FEDERAL PAY DISCRIMINATION IN NON-FOREIGN AREAS

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A. Retirement Annuities

Sally (not her real name) devoted her career to the federal civil service, working in Honolulu, Hawaii. She retired in 2009. Her average salary during her three highest earning years – the primary factor determining the amount of her retirement annuity – was calculated by the Office of Personnel Management from her total earnings history. The amount calculated by OPM (which OPM called the "Actual High-3 Salary") was $58,884. This amount was based on General Schedule pay only. Under rules established by OPM for calculating average salary, Sally's pay did not include the cost-of-living allowance, or COLA, that she had received as a regular part of every paycheck throughout her career for the extremely high costs of living in Hawaii. During Sally's high-3 years, her COLA was an additional 25.0% of her GS pay. This COLA rate, also calculated by OPM, was (and still is) the percentage by which living costs in Hawaii are higher than living costs in the Washington DC area. Nor did Sally's earnings history include locality pay, which employees in Washington DC and throughout the contiguous United States have received since 1994 and which OPM counts in calculating their average salaries for retirement purposes. Locality pay was not authorized for Hawaii or any other "non-foreign" area until 2010. During Sally's high-3 years, the average locality pay rate for Washington DC was 19.9%.

Thus, Sally's gross annuity was based on her GS pay only, and was calculated by OPM as $2,690 per month, beginning in August of 2009. If Sally had been working in Washington DC during her high-3 years, performing exactly the same work, she would have received locality pay instead of COLA, and her annuity would have been 19.9% higher, or $3,225 per month, even though living costs in Washington DC are much lower than in Hawaii. However, Sally worked in a non-foreign area and received COLA instead of locality pay. Under OPM's rules, not only is Sally's original gross annuity lower than that of her contemporaries in Washington DC, but it is also lower than that of any other federal employee who retired since 1994 anywhere in the contiguous United States with the same average GS pay. There is no question that OPM's rules have the ongoing effect of lowering Sally's standard of living during retirement, compared to the standard provided to all other employees who performed the same work.

However, the disparity in retirement income is even worse than it appears from the data above. If, in calculating Sally's average high-3 salary, OPM had counted the COLA Sally received to equalize her salary with the salaries of her counterparts in Washington DC, Sally's annuity would have been not just 19.9% higher, but at least 25.0% higher. In fact, under any reasonable

rule, it would have been around 38.5% higher. Long ago, for the convenience of the government, the Internal Revenue Service decided to treat non-foreign COLA as tax-exempt. (Without the tax exemption, COLA rates would have to be higher to achieve the same effect, and rates would more often be limited by the 25% statutory cap.) This means that COLA is an especially valuable component of regular pay, and excluding COLA from total pay in calculating the high-3 average is especially harmful. In Sally's case, her COLA rate was equivalent to a taxable locality pay rate of around 38.5%. If OPM had counted COLA in calculating her Actual High-3 Salary, Sally's gross annuity would have been set at $3,726 per month, not $2,690. The additional amount would allow Sally to afford more of the high costs of living in Hawaii, and it would make a big difference in her standard of living during the last years of her life.

This injustice – this denial of equal pay for equal work – has never been addressed by Congress. The Non-Foreign AREA Act of 2009 applies only to post-2009 retirees, and it has merely shifted some of the injustice from post-2009 retirees to post-2009 employees. If Sally were retiring in 2016, with the same average GS pay that she had in 2009, her gross annuity would be around 16.6% higher, not the 38.5% needed for equality with retirees in Washington DC. This is because the rates of locality pay inaugurated by the 2009 act in non-foreign areas have averaged only 16.6% in Hawaii. (As many members of Congress have pointed out, locality pay is designed for the contiguous United States and does not reflect the "unusual and unique circumstances" of non-foreign areas.) Although a reduced COLA is still being paid as an essential component of regular pay, OPM continues to exclude COLA in calculating the high-3 average salary. Thus, the annuities of post-2009 retirees in most non-foreign areas are still significantly lower than the annuities of retirees in Washington DC, even though living costs in every non-foreign area are still higher than living costs in Washington DC. Yet the disparity faced by pre-2010 retirees like Sally is the most extreme of all.

B. Regular Salaries

To make matters worse, Sally's salary during the 1990's and 2000's was not allowed to keep pace with federal salaries in the contiguous United States, even though living costs in Hawaii were rising just as fast or faster. In 2009, the year Sally retired, her monthly salary increased by 2.9%, as did the salaries of all other non-foreign area employees, due to an increase of 2.9% in GS rates. However, the salaries of employees in the contiguous United States increased by 3.9%, due to a separate increase of 1.0 points in average rates of locality pay, which non-foreign area employees did not receive. During Sally's career as a federal employee in Hawaii, salary increases in the 48 states and the District of Columbia exceeded salary increases in non-foreign areas by a cumulative 14.8%.[1]

Even after the Non-Foreign AREA Act of 2009 went into effect, federal employees in non-foreign areas are still receiving lower annual pay raises than are received by all other federal

[1] For this reason, during Sally's career, the amounts of starting annuities for new retirees increased faster for retirees in the contiguous United States than for retirees in non-foreign areas. Their high-3 averages were increasing faster. However, the salary lag's adverse effect on retirement benefits is minimal compared to the agency's practice of excluding COLA from the retirement base. Non-foreign area employees remain the only class of federal employees in the United States whose regular salaries are discounted – not fully included – in the calculation of "average pay" for purposes of retirement annuities.

employees at the same grade level. In 2016, for example, the take-home pay of federal employees throughout the contiguous United States increased by 1.3% from 2015, based on an increase of 1.0% in GS pay levels and an increase of 0.3 percentage points in average locality pay rates. However, the take-home pay of employees in non-foreign areas increased by only 1.0% for 2016, because the increase in their take-home locality pay is being cancelled out by a commensurate (dollar-for-dollar, after tax) reduction in their remaining COLA. As a result of this ongoing discrimination in pay raises, the Equal Pay Gap reached 15.6% in 2016 and is expected to increase again to 16.2% in 2017.

In fact, all of the locality payments to non-foreign area employees pursuant to the 2009 act – not merely the increases in locality pay – have been offset by equivalent reductions in COLA payments. Most of the costs projected by the Congressional Budget Office for the Non-Foreign AREA Act of 2009 act have not occurred.[2]

Ramona (not her real name) is a federal career employee in San Juan, Puerto Rico. Her bi-weekly paycheck always includes COLA pay for 80 hours. For the last pay period of 2009, immediately before the 2009 act took effect, Ramona's paycheck included $372.00 of COLA. For the first pay period of 2010, her COLA was reduced to $294.40 in accordance with the formula specified in the act. One year later, for the first pay period of 2011, it was again reduced to $212.00. Two years later, for the first pay period of 2012, it was reduced a third time to $132.80. These reductions corresponded with the amounts of locality pay added to her paychecks in three annual steps. The reductions in COLA cancelled out the net (after tax) amounts of locality pay added. In this way, the exchange of COLA for locality pay was essentially cost-free to the government.

However, the exchange of COLA for locality pay pursuant to the statutory formula has adversely affected the take home pay of all employees in non-foreign areas. The COLA reduction for 2010 cancelled out any benefit to non-foreign area employees from the 0.5 percentage-point increase in the average locality pay rates of all federal employees implemented for that year. After 2010, the next time average locality pay rates were increased (both times by decision of the President pursuant to 5 U.S.C. § 5304a) was for 2016, with the same discriminatory result in non-foreign areas. Ramona's last pay period in 2015 included $139.20 of COLA, but her first pay period in 2016 included only $136.80 of COLA, despite an increase of 1.0% in her GS rate.

It is important to note that the lower pay raises received by federal employees in non-foreign areas have not reduced, but only distorted, the overall cost of federal salaries. This discrimination simply allows federal employees elsewhere in the United States to receive proportionately largely shares of federal pay raises, at the expense of Ramona and all other non-foreign area employees.[3]

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[2] In its July 29, 2008, report, the CBO stated: "The conversion to locality pay for approximately 38,000 eligible federal employees [not counting employees of the U.S. Postal Service] would increase salaries by $1.5 billion over the next 10 years." However, the conversion has been cost-neutral in every year except 2010 and 2016, when the effect of the act has been to reduce salary costs by approximately $250 million each time. These reductions, which will continue to occur (whenever the President decides to increase average locality pay rates), have more than covered the other costs mentioned in the CBO report, such as slightly higher payments on account of post-2009 retirees.

[3] In other words, ending pay discrimination against the approximately 50,000 federal employees in non-foreign areas will not increase federal salary costs, for exactly the same reason (as explained by OPM at 80 Fed. Reg. 30958) that

The conclusion is inescapable: Ramona is enduring the same discrimination in the amount of her salary, and she is facing nearly the same discrimination in the amount of her annuity when she retires, that Sally has been enduring, despite the best intentions of Congress in the Non-Foreign Area Act of 2009. It is now clear that corrective legislation is necessary.

C. Conclusion

The changes needed to end pay discrimination against federal employees in non-foreign areas will not increase the federal budget. They will simply require payroll costs to be allocated in a non-discriminatory manner. To end the salary lag described above, Congress should direct the President and OPM to stop making disproportionate annual increases in the regular take-home pay of employees in the contiguous United States and begin making equal increases in non-foreign areas. (The administration already has statutory tools for doing this, and additional methods can be enacted.) Whatever amount is appropriated by Congress for federal salaries should be expended fairly and proportionately.

Equality in retirement benefits is just as vital as equality in regular pay. The agency should be directed to include COLA in the retirement base, as Congress always intended.[4] If subsidies are necessary to cover the cost of annuities, they should be applied proportionately, and not for the disproportionate benefit of employees in the contiguous United States. Ideally, Congress should ensure that any subsidies to the retirement fund from general taxpayers are repaid through future contributions to the fund from its beneficiaries, but that is a separate matter. Ending this discrimination is a fiscally neutral step that Congress should take now.

Any cost of making restitution for prior discrimination will come from the Judgment Fund (31 U.S.C. § 1304) or the Civil Service Fund (5 U.S.C. § 8348) – not from regular appropriations or from agency budgets. Payments from these funds are made to satisfy legal obligations to claimants. Appropriations to support the funds are made automatically; Congressional discretion is not involved. (Of course, the amounts of such restitution cannot be determined until settlements are reached.) Of the two funds, the Civil Service Fund is to be preferred. All employees and employing agencies contribute to this fund, including those who have received disproportionate benefits and subsidies in the past.

The claim settlement process can begin now, without waiting for legislative direction. The legislation described above can be enacted during the current session. Further delay on either front will only increase the harm – to employees and retirees who are affected and to the nation as a whole – that is being incurred. It is time to bring an end, once and for all, to federal pay discrimination in non-foreign areas.

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ending salary discrimination against the 102,000 federal employees in 13 new locality pay areas approved by the President for 2016 will not increase federal salary costs: the total amount available for federal salaries will be merely reallocated by an infinitesimal degree.

[4] *See*: Robert K. Baldwin, An Overview of the Unlawful Exclusion of COLA from the Retirement Base (April 13, 2015).