CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

August 24, 1999

S. 1232
Federal Erroneous Retirement Coverage Corrections Act

As ordered reported by the Senate Committee on Governmental Affairs on August 3, 1999

SUMMARY

S. 1232 would alter the procedures for correcting situations where federal employees have been mistakenly placed in the wrong retirement system. Many of these retirement coverage errors occurred between 1984, when the Civil Service Retirement System (CSRS) was closed to new entrants, and 1987, when the Federal Employees' Retirement System (FERS) was created.

CBO estimates that this bill would decrease discretionary spending by $42 million over the 2000-2004 period, primarily because of lower agency contributions to the Civil Service Retirement and Disability Fund (CSRDF). The resulting drop in receipts by the CSRDF would also increase direct spending by $42 million over the same period. The bill would have only a minor impact on federal retirement benefits during the next several years because the affected employees are generally still in the middle of their careers. Because the bill would affect direct spending and receipts, pay-as-you-go procedures would apply.

Because the District of Columbia would be required to continue retirement coverage for some employees who have been mistakenly enrolled in the wrong retirement system, S. 1232 contains an intergovernmental mandate as defined by the Unfunded Mandates Reform Act (UMRA). S. 1232 would also create a new private-sector mandate by requiring Gallaudet University to rectify errors where employees were improperly covered under CSRS or FERS. CBO estimates that the cost of these mandates would be small and would not exceed the thresholds established in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1232 is shown in the following table.

TABLE 1. ESTIMATED BUDGETARY EFFECTS OF S. 1232

	By Fiscal Year, in Millions of Dollars									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CHANGES IN SPENDING SUBJECT TO APPROPRIATION										
Makeup Contributions to TSP	- 1	16	3	- 3	- 4	- 5	- 5	- 6	- 7	- 8
Makeup Payments to Social Security	- a	a	0	0	0	0	0	0	0	0
Makeup Payments to the CSRDF	- 3	2	- 4	- 4	- 4	- 4	- 5	- 5	- 5	- 6
Agency Retirement Contributions	- a	- 2	- 3	- 5	- 6	- 6	- 7	- 7	- 8	- 8
Employer TSP Contributions	- 1	- 3	- 6	- 7	- 7	- 8	- 8	- 9	- 10	- 10
Employer Social Security Contributions	- a	- a	0	0	0	0	0	0	0	0
Total	- 5	13	- 10	- 19	- 21	- 23	- 25	- 28	- 30	- 32
CHANGES IN DIRECT SPENDING										
On-Budget										
Makeup Payments to the CSRDF	5	- 2	5	6	6	7	7	8	8	9
Agency Retirement Contributions	a	2	4	8	9	9	10	11	12	13
Transfers from CSRDF to Social Security	- 3	3	0	0	0	0	0	0	0	0
Subtotal	2	3	9	13	15	16	17	19	20	22
Off-Budget										
Makeup Payments to Social Security	1	- 1	0	0	0	0	0	0	0	0
Employer Social Security Contributions	a	a	0	0	0	0	0	0	0	0
Transfers from CSRDF to Social Security	3	- 3	0	0	0	0	0	0	0	0
Subtotal	4	- 4	0	0	0	0	0	0	0	0
Total	6	- 1	9	13	15	16	17	19	20	22
CHANGES IN REVENUES										
On-Budget										
Employee Retirement Contributions	a	a	a	a	a	a	a	a	a	a
Off-Budget										
Employee Social Security Taxes	- a	- a	0	0	0	0	0	0	0	0
Total	a	a	a	a	a	a	a	a	a	a
TOTAL COST OF S. 1232										
Direct Spending and Revenues	6	- 1	9	13	15	16	17	19	20	21
All Spending and Revenues	1	12	- 1	- 5	- 6	- 7	- 8	- 9	- 10	- 11

a. Less than $500,000.

Notes: Components may not sum to totals because of rounding.

The mandatory costs of this legislation would fall within budget functions 600 (Income Security), 650 (Social Security), and 950 (Undistributed Offsetting Receipts). This estimate assumes that S. 1232 is enacted by October 1, 1999.

BASIS OF ESTIMATE

Background

There are two main retirement programs for full-time regular federal employees. Most full-time employees hired before 1984 are in the Civil Service Retirement System (CSRS), a defined benefit plan that does not include Social Security. Those hired after 1983 are generally covered by the Federal Employees' Retirement System (FERS), which features Social Security, a more limited defined benefit, and the defined contribution Thrift Savings Plan (TSP) with government matching contributions. Employees who return to government service after 1987 and have five years of prior service under CSRS may be covered by a hybrid plan known as CSRS Offset that features a combination of CSRS and Social Security benefits.

FERS employees may contribute up to 10 percent of their pay to the TSP. They receive an automatic contribution from their employing agency equal to 1 percent of their pay and may also receive an additional 4 percent in matching contributions. CSRS and CSRS Offset employees may also participate in the TSP, but they may only contribute up to 5 percent of their pay and do not receive any government contributions.

Assumptions about Retirement Coverage Errors

CBO estimated the number of retirement coverage errors that have been made based on discussions with personnel officials in a number of large government agencies, including the Postal Service and the Departments of Defense, Veterans Affairs, and Agriculture. These agencies comprise approximately 70 percent of the federal civilian workforce. On the basis of these discussions, CBO estimates that approximately 18,000 coverage errors have occurred throughout the government, of which approximately 11,000 have already been corrected. The two most common types of coverage errors appear to involve employees who should be in FERS but were accidentally put in CSRS and employees with prior service who returned to government service and were misplaced in either FERS or CSRS Offset.

Under current law, coverage errors are usually corrected by converting the employee to the proper retirement system, retroactive to the original date of the error. However, some employees who were accidentally placed in FERS are able to remain in FERS by making a retroactive election of FERS coverage.

S. 1232 would allow most employees affected by coverage errors to choose whether they would like to be placed in the proper retirement system or make their incorrect coverage permanent. Employees who have been incorrectly covered by CSRS could elect only CSRS Offset or FERS. Employees whose coverage errors have not been corrected would have 180 days after the discovery of the error to make an election; employees whose coverage errors have already been fixed would have 18 months after the issuance of final implementing regulations to make their election. All elections would be irrevocable, and employees who did not make an election would remain in their current coverage. Coverage errors lasting less than three years would not be covered by the bill. CBO assumed that under the bill agencies would stop correcting coverage errors for the first six months of 2000 pending the issuance of final regulations to implement the bill, and that they would finish processing the resulting backlog by the end of 2001.

Employees who are incorrectly covered by CSRS rather than FERS are unable to participate fully in the TSP. Under current law, when an individual's coverage is corrected to FERS, the employing agency makes a lump-sum deposit into his TSP account equal to the government contributions and related earnings that would have been made to the employee's previous TSP contributions under FERS rules. If the employee did not have a TSP account, only a deposit for the automatic 1-percent contributions is made. Earnings are calculated using the individual's own fund allocation decisions (if he had a TSP account) or the G Fund rate (otherwise). Employees may provide makeup contributions to their TSP accounts out of future pay. These makeup contributions receive agency matching contributions (up to the 5-percent FERS maximum) and related earnings as if the contributions had been made at the proper time. However, back earnings are paid only on the agency's matching funds, not the employee's makeup contributions.

The bill would require agencies to pay lost earnings on employee makeup contributions to the TSP for employees who elect FERS coverage. (Employees whose coverage had been corrected to FERS before the bill's enactment would receive makeup earnings on any makeup contributions made prior to enactment.)

CBO assumed that these employees' choice of retirement coverage would be strongly influenced by whether or not they had made significant contributions to the TSP while they were incorrectly covered by CSRS or CSRS Offset. Most employees with little or no prior

TSP contributions would need to make retroactive contributions for a substantial amount of time—as much as eight or nine years—in order to make up the contributions they would have made under FERS. For these employees, CSRS Offset coverage would be relatively attractive. In contrast, employees with significant prior TSP contributions might need only two to three years to catch up. As a result, many of these employees would still choose to have their coverage corrected to FERS.

Most employees covered by CSRS have not made regular contributions to the TSP. According to the Federal Retirement Thrift Investment Board, only 22 percent of CSRS employees made contributions to the TSP in 1989 (the earliest year of data available). This percentage has since risen but did not exceed 50 percent until 1996. CBO estimates that only a third of employees erroneously placed in CSRS or CSRS Offset have made significant contributions to the TSP, and assumed that 80 percent of these employees would elect FERS coverage. Two-thirds of employees incorrectly placed in CSRS or CSRS Offset have little or no TSP contributions, and CBO assumed that 80 percent of these employees would elect CSRS Offset coverage. Overall, 60 percent of these employees would elect CSRS Offset coverage and 40 percent would elect FERS.

Effects on Discretionary Spending

Makeup Contributions to the TSP. S. 1232 would have two effects on the makeup contributions that agencies pay to the TSP. Agencies would not have to pay makeup contributions for employees who elect CSRS Offset coverage instead of FERS, but payments for individuals who elect FERS coverage would be higher than under current law. This latter effect would predominate in 2001 and 2002, when agencies would pay additional lost earnings on the makeup contributions made by employees whose coverage errors were corrected before the bill's enactment. In later years, annual agency spending on makeup contributions would decline because many employees would elect CSRS Offset coverage and not be eligible for makeup TSP contributions. CBO estimates that overall agency spending on makeup TSP contributions would increase by $11 million over the 2000-2004 period.

Makeup Payments to Social Security. Agencies are currently responsible for paying makeup Social Security payroll taxes covering the last 3 years, 3 months, and 15 days for employees whose coverage is changed from CSRS to FERS or CSRS Offset. Since agencies would stop correcting coverage errors in the first six months of 2000 (and thus make fewer corrections than under current law), CBO estimates that makeup payments would decrease slightly in that year. However, makeup payments would be slightly higher in 2001 as agencies work through the backlog of uncorrected errors.

Makeup Payments to the CSRDF. Under current law, adjustments to past agency contributions to the CSRDF are completely retroactive. Agencies contribute 8.51 percent of basic pay for employees covered by CSRS or CSRS Offset and 10.7 percent of basic pay for most employees under FERS. Agencies thus make additional contributions for employees whose coverage is changed from CSRS or CSRS Offset to FERS and receive a partial refund of their retirement contributions for employees whose coverage is changed from FERS to CSRS or CSRS Offset. This bill would have similar requirements, except that agencies could no longer receive partial refunds of their contributions. Since many employees who would be switched to FERS coverage under current law would elect CSRS Offset coverage under the bill, the payments that agencies make for retroactive adjustments would decrease by $13 million over the 2000-2004 period.

Agency Retirement Contributions. The amount that agencies contribute toward their employees' retirement would decline by $16 million over the 2000-2004 period as more employees are covered by CSRS Offset rather than FERS compared to current law.

Employer TSP Contributions. The employees who elect CSRS Offset coverage under S. 1232 would no longer be eligible for the automatic and matching TSP contributions available under FERS, lowering agency spending on TSP contributions by $24 million over the 2000-2004 period.

Employer Social Security Contributions. Agency payments of Social Security payroll taxes would decline by negligible amounts in 2000 and 2001, due primarily to timing differences in the number of coverage errors corrected.

Effects on Direct Spending (On-Budget)

Makeup Payments to the CSRDF. The decrease in agency makeup payments to the CSRDF would lower both agency outlays and offsetting receipts to the CSRDF. As a result, receipts to the trust fund would decrease by $20 million over the 2000-2004 period. The decrease in receipts is larger than the decrease in agency makeup payments because the receipts figure includes payments by the Postal Service. (The estimate assumes that changes in costs to the Postal Service would be offset by changes in postal rates.)

Agency Retirement Contributions. The decrease in agency retirement contributions under the bill would decrease CSRDF receipts by $23 million over the 2000-2004 period. The decrease in receipts is larger than the decrease in agency retirement contributions because the receipts figure includes payments by the Postal Service.

Transfers from the CSRDF to Social Security. Employees who have been mistakenly covered by CSRS when they should have been in CSRS Offset or FERS have been contributing 7 percent of their basic pay to the CSRDF, instead of contributing 0.8 percent to the CSRDF and 6.2 percent to Social Security. When the coverage error is corrected under current law, the 6.2 percent in erroneous CSRS contributions (up to the Social Security taxable maximum) is generally transferred to the Social Security trust funds. S. 1232 would continue this practice, but transfers from the CSRDF to Social Security would decrease by $3 million in 2000 and rise by $3 million in 2001 due to timing effects.

Effects on Direct Spending (Off-Budget)

CBO estimates that S. 1232 would reduce offsetting receipts to the Social Security trust funds by $4 million in 2000 and increase receipts by $4 million in 2001. These effects reflect the fact that agencies would correct fewer coverage errors in 2000 under S. 1232 but would catch up to their current-law pace by the end of 2001.

Effects on Revenues

Employee retirement contributions, which are on-budget, would be slightly higher under the bill because it would allow a small number of employees who would ordinarily be covered only by Social Security to participate in FERS or CSRS Offset as well. The amount of the increase would be less than $200,000 annually. Employee Social Security taxes, which are off-budget, would be slightly lower in 2000 and 2001 due to the bill's impact on slowing down the correction of coverage errors in those years.

Other Provisions

Title V of the bill contains a number of provisions that would better integrate CSRS and FERS with the retirement plans of the Board of Governors of the Federal Reserve System. The bill would allow federal employees who have prior service with the Federal Reserve Board to receive full credit for that service under FERS. The bill would also allow individuals who switch jobs from other federal agencies to the Federal Reserve Board to withdraw their balances in the TSP. Finally, S. 1232 would exempt from FERS coverage certain employees who return to federal employment after a break in service and have five or more years of service under the Federal Reserve Board's counterpart to CSRS. CBO estimates that these provisions would affect only a handful of employees and would not have a significant effect on the federal budget.

PAY-AS-YOU-GO CONSIDERATIONS

The provisions of S. 1232 would affect on-budget direct spending and revenues and therefore be subject to pay-as-you-go procedures. The pay-as-you-go procedures cover only the current year, budget year, and the succeeding four years. The pay-as-you-go effects of the bill are shown in Table 2.

TABLE 2. SUMMARY OF PAY-AS-YOU-GO EFFECTS

	By Fiscal Year, in Millions of Dollars									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Change in outlays	2	3	9	13	15	16	17	19	20	22
Change in receipts	0	0	0	0	0	0	0	0	0	0

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 1232 would change the way the government of the District of Columbia corrects errors associated with the incorrect enrollment of employees in federal retirement plans. This requirement would constitute an intergovernmental mandate as defined by UMRA. However, costs associated with making those corrections would be minimal, and only a small number of District of Columbia employees have been affected by errors addressed by the bill. Consequently, CBO estimates that the total cost of the mandate would be minimal and would not exceed the thresholds established in UMRA.

S. 1232 would also create a new private-sector mandate by requiring Gallaudet University to rectify errors where employees were improperly covered under CSRS or FERS. Because only a small number of Gallaudet University employees have been affected by such errors and the cost per correction would be low, CBO estimates that the cost of the mandate would be small.

COMPARISON WITH OTHER ESTIMATES

In March 1999, the House of Representatives approved H.R. 416, which would also alter the procedures for correcting retirement coverage errors. CBO estimated that H.R. 416 would increase discretionary spending by $346 million and reduce direct spending by $113 million over the 2000-2004 period. The drop in direct spending largely reflects additional receipts by the Social Security trust funds, which are off-budget.

CBO's estimate for H.R. 416 differs from that for S. 1232 for two main reasons. First, H.R. 416 has different provisions regarding the makeup TSP payments that agencies would make for employees who were incorrectly covered by CSRS or CSRS Offset when they should have been in FERS. Under the House bill, agencies would make lump-sum payments that include imputed employee contributions for the period of erroneous coverage plus lost earnings. These payments would be significantly larger than those required under the Senate bill. Second, H.R. 416 would require agencies to make additional retroactive contributions to the Social Security trust funds. Together, these two factors increase discretionary spending and reduce off-budget direct spending relative to the provisions in S. 1232.

ESTIMATE PREPARED BY:

Federal Cost: Eric Rollins
Impact on State, Local, and Tribal Governments: Leo Lex
Impact on the Private Sector: John Harris

ESTIMATE APPROVED BY:

Paul N. Van de Water
Assistant Director for Budget Analysis