CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 5, 2009

S. 507
Non-Foreign AREA Act of 2009

As ordered reported by the Senate Committee on Homeland Security and Governmental Affairs on April 1, 2009

SUMMARY

S. 507 would phase in the use of locality-based comparability payments ("locality pay") to replace cost-of-living allowances (COLAs) for federal employees in certain areas of the United States (Alaska, Hawaii, and the U.S. Territories).

The bill would affect the amount of pay received by certain federal employees and the amount of future retirement benefits those employees receive. By increasing some salaries, S. 507 would result in additional agency payments for employees' retirement benefits and payroll taxes. In total, CBO estimates that discretionary spending would increase by $2.5 billion through 2019, assuming appropriation of the necessary amounts. The legislation also would increase the amount of pay included in the calculation of retirement and Social Security benefits, thereby increasing direct spending by an estimated $276 million over the 2010-2019 period. Furthermore, including additional pay in the calculation of retirement benefits would increase revenues—from higher employee contributions towards those benefits and from additional tax receipts—totaling an estimated $979 million over the 2010-2019 period.

S. 507 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no cost on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 507 is shown in the following table. The direct spending impacts of the bill fall within budget functions 600 (income security) and 650 (Social Security); the discretionary costs fall within many other budget functions.

	By Fiscal Year, in Millions of Dollars											
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2014	2010-2019
CHANGES IN SPENDING SUBJECT TO APPROPRIATION (On-Budget)												
Salary Payments and Other Discretionary Spending												
Estimated Authorization Level	37	119	197	197	200	202	203	207	212	217	750	1,791
Estimated Outlays	37	119	197	197	200	202	203	207	212	217	750	1,791
Employer Contributions[a]												
Estimated Authorization Level	17	50	77	77	78	79	80	81	83	86	299	708
Estimated Outlays	17	50	77	77	78	79	80	81	83	86	299	708
Total Changes in Spending Subject to Appropriation												
Estimated Authorization Level	55	169	273	274	278	281	283	289	295	303	1,049	2,500
Estimated Outlays	55	169	273	274	278	281	283	289	295	303	1,049	2,500
CHANGES IN DIRECT SPENDING (OUTLAYS)												
Total Changes in Direct Spending	2	6	12	20	26	32	38	43	46	50	67	276
On-Budget Spending	2	6	12	20	26	31	37	42	45	48	66	269
Off-Budget Spending	0	*	*	*	*	1	1	1	2	2	*	7
CHANGES IN REVENUES												
Total Changes in Revenues	26	70	105	104	107	109	110	113	116	120	412	979
On-Budget Revenues	20	54	81	80	82	83	84	86	89	91	317	751
Off-Budget Revenues	5	16	24	24	25	25	26	27	27	28	95	229
Memorandum:												
Total Intragovernmental Collections from Employer Contributions[a]	-17	-50	-77	-77	-78	-79	-80	-81	-83	-86	-299	-708
On-Budget	-12	-34	-52	-52	-53	-54	-54	-55	-56	-57	-204	-480
Off-Budget	-5	-16	-24	-24	-25	-25	-26	-27	-27	-28	-95	-229

Sources: Congressional Budget Office and Joint Committee on Taxation.

Notes: Components may not sum to totals because of rounding.
*= costs of less than $500,000.

a. Employer contributions are intragovernmental transactions that do not affect the deficit.

BASIS OF ESTIMATE

For this estimate, CBO assumes that S. 507 will be enacted near the end of fiscal year 2009 and that the necessary amounts will be appropriated for each year beginning in 2010. The bill would affect over 50,000 federal employees working in Alaska, Hawaii, Puerto Rico, the U.S. Virgin Islands, Guam, and the Northern Mariana Islands.

Currently, federal employees in those areas receive a COLA to offset higher costs of living in those areas. (In contrast, federal employees in the contiguous 48 states receive locality pay under the General Schedule to narrow the pay gap between comparable federal and nonfederal positions.) S. 507 would phase in the use of locality pay for employees in the specified areas over three years and would phase out the COLA, in most cases, over a longer period of time. Such changes would affect the federal budget because, while the COLA is not subject to federal income or payroll taxes and is not used to calculate federal retirement benefits, locality pay is both taxable and creditable for retirement benefits.

Spending Subject to Appropriation

S. 507 would increase discretionary spending by $2.5 billion over the 2010-2019 period, assuming the appropriation of necessary amounts, primarily for increased salary payments and agencies' payments for retirement benefits and payroll taxes.

Salary payments and other spending. The conversion to locality pay for eligible current and future federal employees in the designated jurisdictions would increase salaries by $1.8 billion over the next 10 years. For those employees, a provision in S. 507 provides for a phase-out of COLAs over time, intended to preserve the take-home salaries of those employees as their nontaxable COLA pay is replaced with taxable locality pay. As a result, salaries would increase to maintain the take-home pay of affected employees.

A small amount of savings—$2 million over 10 years—would result from discontinuing the surveys currently used by Office of Personnel Management to calculate the COLA adjustments for nonforeign areas.

Employer contributions. Similar to the rise in employees' contributions due to the transition to locality pay (which is creditable towards retirement), federal agencies' costs for payroll taxes and retirement contributions also would increase. Assuming appropriation of the necessary amounts, CBO estimates that spending for those contributions would increase by $708 million through 2019. Those payments are intragovernmental transactions that are recorded as offsetting receipts elsewhere in the budget.

Direct Spending

Increased retirement benefits (a product of increases in salaries) would accrue to approximately 13,000 federal employees anticipated to retire between 2010 and 2019. As a result, CBO estimates that direct spending would increase by a total of $276 million over 10 years—$269 million for additional retirement benefits and $7 million for higher Social Security benefits.

Under S. 507, an estimated 8,300 employees of the U.S. Postal Service (USPS) would not convert to locality pay and would continue to receive COLAs, but a provision of the bill would adjust the COLA calculation. If enacted, future calculations of COLAs for those employees would equal the greater of either the COLA in effect upon enactment of S. 507, or the locality pay applicable to other federal employees (that is, those who converted to locality pay under this bill) for that year and jurisdiction. CBO estimates that the provision could increase gross spending of about $50 million (off-budget) over the 2010-2019 period. However, CBO assumes that any increase would be offset by additional receipts from postage rates charged by the USPS over the same period, and would have no net effect on the budget.

Revenues

S. 507 would increase the portion of salary on which employees must pay taxes and would increase the amount of pay used to calculate employees' contributions for federal retirement benefits. Accordingly, the legislation would increase revenues by a total of $979 million over the next 10 years from additional income and payroll tax collections and from additional retirement contributions from employees, CBO and the Joint Committee on Taxation estimate. That total revenue change represents both on- and off-budget activity. Additional on-budget revenues would total $751 million, including $708 million from Medicare payroll taxes and income tax collections and $43 million from higher contributions from employees toward retirement benefits. The increase in off-budget revenues would total $229 million from additional Social Security tax receipts.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 507 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no cost on state, local, or tribal governments.

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