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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

JANUARY 15, 1982

B-205885

The Honorable Geraldine Ferraro
Chairwoman, Subcommittee on Human
Resources
Committee on Post Office and Civil
Service
House of Representatives

Dear Madam Chairwoman:

Subject: Savings from 1981 and 1982 Personnel Ceiling Reductions (FPCD-82-23)

The President's April 1981 budget submission to the Congress showed that reducing Federal agencies' personnel ceilings by about 43,000 positions would save an estimated $300 million in fiscal year 1981 and $1.3 billion in fiscal year 1982 for a total of $1.6 billion. This represents the net savings which would be achieved by ceiling reductions in civilian agencies less ceiling increases in the Department of Defense.

Your letter of May 28, 1981, asked that we evaluate these savings estimates. Specifically, you wanted to know if the savings from ceiling reductions would be appreciably offset by related reduction-in-force (RIF) costs and reductions in revenues generated by agencies such as the Internal Revenue Service (IRS). The results of our review are summarized below and discussed in detail in appendix I, as are the review objectives, scope, and methodology.

On December 8, 1981, you asked that our report also include information on the effects of mid-year budget changes on implementing full-time equivalent personnel ceilings. This information is included in appendix III.

Office of Management and Budget (OMB) officials could not provide any documentation to support their projected savings or the extent to which they considered offsetting costs. Since OMB had no documentation to support the $1.6 billion estimate, we asked OMB officials to describe how the estimate

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Other costs, which we did not attempt to quantify, would further reduce OMB's estimated savings. These include costs such as (1) preparing for and administering RIFs, (2) resolving employee appeals and grievances resulting from the reductions, (3) training employees who were reassigned to new positions during RIFs, and (4) moving reassigned employees to different geographic locations. OPM data, as of November 1981, shows more than 25,000 Federal employees had already received written notices that their jobs may be abolished.

We believe the RIFs that have already occurred in fiscal year 1981 and that are projected for fiscal year 1982 could seriously disrupt Federal programs with a resulting loss in productivity as agency managers and employees worrying about RIFs divert their time and attention from pursuing assigned programs.

It is too soon to determine whether or not the ceiling reductions will produce long-term savings. In the long run, savings will not result, or will be reduced, if (1) previously separated employees are replaced, (2) agencies compensate for ceiling reductions by awarding contracts or using overtime to perform separated employees' functions, or (3) significant program problems occur as a result of the ceiling reductions. Any of the above would increase costs and reduce projected savings.

CONCLUSIONS

If the Congress and the public are to rely on OMB's budgetary cost and savings' estimates, it is imperative that OMB document these estimates. For OMB to do otherwise diminishes the credibility of the budget proposals and makes it difficult for Congress to make informed decisions on the President's proposed budget. We believe OMB's estimate of budgetary savings from lowering personnel ceilings should have been qualified to recognize that costs such as those discussed in this report would significantly reduce short-term savings.

At your request, we have not obtained agency comments on this report. Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the report is issued to you. At that time, we will distribute it to congressional committees

C o n t e n t s

SAVINGS FROM 1981 AND 1982 PERSONNEL CEILING REDUCTIONS

OBJECTIVES, SCOPE, AND METHODOLOGY

From August through November 1981, we interviewed officials and reviewed records at the Office of Management and Budget (OMB), the Office of Personnel Management (OPM), and the Internal Revenue Service (IRS). We also reviewed previous GAO reports on personnel ceilings and work force planning. To determine how OMB calculated the $1.6 billion estimated savings, we asked for copies of all workpapers supporting the claimed savings. The OMB official who prepared the estimate said he kept no such records. He did, however, prepare a chart for us that described the process and the assumptions OMB used in preparing the original estimate. We used this reconstructed data, together with interview data, to estimate the savings possible from the ceiling reductions before we considered any offsetting costs.

To determine the costs of severance pay, unemployment compensation, lump-sum annual leave payments, and employee retirement refunds that would be paid to RIFed employees, 1/ we used OPM's estimate of the number of civilian agency employees to be RIFed in fiscal years 1981 and 1982 together with cost data from a July 1981 Congressional Budget Office (CBO) study entitled "Cost of Potential Layoffs Under the Administration's Federal Employment Reduction Program." That study acknowledged that any estimate of layoff costs is subject to great uncertainty since actual data was not available on the salaries, ages, and years of service of laid-off employees. These same qualifications apply to the cost estimates in this report.

To estimate early retirement costs, we used estimates submitted by agencies to OPM for fiscal year 1981 and assumed that similar estimates would be submitted for fiscal year 1982.

To determine the effect of OMB's ceiling reductions on the amount of tax revenue collected, we reviewed IRS budget data and interviewed IRS officials. Based on IRS projections

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1/As used in this report, RIFed employees refers to employees separated or expected to be separated from Federal employment.

Since there was no documentation to support the $1.6 billion estimate, we asked the responsible OMB official to explain how the estimate was prepared. According to this explanation and using OMB's average personnel compensation costs for positions reduced or increased, we computed a net savings of only $1.028 billion for fiscal years 1981 and 1982, after offsetting ceiling reductions in civilian agencies with ceiling increases within the Department of Defense. This is $572 million less than the savings OMB reported. (See app. II.) The OMB official responsible for preparing the estimate could not explain the difference in savings, but he speculated it might reflect the considerations unique to each agency that OMB used in preparing the initial estimate. He could not confirm this, however, because he did not not keep any documentation supporting the original estimate.

RIF COSTS OFFSET SAVINGS FROM REDUCING PERSONNEL CEILINGS

It appears OMB was somewhat optimistic in assuming that attrition would reduce Federal employment to the new ceiling levels without the need for major RIFs. OPM data for civilian agencies shows that from October 1, 1980, through November 18, 1981, 4,794 employees were RIFed and another 5,623 RIFs are projected for the remainder of fiscal year 1982, for a total of 10,417. If all the 10,417 RIFs occur, OMB's estimated savings from reducing personnel ceilings in fiscal years 1981 and 1982 could be reduced by $94.3 million for various RIF costs:

--$64.2 million in severance pay.

--$15.5 million in unemployment compensation.

--$14.6 million in lump-sum annual leave payments.

Although payment of some of the above costs would probably extend beyond fiscal years 1981 and 1982, these costs would be associated with RIFs conducted in these years and are, therefore, proper offsets to reported savings for those years.

Severance pay

Federal civilian employees separated through no fault of their own receive severance pay in recognition of their service performed, to extend a measure of compensation for the lost job, seniority, and disrupted life, and to help in

OMB PERSONNEL CEILING REDUCTIONS INCREASE RETIREMENT COSTS

To lessen the number of employees that have to be separated during a RIF, agencies can ask OPM for voluntary early retirement authority. Early retirements can open up jobs for younger employees who would otherwise be RIFed. OPM data shows that during fiscal year 1981, 11 agencies used OPM's approval to offer employees voluntary early retirements. In requesting the early retirement authority all these agencies stated RIFs would be necessary because of personnel ceiling reductions.

The civil service retirement system incurs additional costs when employees retire early. Several factors affect these costs, including (1) the extra years early retirees spend on the retirement rolls, (2) the loss to the retirement fund of the employee and agency contributions that would otherwise be made, and (3) cost-of-living adjustments the early retirees receive, counterbalanced by increased annuities employees would earn if they worked longer.

The additional cost to the retirement system is caused primarily by early retirees' receiving immediate benefits, with little or no reduction. To retire under the early retirement provisions, an employee must be at least age 50 with 20 years of service or any age with 25 years. Early retirement annuities are reduced by one-sixth of 1 percent for each month the employee is under age 55.

In considering requests for voluntary early retirements, OPM requires agencies to estimate the additional cost to the civil service retirement system if the request is approved. OPM data shows that estimated early retirements in fiscal year 1981 are expected to increase costs to the civil service retirement system by about $34.8 million. 1/ This additional cost is only for those agencies that requested early retirement authority because OMB's ceiling reductions necessitated RIFs. These agencies estimated that as a result of employees accepting voluntary early retirements, 852 jobs would be saved for younger employees who would otherwise have been separated from Federal service.

1/Includes the cost of involuntary early retirements in those agency areas affected by RIFs.

retirement system. However, since there may be several factors causing an increase in retirements, we cannot estimate the increased cost related to reduced personnel ceilings.

REFUNDS OF EMPLOYEE RETIREMENT CONTRIBUTIONS WOULD INCREASE CURRENT BUDGET OUTLAYS

Most Federal civilian employees are required to contribute 7 percent of their salaries to the civil service retirement fund. Employees leaving Federal service may receive a refund of their accumulated contributions. Employees with 5 or more years of Federal service can elect to leave their contributions in the fund and receive a deferred annuity beginning at age 62. Refunds are included in budget outlays.

As mentioned previously, OPM estimates that 10,417 employees will be RIFed in fiscal years 1981 and 1982. We assumed, as CBO did in its July 1981 report, that all RIFed employees would receive a refund and that the average refund would be $14,190. Based on these assumptions, budget outlays for fiscal years 1981 and 1982 could increase by $147.8 million to pay the refunds.

REDUCTION IN TAXES ASSESSED AND COLLECTED

IRS personnel ceiling reductions will cost more than they will save. For example, the IRS personnel ceiling reductions should save about $23.1 million in personnel compensation costs by the end of fiscal year 1982 based on OMB's assumptions for average annual compensation costs. However, we estimated, and IRS agrees, that as a result of this ceiling reduction, about $182.2 million in tax revenue will not be assessed and collected during fiscal years 1981 and 1982. 1/ This represents a tax revenue loss of about $7.90 for every dollar of personnel compensation saved. OMB had justified this reduction on the basis that the President's proposed reduction in marginal tax rates was expected to enhance voluntary compliance with tax laws and reduce the need for examination positions.

1/This estimate has not been adjusted to reflect the diminishing rate of tax revenue generated from increasing staffing levels. IRS officials stated they will take steps to mitigate the revenue loss when the ceiling reductions are applied operationally.

but will retain the $38,456 salary of the former position. Just within the two DOE offices we reviewed, 188 downgrades were affected, many involving reductions of several levels.

PERSONNEL CEILING REDUCTIONS CAN CAUSE ADDITIONAL COSTS

Reductions in the size of the Federal work force without corresponding reductions in workload may cause additional costs to the Government as alternative sources of staffing such as overtime or contracting out are acquired or as staff reductions generate offsetting costs.

In a February 9, 1978, report we pointed out problems caused by using a "penny-wise pound foolish" approach to cutting back Federal employment levels. The problems affecting a broad range of Government programs include work backlogs, ineffective implementation of legislative mandates, excessive use of overtime and consultants, and, in several cases, criminal abuses caused in part by insufficient administrative and supervisory staff. 1/

National Aeronautics and Space Administration (NASA) officials, in an April 28, 1981, memorandum to OPM regarding a planned RIF stated:

> "* * * a RIF of this magnitude will seriously disrupt agency operations connected with the continued flight testing and development of the Space Shuttle * * * key people will be displaced by incumbents of positions that will be abolished. The inevitable program disruption this will cause is intolerable."

NASA officials, in a June 19, 1981 memorandum, also recognized the RIF's impact on the cost of the Space Shuttle program:

> "Cost Impact of Disruptive Effects of RIF on the Space Shuttle Schedule Launch: Over the next few years the Marshall Space Flight Center has a critical lead role in the further development and testing of the Space Shuttle. During this period, 5 to 6 Design, Development, Test and Evaluations (DDT&E) launches, each of which will cost in excess of

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1/"Personnel Restrictions And Cutbacks In Executive Agencies: Need For Caution" (FPCD-77-5).

In a September 10, 1981, report 1/ on DOE contracts, DOE officials cited the unavailability of in-house personnel as the most common reason for using contractors for management assistance. Work force size limitations, according to DOE, prevent the agency from hiring the people it needs to do the work. Consequently, officials turn to contracts with private firms, or grants to nonprofit institutions, to accomplish the missions of the various programs. Although contract employees providing such services are not included in personnel ceilings or counted as part of the Federal work force, they are paid with Federal funds and are generally doing the same type of work as Federal employees.

Many of the DOE support service contracts GAO reviewed appeared to provide staff extensions to DOE program offices. In most cases, the contractor was performing work which DOE did not have the in-house resources to perform. Agency officials frequently stated that the contractor's work satisfied a program need which was expected to continue for a least 1 year and could be performed by in-house personnel (i.e., no special expertise was required) but that personnel ceilings and hiring freezes prevented the hiring of needed staff.

To the extent that agencies contract out services previously performed in-house to compensate for personnel ceiling reductions, OMB's estimated savings will be further reduced. Even if one assumes optimistically that the contractor's costs will be somewhat lower than in-house costs, the full price of the contracts and the Governments' costs to administer the contracts would further reduce OMB's estimated savings.

RIFS CAN REDUCE FEDERAL PRODUCTIVITY

Another possibly significant but unquantifiable cost associated with the effort to reduce the size of the Federal work force is the program disruption and lost productivity that can occur when thousands of employees are told that they may lose their jobs.

Department of Agriculture officials, in an August 6, 1981, letter to OPM requesting early retirement authority,

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1/"The Department of Energy's Use of Support Service Contractors to Perform Basic Management Functions," (EMD-81-144).

> actions initiated elsewhere. * * *The manager must also devote his time and effort to participation in the various employee appeal processes. If the manager has been personally affected by reduction-in-force action, he must accomplish the above activities, while pursuing his own course to gain personal relief. The basic managerial function of planning, organizing, directing, and controlling a group of employees in the accomplishment of the specific organizational responsibilities suffers throughout this process."

In addition, NASA officials, in a June 19, 1981, letter to OPM, stated that lost productivity from a pending RIF would be costly:

> "<u>Costs Associated with Reduced Productivity Caused by RIF:</u> Reductions in force have a depressing effect on employee morale. With the knowledge, or even suspicion of an impending RIF, each employee develops fears of reassignment to an unknown position in a different work environment, loss of pay or total loss of employment. Although it is impossible to calculate the specific loss of productive hours as a result of this situation, we believe it could easily approach .2 percent of the Center's productive time which would equate to approximately $250,000. This is in addition to any costs associated with slippage in the Shuttle launch schedule."

More than 25 Federal agencies have already initiated RIF's as of October 1981; undoubtedly, productivity is suffering to some extent.

MID-YEAR BUDGET CHANGES ADVERSELY AFFECT FULL TIME EQUIVALENT CEILING SYSTEM

Beginning in fiscal year 1982, all agencies, with the exception of the Department of Defense, began using the full time equivalent (FTE) personnel ceiling system. The FTE system is intended to replace agencies' end-of-year personnel ceilings with employment ceilings based on the number of work years required to achieve agencies' missions and objectives. Instead of agencies having to meet an end-of-year count as the previous ceiling system required, the FTE system generally requires that agencies deduct actual workyears expended during the course of the year from their FTE workyear ceilings. This results in agencies having a "bank account" of work years that they draw from during the year.

Budget changes that occur near the middle or end of a fiscal year can negate FTE's major advantage over year-end ceilings--avoiding excessive personnel actions in the last month. For example, if an agency learns in the eighth month of the fiscal year that its personnel budget for the entire year has been cut 12 percent, many layoffs and other personnel actions representing a 36-percent cutback may be necessary during the final 4 months of the year to generate the necessary 12 percent savings. Thus agencies may have to RIF three times as many employees in the last months of the fiscal year to generate the necessary savings.