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STATEMENT OF

CLIFFORD I. GOULD

DIRECTOR

FEDERAL PERSONNEL AND COMPENSATION DIVISION

BEFORE THE SUBCOMMITTEE ON

CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

THE COST-OF-LIVING ALLOWANCE PROGRAM IN ALASKA

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the work of the General Accounting Office concerning the cost-of-living allowance (COLA) paid to Federal employees in Alaska and other nonforeign areas outside the continental United States.

Under present law, certain civilian employees in these areas are authorized to receive COLA when living costs are substantially higher than those in Washington, D.C. The allowance, which may not exceed 25 percent of base pay, is not subject to Federal income tax.

The Office of Personnel Management (OPM) is responsible for prescribing regulations governing the payment of the

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allowance and, at least once a year, must determine the rates at which COLA will be paid for each eligible area.

COLAs are authorized for Federal employees whose rates of base pay are the same regardless of where they work. Allowances are not authorized for blue-collar employees since their pay is based on prevailing local rates.

As of November 1980, there were 10,540 Federal civilian employees in Alaska receiving COLA payments estimated to cost $45.6 million during fiscal year 1981.

The General Accounting Office has long been concerned about the appropriateness of paying COLA in nonforeign areas. In a February 1976 report to the Congress entitled "Policy of Paying Cost-of-Living Allowances to Federal Employees in Nonforeign Areas Should Be Changed" (FPCD-75-161), we said that this allowance was inconsistent with the Government's policy of establishing pay rates for its employees on the basis of comparability with the private sector, and it is discriminatory since it does not apply to Federal employees in the 48 contiguous States. We recommended that it be eliminated and replaced with special pay rates based on local private sector pay, where warranted, to overcome any recruitment and retention problems caused by higher private sector pay.

The new administration's pay reform proposal (S. 838) was introduced in the Senate on March 31, 1981. The bill would empower the President to establish locality rates of pay for General Schedule employees and would eliminate the nonforeign area COLA program.

This week we sent a letter to OPM reiterating another recommendation we made in our 1976 report. We believe that if the allowance is continued, it should be based on spendable income rather than base pay. Spendable income is base pay less income taxes, retirement contributions, life insurance premiums, charitable contributions, and savings.

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

We recognize that private sector salaries in Alaska are substantially higher than salaries in the 48 contiguous States, and the Government already pays special rates to some occupational groups for recruitment and retention purposes. Accordingly, we believe that if our recommendation is adopted additional special pay rates would be necessary to retain well-qualified employees in Alaska.

We are currently reviewing OPM's methodology for computing COLA rates. We are also looking at the methods used to set COLA rates by the Department of Defense for military personnel and by the Department of State for civilians in foreign areas. While we have not yet completed this study, I would like to share with you some observations on the COLA programs.

In some aspects, the methodologies used by OPM, Defense, and State are similar. All agencies use a survey of eligible personnel to find out where they shop. Then, the prices of a market basket of goods and services in the area eligible for COLA are compared with prices for a similar market basket in the base area.

There are, however, differences in the methods used by OPM, State, and Defense which make it difficult for Federal personnel to understand and managers to explain how COLA rates are computed. For example, last year the Commanding General of the 172nd Infantry Brigade, Fort Richardson, Alaska, wrote to his superiors that differences between the military and civilian COLA programs and rates make it hard to explain how the programs work. The General wrote, "* * * I find that I am not able to exercise my responsibility to assure my personnel that they are receiving equitable and fair treatment."

Let me highlight a few of the differences in methodologies.

First, different base areas are used to set the rates. By law, the OPM COLA rates are based on prices in Washington, D.C. The statute authorizing the Defense COLA does not specify a base. Defense has chosen to use composite prices which represent the national average adjusted to account for purchases from commissaries and post exchanges. Because prices in Washington generally are higher than average prices throughout the country, the OPM COLA rates will tend to be less than the Defense COLA rates. On the other hand, where military commissaries and post exchanges are readily available, the Defense COLA rates may be lower than the OPM COLA rates because of the lower prices for products sold through the commissaries and exchanges.

Second, there are differing limits on COLA payments. The statute authorizing the OPM COLA provides that COLA for civilian employees cannot exceed 25 percent of base pay. There is no statutory limit for the military COLA. In Juneau, Fairbanks, and Kotzebue, Alaska, the OPM COLA is at the maximum (25 percent of base pay). The military COLA rate is 38 percent in Juneau, 32 percent in Fairbanks, and 52 percent in Kotzebue. However, Defense limits the spendable income on which COLA is paid to $10,771, whereas the OPM COLA rate is paid on total base pay. As a result, while Defense COLA percentages are higher, the dollar amounts actually paid may be less than amounts paid under OPM's COLA.

A third difference is Defense's use of environmental factors in its COLA rate computation. These are not considered in the other programs. In early 1981, Defense added, to its COLA rate computation, consideration of costs unique to Alaska such as winter protective clothing and special lubrication and equipment for automobiles. The effect of these environmental factors was to add several percentage points to the Defense COLA rates. This probably added to the confusion over COLA when, in January 1981, OPM announced that its COLA rate for Anchorage would be decreased, and a month later Defense increased its COLA rate in Anchorage, due largely to the environmental factors.

Defense officials say the environmental factors are needed to offset one-time purchases that military members must make when they are transferred to Alaska. OPM told us that they do not include these environmental factors because the majority of the civilian employees in Alaska are native to the area and thus do not have to relocate and do not face these one-time costs.

We will discuss these matters in more detail and make appropriate recommendations in our report on COLA methodologies which we expect to issue later this year.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions you have.