United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Federal Services, Post Office, and Civil Service, Committee on Governmental Affairs, U.S. Senate

August 1993

ARMY MATERIEL COMMAND

Providing Early Retirement Incentives in 1990 Could Have Saved Money

GAO/NSIAD-93-233

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-253975

August 24, 1993

The Honorable David Pryor
Chairman, Subcommittee on Federal Services,
Post Office, and Civil Service
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In our report entitled Army Materiel Command: Factors Influencing Retirement Decisions During 1990 Reduction in Force (GAO/NSIAD-93-28BR, Dec. 31, 1992), we advised you of Army Materiel Command (AMC) employees' responses to 10 hypothetical voluntary early retirement incentives and the increased rate at which the employees might have retired under each incentive. Subsequently, you asked that we estimate the change in government costs that would have resulted from implementing each of the incentives. This letter provides those estimates and also estimates the impact that each of the incentives would have had on offsetting involuntary separations at AMC had it pursued its initial 10-percent 1990 force reduction goal.

Background

AMC directs the development, test and evaluation, procurement, distribution, maintenance, and disposal of nearly all Army equipment. In 1990, AMC had about 104,000 employees, of whom 59,000 were at locations subject to reductions in force (RIF). In response to anticipated budget cuts, AMC planned to reduce and demote its work force by about 10 percent and 13 percent, respectively, by mid-October 1990. To limit the number of workers who would have to be involuntarily separated, AMC obtained U.S. Office of Personnel Management (OPM) approval to allow early retirements.

In our 1992 report, we pointed out that early retirements helped reduce the number of involuntary separations but they could not have prevented a large number of additional involuntary separations. About 11 percent of the AMC work force was eligible to retire early,[1] and a small proportion (2 percent) chose to do so.

[1] "Early retirement" is retirement with 25 years of total federal service at any age or with 20 years of federal service at age 50 or older. "Standard retirement" is retirement at age 55 with 30 or more years of federal service, at age 60 with 20 years of service, or at age 62 with 5 years of service.

For our 1992 report, we sent a questionnaire to AMC employees who were eligible for early or standard retirement during the 1990 RIF but elected to continue to work. We asked them to assess the probability of their retiring if any of 10 hypothetical incentives to retire had been available. The incentives included various cash payments, annuity increases, and combinations of both. Depending on the incentive, between 6 percent and 75 percent of the retirement-eligible employees said that they would have retired.

Results in Brief

As might be expected, the incentives that were more financially attractive to the employees generally lowered the potential savings to the government. However, the key determinant of whether early retirement causes the government to incur added costs or achieve substantial savings is the extent to which employees are replaced. If a retiring employee is not replaced, the government realizes a savings from the difference between the employee's salary (net of retirement deductions) and the retirement annuity. If the employee is replaced, the savings are offset by the new employee's salary and fringe benefits costs. Because AMC was in a period of budget reduction and employee downsizing, we would reasonably expect that only a minimum number of the employees who opt for voluntary early retirement would be replaced.

If AMC did not replace the voluntary early retirees, we estimate that the net present value life cycle savings—the net reduction in government expenditures—from additional retirements stimulated by the incentives could range from about $100,000 to nearly $205,000 per retiree. (See app. I for each alternative incentive's savings if retiring employees were not replaced and for the costs if they were.)

The four incentives that involve up-front cash payments would require net increases in first-year cash expenditures, but we estimate that this outlay would be offset by savings in the second and/or third year after retirement. The impact of the net increase in first-year cash expenditures could also be mitigated by paying cash incentives in installments. Deferred payments could, however, impact on the number of persons who would have chosen the option.[2] Appendix II identifies how major factors—salary, annuity, and

[2]Our December 1992 report indicates that the prospective elimination of an up-front cash payment (alternative annuity option/lump sum) would have reduced the number of nonincentive early retirees by about 46 percent. We believe the prospect of having received the cash payment on a deferred basis—and potentially mitigating the income tax consequences—could have enhanced its attractiveness.

cash bonuses—affect the savings or costs of the 10 hypothetical early retirement incentives.

Our analysis indicates that the use of some incentives could have provided a means to achieve a substantial increase in the number of voluntary separations and save money, thus reducing the need to resort to involuntary separations under AMC's 1990 planned 10-percent reduction in force. As shown in appendix III, AMC could not have avoided all involuntary separations through the use of retirement incentives. However, on the basis of the employees' responses to our questionnaire, we estimate that prospective involuntary separations could have been reduced by about 24 percent to 73 percent, depending upon the incentives used to increase voluntary early retirements.

The study population in our 1992 report also included 2,456 employees who were eligible for normal retirement. Many of these people also indicated that they would haven chosen to retire under one or more of the hypothetical incentives. On the basis of historical OPM retirement data, the incentives could have induced retirements from 1/2 year to 5 or more years earlier than they would otherwise occur. As with the population of employees eligible for early retirement, savings would occur to the extent that foregone salaries and annuities exceed the size of incentive payments. Under the higher cost incentives, savings for this group could be smaller than those for the early retirement group if those who accepted the incentives were heavily weighted toward employees who would have retired within a year or two without them. The development of costs or savings for this population, however, was beyond the scope of this study.

Scope and Methodology

Our savings and cost estimates are based on a stratified variable probability sample of 5,463 employees who were eligible for early retirement during AMC's 1990 RIF and were stationed at 21 locations throughout the United States. The savings estimates are conservative because salary savings only include the period from the early retirement until about 91 percent of the population would have normally retired. The methodology we used was reviewed by officials of the Congressional Budget Office and OPM's Office of the Actuary. They generally concurred with the overall methodology we used to generate our estimates, and their suggested refinements were incorporated where appropriate.

The questionnaires were administered in July 1991. The answers to the questionnaires represent the respondents' recollections of their attitudes,

perceptions, and circumstances at the time of the 1990 RIF. The passage of about a year's time between the 1990 RIF and the questionnaire may have distorted some recollections.

The costs or savings for early incentive retirements were determined by comparing the difference between the salaries (less 7 percent for the employees' contribution toward retirement) that would be avoided from the time employees took early retirement until the time they would likely have taken normal retirement,[3] minus bonus payments, and plus or minus the difference in life cycle annuity payments the employees would have received for retiring at an earlier and later date. We determined the key cost elements used in this study through a review of ongoing and prior Department of Defense cost studies and discussions with officials from OPM's Office of the Actuary and the Congressional Budget Office.

Using a formula derived from historical retirement rates obtained from OPM, we projected varying retirement rates for successive years based on the average age of the group, until about 91 percent of the population would have retired. The average age, years of service, and salary used to compute annuity values were based on information obtained from AMC's data on employees eligible for early retirement. OPM also provided us with its estimated age/gender-based annuity payout tables from which the total life cycle values of the annuities were estimated. All 1990 dollars were inflated at a 5-percent rate and discounted at a 7-percent rate, which is consistent with OPM projection methodology.

The estimated number of early retirement eligible employees who would opt for an incentivized early retirement was determined using the face value assumption method in conjunction with responses to the early retirement incentive questions in our questionnaire. That is, those responding they would have "definitely," "probably," "about 50/50," "probably not," and "definitely not" retired were assumed to have retired at the following percentage rates, respectively: 100, 75, 50, 25, and 0. A "don't know" response was also considered to be a 0-percent retirement rate. We also assumed that all those who took early retirement without an incentive would have retired under each of the retirement options.

[3]We are aware that in similar analyses, OPM calculates savings using the employee's salary net of both retirement and Medicare deductions. Our analysis assumes that most early retirees will find nonfederal employment elsewhere and will continue to pay Medicare tax as well as social security taxes on the new salaries. To the extent retiring employees do not find other jobs, consistency would require that we take into account lost income tax revenue as well as the aforementioned taxes.

With respect to replacement employees, we assumed that their aggregate salaries would be the same as those of the incentive early retirees. This is a conservative assumption. Most plausible replacement scenarios would yield some level of cost savings since it is likely that controls on aggregate payroll or employee ceilings would accompany the authority to use early retirement incentives. We did not, however, compute the additional pension trust fund liability that would result from adding new replacement employees 1/2 to 8 years earlier.

Our review was performed from January to July 1993 in accordance with generally accepted government auditing standards. Our report was informally discussed with officials of OPM, AMC, and the Congressional Budget Office. Their suggestions have been incorporated as appropriate.

We are sending copies of this report to other involved congressional committees, the Director of the Congressional Budget Office, the Secretaries of Defense and the Army, and the Directors of the Office of Management and Budget and OPM. We will also make copies available to others upon request.

Please contact me at (202) 512-5140 if you or your staff have any questions concerning this letter. Major contributors to this report are William E. Beusse, Assistant Director, and Robert T. Bontempo, Evaluator-in-Charge.

Sincerely yours,

Mark E. Gebicke
Director, Military Operations and Capabilities Issues

Potential Government Savings or Costs Under Hypothetical Early Retirement Incentives Considered in GAO's 1992 Study

	Projected incentive retirements	Net savings if retiree were not replaced		Net costs if retiree were replaced	
		Per retiree	Total	Per retiree	Total
Give a 1-year salary bonus and increase the annuity by 10 percent	2,119	$101,350	$214,760,052	$110,314	$233,755,964
Add 5 years of service to the annuity computation	1,761	100,173	176,404,473	111,491	196,335,831
Give a 1-year salary bonus	1,572	146,819	230,945,814	64,845	102,001,658
Reimburse employee for unused sick leave	1,488	179,777	267,508,390	31,887	47,447,642
Grant a tax-free rollover of employee pension contributions to an individual retirement account	1,347	204,768	275,822,496	6,896	9,288,912
Base annuity on highest 1-year salary	1,258	182,178	229,180,016	29,486	37,093,296
Waive up to 5 years of under-age-55 annuity penalty	1,162	178,613	207,548,044	33,051	38,405,524
Give 1/2-year salary bonus	1,013	169,956	172,165,259	41,708	42,250,373
Grant more time to plan for retirement	788	204,768	161,357,184	6,896	5,434,048
Reduce under-age- 55 annuity penalty to 1 percent	703	187,752	131,989,839	23,912	16,809,953

Note: Savings are shown in 1990 net present value dollars and represent the difference between salary and annuity from the time the incentive retirement was taken until about 91 percent of the employees are estimated to have taken their normal retirement. While the potential savings per individual are based on factual knowledge of the retiree population, it should be noted that the projected numbers of incentive retirements are based on the opinions of survey respondents and may not necessarily represent what they actually would have done.

Major Factors Contributing to Savings or Costs Under Selected Hypothetical Early Retirement Incentives

	Give 1-year salary bonus and increase the annuity by 10 percent			Add 5 years of service to annuity computation		
Factors	**Per individual**	**Population**	**Total**	**Per individual**	**Population**	**Total**
With no retiree replacement						
Savings:						
Salary	**$211,664**	**2,119**	**$448,516,016**	**$211,664**	**1,761**	**$372,740,304**
Costs:						
Increased pension payout to						
—nonincentive retirees	35,710	902	32,210,420	70,776	902	63,839,952
—incentive retirees	42,606	2,119	90,282,114	75,239	1,761	132,495,879
Bonus or sick leave payments to						
—nonincentive retirees	36,830	902	33,220,660	0	0	0
—incentive retirees	36,830	2,119	78,042,770	0	0	0
Subtotal costs			**233,755,964**			**196,335,831**
Net incentive savings	**$101,350**	**2,119**	**$214,760,052**	**$100,173**	**1,761**	**$176,404,473**
With retiree replacement						
Savings:						
Salary	**$0**	**0**	**$0**	**$0**	**0**	**$0**
Costs:						
Increased pension payout to						
—nonincentive retirees	35,710	902	32,210,420	70,776	902	63,839,952
—incentive retirees	42,606	2,119	90,282,114	75,239	1,761	132,495,879
Bonus or sick leave payments to						
—nonincentive retirees	36,830	902	33,220,660	0	0	0
—incentive retirees	36,830	2,119	78,042,770	0	0	0
Subtotal costs			**233,755,964**			**196,335,831**
Net incentive costs	**$110,314**	**2,119**	**$233,755,964**	**$111,491**	**1,761**	**$196,335,831**

Give a 1-year salary bonus			Reimburse employee for unused sick leave			Grant a tax free rollover of employee pension contributions to an individual retirement account		
Per individual	**Population**	**Total**	**Per individual**	**Population**	**Total**	**Per individual**	**Population**	**Total**
$211,664	**1,573**	**$332,947,472**	**$211,664**	**1,488**	**$314,956,032**	**$211,664**	**1,347**	**$285,111,408**
0	902	0	0	902	0	0	902	0
6,896	1,573	10,847,408	2,309	1,488	3,435,792	6,896	1,347	9,288,912
36,830	902	33,220,660	18,415	902	16,610,330	0	0	0
36,830	1,573	57,933,590	18,415	1,488	27,401,520	0	0	0
		102,001,658			**47,447,642**			**9,288,912**
$146,819	**1,573**	**$230,945,814**	**$179,777**	**1,488**	**$267,508,390**	**$204,768**	**1,347**	**$275,822,496**
$0	**0**	**$0**	**$0**	**0**	**$0**	**$0**	**0**	**$0**
0	902	0	0	902	0	0	902	0
6,896	1,573	10,847,408	2,309	1,488	3,435,792	6,896	1,347	9,288,912
36,830	902	33,220,660	18,415	902	16,610,330	0	0	0
36,830	1,573	57,933,590	18,415	1,488	27,401,520	0	0	0
		102,001,658			**47,447,642**			**9,288,912**
$64,845	**1,573**	**$102,001,658**	**$31,887**	**1,488**	**$47,447,642**	**$6,896**	**1,347**	**$9,288,912**

Factors	Base annuity on highest 1-year salary			Waive up to 5 years of under-age-55 annuity penalty		
	Per individual	Population	Total	Per individual	Population	Total
With no retiree replacement						
Savings:						
Salary	**$211,664**	**1,258**	**$266,273,312**	**$211,664**	**1,162**	**$245,953,568**
Costs:						
Increased pension payout to						
—nonincentive retirees	13,287	902	11,984,874	14,886	902	13,427,172
—incentive retirees	19,959	1,258	25,108,422	21,496	1,162	24,978,352
Bonus or sick leave payments to						
—nonincentive retirees	0	0	0	0	0	0
—incentive retirees	0	0	0	0	0	0
Subtotal costs			**37,093,296**			**38,405,524**
Net incentive savings	**$182,178**	**1,258**	**$229,180,016**	**$178,613**	**1,162**	**$207,548,044**
With retiree replacement						
Savings:						
Salary	**$0**	**0**	**$0**	**$0**	**0**	**$0**
Costs:						
Increased pension payout to						
—nonincentive retirees	13,287	902	11,984,874	14,886	902	13,427,172
—incentive retirees	19,959	1,258	25,108,422	21,496	1,162	24,978,352
Bonus or sick leave payments to						
—nonincentive retirees	0	0	0	0	0	0
—incentive retirees	0	0	0	0	0	0
Subtotal costs			**37,093,296**			**38,405,524**
Net incentive costs	**$29,486**	**1,258**	**$37,093,296**	**$33,051**	**1,162**	**$38,405,524**

Give a 1/2-year salary bonus			Grant more time to plan for retirement			Reduce under-age-55 annuity penalty to 1 percent		
Per individual	Population	Total	Per individual	Population	Total	Per individual	Population	Total
$211,664	**1,013**	**$214,415,632**	**$211,664**	**788**	**$166,791,232**	**$211,664**	**703**	**$148,799,792**
0	0	0	0	0	0	7,453	902	6,722,606
6,896	1,013	6,985,648	6,896	788	5,434,048	14,349	703	10,087,347
18,415	902	16,610,330	0	0	0	0	0	0
18,415	1,013	18,654,395	0	0	0	0	0	0
		42,250,373			**5,434,048**			**16,809,953**
$169,956	**1,013**	**$172,165,259**	**$204,768**	**788**	**$161,357,184**	**$187,752**	**703**	**$131,989,839**
$0	**0**	**$0**	**$0**	**0**	**$0**	**$0**	**0**	**$0**
0	0	0	0	0	0	7,453	902	6,722,606
6,896	1,013	6,985,648	6,896	788	5,434,048	14,349	703	10,087,347
18,415	902	16,610,330	0	0	0	0	0	0
18,415	1,013	18,654,395	0	0	0	0	0	0
		42,250,373			**5,434,048**			**16,809,953**
$41,708	**1,013**	**$42,250,373**	**$6,896**	**788**	**$5,434,048**	**$23,912**	**703**	**$16,809,953**

Estimated Impact of Hypothetical Early Retirement Incentives on Involuntary Separations

Incentive	Involuntary separations			
	Without incentive	With incentive	Reduction[a]	
			Number	Percent[b]
Reduce under-age-55 annuity penalty to 1 percent	3,192	2,420	772	24
Grant more time to plan for retirement	3,192	2,327	865	27
Give 1/2-year salary bonus	3,192	2,080	1,112	35
Waive up to 5 years of under-age-55 annuity penalty	3,192	1,016	1,276	40
Base annuity on highest 1-year salary	3,192	1,811	1,381	43
Grant a tax-free rollover of employee pension contributions to an individual retirement account	3,192	1,713	1,479	46
Reimburse employee for unused sick leave	3,192	1,559	1,633	51
Give a 1-year salary bonus	3,192	1,465	1,727	54
Add 5 years of service to the annuity computation	3,192	1,259	1,933	61
Give a 1-year salary bonus and increase annuity by 10 percent	3,192	866	2,326	73

[a]There were 3,192 jobs that had to be abolished through a combination of normal voluntary early retirements, incentive-induced voluntary early retirements, and involuntary separations. The reduction figures represent the number of involuntary separations that might have been avoided had these incentives been available.

[b]The percentages represent the reduction in involuntary separations that could have been made relative to the 3,192 abolished jobs.

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066.

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100