also thank my colleague from Florida, Mr. Bilirakis, for his testimony and service today as a witness. I appreciate your interest and look forward to working with you on this issue.

Mr. BILIRAKIS. Thank you.

Mr. MICA. We will excuse our first panel and call our second panel: Mr. James Blum, Deputy Director of CBO, Mr. Ed Flynn, Associate Director of OPM, and Mr. Johnny Finch, Assistant Comptroller General, the General Government Division of GAO.

Are there additional folks with you? Mr. Finch, do you have anyone else with you?

Mr. FINCH. I have some experts with me. If we need them at the table, maybe we could bring them up.

Mr. MICA. It is the custom of this committee and subcommittee to swear in our witnesses. If you would stand, please, raise your right hand.

[Witnesses sworn.]

Mr. MICA. The witnesses answered in the affirmative.

Welcome to our subcommittee this morning, gentlemen. First, we will call on Mr. James Blum of CBO for his comments. If you have a lengthy written testimony that you would like submitted as part of the record, we will be glad to do that. If you would like to summarize, we would appreciate it. You are recognized, Mr. Blum.

STATEMENTS OF JAMES L. BLUM, DEPUTY DIRECTOR, CBO; WILLIAM E. FLYNN, ASSOCIATE DIRECTOR, OPM; JOHNNY FINCH, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, GAO

Mr. BLUM. Thank you, Mr. Chairman, and members of the subcommittee. I appreciate the opportunity to be here this morning to discuss with you the financing of retirement programs for Federal civilian employees. With your permission, Mr. Chairman, I will, indeed, submit my prepared statement for the record.

Mr. MICA. Without objection.

Mr. BLUM. Given the lateness of the hour, let me try, as best I can, to limit my oral remarks to a few key points that I think should be made at this juncture. There has been a lot of discussion this morning already about my prepared statement, and I appreciate the fact that Members have read it and are knowledgeable. I would just like to highlight a few things at this time. In particular, rather than speaking about the financing of the program—how it exists now and so forth—let me switch immediately to the different proposals that lie before this committee. Those include the one submitted by the administration and its budget office; the one proposed in H.R. 103 that we have been discussing with Mr. Bilirakis; and a proposal not actually made, but we were asked to comment on, which is what would happen if we took the funds completely outside of the budget.

The administration, as we know, has proposed that agencies pay the full normalized cost for CSRS employee retirement benefits as a good cost-accounting measure. That proposal is designed to make the agencies more aware of the full cost of doing business. It would increase intragovernmental transactions, that is, payments from one agency to another, but it would have no effect on total outlays or the deficit.

To accommodate the increase in agency labor costs, the administration proposes to increase the discretionary appropriation caps that exist now in law and will be extended through the year 2002. Without such an adjustment, total outlays in the deficit would actually decrease by over $5 billion annually because money that otherwise would flow outside the Government would remain in the Treasury.

The administration also proposes to pay off the unfunded liability of $540 billion in the Civil Service Retirement Trust Fund over a 40-year period. The only advantage of spreading that payment over 40 years is to avoid an immediate, large increase in the Federal debt limit, which includes government trust fund holdings of Treasury securities.

I know from experience that Members of Congress are very reluctant to vote for increases in the Federal debt limit. Therefore, I think that such increases are the only real cost of doing this administration proposal. It can be explained as an effort to improve

the informational content of the trust fund's balance sheet. If that is the goal, the payment could be made all at once, since it is only a bookkeeping transaction and would not affect budget outlays or the deficit. On the other hand, the same information is already available in the annual OPM actuarial reports for the trust fund and in the consolidated financial statements for the government published each year by the Treasury.

Now, since the cost of deferred compensation, that is the government retirement benefits, can be reduced by either raising the employee contribution rate or lowering the pension benefit, it is not surprising that proposals along these lines are often included in plans to reduce the budget deficit.

For example, CBO always includes a number of options along these lines in our annual volume of deficit reduction options, and as has been observed this morning, the conference report on the budget resolution also assumes that this will be done as part of the effort to reach budget balance. To head off such measures, as we have heard this morning, some Members of Congress have proposed putting the Civil Service Retirement Trust Fund off-budget, which is the same status given to Social Security and the Postal Service. The intent is to provide Federal employees and retirees with the same protection against budget cutbacks as is given to the Social Security program.

As has been observed, a change in budget status would not affect the unified budget totals or necessarily insulate Federal retirement benefits from future cutbacks, given the pay-as-you-go policy of financing benefits. It would increase pressures, however, on programs that remained on-budget and therefore would be opposed by the budgeteers. For example, the statement from Dr. Rivlin at OMB strongly opposed this measure.

More protection to the retirement benefits could be given by changing the financing from a pay-as-you-go basis to a fully funded basis comparable to the retirement plans sponsored by State and local governments and private firms. This might be achieved by moving the trust fund outside of the budget and investing funds in a manner similar to the Thrift Savings Plan. This would have the advantage of recognizing the costs of retirement benefits, or deferred compensation, as they are incurred—when they are most controllable—rather than down the road when the benefits have to be paid.

It would also mean that current taxpayers would pay the current cost of providing government services, which might improve intergenerational equity. It would be consistent with good cost accounting and might encourage better planning up front by the Congress and Federal agencies.

On the other hand, moving the retirement trust fund outside of the budget and fully funding the retirement benefits would have a major impact on the Federal budget. Current outlays and the deficit would increase by about $50 billion a year and about $300 billion over the 7-year period from 1996 to 2002. Those figures assume that the trust fund liabilities of over $850 billion are actually funded, which would be necessary to make this change in financing work.

Over the long term, however, Federal outlays would be unaffected. Spending now projected to occur in distant out years would be reduced by shifting spending to near-term budgets. If only the FERS program, the FERS component of the trust fund, were fully funded and moved outside the budget, the effects on the budget deficit would be smaller, on the order of $10 billion a year or about $85 billion over the 1996–2002 period.

Changing the financing of the civil service retirement program at this juncture would be difficult, given the objective of balancing the budget by 2002. It would also raise a number of other budgetary and nonbudgetary issues that would have to be considered at length.

Finally, many budget experts believe that even with a cleverly designed pension fund outside of the budget, the Congress would still be able to reduce the annual budget deficit by cutting deferred compensation. In fact, the only way to completely protect earned benefits probably would be to switch to a defined contribution plan like the Thrift Savings Plan.

In closing, Mr. Chairman, I would urge the subcommittee to evaluate proposals to change the financing of the retirement benefits not only in terms of the budgetary effects but also in light of their effects on the ability of the government to recruit and retain a skilled work force and, relatedly, on the credibility of the Federal Government as an employer. This, after all, is the primary purpose for the retirement program.

Thank you, Mr. Chairman.

Mr. BASS [presiding]. Thank you very much.

[The prepared statement of Mr. Blum follows:]

PREPARED STATEMENT OF JAMES L. BLUM, DEPUTY DIRECTOR, CBO

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to discuss the financing of the Civil Service Retirement and Disability Fund (CSRDF). In my statement today, I will make five points:

- The CSRDF is a set of accounts, common in the federal budget, for recognizing the cost of deferred compensation as it is earned and the liabilities that have accumulated for future payments. That accounting may give the illusion that the government is setting aside funds to pay future benefits. Unlike private pension funds, however, the trust fund has no independent capacity to make future payments.

- Financing for civil service retirement benefits is on a pay-as-you-go basis. Benefits paid each year are financed by federal revenues received that year, including payroll tax contributions paid by federal employees.

- The retirement fund does not face a financial crisis. Over time, the ratio of beneficiaries to the revenue base does not surge. In fact, the demand on the general fund declines in constant dollar terms after 2015.

- The Administration's proposal to increase agency contributions for Civil Service Retirement System (CSRS) employees could make

agencies more aware of the cost of doing business but is not intended to cause additional changes in the budget.

- Turning the CSRDF into a pension fund comparable to those sponsored by state and local governments or private firms would entail a fundamental policy change. Financial resources would have to be accumulated outside of government as retirement benefits were earned. A substantial increase in federal debt held by the public would be required in the near term to finance the new pension fund.

AN OVERVIEW OF FINANCING FOR FEDERAL RETIREMENT

Federal retirement benefits are an important part of the total compensation offered by the government to attract and retain a skilled workforce. Most civilian federal employees are covered by one of two retirement programs. The Federal Employees' Retirement System (FERS) covers civilian employees hired since January 1984 and earlier hires who elected to join--a total of 1.3 million employees. FERS is integrated with Social Security, in which workers covered by FERS also participate. In addition to the defined benefits of FERS, the government makes automatic and matching contributions on the behalf of workers covered by FERS to the Thrift

Savings Plan (TSP), a defined contribution plan similar to 401(k) plans offered by private employers. The defined benefit program of the Civil Service Retirement System covers most civilian employees not in FERS. Only a few of the 1.5 million employees who are covered under CSRS participate in Social Security as part of their federal employment. Both FERS and CSRS defined benefit payments are made out of the Civil Service Retirement and Disability Fund.

What Is the Civil Service Retirement and Disability Fund?

The CSRDF is a federal trust fund--an accounting entity used to report the cost of retirement to the government and the inflow of employee payroll taxes (contributions) to the defined benefit plans. Even though it is referred to as a trust fund, the CSRDF bears almost no resemblance to a private pension fund, nor was it intended to do so. A private pension fund consists of a pool of assets--that is, claims on real resources set aside and managed by fiduciaries for the exclusive benefit of recipients. By contrast, the CSRDF is a set of entries on the government's books. Although the fund is effective in accounting for contributions from employees and agencies and for amounts to be paid to annuitants, the only asset the account holds consists of paper balances at the Treasury. Those balances do not constitute a claim on specific assets outside the government but rather rely on the power of the government to levy taxes in the future.

The CSRDF is simply a ledger that is useful in measuring costs and liabilities. Unfortunately, it is also a source of misinformation and confusion. When the government collects payroll taxes from its employees, it earmarks those receipts by crediting the collection to the trust fund. Those monies, however, go directly into the Treasury's cash balances where they are used to pay the government's bills as those come due--including the current month's federal retirement benefits. When the flow of collections from current employees is insufficient to cover all of the current period's expenses for benefits, the Treasury must obtain resources from taxpayers now or later by borrowing. Thus, the federal retirement system for civilian employees is on a pay-as-you-go basis, as is military retirement, Social Security, and the rest of the federal government.

The government could hardly do otherwise because a federal account cannot "fund" future payments without purchasing claims on private resources. If the government attempted to purchase and hold stocks and privately issued bonds to pay future federal pensions, it would require more than $850 billion of such assets just for the civil service retirement program. Another $630 billion would be required for the military retirement program. If borrowing and investing that amount were to occur, federal outlays and the deficit would increase and the government's pension fund could become the country's largest stockholder.

Funding the federal pension liability with private assets is not necessary to ensure that retirees receive their benefits. Private pension funds are required to be funded to protect workers' pension benefits in case the employer goes out of business. The federal government does not risk business failure, since it has the sovereign authority to tax.

How Does the Retirement Fund Accumulate Balances?

Balances in the CSRDF represent the cumulative difference between income to the fund from all sources and the benefits paid out of the fund. As shown in Table 1, the retirement fund collects two types of income--intragovernmental transfers and payments from those outside the government (federal employees and the Postal Service, whose employees are eligible for federal pensions). Most workers covered by CSRS contribute 7 percent of their salaries to the fund, but they pay no Social Security taxes. Most FERS employees also pay 7 percent of salary toward their retirement, but only 0.8 percent goes to the CSRDF with the remainder used to pay their 6.2 percent share of the Social Security tax. Employees contributed $4.7 billion to the fund in 1993, the most recent fiscal year for which a complete report is available from the Office of Personnel Management. The Postal Service, which is technically off-budget, paid in $4.8 billion.

TABLE 1. TRANSACTIONS OF THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND, FISCAL YEAR 1993 (In billions of dollars)

Transaction	Amount
Employee Contributions	4.7
Postal Service Payments	4.8
Agency Contributions (Non-postal)	7.7
Government Payments for Past Service Liabilities (Non-postal)	20.2
Treasury Interest Payments	25.5
Total Fund Income	62.9
Total Fund Expense	35.1
Net Effect on the Budget Deficit (Employee contributions and Postal Service payments minus fund expenses)	25.6

SOURCE: Office of Personnel Management.

NOTE: The shaded entries reflect the purely bookkeeping entries. Postal Service contributions are treated differently than other agency contributions because those payments are assumed to be recouped through stamp charges.

The government--that is, taxpayers--must pay all of the costs of federal retirement not financed by employee contributions and Postal Service payments. The concept of normal cost provides a convenient measure of that total. Normal cost is the constant percentage of pay that would have to be invested at a specified rate of interest each year over the working life of a typical group of new employees to finance fully all of their retirement benefits. Currently, the normal cost of defined benefits is estimated to be 12.2 percent of payroll for FERS employees and 25.1 percent for CSRS employees. Inasmuch as FERS and CSRS employees contribute 0.8 percent and 7 percent of pay to the CSRDF, respectively, agencies must contribute 11.4 percent of pay for FERS employees (plus 6.2 percent for Social Security and 3.6 percent for the TSP) and 18.1 percent for CSRS employees to fully cover normal costs. Agencies currently make the requisite payment for FERS employees. For CSRS employees, however, agencies only match the employee contribution of 7 percent of pay. That partial payment by the employing agencies results in a normal cost shortfall of 11.1 percent for CSRS employees.

Financing flows from the agencies to the CSRDF are nearly $8 billion a year, even though the agencies are not covering normal costs for CSRS employees. The deficiency in agency payments means that CSRDF inflows are less than the normal cost of benefits to be paid. That shortfall has necessitated payments to the CSRDF for past service liabilities, which are intended to make up for the failure of agencies to contribute full normal costs in the past. Although those adjusting transfers

amounted to more than $20 billion in 1993, they are less than is needed to close the normal cost gap. Accordingly, even with those extra credits, the accounting shortfall, which has accumulated to $540 billion, is projected to increase until CSRS employees retire.

Another source of income to the retirement fund is interest from the Treasury. Those intragovernmental interest payments are critical to CSRDF because normal cost--the basis for agency FERS payments--is calculated as the amount that, if invested at interest, would grow to the value of benefits to be paid to retirees in the future. The use of normal cost, therefore, requires that interest be earned on CSRDF balances.

The retirement fund paid out $35.1 billion in benefits and operating expenses in 1993. That outflow was almost $28 billion less than the $62.9 billion in total income of the account in the same period. That excess of income over outgo added to the fund's interest-bearing balance at the Treasury, bringing the total balance to $317 billion at the end of 1993. Note, however, that in terms of the transactions between the government and the public (those payments that involve cash), the fund paid out more than it received. In fact, CSRDF transactions with others increased the federal borrowing requirement by $25.6 billion in 1993.

What Is the Significance of the Unfunded Liability?

As of October 1, 1993, the value of retirement benefits already earned by current employees and annuitants was $857.5 billion (see Table 2). The retirement fund account had interest-bearing claims on the Treasury of $317.4 billion. That amount leaves an "unfunded liability" of $540.1 billion, almost all of which is the result of underfunding CSRS benefits.

Some people have described that unfunded liability incorrectly as the cost of federal retirement that future taxpayers must bear. In fact, unless the federal government renegotiates its pension promises, future taxpayers must pay the entire earned benefit of $857.5 billion. The retirement fund's balance of $317.4 billion at the Treasury is merely the cumulative excess of credits to that account over and beyond payments it made to others. The difference between that balance and the total liabilities of the fund reveals only the extent to which the cost of future benefits has not yet been recognized in the budget. But it is the whole of future benefits that taxpayers will have to pay, funded or not.

Of course, the retirement fund could be fully funded by an intragovernmental transfer of $540.1 billion from the Treasury to the fund. That bookkeeping entry, which would require that the federal debt ceiling be raised by that amount, would cost taxpayers and the government nothing, but it would increase the CSRDF's

TABLE 2. STATUS OF THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND ON OCTOBER 1, 1993 (In billions of dollars)

	CSRS	FERS	Total
Actuarial Accrued Liability	815.0	42.5	857.5
Less: Net Assets in Fund	276.7	40.7	317.4
Unfunded Actuarial Accrued Liability	538.3	1.8	540.1

SOURCE: Office of Personnel Management.

NOTE: CSRS = Civil Service Retirement System; FERS = Federal Employee's Retirement System.

balance with the Treasury. Nevertheless, the burden on future taxpayers, who are ultimately liable for all obligations of the federal government, would be unaffected. Inasmuch as that bookkeeping transfer would not change the liability of taxpayers, "full funding" would not afford additional protection to annuitants against the risk of future reductions in pension benefits.

Is the Civil Service Trust Fund Facing a Financial Crisis?

Since employee payroll taxes and Postal Service payments are the only source of real resources to the CSRDF, one can gauge the extent of its call on taxpayers by the annual difference between cash inflows from those sources and cash outflows. In 1993, cash outflows exceeded inflows by $25.6 billion. Projections prepared by the Office of Personnel Management and reported in Table 3 show the cash flow deficit increasing to $95 billion in 2015 and $185 billion in 2035. Stated in constant 1994 dollars, however, the fund's deficit in 2015 is $41 billion and declines to $33 billion in 2035.

Although the projected cash flow deficits of the retirement fund appear to be manageable under the current pay-as-you-go policy, the Congress has two means of reducing the burden to future taxpayers: reducing net pension benefits or increasing national saving and investment.

TABLE 3. LONG-RANGE PROJECTIONS OF CSRDF CASH INFLOWS AND OUTFLOWS
(In billions of current dollars)

	2015	2025	2035
Employee Contributions	3.1	3.6	5.6
Postal Service Payments	16.7	2 4.4	28.1
Total Cash Inflows	19.8	28.0	3 3.7
Cash Outflows	114.6	166.2	218.5
Net Effect on the Budget Deficit	94.8	138.2	184.8
Net Effect on the Budget Deficit (In constant 1994 dollars)	40.8	38.3	32.9

SOURCE: Congressional Budget Office estimates based on projections by the Office of Personnel Management.

NOTE: Figures assume that the Postal Service is 20 percent of payroll.

The cost of deferred compensation to the government can be reduced by either raising the employee contribution rate or lowering the pension benefit. A cutback in pension payments can be achieved through such policies as smaller cost-of-living adjustments ("diet COLAs"), COLA delays, the use of the highest five years of pay (rather than three), or a reduced benefit accrual rate per year of service. Reducing the federal workforce, including what is already planned, will also reduce total compensation, deferred as well as current. Higher payroll contributions by federal employees would help future cash flow, although that form of financing is not common in private pensions.

The greater national income is, the more tolerable will be future tax burdens from financing federal pension benefits when they come due. One way the government can contribute to a larger national economy in the future is to increase saving and investment now. The most direct means of achieving that result would be to reduce the federal deficit. All of the measures reducing normal cost, as illustrated above, would reduce the deficit, but so would policy actions far removed from the federal retirement arena.

Neither the $540 billion unfunded liability nor the annual cash deficit of the retirement fund signals a financial crisis. The government will be able to meet its retirement obligations from anticipated tax revenues. Efforts to reduce the cost of the system and limit taxpayer burdens further should weigh the effects of such actions

on hiring and retaining employees and on the credibility of the government as an employer.

THE ADMINISTRATION'S PROPOSAL

The Administration believes that accurately measuring federal program costs is essential to improving the effectiveness of the federal government. The failure of agencies to pay full normal cost in unfunded plans and for CSRS employees means that both agency operating expenses and retirement trust fund collections understate deferred compensation earned by federal employees in the current period. That understatement may misinform managerial decisions relating to the size and composition of the federal workforce, the use of more capital-intensive production processes, initiatives for early retirement, and contracting out. Accordingly, the Administration proposes charging all federal agencies the full cost of pension benefits as earned. The intent is to establish a consistent, comprehensive, and timely measure of labor costs, even though that would not affect the current pay-as-you-go financing of federal retirement.

For all pension plans, including those in several federal agencies that currently recognize no accrual of pension costs, the Administration's plan would

increase agency labor costs by $5.3 billion per year. Those intragovernmental transfers, however, would not affect budget outlays or the budget deficit. If the discretionary spending cap that limits budget resources under the Budget Enforcement Act (BEA) was adjusted upward by $5.3 billion, then no staff reductions or other cuts in agency spending would be necessary. However, if the cap was not adjusted, those other cash outlays would have to be reduced. The Office of Management and Budget proposed that the cap be adjusted.

The Administration also proposes a series of intragovernmental transfers from the Treasury to the CSRDF that would eliminate the trust fund's $540 billion unfunded liability over 40 years. The only advantage of spreading that transfer over 40 years is to avoid an immediate, large increase in the federal debt limit, which includes government trust fund holdings of Treasury securities. If, however, it is desirable to improve the accuracy of the accounting through full funding, then it would be desirable to do so sooner rather than later. Moreover, inasmuch as that transfer could be accomplished entirely on the books of the federal government, there is no economic cost of doing so. Such a one-time accounting transfer would enable the fund balances to reflect more accurately the amounts that the government has committed itself to pay.

In sum, accounting proposals that reduce or extinguish the unfunded liability do not affect the retirement program's soundness or affordability. The

Administration's proposal to convey a half a trillion dollars in Treasury securities to the retirement fund over 40 years can only be explained as an effort to improve the informational content of the CSRDF's asset balance. If that is the goal, the payment might be made all at once because it creates no burden. Another view is that the pertinent information already exists in the annual actuarial reports of the CSRDF. That information need not be registered in a retirement trust fund at all.

MOVING THE CSRDF EITHER OFF-BUDGET OR OUTSIDE THE BUDGET

Social Security and the Postal Service are off-budget entities under current law. As such, their accounts are segregated within the unified budget. In addition, Social Security by law is exempt from enforcement of pay-as-you-go procedures under the BEA. To provide federal retirees with protection similar to that of Social Security recipients, some analysts have advocated off-budget status for the retirement funds. H.R. 103, introduced by Congressman Bilirakis, is an example of giving off-budget status to the Civil Service Retirement and Disability Fund, although it may not provide the same protection that is given to Social Security recipients. The BEA, however, already exempts federal retirement payments from being cut in a sequestration. A change in budget status will not necessarily further insulate federal retirement benefits from cutbacks. Moreover, placing the retirement fund into the

off-budget category changes neither the pay-as-you-go financing of federal retirement nor the budget totals.

In contrast, placing the CSRDF outside the budget, rather than merely off-budget, implies a fundamental change in financing retirement benefits. Following the state and local government and Thrift Savings Plan model, funds would be invested outside the government as benefits were earned. That approach would require the government to provide the pension fund with $857.5 billion in cash or government securities--the amount needed to pay benefits already earned. That transaction might have significant short-run macroeconomic consequences, unless it was spread over time. It would also require a major increase in the debt ceiling.

Moving the CSRDF outside the budget would also mean that transactions between the retirement fund and other government accounts would no longer be intragovernmental. Agency contributions and Treasury interest payments to the CSRDF would increase budget outlays and the deficit, as shown in Table 4. In fact, shifting the budget status of the CSRDF would increase the deficit by about $50 billion annually. Despite that change in the budget, neither the benefit payments to current annuitants, the benefits earned by current employees, nor the cost to the government would change. Over the long term, federal outlays would be unaffected. Spending now projected to occur in distant out-years would be reduced by shifting spending to nearer-term budgets.

TABLE 4. THE BUDGET'S REACH: WHAT IS COUNTED IN THE DEFICIT?

Transaction	Civil Service Retirement and Disability Fund	
	In the Budget	Outside the Budget
Employee Contributions	Yes	No
Postal Service Payments	Yes	No
Agency Contributions	No	Yes
Treasury Interest Payments	No	Yes
Benefit Payments	Yes	No

SOURCE: Congressional Budget Office.

If only FERS was fully funded and moved outside the budget, the effects on the deficit and debt held by the public would be less than from moving the entire CSRDF outside the budget. A one-time budget outlay of $42.5 billion would have fully funded FERS in 1993. The annual deficit would have been about $8.5 billion higher.

Moving the retirement funds outside the budget raises a number of non-budgetary issues. The new retirement fund, which might invest in private securities, would need a well-defined policy on the extent to which it would exercise its authority over management of private firms. If the investment returns to the new CSRDF were less than expected, the government would have to make additional contributions to the system, unless the retirement plan was converted to a defined contribution system. To maintain the current level of indexing for price inflation, the new pension fund would probably need to hold assets whose income is also indexed. Such dollar-denominated assets do not currently exist in the quantities required to fund federal pension benefits.

Putting the retirement fund outside the budget would have three potential advantages. First, the budget would recognize retirement costs as they are incurred, which is when they are most controllable. Second, retirees would have more assurance that their earned benefits would be paid in full. Third, current taxpayers would pay the current cost of providing government services, which might improve

intergenerational equity. In sum, moving the fund outside the budget might encourage better planning up front by the Congress, agencies, and employees.

Besides increasing the deficit and debt held by the public, moving the fund outside the budget has three potential costs. First, it would create new opportunities to report budgetary savings that might be illusory. For example, critics charge that state and local governments have artificially lowered their budget outlays by manipulating the assumptions that determine their required contributions to the plans. Second, revisions in the actuarial estimates of costs and liabilities could result in shifts of billions of dollars in either direction between the Treasury and the retirement funds, which would reduce budget stability. Third, no matter how cleverly the option is legislated, many budget experts believe that the Congress will still be able to reduce the deficit by cutting benefit payments to retirees. In fact, the only way to protect earned benefits completely would be to switch to defined contribution plans like the TSP.

CONCLUSION

In sum, Mr. Chairman, it is fair to say that if the accumulated unfunded liability of the retirement fund is perceived as a problem, it could be corrected at the stroke of

a pen without economic costs. The unfunded liability appears to be a problem only because of the financial illusion created by the retirement trust fund. In fact, the government has no assets that can be used to spare the American taxpayer the burden of paying all of the liabilities that the government has accumulated for future pension benefits. Seen in perspective, however, that burden does not appear unmanageable. In constant 1994 dollars, the draw on the general fund actually declines after 2015.

The Administration's proposal is designed to perfect the budgetary accounting for retirement benefits so that all normal cost is recognized on the books of the federal government as benefits are earned. Moving the retirement fund to off-budget status, as has been done for Social Security, would have no significant effect on the financing of benefits. Moving the retirement fund outside the budget would require a fundamental change in financing and could have significant macroeconomic consequences.

In closing, Mr. Chairman, I would urge the Committee to evaluate those proposals not only in terms of their costs but also in light of their effects on the ability of the government to recruit and retain a skilled workforce and, relatedly, on the credibility of the federal government as an employer.

Mr. BASS. The Chair will now recognize Mr. Flynn for 5 minutes.

Mr. FLYNN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am pleased to appear today to discuss the financing of the Civil Service Retirement and Disability Fund. I would like to provide an overview of the operation of the Civil Service Retirement and Disability Fund and its relationship to the Civil Service Retirement System and the Federal Employees Retirement System. In doing so, as I talk about those two systems, I will attempt to address the specific questions you have asked prior to the hearing.

Much has been discussed and written about a crisis being faced by the Civil Service Retirement and Disability Fund. That discussion has suggested that either added revenues to the fund or reduced payments from it are necessary to avoid the crisis. Let me state at the outset that the fund faces no crisis.

Notwithstanding the reported unfunded liability of the fund, the fund now possesses, and will continue to possess, sufficient balances to pay all its requirements for as long as one cares to project into the future. Indeed, provisions of current law provide a mechanism for the unfunded liability to gradually be funded and eliminated altogether over time. In a few moments, I will address the administration's proposal to improve the manner in which the unfunded liability will be financed, but it is important to point out that the provisions already exist to accomplish that objective.

Since there is no funding crisis, it is important to emphasize that proposals to increase fund revenues or decrease fund expenditures fundamentally affect the employer-employee distribution of benefit costs or the actual level of benefits provided to retirees. They should be evaluated not only in terms of their cost, but also their impact on the government's ability to recruit and retain a skilled work force.

The Civil Service Retirement and Disability Fund is an account set up at the Department of Treasury to record funds earmarked for the civil service and Federal employees retirement programs, benefits paid by these programs, and amounts owed by the government for future benefit costs. Employee contributions, along with all other sources of income, are deposited in the Treasury and credited to the retirement fund. On the opposite side of the ledger, benefits paid out of the Treasury are debited to the retirement fund. Thus, the retirement fund's balance at any point in time represents the net credits it has accumulated to pay retirement benefits. These net credits will generate the budget authority necessary to pay retirement benefits when they become due.

The fund's activities do affect the budget. Under current scorekeeping rules, employee contributions and Postal Service agency contributions are treated as government revenues, and retirement benefit payments are treated as government outlays. The difference between them represents the amount by which the retirement fund adds to or reduces the Federal deficit. In fiscal year 1995, the fund added $28 billion to the on-budget deficit.

Over the next 40 years, the impact of the retirement fund for the on-budget deficit, measured in nominal dollars, which includes inflation, will go to $51 billion in the year 2005, $95 billion in 2015, $138 billion in 2025, and $185 billion in 2035. However, expressed

in constant 1995 dollars, the real effect upon the budget remains essentially stable, going to $33 billion in 2005, $39 billion in 2015, $37 billion in 2025, and $32 billion in 2035. These figures are included in some material that we provided the subcommittee earlier.

The credits accumulating in the retirement fund are invested in special interest-bearing securities of the U.S. Government which cannot be sold to the public. Since these securities and the interest they earn are nonmarketable, they are, in essence, government IOUs which are liquidated to pay current and future benefits. When this occurs, the securities recorded in the retirement fund are reduced accordingly.

Because the fund securities amount to loans the government makes to itself, loans the government by law is required to repay with interest, there is no need for real cash to change hands when amounts are recorded in the fund. But when we pay out benefits in real cash, in effect, we redeem the paper in the fund with cash from the Treasury.

The vast majority of income that the fund receives is from governmental sources. The fund's income from the public does not approach its outgo to the public. Thus, the operation of the retirement fund does not present a source of cash for financing government operations in general.

Two financing mechanisms already established in current law work together to ensure that the retirement fund, despite operating with a large unfunded liability, will have sufficient budget authority available to pay retirement benefits.

The first, set up in 1969, is a series of extra payments designed to slowly stop the Civil Service Retirement System's unfunded liability from growing and eventually reducing it. The second was set up when the Federal Employees Retirement System was created in 1986. Under it, employing agencies began paying the full accruing cost of benefits for new hires.

Also, the Federal Employee's Retirement System Act makes those assets available to pay any remaining Civil Service Retirement System benefits after that system's funds are depleted, and creates in the process a payment stream to repay the Federal Employees Retirement System. Together, these two financing mechanisms ensure that the retirement fund will always have sufficient budget authority to pay benefits.

Nonetheless, for civilian employees hired before 1984, employing agencies still pay only about two-fifths of the government's share of the accruing cost, resulting in an increasing unfunded liability. The administration's proposal to deal with the situation will require agencies to pay the full accruing employer cost of Civil Service Retirement System benefits beginning in fiscal year 1997. It will also address the $540 billion unfunded liability by amortizing the debt over a 40-year period beginning that same year.

This is a "good government" measure designed to provide more accurate cost accounting, showing Civil Service Retirement System costs when and where they are incurred rather than as a governmentwide cost at some point in the future. It will also respond to concerns about the system's large unfunded liability and stop it from growing further.

The budgetary impact of the administration's proposal has been outlined in the statement from the Director of OMB, and so I won't repeat it as part of my statement. In addition, some of the information you asked about, the cash inflows and outflows when the fund is off budget or out of budget have also been addressed not only in the statement by OMB but also in the statement from the Congressional Budget Office, so I will simply not go back into that, Mr. Chairman. I would be glad to answer any questions the subcommittee may have.

Mr. BASS. Thank you very much, Mr. Flynn.

[The prepared statement of Mr. Flynn follows:]

STATEMENT OF
WILLIAM E. FLYNN, III, ASSOCIATE DIRECTOR
FOR RETIREMENT AND INSURANCE
OFFICE OF PERSONNEL MANAGEMENT

at a hearing of the

SUBCOMMITTEE ON CIVIL SERVICE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

on the

FINANCING OF THE
CIVIL SERVICE RETIREMENT AND DISABILITY FUND

JUNE 28, 1995

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO APPEAR TODAY TO DISCUSS THE FINANCING OF THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND. I WOULD LIKE TO PROVIDE AN OVERVIEW OF THE OPERATION OF THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND AND ITS RELATIONSHIP TO THE CIVIL SERVICE RETIREMENT SYSTEM (CSRS) AND THE FEDERAL EMPLOYEES RETIREMENT SYSTEM (FERS). IN DOING SO, I WILL ADDRESS THE SPECIFIC QUESTIONS YOU HAVE ASKED.

MUCH HAS BEEN DISCUSSED AND WRITTEN ABOUT A CRISIS BEING FACED BY THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND. THAT DISCUSSION HAS SUGGESTED THAT EITHER ADDED REVENUES TO THE FUND OR REDUCED PAYMENTS FROM THE FUND ARE NECESSARY TO AVOID THE CRISIS. LET ME STATE AT THE OUTSET THAT THE FUND FACES NO CRISIS.

NOTWITHSTANDING THE REPORTED UNFUNDED LIABILITY OF THE FUND, THE FUND NOW POSSESSES, AND WILL CONTINUE TO POSSESS, SUFFICIENT BALANCES TO PAY ALL ITS REQUIREMENTS FOR AS LONG AS ONE CARES TO PROJECT INTO THE FUTURE. INDEED, PROVISIONS OF CURRENT LAW PROVIDE A MECHANISM FOR THE UNFUNDED LIABILITY TO GRADUALLY BE FUNDED AND ELIMINATED ALTOGETHER OVER TIME. IN A FEW MOMENTS, I WILL ADDRESS THE ADMINISTRATION'S PROPOSAL TO IMPROVE THE MANNER IN WHICH THE UNFUNDED LIABILITY WILL BE FINANCED, BUT IT IS IMPORTANT TO POINT OUT THAT PROVISIONS ALREADY EXIST TO ACCOMPLISH THAT OBJECTIVE.

SINCE THERE IS NO FUNDING CRISIS, IT IS IMPORTANT TO EMPHASIZE THAT PROPOSALS TO INCREASE FUND REVENUES OR DECREASE EXPENDITURES FUNDAMENTALLY AFFECT THE EMPLOYER/EMPLOYEE DISTRIBUTION OF BENEFIT COSTS OR THE ACTUAL LEVEL OF BENEFITS PROVIDED TO EMPLOYEES. THEY SHOULD BE EVALUATED NOT ONLY IN TERMS OF THEIR COST, BUT ALSO THEIR IMPACT ON THE GOVERNMENT'S ABILITY TO RECRUIT AND RETAIN A SKILLED WORK FORCE.

THE FUND'S CURRENT OPERATIONS AND FINANCING

THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND IS AN ACCOUNT SET UP AT THE DEPARTMENT OF THE TREASURY TO RECORD FUNDS EARMARKED

FOR THE CSRS AND FERS RETIREMENT PROGRAMS, BENEFITS PAID BY THESE PROGRAMS, AND AMOUNTS OWED BY THE GOVERNMENT FOR FUTURE BENEFIT COSTS. EMPLOYEE CONTRIBUTIONS, ALONG WITH ALL OTHER SOURCES OF INCOME ARE DEPOSITED IN THE TREASURY AND CREDITED TO THE RETIREMENT FUND. ON THE OPPOSITE SIDE OF THE LEDGER, BENEFITS PAID OUT OF THE TREASURY ARE DEBITED TO THE RETIREMENT FUND. THUS, THE RETIREMENT FUND'S BALANCE AT ANY POINT IN TIME REPRESENTS THE NET CREDITS IT HAS ACCUMULATED TO PAY RETIREMENT BENEFITS. THESE NET CREDITS WILL GENERATE THE BUDGET AUTHORITY NECESSARY TO PAY RETIREMENT BENEFITS WHEN THESE BENEFITS BECOME DUE.

THE FUND'S ACTIVITIES AFFECT THE BUDGET. UNDER CURRENT SCORE-KEEPING RULES, EMPLOYEE CONTRIBUTIONS AND POSTAL SERVICE AGENCY CONTRIBUTIONS ARE TREATED AS GOVERNMENT REVENUES, AND RETIREMENT BENEFIT PAYMENTS ARE TREATED AS GOVERNMENT OUTLAYS. THE DIFFERENCE BETWEEN THEM REPRESENTS THE AMOUNT BY WHICH THE RETIREMENT FUND ADDS TO OR REDUCES THE FEDERAL DEFICIT. IN FY 1995, THE FUND ADDED $28 BILLION TO THE ON-BUDGET DEFICIT.

OVER THE NEXT FORTY YEARS, THE IMPACT OF THE RETIREMENT FUND FOR THE ON-BUDGET DEFICIT, MEASURED IN NOMINAL DOLLARS INCLUDING INFLATION, WILL GO TO $51 BILLION IN 2005, TO $95 BILLION IN 2015, TO

$138 BILLION IN 2025, AND TO $185 BILLION IN 2035. HOWEVER, EXPRESSED IN CONSTANT 1995 DOLLARS, THE REAL EFFECT UPON THE BUDGET REMAINS ESSENTIALLY STABLE, GOING TO $33 BILLION IN 2005, TO $39 BILLION IN 2015, TO $37 BILLION IN 2025, AND TO $32 BILLION IN 2035. ACCOMPANYING THE MATERIALS SUBMITTED TO THE SUBCOMMITTEE EARLIER, THERE ARE CHARTS SHOWING THE INCOMES AND OUTLAYS YIELDING THESE NET FIGURES.

THE CREDITS ACCUMULATING IN THE RETIREMENT FUND ARE INVESTED IN SPECIAL INTEREST-BEARING SECURITIES OF THE U.S. GOVERNMENT, WHICH CANNOT BE SOLD TO THE PUBLIC. SINCE THESE SECURITIES AND THE INTEREST THEY EARN, WHICH IS REINVESTED IN YET MORE SPECIAL SECURITIES, ARE NON-MARKETABLE, THEY ARE IN ESSENCE GOVERNMENT "IOUS" WHICH ARE LIQUIDATED TO PAY CURRENT AND FUTURE BENEFITS. WHEN THIS OCCURS, THE SECURITIES RECORDED IN THE RETIREMENT FUND ARE REDUCED ACCORDINGLY.

BECAUSE THE FUND SECURITIES AMOUNT TO LOANS THE GOVERNMENT MAKES TO ITSELF, LOANS THE GOVERNMENT IS REQUIRED BY LAW TO REPAY WITH INTEREST, THERE IS NO NEED FOR REAL CASH TO CHANGE HANDS WHEN AMOUNTS ARE RECORDED IN THE FUND. BUT WHEN WE PAY OUT

BENEFITS IN REAL CASH, IN EFFECT, WE REDEEM THE PAPER IN THE FUND WITH CASH FROM THE TREASURY.

THE VAST MAJORITY OF INCOME THAT THE FUND RECEIVES IS FROM GOVERNMENTAL SOURCES. THE FUND'S INCOME FROM THE PUBLIC DOES NOT APPROACH ITS OUTGO TO THE PUBLIC. THUS, THE OPERATION OF THE RETIREMENT FUND DOES NOT PRESENT A SOURCE OF CASH FOR FINANCING GOVERNMENT OPERATIONS IN GENERAL.

ADMINISTRATION PROPOSAL

TWO FINANCING MECHANISMS ALREADY ESTABLISHED IN CURRENT LAW WORK TOGETHER TO ENSURE THAT THE RETIREMENT FUND, DESPITE OPERATING WITH A LARGE UNFUNDED LIABILITY, WILL HAVE SUFFICIENT BUDGET AUTHORITY AVAILABLE TO PAY RETIREMENT BENEFITS. THE FIRST, SET UP IN 1969, IS A SERIES OF EXTRA PAYMENTS DESIGNED TO SLOWLY STOP THE CSRS UNFUNDED LIABILITY FROM GROWING AND EVENTUALLY REDUCE IT. THE SECOND WAS SET UP WHEN FERS WAS CREATED IN 1986. UNDER FERS, EMPLOYING AGENCIES BEGAN PAYING THE FULL ACCRUING COSTS OF BENEFITS FOR NEW HIRES. ALSO, THE FERS ACT MAKES FERS ASSETS AVAILABLE TO PAY ANY REMAINING CSRS BENEFITS AFTER THE CSRS FUNDS ARE DEPLETED, AND CREATES A PAYMENT STREAM TO REPAY THE FERS FUND. TOGETHER, THESE TWO FINANCING MECHANISMS ENSURE THAT

THE RETIREMENT FUND WILL ALWAYS HAVE SUFFICIENT BUDGET AUTHORITY TO PAY BENEFITS.

NONETHELESS, FOR CIVILIAN EMPLOYEES HIRED BEFORE 1984, EMPLOYING AGENCIES STILL PAY ONLY ABOUT TWO-FIFTHS OF THE GOVERNMENT'S SHARE OF THE ACCRUING COSTS, RESULTING IN AN INCREASING UNFUNDED LIABILITY. THE ADMINISTRATION'S PROPOSAL TO DEAL WITH THIS SITUATION WILL REQUIRE AGENCIES TO PAY THE FULL ACCRUING EMPLOYER COST OF CSRS BENEFITS BEGINNING IN FY 1997. IT WILL ALSO ADDRESS THE $540 BILLION UNFUNDED LIABILITY BY AMORTIZING THE DEBT OVER A 40-YEAR PERIOD BEGINNING IN FY 1997.

THIS IS A "GOOD GOVERNMENT" MEASURE DESIGNED TO PROVIDE MORE ACCURATE COST ACCOUNTING -- SHOWING CSRS COSTS WHEN AND WHERE THEY ARE INCURRED, RATHER THAN AS A GOVERNMENTWIDE COST AT SOME POINT IN THE FUTURE. IT WILL ALSO RESPOND TO CONCERNS ABOUT THE SYSTEM'S LARGE UNFUNDED LIABILITY AND STOP IT FROM GROWING FURTHER.

IF THE PROPOSAL IS ENACTED, THE DOMESTIC DISCRETIONARY BUDGET CAPS WILL HAVE TO BE INCREASED BY $4 TO $5 BILLION IN FY 1997 IN ORDER TO PROVIDE AGENCIES WITH THE FUNDS THEY WILL NEED TO PAY HIGHER CSRS

CONTRIBUTIONS WITHOUT REDUCING STAFF OR CUTTING OTHER PROGRAM EXPENSES. THE CAP INCREASE WILL BE EXACTLY OFFSET BY HIGHER INTRAGOVERNMENTAL RECEIPTS IN THE RETIREMENT FUND, AND THUS THERE WILL BE NO IMPACT ON THE DEFICIT.

THE UNFUNDED LIABILITY AMORTIZATION PAYMENT WILL BE CLASSIFIED AS DIRECT SPENDING, AND WILL NOT REQUIRE AN ADJUSTMENT TO THE DISCRETIONARY SPENDING CAPS. ALSO, IT WILL NOT REQUIRE A DIRECT SPENDING (OR PAYGO) OFFSET, SINCE THE PAYMENT WILL BE AN INTRAGOVERNMENTAL TRANSFER, MOVING FUNDS FROM ONE GOVERNMENTAL ACCOUNT TO ANOTHER. THE PROPOSAL IS NOW IN THE FINAL STAGES OF INTERAGENCY CLEARANCES.

BUDGETARY STATUS OF FUND

IF THE RETIREMENT FUND WERE TAKEN OFF-BUDGET, IT WOULD CHANGE THE WAY RETIREMENT COSTS ARE TREATED. AS NOTED EARLIER, UNDER THE CURRENT SCOREKEEPING RULES, THE FUND'S ON-BUDGET DEFICIT IMPACT IS EQUAL TO CSRS AND FERS BENEFIT PAYMENTS NET OF EMPLOYEE AND POSTAL SERVICE CONTRIBUTIONS. IN AN "OUT OF THE BUDGET" SCENARIO, THE FUND'S DEFICIT IMPACT WOULD EQUAL THE GOVERNMENT'S CONTRIBUTIONS TO FINANCE CSRS AND FERS BENEFITS, INCLUDING AMORTIZING THE UNFUNDED LIABILITY, AND INTEREST ON THE FUND

BALANCE. THE STATEMENT OF THE OFFICE OF MANAGEMENT AND BUDGET ADDRESSES THIS ISSUE IN GREATER DETAIL.

I HOPE THIS OVERVIEW HAS BEEN HELPFUL TO THE SUBCOMMITTEE, AND I WILL BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

(Nominal $ in billions)

FY	Outlays	Less: Employee Contributions	Unified Budget Deficit Impact	Less: Postal Agency Contributions	On-budget Deficit Impact
2005	65	5	60	9	51
2015	115	3	112	17	95
2025	166	4	162	24	138
2035	219	6	213	28	185

(Constant 1995 $ in billions)

FY	Outlays	Less: Employee Contributions	Unified Budget Deficit Impact	Less: Postal Agency Contributions	On-budget Deficit Impact
2005	42	3	39	6	33
2015	47	1	46	7	39
2025	44	1	43	6	37
2035	38	1	37	5	32

Mr. BASS. We must now recess for 30 minutes for a vote.

[Brief Recess.]

Mr. MICA [presiding]. If we can reconvene the hearing of the Subcommittee on Civil Service; Mr. Finch, had you finished or had you started?

Mr. FINCH. No, I am ready, it is my time.

Mr. MICA. If you would proceed, then, thank you.

Mr. FINCH. Thank you, Mr. Chairman.

I am pleased to be here to discuss Federal system financing. The previous witnesses have already laid a good foundation in explaining the way the retirement fund is financed. We all seem to be in agreement that the fund does not face a financial crisis. Given that, I will just make one additional point on the issue of the current financing approach and then quickly summarize our thoughts on the other issues you asked us to address and then we can move right into the questions. I would ask for my detailed statement to be submitted for the record.

Mr. MICA. Without objection, so ordered.

Mr. FINCH. Thank you.

Our major concern with the retirement funding process has been that agencies are charged less than the full accruing cost of CSRS, thus understating the cost of government programs.

Our recommendation to charge agencies all accruing retirement costs not covered by employee contributions was adopted for the FERS pension plan when it was put in and for the Military Retirement System but not for CSRS.

The President's budget proposals for fiscal years 1995 and 1996 called for the dynamic normal cost approach to be applied to CSRS and for CSRS' unfunded liability to be amortized over a 40-year period. We agree with the general objective of the proposal as described in the budgets. The effect of the change would be to recognize the full government cost of CSRS in agency budgets without increasing the deficit, as we understand it.

On occasion, consideration has been given to moving the retirement fund off budget. In our opinion, no purpose would be currently served by such an action. On budget or off budget, the Treasury would still have to secure the money necessary to make benefit payments from general revenues or from borrowing. We have long supported the principle of the unified budget, believing that the budget should be a comprehensive statement of receipts and expenditures of activities of the Federal Government.

Changing the investment policy from nonmarketable Treasury securities to private sector securities, that is, as Mr. Blum said earlier, taking the fund entirely out of the budget, would result in significant cash outlays which would further exacerbate the deficit situation. The government would have to borrow the money to make the investments and then run the risk that the investment returns would be less than sufficient to cover its obligations.

Because the accruing cost of CSRS and the FERS pension plan for active employees are greater than the outlays to retirees each year, requiring outside investments would cause an increase in outlay requirements over the amounts required under the current investment policy.

That concludes my statement, Mr. Chairman. I would be pleased to answer questions.

Mr. MICA. I thank you for your testimony and your participation.

[The prepared statement of Mr. Finch follows:]

PREPARED STATEMENT OF JOHNNY FINCH, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, GAO

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss federal retirement system financing. This issue is quite complicated and complex. The purpose of our statement is to attempt to bring some perspective to the issue by describing how the government finances its retirement systems and discussing the budget implications of the financing methods being used and possible changes to these methods. Our statement concentrates on the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS) because they are the largest retirement programs for federal civilian personnel.

Since we noted that you asked the Office of Personnel Management to provide considerable information on the cost, liabilities, and outlays of the two systems, we have not included such data in our statement.

RETIREMENT FINANCING PRACTICES NOW BEING FOLLOWED

There are several similarities in how CSRS and FERS are financed, but there are significant differences as well.

CSRS and the FERS pension plan require employees to contribute toward system costs. As the employer, the government is responsible for funding all costs not covered by employee contributions. If there were no cost to the government, employees, in effect, would not be receiving any retirement benefits from their employer. Thus, the cost of the retirement systems is part of the overall costs taxpayers pay for the government services they receive.

Both CSRS and the FERS pension plan are "funded" programs, in that amounts are set aside (in the same fund) to cover benefit payments. A "normal cost" is calculated for each plan. Normal

cost is expressed as a percentage of payroll and represents the amount of money that should be set aside during employees' working years that, with investment earnings, will be sufficient to cover future benefit payments. Normal cost calculations require that many assumptions be made about the future, including mortality rates, quit rates, interest rates, employee salary increases, and cost-of-living increases over the lifespans of current and future retirees.

The amounts employees in CSRS and their agencies contribute to the retirement fund are approximately equal to the system's "static" normal cost, that is, the cost of future benefits calculated under the assumptions that federal pay schedules will not increase and employees will receive no cost-of-living adjustments (COLA) after they retire. However, when normal cost is calculated on a "dynamic" basis, including assumptions for future pay increases and COLAs, the cost percentage is about doubled. It has long been our position that the dynamic approach is the appropriate way to calculate and provide budget authority for CSRS costs since it identifies the full cost of providing benefits to covered employees. When done properly, recognizing retirement costs as they are being accrued reflects the full costs of providing retirement benefits to federal personnel at the time their services are rendered.

Unlike CSRS, the FERS pension plan is funded on a dynamic normal cost basis. Agencies are required to contribute the difference between dynamic normal cost and employee contributions. The differing approaches result in employing agencies making greater contributions per employee toward the cost of FERS than they make to CSRS, even though the overall costs of the two systems are roughly comparable.

Although the amount of agency contributions covers less than the actual cost to the government of providing CSRS benefits, much of

the remaining costs are covered by other government contributions to the retirement fund. OPM makes annual contributions to the fund from its appropriation to amortize the liabilities created by employee pay raises, once enacted, and other benefit improvements when they are made; the Postal Service makes contributions to the fund to cover retirement system liabilities resulting from collective bargaining agreements with its employee unions and COLAs postal retirees receive; and the Treasury pays the cost of benefits attributable to military service and interest on the system's unfunded liability as if it were funded. No provision exists to fund COLAs received by nonpostal retirees.

Because of the manner in which CSRS costs are determined and funded, the system has accumulated a sizeable unfunded liability. However, that liability is dealt with by the FERS statute.[1] That statute requires that, when the budget authority in the retirement fund for CSRS benefits is exhausted, automatic annual appropriations will be made to amortize the shortfall over 30 years. Thus, provisions have been made for the retirement fund to always have sufficient budget authority to cover future benefit payments.

An understanding of CSRS and FERS financing practices and unfunded liabilities also requires a realization that federal retirement benefits are not prefunded in the manner that private pension plans set aside money during employees' working years to cover the accruing costs of their retirement benefits. Private companies are required by law to fully fund their pension plans, and are not allowed to invest pension funds in their own securities. The chief purpose of these requirements was to protect employees against the loss of earned pension benefits if their employers went out of business or had not properly funded their pension liabilities.

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[1]Public Law 93-335, approved June 6, 1986.

The pension financing law does not apply to federal or state and local government pension plans because of Congress' presumption that governments will continue to exist, as is not always the case for private companies.

The federal retirement fund is "invested" in special issue Treasury securities. These are nonmarketable securities available only to the retirement fund. There is no cash in the fund. It is only when the securities are redeemed to pay retirement benefits that the Treasury must obtain the necessary money through tax receipts or borrowing. This is the point at which actual outlays occur. To the extent that these outlays are met by borrowing, they add to the deficit.

Thus, the CSRS and FERS pension plan retirement fund represents that portion of estimated future benefit obligations that the government has recognized on paper. The unfunded liability is that portion of estimated future benefit obligations that has no paper backing in the form of special issue Treasury securities. Being simply an actuarial estimate, the unfunded liability itself has no effect on the budget or current outlays and is not a measure of the government's ability to pay retirement benefits in the future. In fact, appropriations to increase the amount of nonmarketable Treasury securities in the fund so as to eliminate the unfunded liability (as the FERS statute requires be done eventually) would not affect federal outlays or the deficit or require additional payments by employees or the taxpayers.

Our major concern with the retirement funding process has been that agencies are charged less than the full accruing cost of CSRS, thus understating the cost of government programs. Our recommendation to charge agencies all accruing retirement costs not covered by employee contributions was adopted for the FERS pension plan (and the Military Retirement System) but not for CSRS.

PRESIDENT'S BUDGET PROPOSALS
ON RETIREMENT SYSTEM FINANCING

The President's budget proposals for fiscal years 1995 and 1996 called for the dynamic normal cost approach to be applied to CSRS and for CSRS' unfunded liability to be amortized over a 40-year period. No legislation to implement the proposal was forwarded to Congress last year, and, to our knowledge, none has yet been forwarded this year. While we would prefer to see the actual manner in which the funding change is proposed to be implemented before we express an opinion on it, we agree with the general objective of the proposal as described in the budgets. The effect of the change would be to recognize the full government cost of CSRS in agency budgets without increasing the deficit.

BUDGETARY TREATMENT OF THE
RETIREMENT TRUST FUND

On occasion, consideration has been given to moving the retirement fund out of the unified budget. In our opinion, no purpose would be currently served by such an action. On budget, or off budget, the Treasury would still have to secure the money necessary to make benefit payments from general revenues or borrowing. We have long supported the principle of the unified budget, believing that the budget should be a comprehensive statement of receipts and expenditures of activities of the federal government.

Changing the investment policy from nonmarketable Treasury securities to private sector securities would result in significant cash outlays which would further exacerbate the deficit situation. If investments in outside securities are made, the agency, employee, and other contributions to the fund that are now mostly transfers of appropriations rather than cash, would have to be converted to cash in order to make the

investments. In the current deficit situation, this means the government would have to borrow the money to make the investments and then run the risk that the investment returns would be less than sufficient to cover its obligations.

Moreover, the accruing costs of CSRS and the FERS pension plan for active employees are greater than the outlays to retirees each year. Thus, requiring outside investments would cause an increase in outlay requirements over the amounts required under the current investment policy. If outside investments were used for the government's other retirement systems, Social Security, and other trust funds, the increased outlay requirements would be even greater.

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That concludes our prepared statement Mr. Chairman. We would be pleased to answer any questions the Subcommittee may have.

(966668)

Mr. MICA. I will start with a couple of questions for Mr. Blum, if I may.

I read your full statement to the committee and had a couple of questions. First of all, what method do you think would best reflect the actual contributions and participation toward meeting the requirements of the retirement funds? I guess you oppose also Mr. Bilirakis' proposal to take this, "off budget."

Are you pretty much an advocate of the status quo as far as reporting from where these funds are generated and how they are expended and reserved? Is that basically your position or opinion?

Mr. BLUM. Mr. Chairman, as you probably know, the Congressional Budget Office doesn't make policy recommendations, so in that sense I don't have an official position. I can make some observations, however.

Essentially, as was stated this morning by a number of people, including yourself, the current financing for the retirement benefits is on a pay-as-you-go basis. In other words, current benefits are being financed by current tax revenues and by borrowing from the public.

I would observe that this is true for the entire Federal budget, including military retirement, Social Security benefits, and everything else that the Government provides in the way of services. This cash-based approach, though, does not accurately reflect the cost of doing business today. Therefore, the budget has incorporated a number of accrual-accounting measures in order to better reflect the actual cost of doing business. And included in the actual cost of doing business in the case of paying for Federal employees is the cost of deferred compensation, or their retirement benefits as they are being earned.

So in that sense, the Federal budget is actually a composite of both methods: the bottom line reflects the cash basis financing, which is how the government works, but it also includes elements of accrual accounting. The administration's approach, following the recommendations of GAO and others, is to perfect or improve that accrual-accounting approach and make the cost-accounting picture more accurate. But it doesn't in any way change the underlying reality of how current governmental expenses are financed.

Mr. MICA. Well, basically your report stated pretty much factual information, that everything is now financed out of current revenues or the amounts that employees are contributing, and you stated also that there is no crises as long as that obligation is met by the General Treasury. I would have to concur with that. But obviously the administration feels that there are some inequities or something lacking in the manner in which these funds are reported and accounted. Even by their proposal, they recommend a different accounting mechanism.

So you don't have an opinion on changing the accounting procedures that would better reflect what is going on again with the contributions, the future obligations and commitments that have been made for the various retirement programs?

Mr. BLUM. Well, we would support that as a good cost accounting measure, what the administration has proposed. In my oral remarks, which unfortunately were made when you were absent from the hearing, I did point out that—I did make a couple of observa-

tions about the administration's proposal which I would like to bring to your attention.

Essentially, the administration has proposed two things. One is that agencies should pay the full normalized cost for the CSRS employees for their retirement benefits. At the present time they do not do so, and those payments, therefore, have to be made up either currently or at some future date in other government payments to the civil service retirement fund.

The purpose of the administration's proposal to have the agencies pay the full normalized cost for these employees is to make the agencies more aware of the full cost of doing business today. It would not affect the actual total outlays of the government or the budget deficit, because these higher agency payments to the civil service retirement fund are simply intragovernmental transactions, one agency is paying another, and it all washes out when you add up everything and come to a bottom line as to what is total outlays by the government and the deficit.

Now, there is a potential snag in this in the following sense: To accommodate this increase in the agency labor costs, for example, the budget for the Congressional Budget Office would have to go up by some amount in order to pay these higher benefit costs for the CSRS employees. The administration would propose to increase the discretionary spending caps that have been placed on the appropriation bills since 1991, and these caps are going to be extended through the year 2002 under the budget resolution.

If those caps were not raised to accommodate these higher interagency payments, then actually total outlays on the deficit would go down by that amount, by over $5 billion annually, because money that otherwise would leave the government to pay for purchases from the private sector or to provide benefits or so forth, instead of going outside the government they would simply remain within the Treasury.

Now, the second part of the administration's proposal is to pay off over a 40-year period this $540 billion unfunded liability in the trust fund. That, too, doesn't have any effect, real effect on total outlays or the deficit because it is another intragovernmental transfer or payment. The only observation I made there was paying it off over 40 years could be done all at once. It is simply a paper accounting type of transaction. It could be done all at once.

The only problem with doing it all at once, and I assume this is why the administration proposed doing it over a 40-year period rather than all at once is because there would have to be an increase in the Federal debt limit which Members would have to vote on, and that is because the Federal debt limit includes the securities that are held by trust funds such as the Civil Service Retirement Trust Fund. It also includes the securities held by the Social Security Trust Fund, too.

Mr. MICA. Well, if we were doing proper accounting or accounting that more properly reflected our indebtedness, we would add almost a trillion dollars between CSRS, FERS unfunded liability, and I guess our military retirement unfunded liability; is that correct?

Mr. BLUM. That is correct. As was pointed out this morning, that figure would be something like $1.5 trillion if we were going to recognize these obligations in the Federal budget. But I also observed

that this information is not hidden from the public or from the Congress. It is contained in the annual reports from OPM and from the Department of Defense on the status of the trust fund, and it is included in the consolidated financial statements for the government as a whole that are put out each year by the Treasury Department.

Mr. MICA. I would venture to say that if you questioned 400 Members of Congress, just the House side, that 398 of them would not know there is an additional $1½ trillion liability. Most of them would quote the $4½ trillion they now consider the national debt, would not consider the additional $1½ trillion a part of it, or even recognize its existence.

Mr. BLUM. I dare say you are right, Mr. Chairman, and one way of having them recognize its existence would be to fully fund those liabilities and to have that increased cost included in what we call gross Federal debt—the national debt as a whole.

Mr. MICA. When I present my amendment on the floor to increase the debt by $1½ trillion, I will use your testimony today for substantiating my position.

Mr. Finch, your testimony states that both CSRS and FERS are funded programs and that amounts are set aside to cover benefit payments. Those are your quotes. Is this not somewhat misleading since moneys contributed to the CSRDF simply become part of the general revenue available to pay for all government expenditures?

Mr. FINCH. I didn't mean to infer that there was cash set aside in the retirement fund in that amount. Basically, the intent there was to talk about the budget authority.

Mr. MICA. You also stated that the current system provides sufficient budget authority for future benefits. Is this equivalent to setting aside sufficient money to cover future benefits?

Mr. FINCH. Sufficient budget authority means that the Congress can make appropriations for that amount in the future. It does not mean that there is that much cash set aside.

Mr. MICA. You state that the current matching agency and employee contributions to CSRS approximate its static normal costs of CSRS. Is this by accident or is this by design?

Mr. FINCH. I think this goes back into some of CSRS' history, and I think during most of that history, agencies and employees have been required to contribute the same percentage of salary to the fund. Technically, the law prescribes the employee contribution percentages and says that agencies must match these amounts. That is pretty much the way the law reads.

The current contribution percentages of 7 percent for general employees, which the agencies must match, which is the other 7 percent, equals the 14 percent that you talk about. These percentages were set in 1969 when major changes were made to the CSRS. But in addition to the agency and the employee contribution provisions at that time, the law also called for significant additional contributions by OPM and Treasury. This was to cover some of the unfunded liability. The static cost does not take into consideration possible pay raises in the future. So in 1969 the law was amended so that OPM kicks in additional contributions for pay raises that have been enacted, but not for future pay raises, just pay raises on the books.

So given that, I think Congress made it pretty clear that employees were not expected to pay half of the cost of the retirement system.

Mr. MICA. By deferring the recognition of outlays until an annuity payment is actually due, does the current accounting system hide the true cost of the retirement system to the taxpayer? Mr. Finch, do you think it hides the actual cost of the retirement?

Mr. FINCH. This goes in part to our recommendation that higher agency contributions be required in the budget.

Mr. MICA. So that will give a better definition, recognition of the obligation?

Mr. FINCH. A much better definition of the true cost, yes.

Mr. MICA. Mr. Flynn, you stated in your testimony, "The fund now possesses sufficient balances to pay all its requirements for as long as one cares to project into the future." In that case, what would be wrong with moving the fund and its balances out of the budget, as some would propose for us to do?

Mr. FLYNN. Well, as has been pointed out, Mr. Chairman, by several people who have testified today, the fund balance essentially represents budget authority. Were that to be moved out of the budget entirely, that fund balance would shift from debt held by the government to debt held by the public, and the budgetary impact of that is something that would need to be considered very carefully.

Mr. MICA. Also in your testimony you stated, "Provisions of current law provide a mechanism for the unfunded liability to gradually be funded and eliminated altogether over time." I think that was your quote.

Mr. FLYNN. That is correct.

Mr. MICA. What is the mechanism and what year will the liability be reduced to zero?

Mr. FLYNN. The mechanism, and Mr. Finch talked about the retirement amendments of 1969, the mechanism was first put in place then and later modified with the Federal Employees Retirement System Act of 1986. The payment stream or the payments that Mr. Finch made reference to dealing with interest payments on the static, unfunded liability and amortization payments to cover the cost of future pay increases do set in motion over time a series of annual payments into the Treasury that as the last Civil Service Retirement System employee leaves active employment and goes into retirement, have the effect of reducing the Civil Service Retirement System's unfunded liability but not completely.

The Federal Employees Retirement System Act of 1986 recognized this phenomenon and recognized that approximately $80 billion, I believe in the year 2025, would remain an unfunded liability of the system, resulting from the government's obligations to its Civil Service Retirement System annuitants.

When that law was passed, among its other provisions, it also contained a provision making the Federal Employee Retirement System assets available to pay those Civil Service Retirement System obligations, and at the same time, because it assumes an unfunded liability, creating at that time a 30-year amortization payment to pay off that liability. Those two things acting together, Mr. Chairman, over the course of the next 50 to 60 years have the ef-

fect of reducing gradually and eliminating altogether the system's unfunded liabilities.

Mr. MICA. On page 6 of your testimony you refer to an increasing unfunded liability and you also refer to the administration's proposal, which as you say, will stop it from growing further. Is this the proposal that you are referring to?

Mr. FLYNN. No, I am sorry, Mr. Chairman, the system that I have talked about already is in current law. The administration's proposal would simply revamp, if you will, the current mechanism for providing Treasury payments to eliminate the unfunded liability by amortizing the current unfunded liability over a 40-year period beginning in 1997.

Mr. MICA. Well, you spoke of increasing unfunded liability. What exactly is the source of the problem here of the increasing unfunded liability? What are you referring to?

Mr. FLYNN. The increasing unfunded liability is the amount by which the unfunded liability increases, resulting from current Civil Service Retirement System employees who remain on the rolls today, though in ever smaller numbers, and the fact that under current law only 14 percent of their accruing benefit is deposited into the fund, compared to a normal cost of 25 percent. That difference of 11 percent in broad terms results in an increasing unfunded liability until such time as those employees are no longer actively on the rolls.

Mr. MICA. This is sort of an interesting exercise. We spend a lot of our time denying that we have any problem, denying that we have any crisis, and yet everybody has got a solution to the problems and crises; whether it is the administration, which is going to solve the unfunded liability through a 40-year amortization program; whether it is the House leadership who wants additional employee contributions; or whether it is the Senate who has some other proposal.

Speaking of the proposals that are before us right now, some of you may be aware of some of the budget agreement provisions to increase the employee contribution by a quarter of a percent I think in 2 succeeding—2 future years.

The other provision, as I understand it, deals with putting some cap on the government's payment of health benefits. What impact do you think these will have and do you have any comments relating to these proposals? Mr. Flynn. Mr. Finch.

Mr. FLYNN. I could probably deal with them one by one. First, the proposal to increase contributions by a quarter percent, is that what you were referring to, Mr. Chairman?

Mr. MICA. Yes.

Mr. FLYNN. As you know, the administration has objected to proposals that would increase the cost to employees or increase employee contributions to the retirement fund and has not proposed itself any changes to the retirement system for this year.

On the health benefit proposal, we have taken a look at the proposal as best we understand it coming out of the Budget Committee, and as you said, it will essentially establish a maximum dollar contribution on the part of the government and then adjust it annually by the change in the consumer price index.

I just might comment that some of the impacts or effects of something like that do cause us some concern that we are taking a look at. First, the government's contribution would be adjusted by the overall change in the consumer price index. In a program that is more sensitive to the actual change in the medical price index which can and in fact has over the past several years risen at a faster rate than the overall consumer price index. That can have the effect of shifting more of the cost of the health benefits program away from the government and to the individual employee.

In addition, there are clearly incentives for employees, then, to look for plans that offer a good package of benefits at low rates because under this particular proposal, if they shop around properly and find a plan, there is at least the ability for them perhaps to have their entire premium covered within the maximum contribution that the government would make. That has in the past led to a phenomenon that we call adverse selection where benefit structures are put together and their associated premium costs that attract on average younger, more healthy people, and tend not to attract on average older, less healthy people, and that phenomenon can have really dramatic impacts on health benefit premiums charged by carriers. So those are the kinds of concerns that we are studying as we look at that proposal.

Mr. MICA. Mr. Finch.

Mr. FINCH. We haven't had—those are the first, today is the first time I have heard those numbers, Mr. Chairman, so we haven't really had a chance to focus on them.

I would say that as GAO goes about looking at retirement issues on behalf of the committee and other committees, things that we try to factor into our analyses are ways to try to determine whether it is good retirement policy, and a couple of factors that we consider or a couple of criteria that we consider in those are reasonableness, is it reasonable, and competitiveness.

The Federal Government's retirement system, we think, should be competitive with non-Federal plans. The retirement system not only helps the employees prepare themselves for retirement and represents their major source of income, particularly in the instance of CSRS where you don't have Social Security or a thrift plan with government contributions, but it also serves management objectives in terms of keeping a Federal work force that is both vibrant and productive. This gets to a comment that Mr. Blum made in his opening statement about recruitment and retention tools and the fact that the Federal Government is going to remain in business, and we need a work force that is vibrant and productive. We need a compensation package, of which retirement is a part, that will help us both recruit and retain that work force.

Mr. MICA. Well, we know that we will have some pretty significant obligations in the future on the General Treasury to meet all these various retirement system obligations.

Do you feel that it is prudent for us to propose a small increase, a quarter of a percent over an extended several year period in the future, for employees to contribute to the retirement fund system which is taking more and more of a drain from the Federal Treasury now and projected to do so in the future? When was the last

time they changed this? Was it 1969 or 1979? Was it 1969; 1969 was the last time——

Mr. FLYNN. Yes.

Mr. MICA [continuing]. We adjusted the employee contribution. Do you think this is prudent, fair, meets your criteria, what has been proposed by the budget conferees?

Mr. FINCH. I think any employer has the responsibility periodically to look at the cost of its operations, and I think you are doing that. What I would ask is that, as you look at the cost of government operations, you keep the reasonableness and competitiveness factors under consideration. I am not prepared to endorse the amounts this morning, Mr. Chairman.

Mr. MICA. What about the health benefit? Is there more of a trend that you have seen for requiring a little bit closer scrutiny and selectiveness, on the part of the employee and the employer when selecting a health benefits package? And also various contributions to fund those benefits?

Mr. FINCH. I would be glad to think that one through and respond to that one for the record. I am not really prepared to address that off the top of my head this morning.

Mr. MICA. We will submit that.

[The information referred to follows:]

As discussed in my response to an earlier question, the primary criteria we use in analyzing federal employee compensation programs, including the health insurance program, are whether the programs are reasonable and competitive in serving employee and management needs.

It has been some time since we examined federal health insurance, but our earlier findings suggested that the federal program was not as beneficial to employees as private sector programs. For example, in a 1985 report,[1] we noted that our studies and studies by benefits consulting companies had shown that private sector employers paid a greater share of employee health insurance premiums than did the federal government. The studies also showed that the typical private sector health insurance plan reimbursed more of employees' medical expenses, and calendar year deductibles were less than in federal government plans.

More recent information we have seen indicates that the situation may not have changed all that much since our studies were completed. For example, a 1993 survey of employer compensation practices by Hewitt Associates revealed that the median rate of employer subsidy for employee medical coverage was 82 percent of total costs for employee-only coverage and 80 percent for family coverage. In the federal program, the maximum amount the government will pay is 75 percent. Moreover, the survey found that the majority of employers offered flexible spending accounts whereby employees paid their share of medical costs with pre-tax earnings. This is an advantage not afforded to federal employees.

In June 1995, the Congressional Research Service (CRS) issued a report on federal retirement that also examined other elements of the benefits package.[2] The report cited data compiled by the Hay/Huggins Company on compensation practices followed by about 150 large companies showing that the value of health care benefits the companies provided was greater than the value of federal employee health care benefits.

We believe it is always appropriate to examine whether legitimate economies are available in federal health insurance and other benefit programs. However, the above suggests that there have been no apparent developments in private employers' health insurance financing practices that would justify changing the employer/employee cost sharing arrangements in the federal program from either the reasonableness or competitiveness standpoints.

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[1] *Comparison of Federal and Private Sector Pay and Benefits,* GAO/GGD–85–72, September 4, 1985.

[2] *CRS Report for Congress, Federal Civil Service Retirement: Comparing the Generosity of Federal and Private-Sector Retirement Systems,* Report 95–687 EPW, Congressional Research Service, The Library of Congress, June 5, 1995.

Mr. MICA. I have some questions myself about the health benefit proposals. In fact, I met with the Speaker earlier this morning and relayed some of my concerns about the possible effect there, maybe not so much on current employees but also on our retirees that are under some different constraints and circumstances. I guess it all isn't finished until the bill is signed, so we have got some ways to go.

Mr. BLUM. I would like to make a couple of comments, if I may, Mr. Chairman.

Mr. MICA. Go right ahead.

Mr. BLUM. I am not at liberty to take a position, but I can make some observations for you.

First of all, regarding the Federal Employee Health Benefit Program, the change proposed there in the Government's contribution rate was one of the options for reducing the deficit that was included in CBO's volume of deficit reduction options this year, so I would call it to your attention.

The discussion of that option laid out how it would work and gave the arguments for it and against it, including the comments Mr. Flynn just made in terms of adverse selection possibilities and so forth. I would just commend that to your attention.

With respect to increasing the employee contribution for Federal employee retirement, I would simply note that the rate of contribution has been increased in the past, as you have noted, but typically those increases have occurred when benefits were being increased rather than diminished, as would be happening this time with the shift from the high-three to the high-five average.

Mr. MICA. Actually, the high three and the high five is really the only thing that affects the unfunded liability; is that correct?

Mr. BLUM. No, both would have an effect, I assume.

Mr. MICA. Well, the quarter of a percent times two really just diminishes the amount of the future projected contribution from the General Treasury.

Mr. BLUM. That is true for the FERS program.

Mr. MICA. But not for the old CSRS?

Mr. BLUM. No. I think also included in the budget resolution assumptions is an assumption that there would be an increase of 1 percent on the part of agencies, on Federal agencies to pay toward the CSRS program.

Mr. MICA. But again it was my understanding, I may be wrong, that that really doesn't do much to affect the unfunded liability, that, in fact, only the change in the high five makes a dent there.

Mr. BLUM. I am advised by my staff that raising the employee contribution rate would not have an effect on the unfunded liability.

Mr. MICA. OK. And again it seems like just about every source comes back to the taxpayer for funding all of these benefits, again with some changes being proposed in this legislation that would increase the employee contribution and their current contribution.

I have given you a little chart that we just made up this morning looking at the pension deficit in nominal dollars between 1995. This is projections in billions of dollars up to the year 2035.

Do any of you see anything that we have miscalculated here or would you like to comment on the chart? Is it an accurate reflection of the pension deficit projections? Mr. Blum.

[The chart referred to appears on page 88.]

Mr. BLUM. Well, I assume these are numbers that actually have been provided by the Office of Personnel Management, and therefore would accurately reflect—but I would make this observation, Mr. Chairman, which is the retirement benefits are not benefits that are made because government employees are poor or whatever. This is part of the compensation package. It is part of the labor contract that is made between the government as an employer and the employees. Sooner or later the taxpayer in fact is going to pay for the costs of those retirement benefits. One can say they should pay for them all now as they are being accrued, which could be achieved if, in fact, the pension fund were outside of the budget, as I had talked about in my opening remarks. Otherwise those costs are going to be paid later by future taxpayers. One way or another, it would be the taxpayers that would have to finance the bulk of those benefits, either later or now.

Mr. MICA. I think you are correct, but again I think the ultimate obligation for financing all of this does end up in the taxpayers' lap, particularly with the accounting methods that we have established and the borrowing methods. I mean, if you take just the $25 billion that we paid on the $320 billion we borrowed from the trust fund, that is 10 percent of the annual interest payments, equivalent to 10 percent of the annual interest payments we pay on the national debt. It is a pretty significant amount, just for one accounting or line item as an expenditure.

Mr. BLUM. But that amount is not a real cash outlay. It is merely an accounting transaction. The interest that is being credited——

Mr. MICA. But you either pay interest or you don't pay interest.

Mr. BLUM. No, I think there is a difference between the debt held by the public, on which we pay interest that literally goes out to the public, as opposed to interest that is——

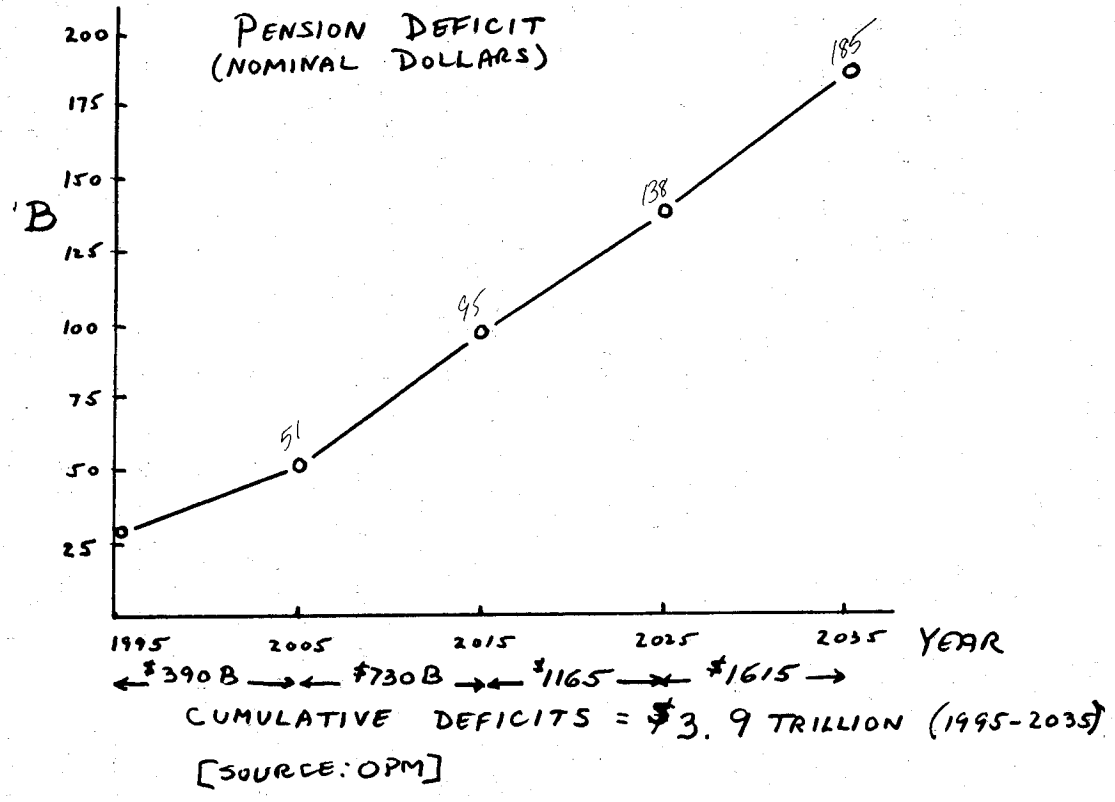
Mr. MICA. We are paying ourselves.

Mr. BLUM. We are simply paying ourselves, and that has no effect on the total outlay.

Mr. MICA. Wouldn't it be nice if we had that money invested in something else and we could be providing employees with even better benefits?

Mr. BLUM. That could be. But as I tried to make clear, that would be—this is where you do get into the policy choice business—that would be changing the real financing of the retirement program from essentially a current pay-as-you-go to a current full funding comparable to that which is done for the private sector and State and local governments.

Mr. MICA. Well, a number of people have proposed a number of alternate approaches to the standard Federal retirement packages that are available: some additional IRA's, some additional savings, some additional programs, even buyouts and let people out of the retirement system, not employment, and let people go into the private market to see if they can get better returns. Maybe we will be looking at some other options in the next couple of years.


PENSION DEFICIT
(NOMINAL DOLLARS)
$B
200
175
150
125
100
75
50
25
51
95
138
185
1995
2005
2015
2025
2035
YEAR
$390B
$730B
$1165
$1615
CUMULATIVE DEFICITS = $3.9 TRILLION (1995-2035)
[SOURCE: OPM]

Mr. MICA. Mr. Flynn, are these accurate figures? Have they been misstated?

Mr. FLYNN. Yes, Mr. Chairman, they are a recap of what we had provided as part of our testimony.

Mr. MICA. And they do represent future obligations?

Mr. FLYNN. They represent, Mr. Chairman, just to be clear, the difference between income to the fund and the cash outlays of the fund in those particular years.

Mr. MICA. Mr. Finch, did you have any final commentary?

Mr. FINCH. No, sir, I don't think so. I would echo a good bit of what Mr. Blum said. I think one thing to keep in mind is that the government is an employer and the taxpayers of course are the government, but there is an employer share to the compensation package and to the retirement fund. If there were no government contribution, the employees, in essence, would be funding their own retirement out of their salaries, and too often I think in these discussions the fact that there is an employer-employee contribution arrangement sometime gets overlooked.

Mr. MICA. I may have some additional questions to submit to the panel, and we will get your response. Also we have some questions coming from the minority side and some of the other Members who had other obligations today. We will, without objection, make those a part of the record.

I have testimony from Representative Hansen and from OMB which will also be made a part of the record without objection.

[The prepared statement of Hon. James V. Hansen follows:]

PREPARED STATEMENT OF HON. JAMES V. HANSEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

Mr. Chairman and Members of the committee, thank you very much for scheduling this hearing and allowing me to testify. I appreciate the opportunity to share my views with you regarding federal employees retirement system.

First, I want to commend the federal work force. The men and women who have chosen to be public servants are dedicated, hard working individuals. They contribute daily in the effort to reduce the deficit. As we begin to reduce the deficit, it is the federal employees who will keep the government operating efficiently and effectively. They are one reason America is as great as it is today.

As a business owner I learned very early that once an obligation was made, there was a responsibility to see it through. I made a lot of good deals and I made a few bad ones but I always kept my word. I feel very strongly that Congress should fulfill the terms they agreed to with current federal personnel.

I am fully aware of the budget constraints placed on each committee and the need to find savings. As Chairman of the Subcommittee on National Parks, I am confronted with difficult decisions. However, federal employees should not be seen as an easy source of revenue. Any changes in the federal employee retirement program should apply to prospective employees, not current employees who have committed years of their lives to government service.

If Congress makes the changes already passed in the Tax Fairness and Deficit Reduction bill, we will be correctly accused of changing the retirement rules halfway through the game for all current federal employees—many of whom have chosen their careers based partly on a known and certain retirement formula, and with many of whom have been employed with the government for decades. I find this highly unfair.

Moreover, according to government studies, federal white-collar wages are lower than private-sector wages by 27 percent. Even though Congress has made efforts to diminish this discrepancy with the passage of the Federal Employees Pay Comparability Act of 1990 (PL: 101–509), for various reasons, this has not happened. Nevertheless, federal employees have been loyal and one reason for this is because of the terms of the pension plans. I believe it is not in the best interest of the federal government to implement the current proposals of raising the contribution or changing the number of years used in computing retirement benefits.

This is a defining moment in history. We are on the path toward a balanced budget of which I am a strong supporter and I firmly believe we must seize the moment. A balanced budget is good for America. It means reduced inflation, stronger financial markets, reduced long-term interest rates, improved purchasing power for families and business and guarantees a financially secure future for our children. These benefits should not be lessened for federal employees.

As many of you know, I have always been fiscally conservative and will continue to vote for less spending and less government. However, I would ask the Committee to apply any changes to the federal retirement system to prospective employees. Do not punish those who have dedicated their careers to federal service and have planned their retirement according to an agreed contract. I thank you for your time.

[The prepared statement of Ms. Rivlin follows:]

PREPARED STATEMENT OF ALICE M. RIVLIN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to present the Administration's views on various civilian retirement issues. My statement will discuss the Administration's February Budget proposal to accrue fully the retirement costs of Civil Service Retirement System (CSRS) employees, the financing and investment of the Civil Service Retirement and Disability Fund (CSRDF) and the Administration's position on H.R. 103.

Before discussing the Administration's accrual accounting proposal, I would like to reiterate the Administration's opposition to recent Congressional actions that reduce Federal employee retirement benefits. In his April 5th letter to Speaker Gingrich, on H.R. 1215, the President pointed out that the bill is unfair to Federal employees, stating: "I do not believe we should reduce the retirement benefits of Federal employees and increase their required retirement contributions in order to help finance a tax cut for wealthy individuals and corporations."

We oppose the use of reductions in Federal employee retirement benefits to finance tax cuts for the wealthy. Unlike Congressional proposals, the Administration's accrual accounting proposal would not affect retirement benefits of current or retired Federal employees or survivors. The proposal in the President's February Budget would charge agencies the full costs for CSRS benefits beginning in FY 1997 and amortize the CSRS unfunded liability over a 40-year period.

Currently, CSRS benefits cost 25.1 percent of base pay. The employee and employing agency each pay 7 percent toward this cost, for a total contribution of 14 percent. Eventually, the general fund covers the remaining 11.1 percent through a payment into the retirement fund. Under the Administration's proposal, the 11.1 percent would be reflected in agency budgets. Charging agencies the full CSRS costs would keep the CSRS unfunded liability from rising in the future.

The proposal includes a $5.3 billion contingent cap adjustment in discretionary budget authority and outlays, beginning in the first year, FY 1997, to implement this proposal. This adjustment, to be made only after enactment of the legislation, would allow agency budgets, beginning with the 1997 budget, to be increased to reflect the additional CSRS charge. The $5.3 billion includes $4.6 billion for CSRS; the remainder is for the other retirement systems (for example, the Foreign Service Retirement System and the Public Health System) not now on full accrual. Note that these cap adjustments do not increase the deficit. The additional payments from the agencies' discretionary salaries and expenses accounts are offset by additional receipts to the CSRDF and other retirement funds—as long as these funds remain on-budget.

When the Clinton Administration took office, it found that the CSRS had an unfunded liability in excess of $500 billion that was not being systematically recognized in the budget. To address this situation, the Administration proposal would amortize the unfunded liability over a 40-year period. The amortization payment would replace the current general fund payment to the Civil Service Retirement and Disability Fund, which covers mainly interest on the static unfunded liability and increases in the unfunded liability resulting from pay raises. The OPM actuaries would determine the schedule of payments necessary for this purpose.

Like the cap adjustment above, the amortization proposal would not increase the deficit. Under the proposal, the amortization payment from the general fund would be transferred into another government account, the retirement fund. In this way, the proposal would not affect Government spending.

The Administration believes that this proposal is a matter of good cost accounting—showing costs in the program when and where they accrue, not as a government-wide cost at some point in the future. The proposal would bring CSRS in line

with the other two major Federal retirement systems. Agencies and employees already pay the full retirement costs under the Federal Employees Retirement System (FERS) which covers most civilian personnel hired since January 1, 1984, and DoD already pays the full retirement costs for military members. Likewise, the proposed amortization of the CSRS unfunded liability parallels the existing treatment of the unfunded liability of the military retirement system.

Now I would like to address some of the questions about the CSRDF raised in Chairman Mica's letter. Since the OPM actuaries are responsible for the long-term projections of income, outlays and assets for the CSRDF, I defer to OPM on these matters.

The CSRDF is like many other government trust funds in that it is financed by dedicated receipts. Its receipts include retirement contributions from Federal employees, agency contributions for employee retirement, and interest on balances. Currently, the CSRDF's receipts exceed its payments and the difference is invested in non-marketable government securities issued by the Treasury. Interest on these securities is paid monthly and is based on the average rate of interest on all long-term marketable securities. These securities add to the total national debt.

Outlays for the payment of retirement benefits are like any other government outlays. Paying retirement benefits requires the government either to use tax receipts or to borrow from the public to finance the payments when they are made. Agency contributions, interest payments and other payments from government accounts into the retirement trust fund remain inside the government and do not affect the deficit.

Finally, I would like to discuss H.R. 103, a bill to move the CSRDF off-budget. The Administration strongly opposes H.R. 103. The Administration supports a unified Federal budget based on the principle that the Federal budget should present in one place the totality of the Federal Government's fiscal operations. This allows decisions to be made about how much of the Nation's resources are to be used by the Government and how these resources are allocated among Government activities. Since 1967, all Administrations have supported the principle of a unified budget. Proposals to move programs off-budget do not support this principle; they merely make artificial distinctions among total Government resources.

If H.R. 103 were enacted, total government outlays would remain unchanged. The following estimates reflect current law. They do not include the Administration proposal described above. In the first year in which the bill is effective, the on-budget deficit would increase by about $28 billion and the off-budget deficit would fall by the same amount. The deficit impact can be summarized as follows:

(1) On-budget outlays would increase by $63 billion because money that currently remains on-budget when it is transferred from one account to another (agency contributions, interest, and a general fund payment to the retirement fund) would become an on-budget outlay as it would flow to a new off-budget retirement account;

(2) On-budget governmental receipts would fall by about $4.5 billion because current on-budget governmental receipts (from employee contributions) would become off-budget receipts; and

(3) On-budget outlays would fall by just under $40 billion because current on-budget outlays (for retirement benefits) would become off-budget outlays.

The combined effect of increasing on-budget outlays by just over $23 billion and reducing on-budget receipts by $4.5 billion would be an increase in the on-budget deficit of about $28 billion. Similarly, the debt held by on-budget accounts would fall by $28 billion and the debt held by off-budget accounts would increase by $28 billion, leaving total debt held by government accounts unchanged.

If the CSRDF, with its existing balance, were moved outside of the budget, retirement benefit payments would not be included in total government spending, just as payments to individuals by the Federal Retirement Thrift Investment Board are not included. Note that moving the CSRDF outside of the budget differs from moving it off-budget where benefit payments would still be included in the unified budget totals. A move outside of the budget would increase government outlays and the deficit by $28 billion. In addition, debt held by the public would increase by over $350 billion; the end of FY 1995 fund balance is projected to be $366 billion.

If FERS were moved outside of the budget, the deficit would increase by about $10 billion. Outlays would increase by slightly less than $10 billion—for the agency contributions to FERS and interest on the FERS fund balance—and governmental receipts from FERS employees would fall by about $400 million.

In conclusion, I would like to reiterate that the Administration believes the budget should fairly and accurately reflect the Government's assets and liabilities. The Administration supports showing retirement costs when and where they accrue as we propose in the FY 1996 Budget—rather than as a government-wide cost at some point in the future. In addition, the Administration strongly opposes proposals like

H.R. 103 that make artificial distinctions among total government resources by classifying some as on-budget and some as off-budget.

Thank you for the opportunity to present the Administration's views on these important issues.

Mr. MICA. There being no further business before the subcommittee, I would like to first thank our panel of witnesses for their patience, their participation, and for their future responses. Thank you so much.

There being no further business of the subcommittee, I declare this meeting adjourned. Thank you.

[Whereupon, at 1:13 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

PREPARED STATEMENT OF HON. BENJAMIN A. GILMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman I thank you for calling this meeting to examine the current and future financial status of the Civil Service Retirement and Disability Fund. It is important that this subcommittee get an accurate reading of the future financial stability of our current system. Even if changes are warranted it is my belief that we must be vigilant to protect the benefits that current employees are using to plan their families future and the benefits that retirees are depending on for their livelihood. Although I understand that we must be steadfast in our efforts to lessen the Federal budget deficit, I believe that we must honor the commitments we have made to Government employees.

Thank you Mr. Chairman.

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