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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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MAY 6, 1981

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

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Dear Madam Chair:

Subject: Cost of Increased Retirement Benefits for Panama Canal Employees (FPCD-81-42)

The Subcommittee's November 15, 1979, letter asked us to provide information on the "appropriateness of the Office of Personnel Management's (OPM's) cost determination" as related to the increased retirement benefits granted Panama Canal employees by Public Law 96-70 (legislation implementing the Panama Canal Treaty). The letter mentioned "the clear intent of the Congress that all increased costs associated with the retirement aspects of the legislation be paid from Canal revenues."

In our February 14, 1980, interim report we addressed this "clear intent" and expressed concern that unless OPM charged the Panama Canal Commission on a basis which considered future pay and cost-of-living increases, all costs of increased benefits would not be recovered. (See enclosure.) At the time of this interim report, OPM had not determined the cost of the extra benefits; nor had it decided the basis on which the costs would be billed.

OPM has since completed its cost calculations, and the Commission has paid the first installment on the increased retirement costs. We are still concerned that OPM is basing its charges to the Commisssion on an actuarial method which assumes that Panama Canal employees will never receive pay increases and that, after retirement, they will receive no cost-of-living adjustments. Because both pay increases and cost-of-living adjustments will add significantly to the ultimate cost, American taxpayers will be subsidizing the cost of the increased benefits by more than $200 million if OPM continues to use this method.

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To evaluate OPM's cost determination, we reviewed pertinent sections of the Panama Canal Treaty, the implementing legislation, and the legislative history which included extensive hearings on the cost of the increased retirement benefits. We discussed with OPM actuaries their cost estimates, addressing, in detail, how the various categories of eligible employees were treated, and what actuarial methods were employed. We reviewed data, provided to OPM by the Panama Canal Commission, concerning the number of eligible employees, their salaries, ages, sex, and years of service.

As agreed with your office, we did not obtain official agency comments on our report.

OPM'S ESTIMATES OF INCREASED COSTS AND OUR EVALUATION

Prior to passage of Public Law 96-70, OPM estimated the cost of increased retirement benefits under both the static and dynamic economic assumptions, 1/ established by the retirement system's Board of Actuaries. The estimates were $205 million under static assumptions and $335 million under dynamic assumptions.

After the law was passed, OPM obtained additional employee profile data from the Panama Canal Commission and recalculated its prior estimates to reflect this data. OPM also used revised economic assumptions established by the Board of Actuaries. The revised cost estimates under the static and dynamic assumptions were $173.8 million and $377.3 million, respectively. The static cost estimate assumed a 5-percent rate of interest. The dynamic estimate assumed a 7-percent rate of interest, and annual pay and cost-of-living annuity adjustments of 6.5 percent and 6 percent, respectively.

Because the static cost estimate ignores current laws providing for annual comparability pay adjustments and semiannual cost-of-living annuity adjustments, based on increases in the Consumer Price Index, we believe the static estimate misrepresents the total cost of the increased benefits. In general, we concur with the actuarial methods and economic assumptions used by OPM to develop the dynamic cost estimate.

Although OPM has developed a dynamic estimate, the agency believes that, to be consistent with current financing practices of the civil service retirement system, it should charge the Panama

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1/Static cost calculations do not include provisions for future general pay increases or future annuity cost-of-living adjustments; dynamic calculations consider such increases.

Canal Commission on a static cost basis until the law is changed to require funding the entire retirement system on a dynamic cost basis. In 1980 the Panama Canal Commission made the first annual payment, based on amortizing an interim static cost estimate of $219 million over 20 years.

In the past, both we and the retirement system's Board of Actuaries have reported that the use of static assumptions is inadequate for realistically estimating the system's future benefit costs. Since 1969, the effects of general pay increases on the retirement system have been financed on an after-the-fact basis through direct appropriations to the retirement fund, and the effects of cost-of-living adjustments have been recognized as increases in the unfunded liability. Also, in its most recent valuation report, the Board of Actuaries recommended that the system should be funded on a dynamic cost basis which recognizes the effects of inflation on the retirement system. OPM agreed with this recommendation and is drafting a legislative proposal to implement it.

If OPM charges the Panama Canal Commission only $173.8 million for the increased retirement benefits without making provisions for recovering costs associated with future pay and benefit adjustments, American taxpayers will bear a subsidy of $203.5 million. Our position is that the Congress did not intend this. Our conclusion is based on discussions at hearings on the proposed legislation and on the following language included in the act:

> "* * * the Panama Canal Commission shall be liable for that portion of <u>any estimated increase in the unfunded liability</u> of the fund * * * to the extent attributable to the amendments made by * * * the Panama Canal Act of 1979." (Emphasis added.)

We believe the Panama Canal Act provides that OPM charge the Commission for costs of the increased benefits estimated on a dynamic cost basis.

RECOMMENDATIONS

To recover the full cost of the increased retirement benefits, we recommend that the Director, OPM, charge the Panama Canal Commission on the basis of the current dynamic cost estimate of $377.3 million. We further recommend that OPM periodically review the cost estimate to determine whether the economic assumptions and other actuarial factors used need revision, and, if so, to adjust the billing accordingly.

As arranged with your office, unless you publicly announce the contents of this letter earlier, we will make no further distribution of this report until 7 days after its issue date. At that time, we will send copies to other interested parties.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

Enclosure

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

FEBRUARY 14, 1980

B-197657

The Honorable Gladys Noon Spellman
Chair, Subcommittee on Compensation
and Employee Benefits
Committee on Post Office and Civil
Service
House of Representatives

Dear Madam Chair:

Subject: Retirement Benefits for Panama Canal Employees (FPCD-80-41)

Your letter of November 15, 1979, asked us to evaluate the Office of Personnel Management's (OPM's) determination of the cost of the increased retirement benefits granted to Panama Canal employees by the legislation implementing the Panama Canal Treaty. As indicated in your letter, an accurate determination of the increased retirement cost is essential because the legislation required that the costs be paid by Canal revenues rather than by the Nation's taxpayers.

OPM has not yet determined the cost of the increased retirement benefits. The purpose of this interim report is to advise you of the status of OPM's progress in implementing the legislation.

The legislation granted major retirement benefits to Canal employees that are not provided to other Federal personnel under the civil service retirement system. Canal personnel who were employed at any time during March 31 to September 30, 1979, are allowed to retire as early as age 48 with 18 years of service, or at any age with 23 years of service. Those employees who remain after September 30, 1979, will have their benefits calculated at the rate of 2.5 percent of their high-3 average salary for each year of service after that date. In comparison, other employees under the system are generally allowed to retire no earlier than age 55 with 30 years of service, and their benefit formula provides a maximum of 2 percent of their high-3 salary for each year of service.

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Other employees can retire as early as age 50 with 20 years of service or at any age with 25 years if their agency is involved in a major reduction-in-force, reorganization, or transfer of function. However, their annuities are reduced by one-sixth of 1 percent for each month they are under age 55. Under the Panama legislation, the annuity reduction does not apply to Canal employees who retire before age 55.

Early retirements are costly in that the employees will be on the retirement rolls for a longer period, receive cost-of-living adjustments that they otherwise would not have received, and will no longer be contributing to the retirement fund. Similarly, the increased benefit formula and elimination of the reduction for early retirement will result in added cost because the employees will receive higher benefits upon retirement, and their cost-of-living adjustments will also be correspondingly greater.

OPM officials told us that the calculation of the added cost of the Panama legislation will not be completed for several months. OPM's previous calculations of the cost were only rough estimates based on its assumptions of the retirement experience that might result from enactment of the legislation.

During hearings on the proposed legislation before the House Post Office and Civil Service Committee, the Director of OPM stated that the added cost associated with the bill would amount to $205 million. This amount was later included in the legislation as the estimated cost of the retirement program changes. Our major concern with this estimate was that it was calculated on a "static" basis whereby no consideration was given to future pay increases and cost-of-living adjustments. A "dynamic" estimate, assuming annual cost-of-living and pay increases of 4 and 3 percent, respectively, was $335 million--or more than 60 percent higher.

These initial estimates were later revised to reflect some updated Canal personnel data. They were $219 million and $357 million on a static and dynamic basis, respectively.

To develop a more specific cost estimate, OPM plans to request data from the Panama Canal Commission (PCC) showing age, salary, and years of service for those Canal employees who retired during the first few months after the legislation was enacted and also for those employees who remain. On the basis of this refined data, OPM will estimate the cost and bill PCC for the amount to be paid in installments over the next 20 years. A 20-year billing period is used because PCC will go out of existence on December 31, 1999. A decision has not yet been made as to whether this estimate will be reviewed periodically and revised to reflect any differences between projected and actual experience.

OPM plans to prepare cost estimates using both static and dynamic assumptions. At this time, OPM is uncertain as to which basis will be used to bill PCC for the liberalized retirement benefits.

During the Post Office and Civil Service Committee's hearings on the personnel aspects of the proposed legislation, there was considerable discussion on the cost of the proposed legislation computed on a dynamic basis. On the basis of this and the statement in the implementing legislation that "* * * the Panama Canal Commission shall be liable for that portion of any estimated increase in the unfunded liability of the fund * * * to the extent attributable to the amendments made * * * by the Panama Canal Act of 1979," we believe that the Congress intended OPM to bill PCC for the full cost of the retirement program changes. Only if the billing considers cost-of-living and general pay increases (dynamic basis) will PCC be paying all the cost associated with the increased retirement benefits.

We will continue to monitor OPM's implementation of the legislation and report to you again when the cost is finalized. We are sending a copy of this interim report to OPM, but we plan no further distribution until the final report is issued.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States