

An hourglass-shaped graphic with a globe in the top bulb and a smaller globe in the bottom bulb. The hourglass is light blue and has a dark blue top and bottom. The globe in the top bulb is dark blue, and the globe in the bottom bulb is light blue. The hourglass is centered on the page.

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*The Balanced Budget Act of 1997: Retirement and Health Insurance Provisions for Postal and Federal Personnel*

Carolyn L. Merck, Education and Public Welfare Division

September 17, 1997

**Abstract.** On June 25, 1997, the Senate and the House of Representatives each passed FY1998 budget reconciliation bills covering spending and saving proposals. These bills, which reflected assumptions included in the FY1998 congressional budget resolution, included deficit reduction provisions pertaining to the federal civil service retirement and health insurance programs. After approval by the House Committee on Government Reform and Oversight and the Senate Committee on Governmental Affairs, these proposals were included in the Balanced Budget Act of 1997 enacted on August 5, 1997 (P.L. 105-33).

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## The Balanced Budget Act of 1997: Retirement and Health Insurance Provisions for Postal and Federal Personnel

Updated September 17, 1997

Carolyn L. Merck  
Specialist in Social Legislation  
Education and Public Welfare Division

<http://wikileaks.org/wiki/CRS-97-635>

# The Balanced Budget Act of 1997: Retirement and Health Insurance Provisions for Postal and Federal Personnel

## Summary

On June 25, 1997, the Senate and the House of Representatives each passed FY1998 budget reconciliation bills covering spending and saving proposals. These bills, which reflected assumptions included in the FY1998 congressional budget resolution, included deficit reduction provisions pertaining to the federal civil service retirement and health insurance programs. After approval by the House Committee on Government Reform and Oversight and the Senate Committee on Governmental Affairs, these proposals were included in the Balance Budget Act of 1997 enacted on August 5, 1997 (P.L. 105-33).

On June 11, 1997, the House Committee on Government Reform and Oversight approved budget reconciliation legislation to (a) increase postal and nonpostal employee contributions to the federal retirement systems by 0.5% of pay (phased in) starting October 1, 1997 (ending after 2002); (b) increase nonpostal agency payments to the federal retirement trust fund on behalf of workers in the Civil Service Retirement System (CSRS) starting October 1, 1997 (also ending after 2002); and (c) establish a new formula governing health insurance premiums for federal employees and annuitants under the Federal Employees' Health Benefits Plan (FEHBP) to retain the current government and enrollee premium shares. These measures would reduce the federal budget deficit by \$4.780 billion over 5 years (including about \$28 million in savings from the new FEHBP formula).

On June 17, 1997, the Senate Governmental Affairs Committee approved reconciliation proposals that were the same as those approved in the House Committee with one exception: The increase in nonpostal agency contributions for CSRS employees would have been 1.6% of pay in the year 2002 instead of 1.51%. The House version prevailed in the final legislation.

Some have questioned whether the employee retirement contribution increases should apply to postal employees, for whom the CSRS is fully funded, and to federal and postal workers participating in the Federal Employees' Retirement System (FERS), which is also fully funded. However, exempting postal or FERS workers from the contribution increases might be perceived as unfair because the effect would be that one group, federal workers covered by the CSRS, would be required to absorb within 5 years the full \$1.8 billion in deficit reduction this provision was estimated to achieve.

An amendment to the budget reconciliation legislation to exempt postal employees and FERS participants from the increase in contributions failed to pass in the House Civil Service Subcommittee markup of the legislation June 10, 1997.

## Contents

Retirement Programs .....	1
Reducing the Budget Deficit .....	1
Financing Federal Pensions .....	1
The FY1998 Budget Resolution .....	2
FY1998 Budget Reconciliation Proposals .....	2
Employee Retirement Contribution Increases .....	3
Nonpostal Agency Contribution Increases for CSRS Participants .....	4
Issues Regarding the Retirement Program Provisions .....	4
Increased Employee Contributions .....	4
Funded and Unfunded Benefits .....	4
Reducing Long-term CSRS Unfunded Liabilities .....	5
Increased Nonpostal Agency Contributions to the CSRS .....	5
Reducing Federal Spending .....	5
Reducing Long-term Unfunded CSRS Liabilities .....	6
Federal Employee and Retiree Health Insurance .....	6
Budget Reconciliation Proposal .....	7

## List of Tables

Table 1. FY 1998 Budget Provisions Pertaining to Federal Retirement (savings for FY1998 through FY2002) .....	3
Table 2. Increased Federal Employee Retirement Withholding .....	3

# The Balanced Budget Act of 1997: Retirement and Health Insurance Provisions for Postal and Federal Personnel

## Retirement Programs

### Reducing the Budget Deficit

The Congress and the Administration agreed to balance the federal budget by the year 2002. Many believe that, like any employer involved in a labor-intensive business, when faced with the need to reduce expenditures, the federal government must look carefully at its payroll costs. The federal pension plans are a major component of those costs. To help with deficit reduction, the Administration and the Congress agreed that federal employees should share more of the cost of their retirement system during their working years and that nonpostal federal agencies should finance more of the cost of their employees' pensions by reducing other spending. Under federal budget rules, increasing employee and agency contributions to the retirement system are counted as revenues to the government and thus reduce the federal budget deficit in the years in which those revenues are received.

In its FY1998 budget, the Administration had proposed to achieve additional savings by delaying the date on which cost-of-living adjustments (COLAs) would be implemented for federal civil service and postal retirees. However, the Congress rejected that proposal in agreeing to the budget resolution for FY1998 (H.Con.Res. 84, approved June 5, 1997).

### Financing Federal Pensions

A retirement plan is considered to be "fully funded" if adequate funds are set aside during employees' working years to pay the cost of their retirement benefits. The Federal Employees' Retirement System (FERS) is fully funded for both postal and nonpostal federal workers, and the Civil Service Retirement System (CSRS), as applicable to *postal employees*, is fully funded. However, the CSRS is only partially funded for nonpostal federal workers. Thus, some contend that CSRS funding for nonpostal federal employees should be increased. Others point out that federal pension funding is achieved by crediting special issue Treasury securities to retirement trust funds, but those securities can be redeemed to pay retiree benefits only by replacing them with general revenues. They say that, even if CSRS pensions were fully funded on an advance basis, the government's share of federal pensions would still have to be paid from general revenues.

In general, the trust fund through which federal pensions are financed is primarily a bookkeeping device for keeping track of future pension obligations. Because the trust fund consists of U.S. Treasury securities and is not invested in private stocks or bonds, it does not generate cash for paying benefits.

## **The FY1998 Budget Resolution**

A concurrent budget resolution is an agreement between the House of Representatives and the Senate regarding federal spending and savings targets. Those budget targets are based on assumptions about certain programmatic changes the authorizing committees might make. For federal retirement programs, the FY1998 congressional budget resolution assumes that employee and agency contributions to the CSRS and the FERS would be increased by specified amounts targeted to save \$4.762 billion over 5 years in “direct” spending programs. (Direct spending programs are entitlement programs for which the level of spending is not limited by annual appropriations.)

The authorizing committees may accept the assumptions on which the resolution is based, modify the assumptions, or substitute alternative provisions to achieve the same level of savings. Each congressional committee is required to report legislation pertaining to direct spending programs under its jurisdiction (if any), and the committees’ proposals are combined by the budget committees into an omnibus budget reconciliation bill. The House Committee on Government Reform and Oversight and the Senate Committee on Governmental Affairs have jurisdiction over civil service programs.

## **FY1998 Budget Reconciliation Proposals**

On June 11, 1997, the House Government Reform and Oversight Committee accepted the assumptions underlying the budget resolution and reported legislation to include them in an omnibus budget reconciliation bill, as follows: (a) all federal and postal workers would pay into the CSRS and FERS an additional 0.25% of pay starting January 1, 1999; an additional 0.15% on January 1, 2000; and an additional 0.1% on January 1, 2001, for a total increase effective in 2001 of 0.5% of pay; and (b) nonpostal agency payments to the federal retirement trust funds on behalf of workers in the CSRS would increase from 7% to 8.51% starting October 1, 1997. These increased employee and agency contributions would end after FY2002.

On June 17, 1997, the Senate Committee on Governmental Affairs approved the same provisions included in the House bill, with one difference. The Senate bill would have increased the nonpostal agency payments for CSRS employees by 1.6% of pay in the year 2002, rather than 1.51% in that year. This was done because of a slight difference in the savings targets the Senate Committee was required to achieve. However, the House version prevailed in the final budget legislation.

On June 25, the House passed H.R. 2015, including the provisions pertaining to civil service retirement and health insurance, and the Senate passed S. 947 with its similar civil service provisions. (The Senate then substituted the language of S. 947 into a bill numbered H.R. 2015). The differences in the House and Senate bills

were worked out in a conference committee. Tax measures were included in separate reconciliation bills.

**Table 1** shows the estimated savings associated with the retirement program provisions in the FY1998 balanced budget legislation.

**Table 1. FY 1998 Budget Provisions Pertaining to Federal Retirement  
(savings for FY1998 through FY2002)**

	5-year savings (billions)
<b>Function 950: Undistributed Offsetting Receipts</b>	
Increase nonpostal agency payments into the retirement fund on behalf of CSRS workers by 1.51% of employee pay (effective October 1, 1997, ending after FY2002)	\$2.933
<b>General Revenue Receipts</b>	
Increase federal and postal employee payments into CSRS and FERS (phased in starting in 1999, ending after FY2002)	1.829
<b>Total Savings</b>	<b>\$4.762</b>

### Employee Retirement Contribution Increases

**Table 2** shows the employee retirement contribution rates which, under the final budget legislation, will be applicable to all postal and nonpostal employees. (Certain federal employees, including Members of Congress, congressional staff, federal law enforcement officers, fire fighters, the Capital Police, and some air traffic controllers currently pay higher rates than those shown in **Table 2**; the contribution rates for these special groups would increase by the same percent of pay applicable to other employees.)

**Table 2. Increased Federal Employee Retirement Withholding  
(as a percent of employee pay)**

	1998	1999	2000	2001-2002
<b>CSRS</b>	7.0%	7.25%	7.4%	7.5%
<b>FERS<sup>a</sup></b>	0.8%	1.05%	1.20%	1.3%

<sup>a</sup> FERS participants also pay the Social Security payroll tax of 6.2% of pay, up to a maximum pay rate of \$65,400 in 1997.

## Nonpostal Agency Contribution Increases for CSRS Participants

The Balanced Budget Act of 1997 requires all federal agencies (excluding the USPS) to increase their contributions on behalf of workers covered by the CSRS from 7% of each worker's pay to 8.51% of pay. (Because FERS is fully funded, no increase in agency contributions is proposed for it.) Agencies will not receive additional appropriations to pay the increased contributions, thus, they may need to reduce spending for things other than retirement contributions in order to make the increased payments to the retirement system. This provision is expected to decrease the federal budget deficit because the increased agency contributions to the CSRS are scored as a receipt of the government (budget function 950, "undistributed offsetting receipts"), and other agency spending would have to be reduced to make the required payment to the retirement system. (The Senate version of the bill would have required the agency CSRS contributions to be 8.6% of pay in the year 2002.)<sup>1</sup>

## Issues Regarding the Retirement Program Provisions

Under federal budget rules, postal and federal employee pension contributions are scored as general revenue receipts. Therefore, increasing those receipts reduces the budget deficit.

### Increased Employee Contributions

**Funded and Unfunded Benefits.** The CSRS for employees of the USPS is fully funded by the combination of postal employee and USPS employer contributions. The FERS is fully funded also for all USPS and other nonpostal federal employees by the combination of employee and employer contributions. Thus, increasing postal employee contributions into the CSRS and postal and nonpostal employee contributions into FERS without an offsetting reduction in the agencies' contributions would exceed the total amount needed to fund fully the retirement plans for those workers.

Some say that because retirement for postal workers and FERS participants is fully funded, those groups should be exempted from the retirement contribution increase. Moreover, they argue that the "overpayments" by postal workers would subsidize the underfunded benefits for nonpostal workers in the CSRS.

Opponents of exempting postal and FERS workers from the contribution increases acknowledge that FERS and postal CSRS benefits are fully funded, but they maintain that the underlying goal of the contribution increases is deficit

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<sup>1</sup> On April 18, 1997, the OPM published in the *Federal Register* revised estimates of the cost of the pension component of FERS. These new estimates show that the cost of FERS has declined since the last estimate in 1993. As a result, agency payments for pensions for FERS employees will be reduced from 11.4% of pay to 10.7%, effective October 1, 1997. Thus, although the reconciliation legislation would increase agency costs for CSRS employees by 1.51% of pay, that increase would be partially offset by the 0.7% reduction in agency costs for FERS employees. On an agencywide basis, the extent of the offset would depend on the proportions of CSRS and FERS employees.



reduction, not pension funding. They argue that exempting those groups would be unfair because (a) nonpostal workers under the CSRS should not have to pay more than postal workers for the same benefits; (b) it would break the agreement in the FERS law that equalizes the required retirement contribution of CSRS and FERS employees; (c) USPS/CSRS benefits and FERS benefits are fully funded because of higher *employer* contributions, not because of higher *employee* contributions; and (d) exemption of any employees from the proposed retirement contribution increase would sacrifice deficit reduction unless larger increases were levied on the nonexempted workers (i.e., nonpostal workers covered by the CSRS).

On June 10, 1997, when the House Subcommittee on Civil Service marked up its budget reconciliation legislation, a majority party committee member proposed an amendment to exempt postal employees in CSRS and all workers in FERS from the increased employee contributions. The Subcommittee did not approve the amendment.

**Reducing Long-term CSRS Unfunded Liabilities.** A reason sometimes advanced for increasing CSRS contributions from nonpostal federal employees is that those contributions would reduce the \$540 billion long-term unfunded liability of that program. According to the Office of Personnel Management (OPM) actuaries, the increased contributions would cause a reduction in CSRS unfunded liabilities in the early years during which the increased contributions were in effect. The reduction would be approximately equal to the amount of the increased contributions (\$1.829 billion). However, because of requirements in current law regarding computation of government appropriations to the retirement fund, the reduction in unfunded CSRS liabilities would be small over the long term, largely because future payments that the government makes directly to the retirement fund (i.e., not the agency contributions) would decline as a result of the increase in employee contributions.

## Increased Nonpostal Agency Contributions to the CSRS

**Reducing Federal Spending.** Increasing agency contributions to the retirement system on behalf of CSRS employees (from 7% of worker pay to 8.51% under the House bill and 8.6% under the Senate bill) increases agencies' costs for CSRS-covered workers and would require them to reduce spending for other purposes in order to make the required retirement payments. Proponents say that agencies would have an incentive to economize and budget their nonpersonnel costs more prudently. The increased retirement contributions might make federal managers more cognizant of the costs of personnel benefits and increase their incentive to compare the cost of labor and the cost of capital in making decisions between employing a federal worker and the cost of contract employees or automation. Moreover, because agency retirement costs for FERS workers are substantially higher than for CSRS workers, this increase in the agencies' costs for CSRS workers would be a step toward equalizing the cost of employees in the different retirement programs.<sup>2</sup>

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<sup>2</sup> For employees covered by the FERS, agencies must pay 11.4% of employee pay to the pension component of FERS, 6.2% to Social Security, and up to 5% to the Thrift Savings Plan.

Critics of this proposal say that the mission of many federal agencies is such that equipment cannot substitute for personnel and there are limited situations in which a choice may be made between labor and capital. They say that any provision that increases personnel costs could result in worker furloughs or layoffs which, coming on top of the substantial downsizing that has occurred recently in the federal workforce, could compromise the government's ability to deliver required services.

**Reducing Long-term Unfunded CSRS Liabilities.** Proponents of the proposal to increase agency contributions to the retirement fund on behalf of CSRS employees say that it would reduce both the federal budget deficit and unfunded CSRS liabilities. Opponents say its primary effect would be deficit reduction (\$2.933 billion over 5 years) and that it would have a very small effect on the long-term funding of the CSRS (again, largely because appropriations for the government's share of contributions would decline). Opponents also note that, despite unfunded liabilities of about \$540 billion, the CSRS trust fund balance exceeds \$340 billion and is no danger of insolvency.<sup>3</sup>

## Federal Employee and Retiree Health Insurance

The Federal Employees' Health Benefits Program (FEHBP) provides health insurance to federal workers and retirees through a variety of fee-for-service plans, Health Maintenance Organizations, and other managed care arrangements. The premiums for these plans are shared by participants and their employer. Postal workers collectively bargain the share of their premium that is paid by the USPS, but the premiums for nonpostal federal employees and all retirees is determined by a premium-sharing formula.<sup>4</sup>

By law, the employer's share of FEHBP premiums has been based on a two-part formula, generally referred to as the "Big-6" formula. This means that the government's share is a fixed dollar amount, set at (a) 60% of the average premium of six specified plans, but it could not exceed (b) 75% of any particular plan's premium. Under this formula, on average, the government pays about 71% of FEHBP premiums for nonpostal employees and annuitants, and participants pay 29%.

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<sup>3</sup> Currently, slightly more than half of the federal workforce is covered by FERS (including employees of the USPS), and less than half is covered by the CSRS. Because the government's share of CSRS funding will decline in the future, OPM estimates that CSRS benefit payments will begin to exceed total CSRS income in about 2010, and retirement fund assets attributable to CSRS will be depleted by about 2024. Foreseeing that this situation would arise as the transition is made from CSRS to FERS, the Congress established a system whereby benefit payments under the CSRS will be authorized by FERS trust fund securities, as needed, until there are no more CSRS benefits to be paid. However, those "borrowed" FERS securities will be paid off through 30-year amortization payments. Using a 75-year projection period, OPM estimates that the trust fund will continue to grow, ultimately reaching a level of nearly 20 times the amount needed to pay annual benefits.

<sup>4</sup> The employer share of premiums for active federal employees is paid by annual appropriations to their employing agency; the USPS pays the employer share for postal workers; and the OPM pays the employer share for all annuitants.

The formula currently governing the USPS share of premiums requires it to pay (a) 71% of the Big-6 average premium for active postal employees (rather than the 60% paid for nonpostal employees), not to exceed (b) 88.75% of the premium of any plan.

In 1989, one of the Big-6 insurance plans dropped out of the program, but was continued in the formula as a “proxy” or “phantom” plan. The plan that dropped out was a high-cost plan sponsored by Aetna. Because Aetna was a high-premium plan, the average premium of the five remaining plans (“Big-5”) would be lower than the average “Big-6” premium. The legislation authorizing continued use of the Big-6 formula with a proxy plan expires at the end of 1998, and the Administration maintained that it could implement a “Big-5” formula without new legislation. Under such a formula, the government’s share of premium costs would decline (because it would be 60% of the lower average Big-5 premium), and the participants’ share would rise by an estimated 20% (effective in 1999). This cost-shifting could result in federal budget savings of nearly \$1 billion in FY1999.

During discussions leading to the budget resolution, Congress and the Administration agreed that the baseline budget assumptions would include continuation of a premium-sharing formula that would not change the share of premiums currently paid by the government. Thus, reconciliation legislation could be enacted to revise the formula without causing an increase in the budget deficit. However, the budget resolution included no assumptions regarding a replacement formula.

### **Budget Reconciliation Proposal**

The Balanced Budget Act of 1997 includes a revision of the formula determining the government’s and participants’ shares of FEHBP premiums for nonpostal participants, and the final legislation.<sup>5</sup> The new formula will go into effect for health insurance premiums in 1999. The new formula will be based on the average total premium cost of all plans in the FEHBP, weighted by the number of participants in each plan. The government’s share of the weighted average premium will be set at a level that will replicate as closely as possible the share of each premium the government pays under current law. Thus, plan participants should not experience an increase in their premiums in 1999 due to the expiration of the current formula. Under the budget baseline assumptions agreed to by the Administration and the congressional budget committees, this change will reduce the government’s share of FEHBP costs by about \$28 million over 5 years

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<sup>5</sup> FHEBP premium sharing arrangements for the USPS and postal employees are collectively bargained and would be unaffected by a revision in the formula for nonpostal participants.