AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. Hrg. 110–657

NON-FOREIGN COLA: FINDING AN EQUITABLE SOLUTION

HEARING

BEFORE THE

OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

FIELD HEARING IN HONOLULU, HAWAII

MAY 29, 2008

Available via http://www.gpoaccess.gov/congress/index.html

Printed for the use of the Committee on Homeland Security and Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE

43–090 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

JOSEPH I. LIEBERMAN, Connecticut, *Chairman*

CARL LEVIN, Michigan
DANIEL K. AKAKA, Hawaii
THOMAS R. CARPER, Delaware
MARK L. PRYOR, Arkansas
MARY L. LANDRIEU, Louisiana
BARACK OBAMA, Illinois
CLAIRE McCASKILL, Missouri
JON TESTER, Montana

SUSAN M. COLLINS, Maine
TED STEVENS, Alaska
GEORGE V. VOINOVICH, Ohio
NORM COLEMAN, Minnesota
TOM COBURN, Oklahoma
PETE V. DOMENICI, New Mexico
JOHN WARNER, Virginia
JOHN E. SUNUNU, New Hampshire

MICHAEL L. ALEXANDER, *Staff Director*
BRANDON L. MILHORN, *Minority Staff Director and Chief Counsel*
TRINA DRIESSNACK TYRER, *Chief Clerk*

OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE

DANIEL K. AKAKA, Hawaii, *Chairman*

CARL LEVIN, Michigan
THOMAS R. CARPER, Delaware
MARK L. PRYOR, Arkansas
MARY L. LANDRIEU, Louisiana

GEORGE V. VOINOVICH, Ohio
TED STEVENS, Alaska
TOM COBURN, Oklahoma
JOHN WARNER, Virginia

RICHARD J. KESSLER, *Staff Director*
JENNIFER TYREE, *Chief Counsel*
THOMAS RICHARDS, *Professional Staff Member*
JENNIFER A. HEMINGWAY, *Minority Staff Director*
JESSICA NAGASAKO, *Chief Clerk*

CONTENTS

	Page
Opening statements:	
Senator Akaka	1

WITNESSES

THURSDAY, MAY 29, 2008

Charles D. Grimes, III, Deputy Associate Director for Performance and Pay Systems, U.S. Office of Personnel Management	3
Bradley B. Bunn, Program Executive Officer, National Security Personnel System, U.S. Department of Defense	5
Jo Ann Mitchell, Manager, Accounting Services, U.S. Postal Service	7
Joyce Matsuo, President, COLA Defense Committee of Oahu, Inc., on behalf of the Oahu and Maui COLA Defense Committees	17
Sharon Warren, President, COLA Defense Committee of Anchorage, Inc., on behalf of all Alaska COLA Defense Committees	19
Manuel Q. Cruz, President, COLA Defense Committee of Guam	21
Michael FitzGerald, President, Chapter 187, NAVFAC Hawaii, Federal Managers Association	23
Terry Kaolulo, President, Hawaii State Association of Letter Carriers and Letter Carrier, Kailua, Hawaii	25

ALPHABETICAL LIST OF WITNESSES

Bunn, Bardley B.:	
Testimony	5
Prepared statement	60
Cruz, Manuel Q.:	
Testimony	21
Prepared statement	102
FitzGerald, Michael:	
Testimony	23
Prepared statement	105
Grimes, Charles D., III:	
Testimony	3
Prepared statement	52
Kaolulo, Terry:	
Testimony	25
Prepared statement	112
Matsuo, Joyce:	
Testimony	17
Prepared statement	69
Supplemental testimony	88
Mitchell, Jo Ann:	
Testimony	7
Prepared statement	66
Warren, Sharon:	
Testimony	19
Prepared statement	96

Page

APPENDIX

PowerPoint presentation entitled "Non-Foreign Area Retirement Equity Assurance Act of 2008, (S. 3013)" submitted by Senator Akaka 39
Prepared statements:
American Federal of Government Employees, AFL–CIO 116
Hon. Luis G. Fortuno, a Representative in the U.S. Congress from Puerto Rico 120
Colleen M. Kelley, National President, National Treasury Employees Union 122
Benjamin T. Toyama, Western Federal Area Vice President, International Federation of Professional and Technical Engineers (IFPTE), AFL–CIO and CLC and President, IFPTE Local 121, Pearl Harbor Naval Shipyard 126
Pedro Romero, Vice President, Puerto Rico COLA Defense Committee 133

NON-FOREIGN COLA: FINDING AN EQUITABLE SOLUTION

THURSDAY, MAY 29, 2008

U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA,
OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS,
Honolulu, Hawaii

The Subcommittee met, pursuant to notice, at 1 p.m., at the Oahu Veterans Center, Honolulu, Hawaii, Hon. Daniel K. Akaka, Chairman of the Subcommittee, presiding.

Present: Senator Akaka.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. I call the Subcommittee on Oversight of Government and Management, Federal Workforce and the District of Columbia to order.

First I want to extend my mahalo, and mahalo is "thank you", to the witnesses that traveled from Washington, DC, Alaska, and Guam to be here today. I appreciate your participation in this hearing to discuss one of the most pressing issues for Federal workers in Hawaii.

In addition, I would like to say mahalo to Senators Inouye and Stevens for sending their staff to this hearing. I'd like to recognize them now. Could the representatives for Senator Stevens and Senator Inouye please stand? Good to see you.

And, a special mahalo to my staff for hosting the numerous meetings this week discussing the legislative proposals to phase-out non-foreign cost-of-living allowance that we call COLA, and phase-in locality pay. My staff has informed me of the comments and questions Federal workers have expressed to date, and I encourage all employees who may be affected by the conversion from COLA to contact me and let me know their views. My staff, of course, is seated up here, Jennifer Tyree and Thomas Richards. I also have other staff in the room from Hawaii who are seated here. Could you please stand? Thank you.

As you all know, under current law Federal employees in Hawaii, Alaska, Guam, and the Northern Marianas, Puerto Rico and the U.S. Virgin Islands may receive up to 25 percent of base pay as non-foreign COLA. This allowance is not taxed and does not count toward retirement. The amount of COLA is based on the cost of living in the non-foreign areas compared to the cost of living in Wash-

ington, DC. Locality pay is based on a comparison between Federal salaries and white collar salaries in the private and public sectors in a given region.

Since the creation of locality pay in the 1990s, there has been much discussion over the disparity between employee's pay and retirement in the non-foreign areas compared to the contiguous 48 States. Despite the efforts of the COLA committees and others to resolve this issue, Federal workers in Hawaii and other non-foreign areas remain disadvantaged in their retirement benefits.

Last year, the President proposed legislation in his fiscal year 2008 budget request to transition from COLA to locality pay. The Administration's proposal would freeze COLA rates for all General Schedule and postal employees at their current level; phase-in locality pay over a 7-year period as COLA is phased-out; reduce COLA by 85 percent of each dollar of locality pay that is phased-in to make up for the additional tax burden on employees who would begin receiving locality pay. This would not penalize any employee receiving non-foreign COLA who is at, or below, a GS–7 step 3, which is less than half the GS Federal workforce in the non-foreign areas.

However, the Administration's proposal left many questions unanswered. It did not address how postal employees, members of the Senior Executive Service, and employees who receive special rates will be treated since they do not receive locality pay. The proposal was also unclear as to whether Federal workers in unique personnel systems would be covered by the legislation.

Because this issue is so important to Federal workers in Hawaii, I sent my Subcommittee staff to Hawaii last July to conduct fact-finding meetings and listen to employees' questions and their concerns first hand. I then submitted those questions to Administration officials and posted the responses on my website.

Based on the responses from Administration officials and comments received from affected Federal workers, Senators Stevens, Inouye, Murkowski, and I introduced S. 3013, the Non-Foreign Area Retirement Equity Assurance Act, also known as the Non-Foreign AREA Act, as a discussion piece to move this issue forward. Our bill seeks to address these unanswered questions in the Administration's proposal and respond to the concerns raised by affected employees. Specifically, our bill would cover all Federal employees; protect employees' take home pay; phase-in locality pay over 3 years; allow current employees a one-time option to receive frozen COLA rates or transition to locality pay; and allow employees who will retire in the next 3 years the opportunity to pay into the Federal retirement system and transition to locality pay before retirement.

The Non-Foreign AREA Act is not to be seen as the last word, only the latest step forward in determining the best way to ensure retirement equity for Federal workers in the non-foreign areas. So again, I want to encourage employees in the audience and in the non-foreign areas to contact me with their questions and concerns on these proposals. After the hearing adjourns, we will hold a meeting where the Administration witnesses and my staff can answer questions from audience members on the proposals. Should anyone in the audience want to ask questions or speak out, you

may do so at the town hall meeting. So please remain here and immediately after the hearing and a short break, we'll convene the town hall meeting.

My ultimate goal remains to ensure that Federal workers in the non-foreign areas are not disadvantaged when it comes to their pay and retirement. By working together I really believe we can come up with an equitable solution.

And so with that, I want to introduce our first panel. Our first panel consists of three witnesses: Chuck Grimes, Deputy Associate Director at the Office of Personnel Management; Brad Bunn, Program Executive Oficer for the National Security Personnel System at the Department of Defense; and Jo Ann Mitchell, Manager of Accounting Services at the U.S. Postal Service.

It is the custom of this Subcommittee, as you know, to swear in all witnesses. Please stand and raise your right hand. Do you solemnly swear that the testimony you are to give before this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

THE PANEL MEMBERS. I do.

Senator AKAKA. Thank you very much. Let the record show that the witnesses responded in the affirmative.

Although statements are limited to 5 minutes, I want all of our witnesses to know that their full statements will be included in the record.

Mr. Grimes, will you please proceed with your statement?

TESTIMONY OF CHARLES D. GRIMES III,[1] DEPUTY ASSOCIATE DIRECTOR FOR PERFORMANCE AND PAY SYSTEMS, U.S. OFFICE OF PERSONNEL MANAGEMENT

Mr. GRIMES. Thank you. Mr. Chairman and Members of the Subcommittee, my name is Chuck Grimes and I'm here today on behalf of Linda M. Springer, Director of the U.S. Office of Personnel Management (OPM), to discuss the proposals to extend locality pay in lieu of cost-of-living allowances (COLA's) to Federal employees working in Hawaii, Alaska, Guam, Puerto Rico, the U.S. Virgin Islands, and other U.S. territories and possessions.

Over the years, the focus of Federal pay policy has evolved from simply keeping pace with the overall labor market to effectively competing within that market. The implementation of locality pay under the Federal Employees Pay Comparability Act (FEPCA) of 1990, is a tangible manifestation of that shift. However, FEPCA applies only in the contiguous 48 States. In the non-foreign areas, we have a conflicting compensation policy that provides for a COLA.

The COLA program predates locality pay by nearly 50 years. It was originally designed to address recruitment and retention issues resulting from higher costs of living in the non-foreign areas. COLA rates are based on OPM surveys measuring the differences in the cost of living between each non-foreign area and the Washington, DC area.

[1] The prepared statement of Mr. Grimes appears in the Appendix on page 52.

COLA affects employees' take-home pay and retirement annuities. For instance, some employees like the fact that COLA payments are not subject to Federal income tax.

On the other hand, COLA payments are not considered base pay for retirement purposes and are capped at 25 percent.

There is a growing perception that total pay and retirement benefits of white-collar civilian Federal employees in the non-foreign areas are gradually eroding in comparison with employees in the continental United States.

We believe these issues are best addressed by extending locality pay in lieu of COLA to the non-foreign areas. Locality pay is retirement creditable and allows for larger Thrift Savings Plan contributions.

Locality pay is not capped at 25 percent and continues to rise. COLA payments in contrast are trending downward.

Finally, because of subjective elements in measuring relative living costs, the COLA program has been the subject of much litigation. The recent Caraballo settlement topped some $230 million. We expect the bill, once finalized, to reduce ongoing litigation risk.

In May 2007, the Administration transmitted a proposal to Congress to address these issues. We are pleased that Senator Akaka, and Senators Inouye, Stevens, and Murkowski, have recently introduced S. 3013, the Non-Foreign Area Retirement Equity Assurance Act of 2008, to stimulate discussion on how best to transition from COLA to locality pay. Also, the Federal Managers Association (FMA) has put forth a proposal. The Administration's proposal, the FMA's proposal, and S. 3013 would extend locality pay to white-collar employees in the non-foreign areas over time, while gradually reducing COLA. However, the Administration's proposal differs significantly from FMA's proposal and S. 3013 regarding phase-in, the offset, and employee coverage.

The Administration's proposal would phase-in locality pay over a 7-year period to limit the impact of locality pay on retirement behavior. During the phase-in period, decreases to COLA would be limited to 85 percent of the increase in locality pay in order to reduce the impact on take-home pay of increased deductions for retirement contributions and tax liability. S. 3013 would reduce the phase-in of locality pay to 3 years, and would set the offset of COLA at 65 percent of the increase to locality pay. The FMA proposal would phase-in locality pay over 2 years, with an offset of 75 percent.

The Administration's proposal would permit OPM and other agencies to promulgate regulations for various categories of employees such as those on special rates. S. 3013 specifies employee coverage and further gives employees a chance to opt out of the coverage and keep a frozen COLA rate. One result of this specificity is that Senior Executive Service (SES) members in non-foreign areas would be granted locality pay, which SES members currently do not receive, regardless of location.

Under any of the proposals we expect the Federal Salary Council and the President's Pay Agent would establish locality areas for Hawaii and Alaska, and that Puerto Rico, Guam and the Virgin Islands would be covered by the rest of the United States (RUS) locality pay area. Based on existing data, we estimate the locality

pay rates for Hawaii and Alaska would be 20.38 percent and 27.68 percent, respectively. The current rate for the RUS area is 13.18 percent.

The Administration's proposal addresses the issues in a responsible fashion, with regard to cost and reduced litigation risk. S. 3013, though welcomed as a step forward in resolving these issues, would cost significantly more due to the shorter phase-in period and reduced offset. In addition, we believe the opt-out provision would lead to further litigation, rather than reducing litigation risk.

We believe the time is upon us to extend locality pay to the non-foreign areas. Locality pay provides employees in the non-foreign areas a retirement benefit comparable to employees in the continental United States.

Mr. Chairman, thank you for the opportunity to discuss this important issue with you today and for your support as we work towards a more market-based pay system in our non-foreign areas. We will continue to work closely with your Subcommittee and the cosponsors on S. 3013. I would be happy to address any questions you may have.

Senator AKAKA. Thank you very much, Mr. Grimes, for your testimony in representing OPM. Now we're going to hear from Mr. Bunn. Please proceed with your statement.

TESTIMONY OF BRADLEY BUNN,[1] PROGRAM EXECUTIVE OFFICER, NATIONAL SECURITY PERSONNEL SYSTEM, U.S. DEPARTMENT OF DEFENSE

Mr. BUNN. Thank you, Mr. Chairman. My name is Brad Bunn, and I'm the Program Executive Officer for the National Security Personnel System, also known as NSPS, in the U.S. Department of Defense. I want to thank you for the opportunity to appear before you today to discuss the proposals to extend locality pay in lieu of cost-of-living allowance to employees working in Hawaii, Alaska, Guam, Puerto Rico, U.S. Virgin Islands and other U.S. territories and possessions.

Let me at the start, Mr. Chairman, say thank you for your ongoing support of the 700,000 DOD civilian employees who work every day, worldwide, in support of our national defense, including the thousands of civilians employed by DOD right here in Hawaii. We appreciate your leadership on our critical civilian human capital issues facing the Department, including the issue that we talk about today.

I'm here today representing the Department's National Security Personnel System, a new personnel system and a key driver to our department's human capital transformation. To date, we've successfully implemented NSPS to over 180,000 civilian employees across DOD, who are now working under a more modern, mission-focused, results-oriented personnel system.

One of the features of NSPS that's critical to the department is the ability to move towards a more market-based approach to compensation. So with respect to locality pay, NSPS includes an element of pay called a local market supplement, which is essentially

[1] The prepared statement of Mr. Bunn appears in the Appendix on page 60.

identical to GS locality pay. NSPS mirrors the GS locality pay areas and percentages for these local market supplements. Under NSPS, however, an employee must be performing above the unacceptable performance level in order to be eligible for these local market supplement increases. This aligns with the underlying principles of NSPS, as required in the law, that pay be linked to performance. NSPS employees with performance ratings above unacceptable receive local market supplement adjustments equal to the GS locality pay increases.

Regarding COLA in non-foreign areas, NSPS does not affect the payment or the amount of non-foreign COLA. The NSPS statutory authorities do not extend to COLA, so employees under NSPS in these areas are receiving COLA, similar to their GS counterparts.

As one of the largest Federal employers in these non-foreign COLA locations, we're well aware of the issues surrounding COLA and locality pay. DOD employs over 26,000 appropriated fund civil servants in Hawaii, Alaska, Puerto Rico, and other U.S. Territories. Almost 18,000 of these employees are in white-collar occupations and are impacted by the non-foreign COLA issue. Currently, we have about 7,000 employees in these areas covered by NSPS. Over the years, we've heard concerns from our employees about COLA, in particular the issue of equity in retirement benefits. The perception that compensation and retirement benefits for our white-collar workforce in these areas are eroding would have a detrimental effect on our ability to recruit and retain the talent needed to carry out our natural security mission. So we applaud the Subcommittee and you, Mr. Chairman, for taking this issue on, and agree with our colleagues at the Office of Personnel Management as well as with you, Mr. Chairman, that the time has come to extend locality pay in lieu of COLA to these non-foreign areas.

We realize there are a number of considerations and potential approaches to implementing this concept. Last year, the Department endorsed the OPM legislative proposal that would phase in locality pay over a 7-year period, while gradually reducing COLA payments. The Department continues to support that proposal. We're also aware of the bill that you recently introduced along with Senators Inouye, Stevens, and Murkowski, which also phases in locality pay in these areas, while reducing COLA payments gradually. The Department hasn't completed a full analysis of the introduced bill, but I'm prepared to speak to a few points.

First, let me address how these proposals would affect employees under NSPS. Because NSPS local market supplements mirror the GS locality pay areas and percentages, if either of these proposals were enacted, the Department would establish and phase-in local market supplements equal to the GS locality pay that's established by OPM. In other words, NSPS employees would be treated like GS employees for purposes of implementing these provisions. One significant difference, however, is that under NSPS, employees with a performance rating of unacceptable would not be eligible for these increases in accordance with the NSPS statue. The Department would not favor a proposal that doesn't allow for this practice, as it would be contrary to the fundamental principles of NSPS and paid for performance and result in inconsistent treatment of employees within NSPS.

Second, we understand that the introduced bill proposes a shorter phase-in period of 3 years, and sets the offset to COLA at 65 percent versus the 85 percent that OPM has proposed. As I previously stated, the Department hasn't completed a full analysis of the proposal, but we would have to look very carefully at the cost of implementing these provisions over a shorter timeframe and determine the impact to our organizations' budgets. While we support implementation plan that minimizes the impact to the take-home pay of our employees, we also believe we must accomplish this in a fiscally responsible, affordable manner. We're also cognizant of the fact that the extension of locality pay in these areas would count towards retirement calculations and may influence retirement behavior. The Department would favor an approach that promotes stability in the workforce, so that our mission is not adversely affected. Finally, we understand the introduced bill provides affected employees the opportunity to opt out of the locality pay provisions, and continue to receive COLA. While we have serious concerns over the administrative burden this provision would impose, the Department also believes this would be contrary to the fundamental purpose of the proposed legislation, and would result in continued inconsistencies in compensation for employees.

Mr. Chairman, we at DOD realize that this is not an easy issue, and we are gratified to be part of the conversation as we collectively wrestle with these matters. For our part, it's critical for the Deprtment of Defense, and our organizations located in these important geographical areas, to be able to recruit, fairly compensate, and retain a civilian workforce that continues to provide world-class support to our military in this dynamic and unpredictable national security environment.

I appreciate the opportunity to testify and welcome your questions, sir. Thank you.

Senator AKAKA. Thank you very much, Mr. Bunn.

Now we will hear from Ms. Mitchell. Will you please proceed with your statement?

TESTIMONY OF JO ANN MITCHELL,[1] MANAGER OF ACCOUNTING SERVICES, U.S. POSTAL SERVICE

Ms. MITCHELL. Thank you, Mr. Chairman. I am Jo Ann Mitchell, Manager of Accounting Services for the U.S. Postal Service.

I am honored to be here with you today to discuss the Postal Service's views on non-foreign COLA payments, but first let me begin by sharing some facts about the Hawaiian postal workforce with you, as well as some of our financial challenges.

We employ approximately 2,700 employees throughout Hawaii. Together, these employees handle nearly 1.2 billion pieces of mail a year to more than 650,000 addresses in the Honolulu Postal District. And, they do a great job. For the most recent quarter of 2008, they delivered an impressive 98 percent overnight service, which was two points higher than the national average of 96 percent.

We are proud of their outstanding service. They have excelled during a particularly challenging time for the Postal Service. For the quarter just ending, mail volume was down 3.3 percent from

[1] The prepared statement of Ms. Mitchell appears in the Appendix on page 66.

last year, which is a very significant decline. The Postal Service is facing tough times as businesses and consumers nationwide are trying to manage their own budgets against rising prices that are affecting the economy of the whole Nation. We are engaged in the same struggle in managing rising costs and have embarked upon an aggressive cost reduction and revenue enhancement plan to, at best, financially break even this year.

The Postal Service has weathered these economic storms before, and will again. We have done so by having one of the most dedicated workforces in America, and by benefiting from management tools, such as the collective bargaining process. In place since 1970, collective bargaining defines the way the Postal Service and its unions discuss wages and working conditions. The result is that the Postal Service policy is to pay employees comparable wages and benefits as compared to the private sector. These pay policies include the areas covered by the non-foreign COLA.

As you know, the non-foreign COLA is a percentage of an employee's base pay and is not subject to Federal income tax, nor is it considered pay for the purposes of retirement. The maximum non-foreign COLA payment is 25 percent of base pay. In Hawaii, percentages for 2008 ranged from 17 to 25 percent.

Pay parity was brought about for Federal employees through legislation that set Federal salaries at a level comparable to non-Federal pay in the locality. However, this locality pay does not apply to postal employees in the 48 continental United States.

Over time, the Postal Service and its unions have discussed forms of locality pay during contract negotiations; however, it has never been adopted.

We have repeatedly stated to Congress, and do so respectfully again today, to let the collective bargaining process continue to deal with pay and other bargainable issues. We strongly oppose the statutory imposition of locality pay upon postal employees in the non-foreign COLA areas because this action will interfere with collective bargaining. The Postal Service bargains over pay with its unions, unlike other agencies in the Executive Branch. If Congress enacts legislation to provide a new benefit over and above the non-foreign COLA areas, it sets a dangerous precedent of interference, which could spill over to many other negotiated areas.

The second reason that we strongly oppose requiring the Postal Service to pay locality pay for its employees is because Postal Service wages are already comparable to private sector wages, as required by Title 39.

Finally, paying postal employees locality pay in the defined areas would greatly affect the Postal Service's bottom line. Locality pay is considered base pay for retirement and the Postal Service cost for retirement, Thrift Savings Plan, Social Security, and Medicare would increase by some 12.5 million per year. That figure does not include the increased long-term retirement obligation that we would also face. This comes at a time when the Postal Service is struggling financially.

The Postal Service shares Senator Akaka's concern for postal employees and their long-term financial health when they retire. The agency regularly provides financial education seminars and mate-

rials to employees reminding them that non-foreign COLA is not part of their retirement benefits.

While we understand the rationale behind S. 3013, we would like to state again that the Postal Service pay and compensation systems are very different than those of other Federal Government agencies. We hope that we can work with Congress and the Administration on finding solutions to this problem.

Thank you and I would be pleased to answer questions that you may have.

Senator AKAKA. Thank you very much, Ms. Mitchell.

My first question is for the entire panel. For the past few days, you have been traveling with my staff and talking to employees about proposals to convert COLA to locality pay. Based on these meetings, what do you believe are the employees' top concerns and what are your thoughts on how to address them? Let me start with Mr. Grimes.

Mr. GRIMES. Thank you, Mr. Chairman. Time and time again we hear concern over the phase-in period, and we, too, are concerned about the long phase-in, but we also are concerned about staffing issues that might develop if that phase-in period is dramatically shortened. We've also heard many times about the offset, so that is clearly an employee concern. Thank you.

Senator AKAKA. Thank you. Mr. Bunn.

Mr. BUNN. I would echo that, that there seems to be a lot of concern over the impact that this will have on retirement. There's a lot of support that I saw among employees who attended these meetings for this concept for phasing in locality and improving the retirement benefits and addressing that inequity. I think there's a lot of different ways that it could be addressed and we have learned a lot from the feedback sessions we had with the employees. And certainly Mr. Grimes said the time the phase-in and the time that it would take to phase it in, and also the impact on take-home pay, frankly, as locality pay is phased in and now subject to Federal taxes, what is the bottom line. As we've heard, concerns over gas prices and generally, cost of living here in Hawaii, so all of those things are clearly major concerns for employees.

Senator AKAKA. Ms. Mitchell.

Ms. MITCHELL. Thank you, Mr. Chairman. I have spoken to several of our employees after the town hall meetings, and there's a difference of opinion I think between the younger employees and the older employees. I think the younger employees favor the non-foreign COLA for tax purposes, and of course the older employees approaching retirement would favor moving to locality based pay. But regardless of that, it's interesting to note that the employees understand it would actually create inequity for us, that they would be receiving something that the rest of postal employees would not receive.

Senator AKAKA. Now, I know what you're reporting here was based on your meetings in Hilo and Kona on Tuesday, and yesterday on Maui. This afternoon I'm sure you will hear additional questions and concerns from employees here in Honolulu and tomorrow in Kauai.

Mr. Grimes, I firmly believe that we must protect employees' take-home pay if we transition from COLA to locality pay. This has

become even more necessary given the current economic climate. Please explain the assumptions that the Administration made in determining that 85 percent offset could help protect employees' take-home pay.

Mr. GRIMES. Thank you, Mr. Chairman. I would like to say that there was no intent to protect take-home pay in the absolute by establishing an 85 percent offset. It was designed to mitigate the impact of increased taxes and retirement contributions, not eliminate the impact of those taxes and contributions. But we believe that in the interest of cost, that an 85 percent number is a fair number, but it is not a magic number. It wasn't a calculated number. It's a number that helps, not a number that solves.

The other thing I'd like to say about protecting take-home pay is that there are a lot of issues that go into take-home pay, the number of deductions somebody claims, whether they've got allotments, whether their mortgage comes out of their paycheck and so forth. So it would be difficult to guarantee the take-home pay would go unchanged.

In the bill the Administration presented, it would implement the bill if enacted on or about January 1, 2008 in conjunction with the Federal pay increase. That Federal pay increase would, we believe in the vast majority, if not all cases, prevent any decrease in take-home pay. What it would do, and I will not shy away from this, that it would limit—the increase would not be as great for those people who are transitioning as others. But once transition is complete and everybody is on an even playing field, then of course Hawaii and Alaska and the other non-foreign areas would be getting the same increases that employees in the contiguous 48 States get. Thank you.

Senator AKAKA. Mr. Bunn, employees under NSPS are particularly concerned about protecting their home pay in the transition from COLA to what you've been talking about, local market supplements. Currently, non-foreign COLA is guaranteed, while LMS increases are based on an employee's performance in NSPS. How could DOD adjust local market supplements to ensure employees' take-home pay is not reduced?

Mr. BUNN. The local market supplements if this were enacted and locality pay was extended to the non-foreign COLA areas and COLA was reduced, NSPS would mirror the GS locality pay increases, and that essentially is written into the NSPS statue, that as GS locality pay increases, employees under NSPS will get the same increase in the form of a local market supplement.

And as I stated in my statement, the only difference would be that if there were employees who were performing unacceptably, which is the lowest possible level of performance, they would not be eligible for that increase and that in fact is also in the statute, and that mirrors the fundamental principles of pay for performance that individuals who fail in their performance are not eligible for a pay increase of any kind.

Now, there are very few employees who are in that category, sir. In this past rating cycle we had less than a half percent of our employees under NSPS were rated as unacceptable, so that affects a very small portion. But it is a principle in NSPS and it is in fact

in the statute. But for the rest of the employees, they would get the increases just like their GS counterparts.

Senator AKAKA. Mr. Grimes, as you know, S. 3013 covers all Federal employees in the non-foreign areas who currently receive COLA. However, the Administration's proposal raises questions about who would be transitioned to locality pay and how they would be transitioned. Please list the groups of employees who would not be transitioned to locality pay under the Administration's proposal and detail what pay changes OPM would make for those workers.

Mr. GRIMES. It is true, Mr. Chairman, that the way that the Administration's proposal was worded that we didn't call out each and every group and say exactly what would happen. There are a number of different types of employees, for example, Senior Executives, that get COLA but don't get as a rule locality pay.

The Administration's proposal would have OPM and other affected agencies promulgate regulations to deal with each of those groups. And as you know, regulations are in the form of a proposal with public notice and comment followed by final regulations, and we believe that dealing with Senior Executives and special rate employees in that manner would allow a lot of exposure and a lot of comment from the affected individuals and then we would arrive at a good solution.

We are concerned if we codify approaches to these groups in legislation, if we make a mistake it will be hard to correct. So we prefer the regulatory approach.

Senator AKAKA. Mr. Bunn, I understand that nonappropriated fund employees do not receive locality pay, but that DOD has discretion to grant NAF workers non-foreign COLA. The intent of S. 3013 was to cover all employees currently receiving COLA. What are your thoughts about giving NAF employees locality pay?

Mr. BUNN. We have several categories of our NAF workforce. The folks that are in the lower grades are prevailing rate employees similar to blue collar, so their pay is already based on prevailing rates of a local area. So those employees don't currently get COLA and they're handled within our authorities to set their pay. The NAF workforce and the higher grades do get COLA, and we have been exploring options on how we would address the issue if COLA were to be phased out. Most of our NAF employees do receive COLA in these areas.

We have under the Title 10, nonappropriated funds, personnel authorities, a lot of discretion and flexibility in addressing those issues, and we would follow the principles that OPM would follow in ensuring that we take care of these employees, that they don't take pay cuts, and we already have the statutory authority to do that. So we would be able under our existing authorities to address those issues with the phase-out of COLA by providing increases. We would likely not call it locality pay, but we would be able to provide an offset if the COLA were reduced using our existing Title 10 authorities. Thank you, Mr. Chairman.

Senator AKAKA. Let me ask about one particular group, and what are your thoughts about the intelligence community employees who receive locality pay and non-foreign COLA?

Mr. BUNN. Technically they don't receive locality pay, they get something that's equivalent to locality pay. And that was something that we did under our existing Title 10 statutory authorities for intelligence workforce, and that was to address recruiting and retention issues that we were having in filling jobs in these areas in that segment of our workforce, and I would at this point without making a commitment on what we would do, I have spoken to our experts who deal with the intelligence pay systems, and again, we do have the ability to deal with those matters under the existing Title 10 statutory authorities for our intelligence workforce, and we would ensure that those employees are treated fairly in terms of if they lose COLA, we would be able to offset that with other pay flexibilities that we have.

So again, we don't have all the answers yet. If S. 3013 or the Administration's proposal or some combination is implemented, we would certainly go off and look at that and make sure that those employees were taken care of. Again, with the kind of the underlying principles being treating our employees fairly but doing it in an affordable manner.

Senator AKAKA. Thank you. Ms. Mitchell, I'm concerned with Administration's proposal to freeze COLA rates indefinitely for postal employees. We need a long-term solution for present and future employees that does not diminish their current benefits. I have proposed creating territorial pay in an effort to address this problem. How would the postal service propose to address this issue in the long run?

Ms. MITCHELL. Well, Mr. Chairman, we agree as well that freezing COLA rates is not a long term solution, it's a short term solution. So we would look at adopting something probably in the same respect as locality pay for just the percentage purposes of it, but treat it as if it were a non-foreign COLA payment, because as you know, we do not pay locality pay for the rest of the United States, so for us to take the bill as written would actually create an inequity for us, the same inequity it's trying to resolve for the rest of the Federal sector.

Senator AKAKA. Would this also apply to current and future employees?

Ms. MITCHELL. We would work with you, Senator, on how we would handle that.

Senator AKAKA. There is an inequity when postal employees retire in the non-foreign areas. The gap between take-home pay and retirement annuity of postal employees is significantly greater than postal employees in the other 48 States. How would you address this inequity?

Ms. MITCHELL. Well, sir, we feel that through collective bargaining we negotiate standard rate of pay across the country. Consider an employee who is in the same level, earning the same amount of money in San Francisco than the employee in Hawaii, yet in Hawaii, or in any of the other non-foreign COLA States that employee enjoys a benefit that the employees in the rest of the country do not receive, even though locality percentages would actually be higher for them. So the only way we do address it now is through financial education, explaining to employees that they

have a benefit now that will not be there for them when they retire, and how to financially plan for that.

Senator AKAKA. You testified to the benefits of collective bargaining.

Ms. MITCHELL. Yes, sir.

Senator AKAKA. And I'm a strong supporter of employees' rights to bargain collectively and have a say in their working conditions. Is the postal service's position that the best way to address the non-foreign COLA issue is through collective bargaining with postal workers from the non-foreign areas in the 48 states?

Ms. MITCHELL. Locality pay have been discussed with the unions but not adopted. It's always been silent as far as non-foreign COLA because it was a benefit prior to collective bargaining. However, if we were to do something that actually changed the way we calculated retirement for employees, then that would be better served through collective bargaining.

Senator AKAKA. Mr. Grimes, you mentioned that OPM would issue regulations on how it would treat employees like the SES. Can you provide details on what exactly you had in mind?

Mr. GRIMES. We have a number of ideas in mind, and one, for example, might be to even continue COLA for those folks or freeze it or grandfather the existing employees. We could increase the pay of the SESers, and again, grandfather them. But as you know, we've got a worldwide, nationwide schedule for SES employees, and we would be creating again a similar inequity if we were to turn that money into retirement credible pay in the non-foreign areas vis-a-vis the SESers in the contiguous 48 States.

Senator AKAKA. Mr. Grimes, I understand that one of the reasons that the Administration proposed a 7-year phase-in of locality pay was to avoid an increase in the number of retirements. However, OPM itself estimates that one-third of the Federal work force will retire in the next 5 years, before the 7-year phase-in is complete. As you know, more than half of the Federal workers in Hawaii and Alaska are retirement eligible. Do agencies have succession plans in place and recruitment strategies to address the expected retirement wave despite any changes in COLA?

Mr. GRIMES. We believe agencies have succession plans in place and recruitment and retention strategies in place to deal with the normal retirements that are taking place now. Since the introduction of this bill, I couldn't speak to whether agencies have thought about the incentives to retire that may or may not occur depending on how the bill turns out. Just as an example, if we allow employees to opt in for those first 3 years, it's not inconceivable that nobody would retire for 3 years. And then in year 4 they would all retire, the ones that would have retired each year, so that would create a bit of a hiccup, but we'll just have to see how the final bill turns out, and I believe agencies would in fact prepare for it.

Senator AKAKA. I understand that one of the reasons for the 7-year phase-in of locality pay is to avoid having Federal workers retire earlier than expected resulting in staffing shortages. With a longer phase-in period, wouldn't employees continue to leave for California to earn their high three leave in Federal agencies in Hawaii and Alaska in the same situation?

Mr. GRIMES. That could be. We believe that with the Administration's proposal as written, even with 2 or 3 years into the phase-in period, employees' retirement pay would be significantly higher than it would be without phasing in locality pay at all. Now, certainly you can make arguments that if you phase it in quicker, their retirement would be higher. At least that gives us a path to solve this vexing issue. And we definitely are not in favor of having our wonderful long-term employees start thinking about retirement and moving away just when we need them the most. So we're in favor of phasing in locality pay and we believe that the 7-year phase-in period is appropriate. Thank you.

Senator AKAKA. In my opinion, Mr. Grimes, the main reason for converting to locality pay is to help address the long standing retirement inequities between individuals in the 48 States and the non-foreign areas. Several witnesses on our second panel have mentioned the need to cover current retirees and allow them to apply to the locality pay system. What are your thoughts about that proposal?

Mr. GRIMES. Generally speaking, changes in compensation policies are prospective in nature. It becomes very expensive to look back. It's important to note that employee contributions and agency contributions are only a part of the amount of money that actually gets paid out in terms of annuities and there's an unfunded liability that employees really wouldn't be able to cover. So, we would look to prospective implementation of this bill. We understand that a number of years ago there was some concern about this issue and for whatever reason it didn't go forward. We are very grateful to you, Mr. Chairman, for getting a bill on the table and hopefully now we'll be able to get this solved. Thank you.

Senator AKAKA. Mr. Grimes, if S. 3013 is passed, how many new locality areas will be established and how would they be defined? Will the new locality pay areas encompass entire States?

Mr. GRIMES. The anticipation on the part of the Administration is that Hawaii and Alaska would be defined as new locality pay areas, that the other non-foreign areas will fall under the rest of the U.S. category. Now, we do have to note that the Federal Salary Council makes recommendations to the President's Pay Agent, who has the final say in creating locality pay areas, but we would anticipate that that's what they would do. Now, the fact that an entire State would be a locality pay area is a new concept. Generally speaking, we go by the census definitions for consolidated metropolitan statistical areas and so forth, but we believe that establishing the locality pay rate statewide for both Alaska and Hawaii is a good solution.

Senator AKAKA. So the territories then would receive the rest of U.S. rate?

Mr. GRIMES. The territories would fall under the so-called rest of the U.S. rate, which currently is about 13.18 percent.

Senator AKAKA. Many employees are concerned that they may receive less than the rest of the U.S. locality pay rate. Could this ever happen?

Mr. GRIMES. The rest of the United States is indeed a floor. So that's inconceivable in the way that we currently do things. We also heard a concern that locality pay might go down. That has

happened once in one area, since 1994. I believe Dayton, Ohio, went down by six-hundredths of one percent 1 year, but with the methodology they would use to adjust locality pay rates now, it's just about impossible for our rates to go down.

Senator AKAKA. Mr. Grimes, non-foreign COLA rates go up or down and so what you said is helpful to those employees worried about locality pay going down.

Mr. Bunn, instead of locality pay, employees in NSPS receive local market supplements. One concern with COLA is the fact that the rates are decreasing due to the increase in the cost of living in Washington DC. Can you tell me whether local market supplements can ever decrease, and if so, on what conditions?

Mr. BUNN. The local market supplements that NSPS uses are essentially adopted from the GS locality areas and percentages, so I would refer to Mr. Grimes' answer and essentially say the same thing. Local market supplements are very much hooked to the GS locality percentages, so the only way that a local market supplement under NSPS standard LMS, as we call it, would go down is if a GS locality pay were to decrease. And I would agree with Mr. Grimes, that the likelihood of that happening is very small. But the Department of Defense would not take the action to decrease the local market supplement because of the way that our statute reads now, after the defense authorization bill from last year that essentially hooked us to the GS locality rates.

Senator AKAKA. Mr. Grimes, employees who receive special rates do not receive locality pay. However, employees receiving non-foreign COLA can also receive special pay rates. Under S. 3013, an employee would not lose their special rate due to the conversion. How would you propose to address the pay for special rates in a conversion from COLA?

Mr. GRIMES. Again, Mr. Chairman, we would propose to address that through regulation, but in terms of the concept, we really would view the 25 percent COLA in the case of most of the islands as really part of that special rate. We don't want to give locality payments to special rate employees, but we would propose to increase the special rate component of their pay in accordance with a decrease in COLA so that people's pay rate does not go down during the phase-in period, for example. If at the end of the day after 7 years, if the pay rates were over and above statutory limits on special rates, we would have the same pay provisions that could take care of it, but the essential concept if someone is receiving a 30 percent special rate today, they would keep that differential over existing employees. Now, after the phase-in period, special rates, as you know, may be adjusted up or down. I will tell you from experience they don't go down very often. It has happened but it's pretty rare.

Senator AKAKA. Mr. Bunn, under NSPS, special rates are covered by local market supplements. How would NSPS address employees receiving special rates as part of their local market supplement in the conversion from COLA?

Mr. BUNN. Thank you, Mr. Chairman. We do have a feature in NSPS called a targeted local market supplement. Most of our special salary rate employees that we converted to NSPS, we were able to incorporate their special salary rates within the broad

bands under NSPS, and those special salary rates went away. They didn't lose any money but they were now able to be paid within the broad NSPS pay bands. For those few employees that we were not able to incorporate that special salary rate, we created an additive called a targeted local market supplement, and we treat them very similar to GS special salary rate employees and we would adopt the same approach that OPM would take for special salary rates, meaning as COLA were to go down, we would ensure that our targeted local market supplements were to go up unless they were overtaken by a local market supplement or locality pay that turned out to be higher than the targeted local market supplement, so we would take a very similar approach to OPM in ensuring that differential remains.

Senator AKAKA. I want to thank you for your responses, but I have a final question to all of you. Do you have any closing thoughts or recommendations as we move forward in this discussion on transitioning from COLA? Let me start with Ms. Mitchell.

Ms. MITCHELL. Thank you, Mr. Chairman. Of course we want to work with the Senator and the Subcommittee to come up with the most equitable solution. We do not want to disadvantage the current situation with the employees who are in the non-foreign COLA areas, but then yet again, we do not want to jeopardize collective bargaining with the Postal Service or put the Postal Service in a worse financial situation than it is today. So we would continue to work with you.

Senator AKAKA. Your thoughts, Mr. Bunn.

Mr. BUNN. The thoughts I would like to share is that from an agency perspective, from the Department of Defense perspective, I'd like to, on behalf of DOD, thank you for bringing this issue to the fore so that we can get it behind us. It's been, as Mr. Grimes said, a vexing issue for a very long time and it is time to resolve it, so we appreciate your help in doing that. We have a large DOD civilian population here in Hawaii and the other non-foreign COLA areas, so the quicker we can get a solution, the better off we'll be, we'll be able to focus on our national security mission, and one final thought is that if you would like to continue to discuss this matter, I am more than willing to come to Hawaii any time on behalf of the department and talk about it. So thank you, sir.

Senator AKAKA. Thank you so much. Mr. Grimes.

Mr. GRIMES. Thank you, Mr. Chairman. I think it's probably best said by a comment that an employee made when I was here in January. This person said, "well, if we had done this 10 years ago, you wouldn't be here right now." And that would have been a shame, because I, too, enjoy the islands. But we did come close, we provided some technical assistance 10 or 15 years ago, and it just didn't go anywhere, and we are exceedingly grateful to you and your staff for getting this bill introduced. We look forward to working with you and hope sincerely that we can get something accomplished this year. I would worry that if we don't get it done this year then if not now, when? That would be my closing thought. Thank you very much.

Senator AKAKA. Well, I thank you so much for your closing thoughts, and again, for your responses to all questions. It has been very helpful, and we look forward to continuing to work with

you and your agencies and departments as well. So thank you so much for being here and wish you a safe trip home.

Ms. MITCHELL. Thank you, Mr. Chairman.

Mr. GRIMES. Thank you, Mr. Chairman.

Mr. BUNN. Thank you.

Senator AKAKA. Thank you. And now I would like to call the second panel to come up.

[Discussion off the record.]

Senator AKAKA. The hearing will be in order. I want to thank our second panel again for being here, and I would like to introduce them to you. Joyce Matsuo, President of the Oahu COLA Defense Committee. Sharon Warren, President of the COLA Defense Committee of Anchorage. Thank you for being here. Manuel Cruz, President of the COLA Defense Committee of Guam. Michael FitzGerald, President of the Federal Managers Association, Chapter 187. And Terry Kaolulo, President of the Hawaii State Association of Letter Carriers.

As you know, it is the custom of the Subcommittee to swear in all witnesses, and I ask all of you to please stand and raise your right hand. Do you solemnly swear that the testimony you are about to give this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

THE PANEL MEMBERS. I do.

Senator AKAKA. Thank you. May the record note that the witnesses responded in the affirmative.

Ms. Matsuo, will you please proceed with your statement?

JOYCE MATSUO,[1] PRESIDENT, COLA DEFENSE COMMITTEE OF OAHU

Ms. MATSUO. Chairman Akaka and Members of this Senate Subcommittee, my name is Joyce Matsuo, and I am President of the COLA Defense Committee of Oahu. The 15,000 or more Federal employees on Oahu is the largest group of COLA recipients covered by a COLA committee. In Hawaii, COLA committees were originally established on each island but only two remain today—the Oahu and Maui COLA Committees.

Today, on their behalf, I would like to thank you for this opportunity to present our comments and recommendations on S. 3013 which proposes to resolve the retirement inequity in COLA areas.

To convert or not to convert COLA to locality pay. From the latest COLA survey results, we see that the COLA rates will continue to drop for all areas in Alaska, except Rural Alaska, and they will also begin to drop for the Pacific COLA areas.

In 2007, your staff informed us that the estimated locality pay rates would be about 20 percent for Hawaii and 27 percent for Alaska. With the projected decreases in COLA, it would seem prudent that Alaska move to locality pay, and Hawaii should, too. It is more probable that future COLA rates in Hawaii will continue to decrease and locality pay will increase and eventually exceed the 25 percent COLA statutory cap. A conversion of COLA to locality pay actually benefits Hawaii more than it does Alaska because a

[1] The prepared statement of Ms. Matsuno appears in the Appendix on page 69.

conversion protects the remaining COLA until COLA is completely converted to locality pay.

On the phase-in period to achieve full locality pay, in the Administration's 2007 proposal, OPM proposed a 7-year phase-in period. S. 3013 improves the phase-in period to 3 years.

I support the Federal Managers' Association proposal of full locality pay in Year 1 because this will definitely help stop the exodus of experienced employees transferring to locality pay areas to earn their high-3 years for retirement purposes.

This Senate bill proposes a 3-year phase-in. The first year locality pay rate would be one-third of RUS, which is 13.18 percent or about 4 percent in the first year. This 4 percent is a far cry from 20 percent locality pay for Hawaii and 27 percent locality pay rate for Alaska. If full locality pay is not possible in Year 1, I would recommend that at least full RUS be used in the first year.

On the impact on take-home pay, the Oahu COLA Committee made calculations of the impact on take-home pay and it supports that the proposed adjustment factor of 65 percent will minimize a negative impact on take-home pay. Without the 65 percent factor, Federal employees, especially FERS employees, cannot accept this conversion proposal due to the significant impact on their take-home pay from Federal taxes that would now be due on locality pay.

On the buy-in provision as provided in Section 7, the conversion to full locality pay in Year 1 will give Federal employees their proper locality pay on which retirement benefits would be determined. The locality pay amounts and the resulting retirement benefits would be comparable to those received by Federal employees in the 48 States. No buy-in provision would then be needed.

There are two problems that we see with this provision. First, it is conceivable that an employee who makes this election could have the remaining unconverted COLA and the locality pay rates total more than their true locality pay rate. Hence, COLA employees would receive higher retirement benefits than Federal employees in the 48 States and this would not be fair to those in the 48 States. I believe that it is the intention of this bill to fix inequity and not to create another inequity.

The second problem is that S. 3013 has no provision for retirees. These retirees are not provided any remedies for the retirement inequity that really began in 1994 due to the exclusion of Hawaii and Alaska from FEPCA. They are receiving significantly decreased retirement benefits because of this. If the buy-in provision of Section 7 is included, I ask that the senators include a provision for retirees which, similar to Section 7, provides them with the opportunity to buy in to a retirement program that includes COLA or locality pay. If it can be part of this legislation, it would eliminate the inequity for all employees, past and present.

How the NSPS impacts the conversion. Under the NSPS pay system, locality pay is frozen at the time of NSPS implementation. The year-to-year conversion of COLA to locality pay is dependent on the yearly increases to locality pay. If locality pay rates are frozen at the time of NSPS implementation, there will be no yearly locality pay increases and the COLA to locality pay conversion will become fixed for these DOD employees. So, the COLA conversion

must take place outside the NSPS system until COLA is completely converted to locality pay.

For current retirees, as I stated earlier, I ask that this Subcommittee seriously consider adding some provision for current employees. As he wrote in his decision in *Matsuo vs. the United States,* which is currently on appeal, District Court Judge Phillip Pro opined that he felt the retirement inequity issue raised in that lawsuit should have been dealt with through legislation. Now would be a perfect time to fix the retirement inequity through legislation for all Federal employees, past and present.

If legislation is not possible, we would have to continue to seek resolution through our current lawsuit. Should we prevail in the Supreme Court, the COLA conversion to locality pay would become moot as winning in the Supreme Court means employees in Hawaii and Alaska are entitled to locality pay—regardless of receiving COLA.

We are seeking a fair and equitable retirement fix for both current and retired Federal employees. We could accept a fairer version of S. 3013 as a settlement for current Federal employees. For the remaining class members, the retirees, an additional provision to cover retirees could resolve our lawsuit.

Mr. Chairman, I sincerely hope this information will aid your Subcommittee in finally developing a legislation that is both fair and equitable for Federal employees, and retirees, in the COLA areas. If you need any additional feedback or have any questions, I will be available to offer any assistance I can.

Senator AKAKA. Thank you very much, Ms. Matsuo.

And now we'll proceed with testimony from Ms. Warren.

TESTIMONY OF SHARON WARREN,[1] PRESIDENT, COLA DEFENSE COMMITTEE OF ANCHORAGE

Ms. WARREN. Good afternoon, Chairman Akaka. My name is Sharon Warren, President of the COLA Defense Committee of Anchorage, and representing all three Alaska COLA Defense Committees—Anchorage, Fairbanks, and Juneau. I would like to thank you for allowing us to express our views regarding the proposed plan for eliminating the COLA and including the non-foreign areas in the locality pay program.

There are nearly 13,000 Federal and postal employees in Alaska who receive COLA.

The Administration seeks to transition from the COLA program to the locality pay program. As you know, COLA is not included in the calculation of retirement benefits whereas locality pay is. This results in Alaskan retirees receiving significantly less retirement pay than their counterparts in the 48 States.

The Administration also seeks to limit their exposure to future litigation arising out of the COLA program. The COLA program has given rise to much controversy in several lawsuits, which have cost the U.S. Government hundreds of millions of dollars. Currently, the Office of Personnel Management is working with the COLA Committee representatives through the Survey Implementation Committee to carry out the 2000 Caraballo Settlement Agree-

[1] The prepared statement of Ms. Warren appears in the Appendix on page 96.

ment. Denise Hernandez, President of the COLA Defense Committee of Fairbanks and I serve on the Committee with the Office of Personnel Management.

The concept of transitioning from the COLA Program to the locality pay program has been discussed for a number of years. In 2003, all Alaska COLA Defense Committees were pursuing the concept to transition to locality pay. Finally, after 4 years, the proposal was included in the President's budget and submitted to Congress in May 2007. We support the Administration's proposal to transition from COLA to locality pay with modifications, which are necessary to ensure Federal and Postal employees are treated fairly and equitably.

Based on the 1996 locality pay surveys in Alaska, Alaska was projected to receive the highest locality pay rate in the Nation. The OPM estimated Alaska's locality pay rate at 38 percent. Since 1996, the method of the calculating locality pay rate has changed and now Alaska is estimated to have a locality pay rate of 27.68 percent.

Under the Administration's proposal there is a 7-year phase-in provision. In the first year, Alaska Federal Employees would receive one-seventh of the Rest of the U.S. locality pay rate which is 13.18 percent. Employees in Alaska are being asked to work many more years in their career to achieve retirement benefits similar to those received by Federal employees in the 48 States.

At the two March 2008 town hall meetings in Anchorage and Fairbanks, Alaska sponsored by Senator Stevens, the overwhelming response by the employees was phasing in locality pay over 7 years was not acceptable. Since 2003, Alaska Federal employees have been waiting for the opportunity to convert from COLA to locality pay. The reason provided by OPM that the RUS rate should be used the first year in Alaska is not a separate locality pay area, and it would take the government a year to determine appropriate locality pay rate for Alaska. While it is true Alaska has not been designated a separate locality pay area, the OPM was nevertheless able to estimate the locality pay rate for Alaska when they provided information at your request, Senator Akaka, for the locality pay calculator. We recommend using the Alaska locality pay rate in the conversion.

The Administration's proposal protects Postal employees pay by permanently freezing their Territorial COLA. Postal employees have expressed concern over being the only employees left receiving a non-taxable income and becoming low hanging fruit only to be plucked at another time. Postal employees would like to stay under the umbrella of all Federal employees in the COLA areas, as they are now. S. 3013 successfully keeps Postal employees under that umbrella.

Where there are shortfalls in the Administration's proposal, S. 3013 seeks to address these issues by using an adjustment factor of 65 percent instead of 85 percent, phasing in the conversion of locality pay over 3 years instead of 7 years, allowing Postal employees to benefit with their counterparts in the COLA areas regarding retirement benefits, allowing employees to elect to have additional basic pay for annuity computation during the phase-in period and allowing employees to pay into the Civil Service Retirement Fund.

Overall S. 3013 addresses many of the concerns expressed by employees in Alaska, except retirees. Apparently, there is a reluctance to include provisions in legislation to recognize the retirement inequities experienced by retired Federal employees. I am sure Congress never intended to have such disparity of retirement benefits between the Federal employees in the COLA areas and the 48 States. Implementation of the locality pay program drastically reduced the retirement benefits of Federal employees in Alaska. Federal employees who retired from Alaska were dedicated to Federal service and it cost them dearly in their retirement benefit. We recognize retirees have not paid into the retirement fund. Section 7 of S. 3013 could be amended to include language for allowing retirees to pay into the Civil Service Retirement Fund or by an offset withheld from the increased retirement benefit.

The Alaska COLA Committees support S. 3013. We understand that any legislation will not be perfect for everyone. The Alaska COLA Committees believe it is important to have a fair and equitable resolution with respect to both pay compensation and retirement inequities that have existed since the implementation of the locality pay program.

Thank you again, Mr. Chairman, for the opportunity to testify before your Subcommittee, and for your time and attention to this important matter. If you need additional feedback or have questions, we would be glad to offer our assistance.

Senator AKAKA. Thank you very much, Ms. Warren.

And now we ask Mr. Cruz for your testimony.

TESTIMONY OF MANUEL Q. CRUZ,[1] PRESIDENT, COLA DEFENSE COMMITTEE OF GUAM

Mr. CRUZ. Hafa Adai, Mr. Chairman and Members of the Subcommittee. My name is Manuel Q. Cruz and I am the President of the COLA Defense Committee of Guam. I want to thank you for the opportunity to appear before this Subcommittee to testify on S. 3013. I also want to thank you and Senator Voinovich for inviting me to this hearing.

Almost to the exact date last year, May 30, 2007, the Office of Personnel Management sent a legislative proposal to Congress that would phase-out the Non-Foreign Cost of Living Allowance and phase-in locality pay for the Federal employees in Alaska, Hawaii, Guam and the Commonwealth of the Northern Mariana Islands (CNMI), Puerto Rico, and the U.S. Virgin Islands. President George Bush proposed the change in compensation policy as part of his fiscal year 2008 budget. It would change the pay system that is in place since 1948.

You will note in the President's proposal that locality pay will be extended to white-collar Federal employees in the COLA areas, while reducing COLA payments gradually. The changes will be phased-in over a 7-year period, and at the same time, workers will be receiving their so-called locality pay, which would boost salaries based on surveys of what is paid by the private sector in local labor markets.

[1] The prepared statement of Mr. Cruz appears in the Appendix on page 102.

While not knowing the full details of the proposal, it was felt by many of the affected white-collar workers on Guam and the CNMI that the 25 percent COLA that were being received at the time could be in jeopardy. Locality pay was considered, in most cases, to be not as high as COLA. Thus, it would appear that some workers may benefit under the proposal, while others could be hurt.

Since 1948, Federal employees in Guam have received COLA to ensure that their pay reflects the high cost of living. COLA is not subject to Federal or Social Security/Medicare taxes. Locality pay, on the other hand, is taxed and considered part of base pay, which is used to calculate an employee's retirement annuity. COLA is based on living costs, while locality pay is based on differences in the cost of labor. Additionally, COLA payments can be reduced, while locality pay has been increasing in the last few years.

With the introduction of the Non-Foreign Area Retirement Equity Assurance Act of 2008, S. 3013, it is my understanding that COLA rates will no longer be determined based on the difference in the cost of living in Washington DC, but will now be the rate in effect on December 31, 2008. The Office of Personnel Management has been seeking slowly to phase-out the COLA system in favor of the locality pay system, but this new legislative proposal will speed up the process. The result will be that the new system will be fully in place in 3 years rather than the 7 years that was suggested by OPM.

It is also my understanding that the legislative process is intended to benefit all Federal employee groups whose counterparts in the U.S. Mainland currently receive locality pay. Employees, who will soon be forced to retire due to age and those intending to retire in 3 years or less, will be able to buy in to the program to ensure that they may fully participate in the new system. The legislative proposal, however, doesn't address already retired employees.

It must be noted that Guam and the CNMI have some unique situation that may not be fully addressed by the new legislative proposal. No. 1, Post differential. Post differential is based on environmental conditions being significantly different from the continental United States and used by Federal agencies for recruiting purposes. PDs are authorized for Guam and the CNMI. The PD rate for Guam and the CNMI has been set at 20 percent. Like COLA, PDs do not count toward retirement. It is not clear in the legislative proposal how PDs will be addressed. Locality pay has no effect on the price of goods either in Washington, DC, or in the foreign areas.

No. 2, NSPS. The NSPS Program only applies to Department of Defense (DOD) civilian employees. The majority of Federal employees on Guam work for DOD activities. How are questions on NSPS features (local market supplements) going to be addressed? NSPS implementation apparently has no effect on COLAs, so employees continue to receive COLA at the time of conversion. But, what about locality pay?

No. 3, Non-Appropriated Fund (NAF) Employees. NAF employees do not receive locality pay. Also, COLA is not granted to employees in NAF position in paybands NF–1 and NF–2.

No. 4, CONUS COLA. As a requirement of their military service, members of the Uniformed Services move about the country. Many military members and their families are assigned to a variety of low, moderate and high-cost locations. Private sector pay scales tend to reflect local living costs in U.S. locations, but military pay tables do not. Would such a COLA Program become a problem when the non-foreign COLA Program is phased-out?

No. 5, DODEA Schools. OPM claims that the change would benefit workers because locality pay, unlike COLA, counts toward retirement. However, there would be no true benefit since the locality pay in a location, such as Guam, would amount to less than DODEA employees have been receiving from their salaries alone under their current system.

In closing, I have to admit that I still have some mixed feelings regarding the proposed legislative proposal. Until such time that I learn more of the various provisions and ramifications of the proposal, I have to keep an open mind regarding the matter. However, I do want to point out for the record that the COLA issue will continue to be of great importance to Federal employees in the COLA areas, since it truly represents such a significant portion of their cash compensation. The fact is that although Guam and the CNMI are currently under the COLA program, they have profoundly different economies, labor markets, climates, and access to various resources, including those purchased by the Washington, DC area's "typical" Federal employee household. It is possible that different solutions may be appropriate for the different COLA areas, and that while a continuation of the COLA program is warranted in some areas, it may not be in others. As such, I sincerely urge the Subcommittee to address problems in the COLA areas, taking into consideration the unique attributes of each area.

So, on behalf of the COLA Defense Committee of Guam and all the Federal employees on Guam and the CNMI, thank you again, Mr. Chairman and Members of the Subcommittee, for this opportunity for me to appear before you all. Si Yu'os Ma'ase! I will be happy to answer any question you have at this time.

Senator AKAKA. Thank you very much, Mr. Cruz.

And now we will hear from Mr. FitzGerald. Will you please proceed with your testimony?

TESTIMONY OF MICHAEL FITZGERALD,[1] PRESIDENT, FEDERAL MANAGERS ASSOCIATION CHAPTER 187, NAVAL FACILITIES ENGINEERING COMMAND HAWAII

Mr. FITZGERALD. Good afternoon, Chairman Akaka. My name is Michael FitzGerald and I'm the President of the Federal Managers Association Chapter 187, Naval Facilities Engineering Command Hawaii where I serve as the Utilities Supervisor for potable water. On behalf of the 200,000 managers and supervisors in the Federal Government whose interests are represented by FMA, I'd like to thank you for allowing us to express our views regarding proposals to change the pay system for Federal employees in Alaska, Hawaii, and U.S. Territories.

[1] The prepared statement of Mr. FitzGerald appears in the Appendix on page 105.

Since 1948, Federal employees outside the contiguous United States have received a non-foreign cost of living allowance to ensure that their pay reflects the high cost of living in these areas. In Hawaii, this non-taxable payment can be up to 25 percent of the employee's basic pay; however, COLA is not credited toward retirement. At the time of its inception, COLA was viewed as hardship pay for Federal employees. Today, however, we are faced with a much different situation and population dynamic.

Since 1990, employees in Hawaii and Alaska have not been included in the locality pay pool. Initially, locality pay was rather low and the COLA seemed to offer reasonable compensation for the high cost of living in these remote States. As time went on, however, it became apparent that retiring COLA recipients were disadvantaged by receiving smaller annuities than their fellow Federal employees on the mainland.

High locality pay in the 48 States lures employees to leave Hawaii and seek an increased annuity toward the end of their careers. With the Los Angeles area offering a 25 percent locality pay adjustment and the San Francisco area offering 32 percent, it's easy to see why employees would be looking to complete their final 3 years in these cities. Specific data to document this migration is hard to come by, but the stories are endless. In my office alone, a husband and wife have separated for their careers, with the wife heading to San Francisco and the husband staying here in Hawaii. They plan to retire in the islands, but must endure a long distance relationship in order to properly plan for their retirement.

In May 2007, at the urging of the President, OPM issued the Locality Pay Extension Act, which proposed to phase in locality pay and phase out the non-foreign COLA. We at FMA appreciate the support and the attention the Administration is placing on this problem. However, we at FMA believe that the OPM plan does not go far enough to recognize the needs of today's hardworking Federal employees outside the contiguous United States. In fact, it is our belief that the proposal continues the discriminatory and illogical denial of full locality pay for Federal employees in these areas. OPM's 7-year phase-in is 7 years too late. We are facing real retention and recruitment issues and we need to move up the timetable on any COLA to locality pay conversion.

More problematic is that the proposal actually reduces net take home pay for most Federal employees in Hawaii and Alaska, since the added locality pay component also brings with it a tax burden. OPM recognizes this with a 15 percent offset to adjust for added taxes, but most employees in Hawaii fall into the 25 or 28 percent tax bracket. By applying this 15 percent offset, most employees will see less money in their paychecks than if the system is left as is. Simply put, this is unacceptable and will only exacerbate our growing retention problem.

In response, FMA submitted an alternative plan based on a similar formula with two key changes. We recommend full implementation of locality pay authorized by law in the first year of conversion. Additionally, we believe an offset to COLA must be at least 25 percent to mitigate the tax burden associated with locality pay. Our members strongly believe that any plan must address retention and recruitment issues as well as protect take home pay.

The baby boomer retirement period is upon us. However, contrary to OPM, we at FMA do not believe a phase-in period will delay the retirement tsunami. We are, however, sensitive to the cost burden of locality pay in the form of increased annuities. At the same time, the additional taxes collected as a result of locality pay, coupled with shrinking tax free COLA payments, would offset increased annuity amounts. After the first year of implementation, a Hawaii area locality pay should be established and the proper amount of compensation applied. We have seen some preliminary studies that put Hawaii's locality pay around 20 percent and Alaska's at 28 percent.

I would like to take a moment to address recently introduced legislation, S. 3013, the Non-Foreign Area Retirement Equity Assurance Act, introduced by Senators Akaka, Inouye, Stevens and Murkowski. We are encouraged to read that several of our concerns are addressed in the bill and we congratulate the fine Senators from Alaska and Hawaii on developing this critical piece of legislation.

The bill proposes a 3-year phase-in of locality pay combined with an annuity buy-in aimed at stabilizing the current retirement eligible workforce. The legislation also advises a 35 percent offset to COLA to protect the pay of all Federal employees as they transition from COLA to locality pay. This is critical to retaining younger employees who have told us they would oppose any change that would adversely affect their pay check.

Additionally, Thrift Savings Plan participants will see increased eligible matching funds due to the rise in basic pay. The resulting compensation package will make the Federal Government more competitive in the current tight labor market. This is essential if the highly critical missions of Federal agencies in Hawaii and Alaska are to be met.

COLA served its purpose half a century ago. It is now outdated and serves as a barrier to Federal employment. By acting now and implementing a market-oriented approach to determining local salaries, Congress can arm Hawaii and Alaska managers with one more tool to attract and retain today's highly mobile and talented workforce. Thank you for your time and consideration of our views. I look forward to answering any questions you may have.

Senator AKAKA. Thank you very much, Mr. FitzGerald.

Now we will hear from Ms. Kaolulo.

TESTIMONY OF TERRY KAOLULO,[1] PRESIDENT, HAWAII STATE ASSOCIATION OF LETTER CARRIERS, U.S. POSTAL SERVICE, AND LETTER CARRIER, KAILUA, HAWAII

Ms. KAOLULO. Aloha, Chairman Akaka, and thank you for the opportunity to appear before your Subcommittee today. My name is Terry Kaolulo and I have been a full-time letter carrier in Kailua for 23 years. In addition, I also serve as the President of the Hawaii State Association of Letter Carriers. On behalf of letter carriers in the non-foreign areas I would like to thank you for introducing S. 3013, the Non-Foreign Area Retirement Act of 2008. It is also my understanding that the postal employees represented by

[1] The prepared statement of Ms. Kaolulo appears in the Appendix on page 112.

other postal unions here in Hawaii share our general support of the legislation.

Traditionally, postal employees have received a Territorial COLA or T–COLA in the non-foreign areas. This T–COLA is a percentage amount added to our base pay that is derived from a cost of living survey conducted by the Office of Personnel Management. It is a tax-free payment made to employees. However, these employees cannot factor these payments into their base pay and therefore they do not count towards retirement. Postal employees living in the non-foreign areas are generally supportive of the approach that your legislation takes to address this issue, though our national organizations do not support area COLA's or locality pay in general. So while we can support your bill's enhancement of a long established pay differential for workers employed in non-foreign areas, we would propose an amendment to the bill defining this change as Territorial Postal Pay as it pertains to postal employees.

Bargaining unit employees of the Postal Service living in these non-foreign areas support the integration of T–COLAs into taxable base pay, as S. 3013 provides. We would also like the Territorial Postal Pay to be phased in and paid in the same manner as you propose for the other Federal workers under the General Services schedule—over a period of 3 years.

Territorial Postal Pay would be set at the same level as the locality pay established for Federal employees in the non-foreign areas. A possible alternative to this pay methodology could be for postal employees to have their T–COLA completely phased into Territorial Postal Pay over the same 3-year period with one-third of T–COLA phased into Territorial Postal Pay each year. The phase-in would include the same 65 percent formula used for GS employees to compensate for lost take home pay due to additional taxes.

Postal employees in the non-foreign areas realize that the price of goods has skyrocketed throughout the entire country and families everywhere are feeling the pain. However, postal employees here still pay a huge premium for both domestic and imported goods and services compared to our co-workers on the mainland. We, therefore, believe that continuation of a T–COLA or Territorial Postal Pay is not only essential to our members but also entirely justified.

We look forward to working with you to ensure that this legislative proposal is effective and a bill that postal employees in the non-foreign areas can ultimately support. Thank you for the opportunity to testify here today and I would be happy to answer any questions that you may have.

Senator AKAKA. Thank you very much, Ms. Kaolulo. I have a question here for all of the witnesses on the panel. I understand how important this issue is to each of you, and you expressed that very well. As you know, my goal is to protect employees' take home pay and ensure retirement equity for employees in the non-foreign areas.

I introduced the Non-Foreign AREA Act with Senators Stevens, Inouye, and Murkowski to further the discussion on conversion to locality pay and to resolve questions with the Administration's proposal.

What recommendations do you have to improve upon the Non-Foreign AREA Act? Are we missing anything? Let me start with Ms. Matsuo.

Ms. MATSUO. I think the Act, as proposed, encompassed all of the comments that your team gathered when they were here last year, so every aspect of concerns that people have, recommendations are captured in this proposal. So in terms of all the ideas being on the table, yes, they are on the table. Whether or not they mix, they blend well together or actually fix the problem, I think that's still what needs to be discussed because there are some parts that just don't seem to fit a permanent fix. So if a permanent fix is being sought after, there still needs to be some discussions on how to make things fit.

Senator AKAKA. Ms. Warren.

Ms. WARREN. I would agree with Ms. Matsuo concerning there's a lot of information that is in the bill and expressed the concerns of employees. From Alaska's standpoint, what I've heard from employees is that the 27.68 percent, using that as the amount to be used at the phase-in and having a phase-in—if 7 years is too long, 3 years you have it and the buy-in is available there for those who would be able to buy in if they left earlier.

But depending on how all the provisions of the Act stay in and work together will depend on what really will be best. I think it's an excellent piece for discussion, and if one provision comes out, it will have to be looked at, how it affected another provision that was in there and whether or not it would place a permanent fix for this.

And another issue is retirees. Retirees is not within the bill, and that is one thing that is missing out of the bill is those employees that have already retired.

Senator AKAKA. Mr. Cruz.

Mr. CRUZ. I believe that everything that we have on the floor has been taken care of. But one of the issues that was brought up by the younger employees had to do with the opt out, that saving clause provision. What happens after a person opts out, and have that 25 percent on COLA, then after 10 years, let's say the locality pay went beyond 25 percent. Would that employee then feel that he made a mistake and that somehow the younger generation employees felt that he chose the wrong decision? And, I guess it's a question that after 10 years, like I said, the COLA rate might have gone up more than the 25 percent.

Senator AKAKA. Thank you.

Mr. CRUZ. That's one of the issues that I just wanted to put on the table. Thank you.

Senator AKAKA. Thank you, Mr. Cruz. Mr. FitzGerald.

Mr. FITZGERALD. The dangers of opting out notwithstanding, I think the biggest thing that caught us by surprise with the bill was the buy-in provision, and we are encouraged to see that because it helps stabilize the current retiree eligible work force, which was our biggest concern and the reason why we recommended full locality in the first year of inception. I think the mechanics of that buy-in are not well known, and I think that's where a lot of the discussion in the coming months will be focused, especially from our membership and groups that we've been working with.

How will that buy-in work? We have to run the numbers and can we extend that buy-in period, can we say look back 3 years from the inception to make sure that the high three is captured with COLA and can we extend it past 2011 or a 3-year phase-in period to ensure that all COLA is captured for the high three, if in fact the COLA continues, as we think it will, past the 3-year phase-in. So I think the buy-in is the one piece that really needs to be looked at. Thank you, sir.

Senator AKAKA. Thank you. Ms. Kaolulo.

Ms. KAOLULO. Chairman Akaka, I'm very pleased with the outcome of the bill that is before us. I believe that your staff has worked very hard on the fact-finding meetings that they held here in the islands and that they have taken everything into consideration and I'm very pleased to see what has come out of this bill and I think that you have not overlooked anything. Thank you.

Senator AKAKA. Thank you. I have another question for the entire panel. I know many of you are concerned about retroactive coverage for retired Federal employees. You heard OPM's response to my question about covering retirees. What are your reactions? Ms. Matsuo.

Ms. MATSUO. Yes. Well, it's no secret that we filed a lawsuit. We believe strongly that if Hawaii and Alaska were included from the inception that we would not have this problem and this huge meeting to discuss how we are going to resolve this problem that has grown out of proportion. So when I hear OPM say that there would be no retroactive, that's a statement that I could expect from the government to say. But on the other hand, I would be asking them to be open to trying to fix an inequity that they were well aware of since 1994, and they even proposed trying to consider converting our COLA to locality pay at that time because there is an internal memo that was surfaced in our lawsuit that OPM discussed how do we take care of the retirement inequity in the COLA areas since they do not receive locality pay. So it's been 14 years that this conversion idea has been out there. We even proposed working with OPM several times to try to do a conversion and they even proposed language that we could consider and it didn't go anywhere, unfortunately.

But getting back to your question of how do I respond to not being retroactive? I said, well, we have to fix that retirement inequity. It has been there for 14 years, I'm living it as a retiree not receiving my proper share of my proper retirement benefits so I definitely am experiencing it now.

So I can only ask OPM to be open to this. We are trying to arrive at some kind of settlement in our lawsuit that will take care of all employees and if some kind of legislation could be done to include retirees in this fix, our lawsuit will go away.

Senator AKAKA. Ms. Warren.

Ms. MATSUO. And it is OPM's desire not to have any more lawsuits, so what better way to discontinue this current lawsuit than to arrive at some kind of legislation.

Senator AKAKA. Thank you, Ms. Matsuo. Ms. Warren.

Ms. WARREN. Thank you, Chairman Akaka. I think there's the term retroactive is out there for the retirees, and I think there needs to be a look at openness concerning what retirees I've heard

that are being looking at is starting from this date forward to receive an increase in the retirement benefits, so whether or not that's really the term of retroactiveness that we think about when we're going to go back clear in time and all, but what retirees are looking at is increase in retirement benefits, and that could be done a number of ways and how you look at that. And I really think this is an opportunity to be open, to have the discussions about it, and see if there is a way that would help the retirees get their increased retirement benefits that they should have had all along, settle the lawsuit that's out there, and also have it simplified enough that the government will be able to implement it.

Senator AKAKA. Mr. Cruz.

Mr. CRUZ. As you know, the territories and the commonwealth, because we are not one of the 50 States, it's almost like a double whammy and we're in self denial in a sense because of the fact that if the FEPCA did not include the territories, and even if they tried to include them, only the contiguous States and Hawaii and Alaska should be included as States. More or less we need to really have a clear understanding whether we can be eligible for those retroactive retirement issues.

So in a sense, because we don't have a Senator, we look to the Senators of Hawaii and Alaska for answers regarding this matter because we do feel that it was an inequity on their part because we're all Federal employees and if we're entitled to this retroactive retirement issues, then we should be participating. Thank you.

Senator AKAKA. Mr. FitzGerald.

Mr. FITZGERALD. Senator, we have many retirees in our association, and they're very active and vital members, and I believe that they align with us and focusing on today's workforce in trying to come up with a solution that would keep our workforce in the Federal Government vital, keep Federal Government as the employer of choice, and while we're open to any discussion for retirees, we didn't really expect that any bill coming forward would include retirees, so we will definitely talk to our members, but the focus of the Federal Managers Association is to maintain a vital work force for today and tomorrow. Thank you.

Senator AKAKA. Thank you. Ms. Kaolulo.

Ms. KAOLULO. Well, I believe there needs to be a starting point, and I think that is a big topic of discussion. I think what we would really like to see is fairness being brought up. We're not out here to take the world in our own hands, but we want to be fair, we want our employees to be treated fairly. And so that starting point will have to come up in a discussion with the postal service in regards to the postal service. Thank you.

Senator AKAKA. Let me try your memories. I understand that a proposal similar to those we are discussing today was discussed about 5 years ago. What were the concerns with the proposals at that time? Do those concerns remain today? Ms. Matsuo.

Ms. MATSUO. Actually the only two persons who can talk about that proposal are Ms. Warren and myself because we actually worked with OPM in that 2003 legislative language. And at that time, we were actually contemplating just a straight conversion of COLA to locality pay, and the employees would have to take the

brunt of the Federal income tax burden in our proposal just to get something done.

But it was actually OPM that came back with that 65 percent factor, and when it was explained to us, OPM said, well, the only way we can keep your pay whole, intact is to provide you an additional COLA amount that would help cover the Federal income tax burden. So, Ms. Warren and I were totally shocked at that because we never expected it. But here was OPM saying that it is not the government's intention to take away pay, so let's do this adjustment to your COLA to give you an additional amount to help pay your Federal income taxes until COLA is completely phased into locality pay.

So it was on the part of the government that this take home pay protection came about, not from any of us. We were extremely pleased because of our long working relationship with the OPM staff that we had established a trust and a fairness in our discussions in trying to find the best solution for our COLA employees.

That 2003 proposal also took care of the special pay situation. At the time if it had been implemented then, we would not have had the budget concerns that we have today. That proposal could have passed, I think, we think, and OPM thought then, that it could have passed even the budget process, and so unfortunately for some reason, the proposal was not out in the public, but it was out to some people who felt that the conversion would not apply because they just didn't understand the mechanics of that take home pay preservation.

And so we got a lot of feedback from FERS employees who would benefit from it but who said they won't do it because all they understood was now the locality pay is taxable and it will impact my take home pay. But that's why we did the calculations, and our calculations show that there is very little impact on take home pay for FERS employees using the 65 percent factor.

Senator AKAKA. So does S. 3013 address these concerns?

Ms. MATSUO. Yes, it does. Definitely.

Senator AKAKA. Ms. Warren.

Ms. WARREN. Yes, it does. And in the 2003 legislative concept, it was a concept to lay out there to discussing, and Ms. Matsuo says it is, we had FERS employees who thought that they would be left out of it and didn't understand that with the conversion that their take home pay would be protected, and we worked extensively with individuals when we were doing that and it just didn't go anywhere, but yes, S. 3013 takes into those concerns.

Senator AKAKA. Now, let me just ask the other three witnesses if you care to make a statement on this.

Mr. CRUZ. Because of the fact that this only applies to the two of them, COLA areas, we're just waiting on the wing to see how things happen. So that's all I can say for now.

Senator AKAKA. All right. Thank you, Mr. Cruz. Mr. FitzGerald.

Mr. FITZGERALD. If I could add something, Senator, I wasn't around during those initial discussions. I was around, but I wasn't in the discussion, but I think one thing that changed since, from what I gather is the dissemination of information has increased greatly during that period, since May 2007, almost a year ago, until today, and a lot of people are more aware, and I think the

push back that was being felt by the FERS employees or the push back that the FERS employees were giving is less now as they start to understand the mechanics of how their base pay will be protected, how their TSP will grow, how they will be able to keep up with the counterparts on the mainland and how COLA is now starting to shrink.

And I think that S. 3013 addresses a lot of the issues that were discussed in 2003, but with the heightened awareness, I think it is falling on more receptive ears now than it maybe had in the past.

So I want to thank your staff, and your website is a great source of information and I think a lot of people have been taking a look at that.

Senator AKAKA. Since you mention that, let me tell all of you in the audience that you can find a lot of information about S. 3013 and the Administration's proposal on my website. So please make use of that.

Ms. Kaolulo, do you care to make any statement?

Ms. KAOLULO. No. I think Ms. Matsuo is more knowledgeable on that part.

Senator AKAKA. Ms. Kaolulo, the Administration's proposal would freeze COLA rates for postal workers, but provides no additional information. You have heard the proposals from Ms. Mitchell on the first panel as to how the Postal Service would address this issue. What do you think of the postal service's proposal?

Ms. KAOLULO. Well, I'm a little concerned. I don't think that it is concrete enough to really understand. I think that most of us have to have input into it, but I don't think I would be afraid. I would be really afraid if they were to take it into their hands that our employees would be afraid. Later on down the road, 5 years from now, people would forget what T–COLA is all about and that it would go away. It would just disappear and nobody would remember what T–COLA was about. So I'm a little afraid of that, that it would disappear somewhere in the distance because we'd be the only ones receiving T–COLA.

Senator AKAKA. Mr. FitzGerald, we consistently hear from the Senior Executives Association how the pay for performance system is a disincentive for GS–15 employees looking at the Senior Executive Service. If there is no locality pay or non-foreign COLA for SES employees in Hawaii, what impact will that have on the Federal managers looking to apply for the SES?

Mr. FITZGERALD. Well, in my remarks I mentioned people leaving Hawaii to accept positions, on the West Coast especially, but the back end of that problem is it's also hard to recruit at the upper level leadership levels of SES, higher level technicians, engineers, and leaders basically come from.

As people get further along in their careers and assume lead positions of leadership and technical expertise, they become more recruitable and more mobile. A lot of them, so called empty nesters can take jobs on the West Coast, and so we see them leaving to finish out those 3 years and then backfilling those positions becomes increasingly difficult because people don't want to give up their locality pay, especially high locality pay to come to live in Hawaii. So we have seen that happen at the Pearl Harbor Naval Ship-

yard and a couple positions which go months at a time unfilled, and that has an impact on project management and other vital functions that the shipyard now holds.

Senator AKAKA. Mr. FitzGerald, recruitment and retention and Federal agencies is a big concern for many managers. What impact would S. 3013 have on recruitment and retention of employees in non-foreign areas?

Mr. FITZGERALD. It would be huge, sir. It would put the pay in Hawaii comparable across the Nation. It would allow for people who are currently holding positions of importance to stay in Hawaii and to fulfill succession planning plans, make sure that the seamless changeover takes place, wouldn't leave so called hiccups in leadership, and it would also allow people to retire on their own terms, so instead of stampeding out the door, or holding on too long, they could retire on their career plan. So we think that S. 3013 really does address the recruitment and retention issue primarily.

On the other side, for people coming into the service at the lower levels, the protection of take home pay and making sure that younger employees see the Federal Government as an attractive place to work is also important. The bill does that as well.

Senator AKAKA. Ms. Matsuo and Mr. FitzGerald, the Department of Defense is the largest employer of Federal workers in Hawaii. As you know, the Department continues to roll out NSPS, which gives the Department the flexibility and pay to its employees. What concerns have you heard from DOD workers who are under NSPS about the conversion to locality pay?

Ms. MATSUO. Let me answer that. First of all, I want everybody to know I'm not a DOD employee, so everything I know about NSPS is what I read, what I hear from other people and from my own husband, who is going under NSPS now. My understanding of this conversion is a lot of NSPS people have not really looked at how this conversion will impact on their program. And I think that Mr. Bunn, who spoke for NSPS, kind of indicated that there is no clear understanding of how this conversion will work out for the DOD people.

For example, COLA is something that our employees currently receive and what we're doing is converting that COLA over to locality pay intact as best as possible. So it's not that they're rolling over into locality pay per se under the NSPS system. It's trying to convert COLA intact wholly over to locality pay so that they can enjoy the locality pay that their counterparts receive in the 48 States.

If we were to convert COLA to locality pay, and NSPS has been implemented in an area, what I understand about NSPS is locality pay is frozen at that point in time, so whatever you earn, you receive up to that point in time, is in your base pay permanently. It's only the additional raises, locality pay raises that will now go into a pool from which that local pay supplement will be paid from.

Mr. FITZGERALD. Market supplement.

Ms. MATSUO. So we need to try to get this COLA over to that locality pay that they're entitled to as you convert COLA, and so that needs to work outside of the NSPS pay system. And once it's fully converted over, then the employees would—well, that's not

quite true. We need to roll over COLA to locality pay outside of their system.

Whatever is currently happening in NSPS with the annual pay increases henceforth will still continue to go into the pool from which that local market supplement will be paid. And so that needs to happen separately because it's still COLA and we're entitled to that full amount in that conversion process. And it can only happen if it works outside of the current system.

So we're trying to do something and it's being placed into the box, but that box doesn't help the conversion to occur fairly and properly. And so we need this additional attention to make sure that the COLA conversion converts completely to locality pay before they get put into this box.

Senator AKAKA. Mr. Fitzgerald.

Mr. FITZGERALD. As was related to the Subcommittee earlier by Mr. Bunn, the roll out in Hawaii has been rather slow for NSPS and it's maybe a cautious approach or just the way it worked out, I'm not really sure. So there hasn't been a lot of feedback on whether it's good or bad.

There has been some concerns with the pay banding and lumping of what traditionally would have been different GS levels into one pay band and how would that work, how would the local market supplement be for a traditional GS–9 now lumped in with a GS–11. There's been concerns about that, and also, there's been concerns about the slow roll out or phase in of locality pay during a conversion that the performance monies that would be paid for people who are your top performers just isn't there. A slow roll out just means that money just dribbles in.

Like Ms. Matsuo was saying, all you get is the annual increase to pay right now for the pay pools, so we advocate a quick conversion so that this local market supplement, which apparently is tied to locality pay, those issues can be worked out and the money will be there to reward the top performers, the people who are really out there making it happen for the DOD. And so that's one of the concerns.

Senator AKAKA. Well, thank you. You started to answer my final question. I have a final question for all of you on the panel, and it has to do with recommendations and suggestions. The question is are there any other recommendations or suggestions you would offer to address the retirement inequity for employees receiving non-foreign COLA? This would be your closing remarks, so you can make any other comment as well. So let me begin with Ms. Matsuo.

Ms. MATSUO. Yes. On the retirement inequity, I believe that we've worked with OPM since 1995 on the COLA program, and our involvement with the COLA program then, we were able to get the COLA methodology fixed, so that is a more fair and accurate calculation of our COLA rates today and that's probably why our COLA rates are decreasing because we fixed the program well. But we did it fairly with the objective being that we wanted something to be more fair and accurate in the COLA program.

And in our relationship with OPM staff people in the COLA program, I think we've established a really good working relationship, one of respect, we listen. We listen to each other, we listen to the

goals, we try to find a common solution that will benefit both the government and Federal employees.

So trying to fix something for retirees, I would strongly recommend that a group be formed where we can actually sit with OPM to try to craft something out for the retirees. And by doing that, it could possibly satisfy what we're looking for in our lawsuit, too, so we would actually be killing two birds with one stone by doing that.

Senator AKAKA. Ms. Warren.

Ms. WARREN. Thank you, Chairman Akaka. I would like to thank the senators, Senator Inouye, Akaka, Murkowski and Stevens for introducing this bill, the Senate bill, because it is a start of looking at the issues concerning the COLA areas, and on the note of the retirement program, the inequities in the retirement, it is true that through the COLA program we work successfully with the Office of Personnel Management and made great strides in improving that COLA program, and I think with this retirement inequity issue, that is an opportunity to also work quickly with the Office of Personnel Management and others to really understand what the inequity is and how to really fix it so that it can be done. I really think it can be done if there's an openness and an understanding by all parties.

Senator AKAKA. Thank you so much. Mr. Cruz.

Mr. CRUZ. Senator, the only big thing that I'd like to bring up is that, if you remember, Guam went through a contracting outsourcing a few years ago and we lost a lot of good Federal employees as a result. And a lot of these employees, in order to make good of this situation, a lot of them took early retirement and really lost out because there's nothing else they can do, unless they have to leave the island, and we have a lot of them that left the island, thousands of them. In fact, some of them may be here in Hawaii in the shipyard, in NAVFAC Hawaii. We lost a lot of good employees.

And when they heard about this retroactive retirement, a lot of them felt that maybe a lot of good things can come out of this. And also, the possibility that some of them are still young, in a sense. But, the fact remains that any future employment, unless the military build-up should bring in "contracting in," like they did here in Hawaii, maybe some of these employees may want to come back and work for the government again.

But, this is really an issue, more or less—and a lot of the employees right now are looking at their future. If they continue to be outsource, those retirement issues become very real in time.

So, if we're going to address any of these retirement issues, we have to be looking on both sides of the street here, those who left the service not of their own account, but wanted to keep whatever they can get, and those employees on the island who left the island and working all over the country now, but they're still yearning to come home. And, if that day should ever be possible, maybe something good could come out of this. Thank you.

Senator AKAKA. Thank you. Mr. FitzGerald.

Mr. FITZGERALD. I think a lot of what's been said we would echo at the FMA, that taking care of retirees is important to the Federal managers, supervisors and Federal agencies everywhere. We would

like to keep the dialogue open. We would offer the support of our association to continue to work on this issue. We have, like we stated earlier, many vital retirees who are keenly interested in this issue and we would like to offer our support and move forward with the current S. 3013, and hopefully include a provision for them, but if not, a parallel effort would be more than acceptable for us in the association.

Senator AKAKA. Thank you. Ms. Kaolulo.

Ms. KAOLULO. Chairman Akaka, I must express to you that we are an island, we all live on this island, we work on this island, and unfortunately we are apart from the United States, apart from the contiguous 48 States. As gas prices soar and our economy takes the slide it is in now, further on in maybe 5 to 10 years, I shudder to think what it would be for the cost of living here in Hawaii. I don't want the postal employees to be left behind. I thank you very much for including us in your S. 3013.

There is just too many things we take for granted, and one of them is we are on an island, but we do have to remember we are apart from the rest, so I thank you very much for your consideration.

Senator AKAKA. I want to thank all of you, so let me say mahalo again to our witnesses for being here today. Your participation has helped address the questions and also the concerns raised by Federal workers in the non-foreign areas, and also by agency officials. I continue to believe that by working together we can ensure that employees in Hawaii, Alaska and the territories are not disadvantaged when it comes to their pay and retirement. I will continue to ask that employees write me and let me know their views on these proposals so that we can improve S. 3013 in the best interest of all parties.

The hearing record will be open for 2 weeks for additional statements, and I would say that some of you, your comments and recommendations here will certainly help us in moving forward. Again, thank you all for coming. This hearing is adjourned.

[Hearing was concluded at 3:33 p.m.]

APPENDIX

PREPARED STATEMENT OF SENATOR STEVENS

Thank you, Chairman Akaka for holding this important hearing on an issue that greatly affects Federal employees in both Alaska and Hawaii.

I also thank the witnesses for traveling so far to be here today. We very much appreciate your input on this bill, S. 3013, which Senator Akaka, Senator Inouye, Senator Murkowski, and I introduced.

It is our goal to produce the best legislation possible to finally bring equity in retirement to the many Federal employees in Alaska, Hawaii, and the territories.

Alaska and Hawaii are the only States in which Federal employees do not receive locality pay. Instead, they receive what is called a non-foreign cost of living allowance, or COLA.

COLA was put in place in 1949, before Alaska and Hawaii were States. It is based on the cost of living in an area compared to the cost of living in Washington, DC. COLA was not available to employees in the lower 48 States.

When locality pay was established to benefit Federal employees in the lower 48, Alaska and Hawaii were not included because they were already under the COLA system.

Locality pay brings Federal salaries closer to private industry salaries in an area.

The key difference betwen these two systems is how it affects a Federal employee's retirement.

As you know, a Federal employee's retirement is based on their "high three" years of service, usually the final 3 years of their base pay salary.

COLA is non-taxable income that cannot exceed 25 percent of the base pay. It is currently being reduced in Alaska and Hawaii by 1 percent each year.

Because COLA is not taxed, it is not considered as part of an employee's base pay for retirement purposes.

This means an employee in Alaska retires with a much lower "high three" than an equivalent position in the lower 48.

Locality pay is taxable income, but is also considered part of an employee's base pay for retirement purposes. This makes a big difference in the amount of retirement benefits an employee receives.

Alaska has one of the highest costs of living in the Nation. Our Federal employees need to know they can continue to afford living in the State they call home on the money they receive through their retirement benefits.

Many Alaskan Federal employees nearing retirement relocate to the lower 48 in order to receive locality pay for their "high three."

This puts my State at a disadvantage because we are losing highly skilled, seasoned employees.

This is an inequitable and out-dated system. It is time to bring retirement equity to all States.

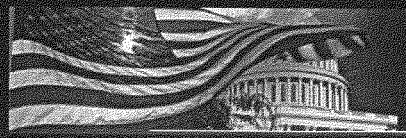
While drafting this bill, Senator Akaka and I attempted to address several employee groups with unique circumstances, including postal employees.

I understand that the legislation as currently written is problematic for the Postal Services, and I am confident we can work closely with them and the postal employee unions to ensure that postal employees in Alaska and Hawaii are protected.

I have often said the Postal Serice is a lifeline for Alaskans, and I intend to do what is best for both the Postal Service and its employees during this transition.

It is fortunate that Senator Akaka is the Chairman of the Subcommittee with jurisdiction over this issue, and I will continue to work very closely with him to pass this legislation before the 110th Congress concludes.

Again, I thank all the witnesses and look forward to their testimony, comments, and suggestions.



Senate Committee on
Homeland Security &
GovernmentalAffairs

Non-Foreign Area Retirement Equity Assurance Act of 2008 (S. 3013)

Senate Committee on Homeland Security and Governmental Affairs

Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

Senator Daniel K. Akaka, Chairman

Jennifer Tyree, Chief Counsel
Thomas Richards, Professional Staff Member

Senate Committee on
Homeland Security &
GovernmentalAffairs

- This bill is a discussion piece
- Administration proposed draft legislation on May 29, 2007
- Senate Subcommittee staff met with Federal employees in Hawaii the week of July 4th, 2007
- Solicited feedback through FAQs on http://akaka.senate.gov

Senate Committee on
Homeland Security &
Governmental Affairs

- OPM visited Hawaii in January 2008
- Senator Stevens and OPM met with Federal employees in Alaska in March 2008
- May 13, 2008, Senators Akaka, Stevens, Inouye, and Murkowski introduced S. 3013, the Non-Foreign AREA Act
- Subcommittee meetings and hearing in the State of Hawaii the week of May 27, 2008

Senate Committee on
Homeland Security &
GovernmentalAffairs

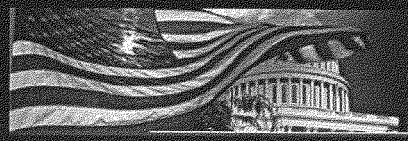
"Together we can work to ensure that these federal workers are not disadvantaged when it comes to their compensation or retirement."

Senator Daniel K. Akaka
May 30, 2007

Senate Committee on
Homeland Security &
Governmental Affairs

Senator Akaka's guiding principles in developing the discussion piece:

- Protect employees' take-home pay
- Cover all employees
- Incorporate feedback from affected employees
- Work with fellow Senators from Alaska and Hawaii



Senate Committee on
Homeland Security &
Governmental Affairs

Differences between Administration's proposal and S. 3013

Administration Proposal	**S. 3013, Non-Foreign AREA**
7-year phase-in of locality pay.	3-year phase-in of locality pay.
85 percent offset of non-foreign COLA to protect take home pay for less than 50 percent of the workforce.	65 percent offset of non-foreign COLA to protect take home pay for all affected employees.
Employees would not have a choice of COLA or locality pay.	Current employees would have a choice of COLA or locality pay. New employees would be given locality pay.

Senate Committee on
Homeland Security &
GovernmentalAffairs

Administration Proposal	S. 3013, Non-Foreign AREA
Does not address employees receiving special pay rates.	Protects employees receiving special pay rates from having their pay reduced.
Does not address other employees receiving COLA who may not otherwise receive locality pay like Senior Executive Service.	Covers all employees currently receiving COLA.
Does not address employees facing mandatory retirement like law enforcement officers or employees nearing retirement.	Allows all employees eligible to retire in the next three years to buy back their time so they can receive the full retirement benefits of locality pay.

Senate Committee on
Homeland Security &
GovernmentalAffairs

Locality Pay Offset

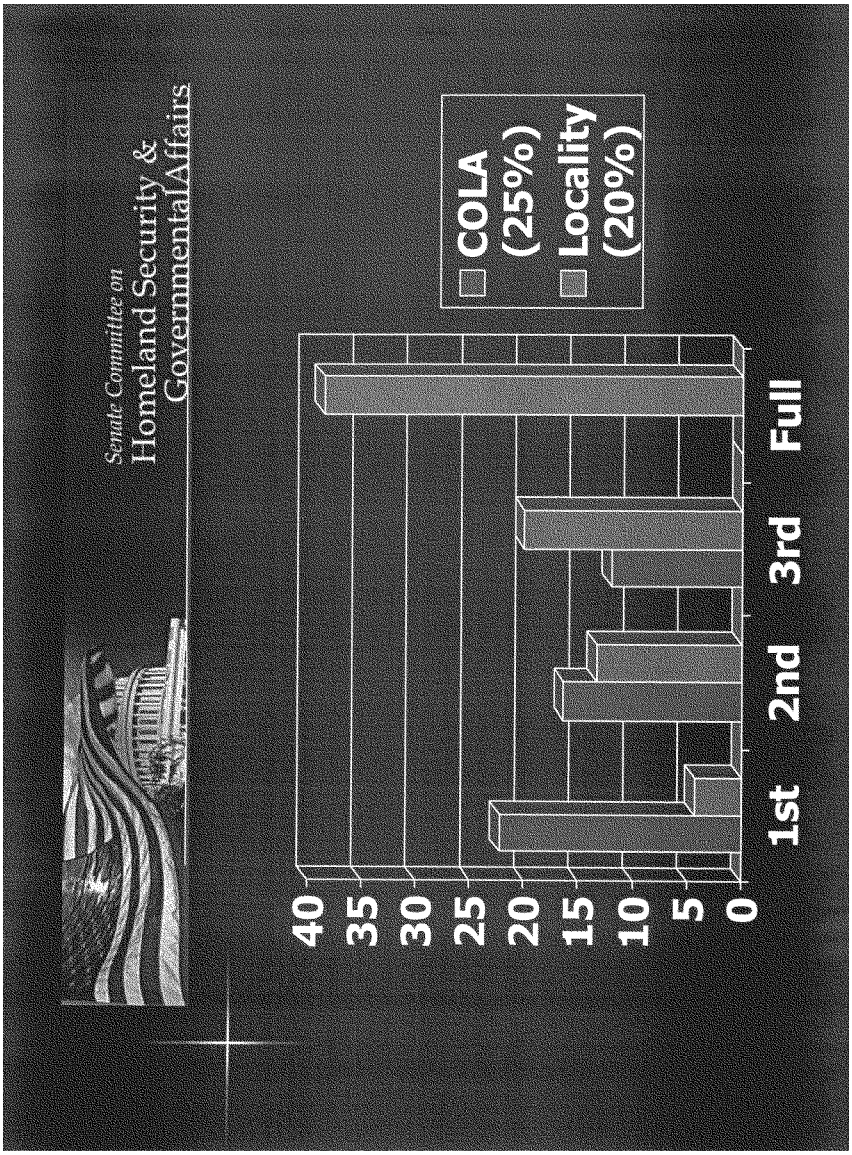
- As locality pay is phased in, COLA is reduced at a slower rate. For every 1 percent of locality phased in, .65 percent of COLA is phased out.

Hypothetical calculation:

20% (Locality) * 0.65 (65% of Locality) = 13% (Offset)
25% (COLA) – 13% (Offset) = 12% (COLA)
20% (Locality) + 12% (COLA with Offset) = 32%

COLA must equal the offset to go away:

25% (COLA) – 25% (Offset) = 0% (COLA)
25% (Offset) / 0.65 (65% of Locality) = 38.47% (Locality)


Senate Committee on
Homeland Security &
Governmental Affairs
40
35
30
25
20
15
10
5
0
1st
2nd
3rd
Full
COLA
(25%)
Locality
(20%)

Senate Committee on
Homeland Security &
GovernmentalAffairs

Postal Employees

- Frozen T-COLA leaves postal employees vulnerable
  - No justification for different T-COLA amounts
  - No guarantee of how long employees will receive T-COLA
  - No alternative proposals offered
- Territorial COLA transitions to Territorial Pay
  - Counts towards retirement and is taxed
  - Based on employment costs, but not a direct comparability of like occupations

Senate Committee on
Homeland Security &
Governmental Affairs

Legislative process

- S. 3013 has been referred to the Homeland Security & Governmental Affairs Committee
- Meetings in Hawaii the week of May 27, 2008
- Hearing in Honolulu on May 29, 2008

Senate Committee on
Homeland Security &
GovernmentalAffairs

Next Steps

- Continue to solicit views from affected employees
- Committee consideration and markup
- Senate Floor consideration
- House consideration

Senate Committee on
Homeland Security &
Governmental Affairs

"The legislation we introduce today is the result of the many comments and questions we have received from employees in the non-foreign areas and the collective efforts of Senators Stevens, Inouye, Murkowski, and me to find an equitable solution to a difficult issue that continues to lack a consensus.

*"**This bill is not the last word, only the latest step forward toward retirement equity.** I continue to encourage employees in Alaska, Hawaii, and in the territories to write me or attend our meetings and let me know your questions and concerns."*

Senator Daniel K. Akaka
May 13, 2008

STATEMENT OF

CHARLES D. GRIMES III
DEPUTY ASSOCIATE DIRECTOR FOR
PERFORMANCE AND PAY SYSTEMS
U.S. OFFICE OF PERSONNEL MANAGEMENT

before the

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT
MANAGEMENT, THE FEDERAL WORKFORCE, AND THE
DISTRICT OF COLUMBIA
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

NON-FOREIGN COLA: FINDING AN EQUITABLE SOLUTION

May 29, 2008

Mr. Chairman and Members of the Subcommittee:

I am here today on behalf of Linda M. Springer, Director of the Office of Personnel Management (OPM), to discuss the proposals to extend locality pay in lieu of cost-of-living allowances (COLA) to Federal employees working in Hawaii, Alaska, Guam, Puerto Rico, U.S. Virgin Islands, and other U.S. territories and possessions.

Background

Over the years, the focus of Federal pay policy has evolved from simply keeping pace with the overall labor market to effectively competing within the labor market. The enactment of the Federal Employees Pay Comparability Act (FEPCA) of 1990 is a

tangible manifestation of that change in focus. Under this market-based policy, the Federal Government, as an employer, has achieved greater comparability and competitiveness with the private sector by paying a locality-based pay adjustment based on non-Federal pay data collected by the Bureau of Labor Statistics (BLS). However, FEPCA applies only in the 48 contiguous states. In the nonforeign areas noted above, we have a conflicting compensation policy that provides for a cost-of-living allowance (COLA). The conflicting policies create real differences in employee take-home pay and in retirement benefits.

Market-based Pay

Implemented in 1994, FEPCA provides for an annual pay adjustment, called locality pay, to narrow the pay gap between Federal and non-Federal salaries. Under FEPCA, locality pay is paid within each locality pay area determined to have a Federal – non-Federal pay gap greater than 5%. The Federal Salary Council recommends establishment of particular locality pay areas, and the President's Pay Agent approves the areas. There currently are 32 locality pay areas, including a catch-all area called Rest of the U.S. (RUS).

The COLA Program

The COLA program, which pre-dates locality pay by nearly 50 years, covers white-collar civilian Federal employees in the nonforeign areas noted above. Enacted in 1948, the COLA program was originally designed to address recruitment and retention issues resulting from higher costs of living in the nonforeign areas. Accordingly, COLA rates

are based on OPM surveys measuring the differences in the cost of living between each nonforeign area and the Washington, D.C., area.

Beyond being philosophically different from locality pay, COLA has tangible effects on an employee's take-home pay and retirement annuity. Employees view some of these effects positively and some negatively. For instance, some employees like the fact that COLA payments are not subject to Federal income tax because they are not intended to increase income, but to stabilize buying power.

On the negative side, given that COLA payments are non-taxable allowances, they are not considered base pay for retirement purposes. Therefore, when an employee retires, his or her retirement benefit, under either the Federal Employees' Retirement System (FERS) or the Civil Service Retirement System (CSRS), does not reflect COLA payments. In addition, COLA is capped at 25% of base pay by law. As locality pay continues to increase, particularly as it approaches or even exceeds existing COLA payments, agency recruitment and retention efforts in the nonforeign COLA areas could suffer.

Given these negative effects, there is a growing perception that total pay and retirement benefits of white-collar civilian Federal employees in the nonforeign areas are gradually eroding in relation to the pay and retirement benefits of similarly situated employees in the continental United States. The disparities between the pay and retirement benefits of the two groups of employees create staffing problems for Federal agencies in nonforeign

areas, especially with regard to retaining experienced employees who are near retirement. As employees in the COLA areas near retirement, many consider and seek short term employment in the continental United States, where their "high 3" salaries are boosted by locality pay.

The Administration, FMA, and Senate Proposals

For several reasons, the Administration believes that these disparities are best addressed by extending locality pay in lieu of COLA to the nonforeign areas. First, locality pay is retirement creditable. Although it is taxable, locality pay increases an employee's "high-3" average salary used in retirement calculations. For employees covered under CSRS, locality pay increases the monthly annuity payments significantly. For employees covered under FERS, locality pay increases base pay for the defined benefit aspect of the FERS package as well as the matching contribution paid by the Government into employees' Thrift Savings Plan accounts.

Second, locality pay is not capped at 25%. In high cost-of-labor areas like San Francisco, locality pay has risen to more than 32% and will likely continue to rise. Over the past few years, locality pay has increased about 1% per year on average, although the increase amounts have been higher in the higher cost of labor locality pay areas. We expect locality pay to make similar gains going forward.

Finally, because of subjective elements in measuring relative living costs, the COLA program has been the subject of litigation numerous times since its inception. The most

recent settlement, reached in the *Caraballo* case, topped $230 million. We expect the bill, once finalized, to reduce the ongoing litigation risk associated with the COLA program.

In May 2007, the Administration transmitted a legislative proposal to Congress to address these issues. We are pleased that Senator Akaka, and Senators Inouye, Stevens, and Murkowski, have recently introduced S. 3013, the "Non-foreign Area Retirement Equity Assurance Act of 2008," to stimulate discussion on how best to transition from pay based on the relative differences in cost of living to pay based on the labor market. Also, the Federal Managers Association (FMA) has put forth a proposal. The Administration's proposal, the FMA's proposal, and S. 3013 would extend locality pay to white-collar Federal employees in the nonforeign areas over time, while reducing COLA payments gradually. However, the Administration's proposal differs significantly from the FMA's proposal and S. 3013 regarding the phase-in period, the offset, and employee coverage.

The Administration's proposal would phase in locality pay over a 7-year period. One purpose of the phase-in period is to limit the impact of locality pay on retirement behavior. We believe it is not advisable to exacerbate staffing problems by creating an incentive to retire, as might be the case if there were a shorter phase-in period. The phase-in period also reduces the financial impact on agency budgets caused by higher employer retirement contributions. During the phase-in period, decreases to COLA would be limited to 85% of the increase in locality pay in order to reduce the impact on take-home pay of increased deductions for retirement contributions and tax liability. S.

3013 would reduce the phase in of locality pay to three years, and would set the offset to COLA at 65% of the increase in locality pay. The FMA proposal would phase in locality pay over two years, with an offset of 75%.

In both the Administration's proposal and S. 3013, the RUS rate, subject to their differing phase-in rates, would apply in all areas in the first year of phase in while data are being collected, pay gaps are determined, and recommendations for pay rates are being made. That is, under the Administration's proposal, the first year locality payment would be one seventh of the RUS rate, and under the Senate bill, one third of the RUS rate. The FMA's proposal would implement the full RUS locality pay rate in the first year, and the full locality pay rate for Hawaii and Alaska in the second year. We believe that Hawaii and Alaska would likely be established as separate locality pay areas by the Federal Salary Council and the President's Pay Agent, with locality rates based on BLS data from Honolulu and Anchorage, respectively. Puerto Rico, Guam and the Virgin Islands would likely be covered by the RUS locality pay area rather than become separate locality pay areas. Based on existing data, we estimate the locality pay rates for Hawaii and Alaska would be 20.38% and 27.68%, respectively. The current rate for RUS is 13.18%.

The Administration's proposal would permit OPM to promulgate regulations for various categories of employees such as those on special rates. With the concurrence of OPM, certain other agencies like the Transportation Security Administration and the Federal Aviation Administration would promulgate their own regulations to comply with the proposal and OPM regulations. Finally, Postal Service employees would receive a frozen

COLA rate, set at the COLA rate effective at the time of the draft bill's passage, since Postal Service employees are not eligible to be paid GS locality pay. S. 3013 specifies in statutory language what employees are covered, and further gives employees a chance to opt out of coverage and keep a frozen COLA rate. One result of this specificity is that Senior Executive Service (SES) members in the non-foreign areas would be granted locality pay, which SES members currently do not receive, regardless of location.

We believe the Administration's proposal addresses the issues in a responsible fashion, particularly with regard to cost and reduced litigation risk. S. 3013, though welcomed as a step forward in resolving these issues, would cost significantly more due to the shorter phase in period and reduced offset. The FMA's proposal would cost even more, since it would establish the RUS locality pay rate for all areas immediately, followed in year two by full locality pay for Hawaii and Alaska. In addition, we believe the opt-out provision S. 3013 could lead to further litigation, rather than reducing litigation risk.

Mr. Chairman, we appreciate your website which contains much information on this issue. As you know, we provided your office with a list of Frequently Asked Questions, as well as a calculator to help individuals determine the effect of phasing in locality pay. In addition to meetings with employees this week and earlier this year in Hawaii, we also joined Representative Luis Fortuno for a townhall meeting with his constituents in Puerto Rico last August, and we joined Senator Ted Stevens this past March for similar meetings with his constituents in Alaska.

We believe the time is upon us to extend locality pay to the nonforeign areas. Locality pay provides employees in the nonforeign areas a retirement benefit comparable to employees in the continental United States. Additionally, locality pay is uncapped and traditionally has increased about one percentage point a year over the last few years, unlike COLA, which has a history of fluctuations with most areas currently trending downward.

Conclusion

Mr. Chairman, thank you for the opportunity to discuss this important issue with you today and for your support as we work towards a more market-based pay system in our nonforeign areas which will benefit both employees and agencies. We will continue to work closely with your subcommittee and the cosponsors on S. 3013. I would be happy to address any questions you may have.

STATEMENT OF

BRADLEY B. BUNN
PROGRAM EXECUTIVE OFFICER
NATIONAL SECURITY PERSONNEL SYSTEM
U.S. DEPARTMENT OF DEFENSE

Before the

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT
MANAGEMENT, THE FEDERAL WORKFORCE, AND THE
DISTRICT OF COLUMBIA
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

NON-FOREIGN COLA: FINDING AN EQUITABLE SOLUTION

May 29, 2008

Mr. Chairman and Members of the Subcommittee:

My name is Brad Bunn, and I am the Program Executive Officer for the National Security Personnel System, or NSPS, in the Department of Defense (DoD). Thank you for the opportunity to appear before you to discuss the proposals to extend locality pay in lieu of cost-of-living adjustments (COLA) to employees working in Hawaii, Alaska, Guam, Puerto Rico, U.S. Virgin Islands, and other U.S. territories and possessions, in particular, DoD civilian employees, including those covered by NSPS.

Let me, at the start, thank you for your ongoing support of the 700,000 DoD civilian employees who work every day, worldwide, in support of our national defense, including the thousands of civilians employed by DoD here in Hawaii. We appreciate your leadership on the many civilian human capital issues facing the Department, including the issue before us today.

I am here today representing the Department's National Security Personnel System, a key driver in the Department's transformation. DoD civilians play a unique role in our government, as they are responsible for supporting the military around the world, in all manner of occupations, in a variety of work settings and operational environments. The flexibilities built into NSPS provide the DoD with a modern and agile human resources system that is more responsive to the national security environment, while preserving employee protections and the fundamental principles of the merit system. To date, we have successfully implemented NSPS to over 180,000 employees

across DoD, who are now working under a more modern, mission-focused, results-oriented personnel system.

NSPS enables DoD to compensate and reward employees based on their performance and contribution to our mission. While the National Defense Authorization Act for Fiscal Year 2008 brought significant changes to the underlying NSPS statute, the core features of NSPS that we have implemented, including compensation flexibilities and pay for performance, remain intact.

One of the features of NSPS that is critical to the Department is the ability to move towards a more market-based approach to compensation. We have implemented a simplified, streamlined classification structure, using a pay banding system that collapses the fifteen General Schedule (GS) grades to three or four pay bands. This allows the Department to be more competitive in the labor market, and gives our employees the ability to progress through broader pay bands based on their performance and contribution. With respect to locality pay, NSPS includes an element of pay called a "local market supplement," which is essentially identical to locality pay under the GS system. NSPS mirrors the GS locality pay areas and percentages for these local market supplements. Under NSPS, however, an employee must be performing above the "unacceptable" level in order to be eligible for any increases to local market supplements. This aligns with the underlying principles of NSPS, as required in the law, that pay be linked to performance. NSPS employees with performance ratings above "unacceptable" receive local market supplement adjustments equal to the GS locality pay increases.

Regarding COLA in non-foreign areas, NSPS does not affect the payment or amount of non-foreign COLA. The NSPS statutory authorities do not extend to COLA, so employees under NSPS in these areas are receiving COLA, similar to our GS employees.

As one of the largest Federal employers in these non-foreign COLA locations, the Department is well aware of the issues surrounding COLA and the potential extension of locality pay to these areas. DoD employs over 26,000 appropriated fund civil servants in Hawaii, Alaska, Puerto Rico, and other U.S. Territories (not including the DoD Intelligence community). Almost 18,000 of these employees are in white-collar occupations and are impacted by the non-foreign COLA issue, with over 11,000 of these civilians employed here in Hawaii. Currently, approximately 7,000 employees in these non-foreign areas are covered by NSPS, with an additional 10,000 eligible for coverage. Over the years, we have heard concerns from our employees about the COLA, in particular, the issue of equity in retirement benefits. The perception that compensation and retirement benefits for our white-collar workforce in these areas are eroding will have a detrimental effect on our ability to recruit and retain the talent needed to carry out our mission. We applaud the Committee for taking this issue on, and agree with our colleagues at the Office of Personnel Management (OPM), as well as with you, Mr. Chairman, that the time has come to extend locality pay in lieu of COLA to these non-foreign areas.

We realize that there are a number of considerations and potential approaches to implementing this concept. Last year, the Department endorsed the OPM legislative

proposal that would phase in locality pay over a seven-year period, while gradually reducing COLA payments. The Department continues to support that proposal. We understand that Senator Akaka, along with Senators Inouye, Stevens, and Murkowski, has recently introduced the "Non-foreign Area Retirement Equity Assurance Act of 2008," which also phases in locality pay in these areas, while reducing COLA payments over time. The Department has not completed a full analysis of the introduced bill, but I am prepared to speak to a few points.

First, let me address how these proposals would affect employees under NSPS. Because NSPS local market supplements mirror the GS locality pay areas and percentages, if either of these proposals were enacted, the Department would establish and phase-in local market supplements equal to the GS locality rates established by OPM for these areas. In other words, NSPS employees would be treated like GS employees for purposes of implementing these provisions. One significant difference, however, is that under NSPS, employees with a performance rating of "unacceptable" would not be eligible for these increases to local market supplements, in accordance with the NSPS statute. The Department would not be in favor of a proposal that does not allow for this practice, as it would be contrary to the fundamental principles of NSPS, and result in inconsistent treatment of employees in NSPS.

Second, we understand that the introduced bill proposes a shorter phase-in period (three years), and sets the offset to COLA at sixty five percent of the increase to locality pay, versus the eighty-five percent proposed by OPM. As I previously stated, the

Department has not completed a full analysis of the proposal, but we would have to look carefully at the cost of implementing these provisions over a shorter timeframe to determine the impact to our organizations' budgets. While we support an implementation plan that minimizes the impact to the take-home pay of our employees as locality pay is phased in, we also believe we must accomplish this in a fiscally responsible, affordable manner. We are also cognizant of the fact that the extension of locality pay in these areas, which will count towards retirement calculations, may influence retirement behavior. The Department would favor an approach that promotes stability in the workforce, so that our mission is not adversely affected. Finally, we understand the introduced bill provides affected employees the opportunity to "opt out" of the locality pay provisions, and continue to receive COLA. In addition to our concerns over the administrative burden this provision would impose, the Department believes this would be contrary to the fundamental purpose of the proposed legislation, and would result in continued inconsistencies in compensation for employees.

Mr. Chairman, we at DoD realize that this is not an easy issue, and we are gratified to be part of the conversation as we collectively wrestle with these matters. For our part, it is critical for the Department, and our organizations located in these important geographical areas, to be able to recruit, fairly compensate, and retain a civilian workforce that continues to provide world-class support to our military in a dynamic and unpredictable national security environment.

I appreciate the opportunity to testify and welcome your questions.

STATEMENT OF JO ANN MITCHELL,
MANAGER, ACCOUNTING SERVICES

BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

MAY 29, 2008

I am honored to be here with you today to discuss the Postal Service's views on phasing out the non-foreign Cost-of-Living Allowances (COLA) and replacing this benefit with locality pay for federal and postal workers in Alaska, Guam, Hawaii, Puerto Rico and the Virgin Islands.

I would first like to share some facts about the Hawaiian postal workforce with you, as well as some details concerning the greater challenges facing the Postal Service.

The Postal Service has a presence on each of the Hawaiian islands, and employs approximately 2,700 letter carriers, mail clerks and other employees throughout the state. Together, these employees handle nearly 1.2 billion pieces of mail a year to more than 650,000 addresses in the Honolulu Postal District. And, they do a great job. For the most recent quarter of 2008, they delivered an impressive 98 percent overnight service, which was two points higher than the national average of 96 percent.

We are proud of the outstanding service that our employees in Hawaii provide. They have excelled during a particularly challenging time for the Postal Service. For the quarter just ending, mail volume was down 3.3 percent from last year, which is a very significant decline. The Postal Service is facing tough times as businesses and consumers nationwide are trying to manage their own budgets against rising prices that are affecting the economy of the whole nation. The Postal Service is engaged in the same struggle in managing its rising costs and has embarked upon an aggressive cost reduction and revenue enhancement plan to, at best, financially break even this year.

The Postal Service has weathered these economic storms before, and will again. We have done so by having one of the most dedicated workforces in America, and by benefiting from management tools, such as the collective bargaining process. This system has resulted in providing postal employees with competitive wages and benefits while safeguarding the financial health of the postal system. In place since 1970, the collective bargaining process defines the way the Postal Service and its unions discuss wages and working conditions. Section 1003 of Title 39, United States Code, states, "It shall be the policy of the Postal Service to

maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy."

The Postal Service has negotiated pay schedules with its unions that set nation-wide standard rates of pay, including areas covered by the non-foreign COLA. These pay agreements set by the labor contracts cover roughly 600,000 Postal employees, including the 8,300 or so who receive the non-foreign COLA.

It is against this backdrop that I would like to discuss the purpose of the non-foreign COLA. As you know, it was established in 1948 and was originally intended to serve as an incentive for Federal and Postal employees to move to Alaska, Hawaii, and to U.S. territories.

The non-foreign COLA is intended to reflect the differences in the cost of living between Washington, D.C. and the various COLA areas. To set the COLA rates, the Office of Personnel Management surveys the prices of over 300 items, including goods and services, housing, transportation, and miscellaneous expenses. The surveys are very detailed, time-consuming and costly to perform, and require expertise to implement.

As you know, the non-foreign COLA is a percentage of an employee's base pay and is not subject to Federal income tax, nor is it considered pay for the purposes of retirement. The maximum non-foreign COLA payment is 25 percent of base pay. In Hawaii, the percentages for 2008 ranged from 17 to 25 percent.

To help bring about pay parity for federal employees, the Federal Employees Pay Comparability Act (FEPCA) was implemented in 1994 to set Federal salaries at a level comparable to non-Federal pay in the locality. This so-called "locality pay" currently applies only to Federal General Schedule, not postal employees in the 48 continental United States.

Throughout the years, and to a limited extent at its most recent collective bargaining sessions, the Postal Service and its unions have discussed forms of locality pay during contract negotiations; however, locality pay has not been adopted through these negotiations.

The collective bargaining process in the United States Postal Service is a process that works. Last year, we reached labor agreements with three of our largest unions, and year after year we reap the benefits of that cooperation. For example, together with our unions we have streamlined our grievance process and have implemented several award-winning safety programs that reflect industry best practices.

We have repeatedly stated to Congress, and do so respectfully again today, to let the collective bargaining process continue to deal with pay and other bargainable issues. One of the reasons that we strongly oppose the statutory

imposition of locality pay upon postal employees in the non-foreign COLA areas is precisely because this action would interfere with the collective bargaining process. The Postal Service bargains over pay with its unions, unlike other agencies in the Executive branch. If Congress enacts legislation to provide a new benefit over and above the non-foreign COLA, it sets a dangerous precedent of interference, which could spill over into many other negotiated areas.

The second reason that we strongly oppose requiring the Postal Service to pay locality pay for its employees is because Postal Service wages are already comparable to private sector wages, as required by Title 39. The imposition of locality pay that, in many areas is higher than the non-foreign COLA payment, on top of its current wage schedules would artificially increase pay in those areas above comparability, which is the goal of both FEPCA and Section 1003 of Title 39.

Finally, paying postal employees locality pay in the defined areas would greatly affect the Postal Service's bottom line. Locality pay is considered base pay for the purposes of retirement and the Postal Service's costs will rise as a result. The Postal Service's employer contributions for roughly 8,300 employees who receive the non-foreign COLA would increase for retirement, Thrift Savings Plan, Social Security, Medicare, and life insurance. We estimate this bill would cost us approximately $12.5 million per year. That figure does not include the increased long-term retirement obligation that we would also face. This comes at a time when the Postal Service is struggling financially and, as I mentioned, is reducing costs in line with lower than expected revenue.

The Postal Service shares Senator Akaka's concern for postal employees and their long-term financial health when they retire. The Postal Service regularly provides financial education seminars and materials to employees reminding them that non-foreign COLA is not part of their retirement benefits, and the agency works hard with its employees to ensure that they understand their retirement package when it comes time to retire. As you are aware, employees currently receive tax-free non-foreign COLA payments, allowing them additional flexibility in terms of investing funds for their future.

While we understand the rationale behind S. 3013, we would like to state again that the Postal Service's pay and compensation systems are very different than those of other Federal Government agencies. We hope that we can work with Congress and the Administration on finding solutions to this problem.

Thank you and I would be pleased to answer questions that you may have.

###

Testimony of Joyce Matsuo, President of the COLA Defense Committee of Oahu, Inc.

On Behalf of the Oahu and Maui COLA Defense Committees

Before the United States Senate
Committee on Homeland Security and Governmental Affairs
Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia

Thursday May 29, 2008

Non-Foreign COLA: Finding an Equitable Solution

Chairman Akaka, Ranking Member Voinovich and Members of the Senate Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia:

My name is Joyce Matsuo. I am president of the COLA Defense Committee of Oahu, Inc. (henceforth, the Oahu COLA Committee), a non-profit corporation which was formed in 1986. With 15,000 federal employees on Oahu, the Oahu COLA Committee covers the largest group of COLA recipients. The primary purposes of this corporation are to monitor the COLA program as implemented by the U.S. Office of Personnel Management (OPM) and to share information about the COLA program and other compensation programs with the white collar federal employees and the U.S. Postal Service employees on the island of Oahu. For the past six years or more, the Oahu COLA Committee has taken on the task of keeping the federal employees on the neighboring islands of Kauai and Hawaii informed as their COLA corporations were legally dissolved. We also apprise the Maui COLA

Committee of new developments. The COLA Committees, by our charters, do not represent federal employees as do labor organizations. The Oahu COLA Committee speaks on behalf of federal employees in presenting information, comments and recommendations for consideration by OPM and senate committee such as this one with respect to potential changes in the COLA program.

I have been involved with the Oahu COLA Committee since 1986 and continue to remain active. I have been involved in three of the four COLA lawsuits, the *Karamatsu*, *Alaniz* and *Caraballo* cases, as they pertained to federal employees in our State of Hawaii. In 1995, the COLA class attorneys suggested to the courts that OPM enter into collaborative studies with the COLA Committees to fix the COLA program once and for all. The Oahu COLA Committee was instrumental in getting OPM to agree to such studies. The results of those extensive collaborative studies are embodied in the *Caraballo* settlement terms. Two important outcomes of the collaborative studies were that (1) it updated the methodology with current economic concepts, and (2) it resulted in a more objective survey methodology that would protect the government from future COLA methodology lawsuits. With six other COLA Committees' representatives, I continue to participate with OPM in the implementation phase of the settlement principles of *Caraballo.* This ongoing work helps OPM to implement the settlement principles properly so as to avoid lawsuits due to implementation problems. It was originally envisioned that this collaborative implementation work would take only one three-year survey cycle but OPM has just begun the third survey cycle and we are still at work. We hope to wind down by December 31, 2008.

I am not an expert on the COLA program nor on the locality pay program. However, my involvement with the COLA program over the past 23 years and keeping informed about the locality pay program have given me particular insight into the impact Senate Bill 3013 will have on the COLA program and on our federal employees.

In July 2007, this subcommittee held information-gathering meetings in Hawaii. I was present at most of the Honolulu meetings, which were attended by federal employees at the Federal Building, Tripler Army Hospital, Pearl Harbor, USPS and Customs to listen to what federal employees had to say. At these meetings, I heard the same concerns, complaints, suggestions and ideas that the Oahu COLA Committee has discussed and considered all these years. As a result of these experiences, I am confident that I am able to express the views of virtually all the federal employees in Oahu.

The concept of converting COLA to locality pay is not a new concept for the Oahu COLA Committee. Near the end of the 1995 to 1998 collaborative studies with OPM, OPM offered for consideration a proposal to convert COLA to locality pay.[1] At that time, the results of the studies indicated that the COLA rates would drop with the contemplated changes to the COLA methodology. These decreases would be substantial in Alaska and Puerto Rico and some decrease could occur for the Pacific COLA areas. There was a dissenting opinion from a COLA Committee and no further discussions took place.

In 2001, the Oahu and the Alaska COLA Committees submitted a proposal to our senators to consider a conversion of COLA to locality pay. Another such proposal was made in 2003. Senator Akaka's office submitted the proposal to OPM for their consideration and

[1] In documents submitted to the Court in *Matsuo vs. U.S.*, we learned from a 1991 OPM internal document that OPM staff suggested the idea of converting COLA to locality pay largely in order to provide adequate retirement benefits to employees in COLA areas. The records do not reflect whether this suggestion was presented to the Hawaii and Alaska senators for their consideration.

technical assistance. OPM provided proposed legislative language which has been tagged a "legislative concept". This "legislative concept" was a COLA to locality pay conversion and it was shared with the COLA Committees and interested federal employees. It did meet some resistance due to a lack of understanding of the provisions and also because some felt the inequities in the current COLA statutory scheme might be better addressed through new COLA litigation.

Then, in June 2005, I and several other federal employees, joined in filing a lawsuit against the government for failing to include Hawaii and Alaska federal employees in the locality pay program. We felt that, if we could not achieve retirement equity through the COLA program, then we needed to look for it through changes in the locality pay program. The FEPCA statute was initially intended to be a pay statute applicable to all federal employees. We were told by Donald Paquin, the OPM staff member who was one of the technical assistants in helping develop the FEPCA language, that FEPCA originally read as such. Subsequently, the language excluding Hawaii and Alaska employees was added. Mr. Paquin stated that it was unfair that Hawaii and Alaska were excluded from the FEPCA pay statute and he gave us his permission to quote him as saying so should he be retired when the time came that this information would become pertinent. Mr. Paquin passed away in 2007.

Our lawsuit for locality pay, whose primary purpose is to address the retirement inequity, is in the appeals court. We were recently informed that Department of Justice believes that the case cannot be resolved in a lower court without legislation. We are prepared to take our case to the Supreme Court if we cannot get supporting legislation.

Today, on behalf of the Oahu and Maui COLA Committees, I am here to provide testimony on Senate Bill 3013 which proposes to

resolve the retirement inequity in COLA areas. I thank you for this opportunity today to speak before this panel and submit testimony on the pros and cons of this Senate Bill 3013.

To convert or not to convert COLA to locality pay: The decision-making process requires that one review the current COLA program. From our latest COLA survey results, we see that the COLA rates will continue to drop for all areas in Alaska, except Rural Alaska, and it will begin to drop for COLA areas in Hawaii. The latest COLA indexes for all COLA areas are as follows:

COLA Area	COLA Rates - pre-*Caraballo*	Latest COLA Indexes/Rates	Present COLA Rate
Anchorage	25.0%	109.81 – 10%	24%
Fairbanks	25.0%	118.90 – 19%	24%
Juneau	25.0%	120.08 – 20%	24%
Honolulu County	25.0%	121.17 – 21%	25%
Kauai	22.5%	118.15 – 18%	25%
Maui/Molokai	22.5%	123.63 – 24%	25%
Hawaii	15.0%	111.72 – 12%	17% *
Guam/Marianas	22.5%	121.47 – 21%	25%
Puerto Rico	10.0%	103.32 – 3%	10.5% *
Virgin Islands	20.0%	128.21 – 25%	25%

(1) Alaska COLA areas – Proposed indexes based on their 2006 surveys were published in FR Vol. 73, No.2;Thursday, January 3, 2008.
(2) Pacific COLA areas – OPM is currently drafting the FR notice to report the proposed indexes based on their 2007 survey.
(3) Caribbean COLA areas – Proposed indexes based on their 2005 surveys were published in FR Vol 71, No. 208/Friday, October 27, 2006
* The COLA rates for Hawaii and Puerto Rico will increase to 18% and 13% respectively sometime in 2008 when the final rule process is completed. The increases are due to interim adjustments based on previous survey results.

Note: COLA rates can only decrease 1% per year. COLA rates in Alaska will decrease another 1% this year and for the Pacific areas, their first 1% decreases will take effect in 2009 after the FR notice requirements are satisfied.

During the 2007 information-gathering meetings, your staff members informed us that the estimated locality pay rates would be 20.38% for Hawaii and 27.68% for Alaska. With the projected decreases in their COLA, it is readily seen that Alaska employees would clearly benefit from a conversion to locality pay. It may also be wise for Hawaii employees to convert to locality pay even though our COLA appears not to decrease so significantly as in Alaska. COLA rates are unreliable because they are based on how fast our cost of living is increasing as compared to DC's cost of living. If DC's costs rise faster, our COLA decreases even if our costs of living are increasing. It is probable that future locality pay in Hawaii will increase and eventually exceed the 25% COLA statutory cap.

In short, the opportunity to convert from COLA to locality pay is in the best interests of both Alaska and Hawaii federal employees.

Conversion Period: In OPM's 2003 "legislative concept", OPM proposed full locality pay in year 1 of the conversion. In the Administration's 2007 proposal, OPM proposed a seven-year phase-in period. Senate Bill 3013 improves the phase-in period to three years.

Had a conversion begun in 1994 or 1998 or 2001, we would have achieved full locality pay by 2008. With a three-year phase-in period begun in 2003, we would have achieved full locality pay by 2008.

I agree with the Federal Managers' Association that, if a conversion takes place, it should begin with full locality pay, estimated as best as possible. It is only fair that we begin at a point where our counterpart employees are in the 48 states. We've waited at least ten years since OPM's first proposal of a conversion in 1998.

The Administration's version and this senate bill propose to use 1/7 or 1/3, respectively, of RUS for year 1 locality pay. It was explained at the information-gathering meetings that OPM needs the first year to conduct locality pay surveys in the COLA areas to determine their applicable locality pay rates. BLS already captures pay data in the COLA areas that is used to determine the RUS rate. It was from this data base that OPM calculated the estimated locality pay rates for Hawaii and Alaska that were shared with federal employees at the information-gathering meetings.

Using this senate bill proposal of a three-year phase-in, one-third of 13.18% RUS (2008) is 4.39%. There is a big gap between 4.39% and 20.38% (Hawaii) and an even bigger gap between 4.39% and 27.68% (Alaska). If full locality pay is not possible in year 1, I recommend that a number closer to our estimated locality pay rates be used. To avoid overpaying and being stuck with an overly compensating percentage, [2] one could use the estimated locality pay rates less a reasonable and fair percentage, say 5%, as the year 1 locality pay rates that are decently higher than 4.39%.

Impact on Take-Home Pay: Our own calculations of impact on take-home pay indicate that Senate Bill 3013's proposed adjustment factor of 65% will minimize a negative impact on take-home pay. Without this 65% factor, federal employees, especially FERS employees, cannot support the conversion proposal because of the significant impact on their take-home pay due to federal taxes on locality pay. (FERS employees currently comprise two-thirds (2/3) of our current workforce.)

[2] In the locality pay program, if the locality pay rate in an area dips, the locality pay rate is frozen. There is no further increase until the actual locality pay rate exceeds the frozen rate.

This adjustment factor has been difficult to explain to the average FERS employee. It requires that a person know the tax withholding impact on their bi-weekly pay and their bottom line when filing their income tax returns. It also requires that he or she understand that there will be a negative impact on take-home pay due to the increased retirement deductions and increased TSP contributions on the locality pay portion. I agree with OPM that the adjustment factor should not cover the increased retirement and TSP contribution deductions. These are retirement savings that return to the employee upon retirement. If the employee's goal is to preserve take-home pay, the employee can adjust his or her increased TSP contributions to pre-conversion amounts.

I must point out here that OPM's locality pay calculator program, which is posted to Senator Akaka's website, is misleading. That calculator program attempts to help employees determine the impact on take-home pay for several years using an 85% adjustment factor. We know that an 85% factor creates a negative impact on take-home pay in year 1 and for each year thereafter. Yet OPM's calculations show no negative impact on take-home pay. The reason is that OPM included projected annual pay raises into the calculation. This annual pay raise amount nets out the decrease in take-home pay caused by the conversion using an 85% adjustment factor.[3] In essence, use of an 85% adjustment factor would deprive employees of the benefit of any annual pay raises.

Senator Akaka is committed to protecting employees' take-home pay. It is important to keep the adjustment factor at 65%.

---

[3] To understand the real impact on take-home pay due to the conversion, base pay must be held constant year to year with only the COLA and locality pay portions changing.

Special Rate Pay: Similar to the adjustment factor above, a comparable adjustment must be made for employees receiving special rate pay. Otherwise, these groups of employees would see negative impacts in their take-home pay. Senate Bill 3013 provides for such protection.

Buy-In Provision (Section 7): As this provision states, an employee who intends to retire sometime during the three-year phase-in period will have the option to have their remaining COLA portion also count towards retirement by paying in their retirement contributions on the COLA portion and also requires the agency to pay in matching share.

It is conceivable that such an employee's unconverted COLA and locality pay rates could total more than the applicable locality pay rate. See Attachment 1 which shows the locality pay rates and adjusted COLA rates during the first six years of conversion. Using the 3-year phase-in and the 65% adjustment factor, this will occur for all three years in the Pacific areas, except for Hawaii island and the Caribbean COLA areas. This will occur in the second and third years for Hawaii island and Rural Alaska and only in the third year for Non-Rural Alaska. Under this provision, COLA employees would be receiving higher retirement benefits than federal employees in the 48 states.

The conversion to full locality pay in year 1 will give federal employees their applicable locality pay on which retirement benefits would be determined. The locality pay amounts and resulting retirement benefits would be comparable to those received by federal employees in the 48 states. No buy-in is needed.

Senate Bill 3013 has no provision for retirees. These retirees are not provided any remedies for the retirement inequity due to the exclusion of Hawaii and Alaska from FEPCA and are receiving decreased retirement benefits because of this. If the buy-in in Section 7 is required by the senators, the senators should include some provision for current retirees. Such a provision could make our present lawsuit moot. I am readily available to discuss this further.

I am well aware that OPM and OMB in the past have been lukewarm to the idea that current retirees should be provided for, either by modifying the COLA program or as a component of a program converting COLA to full locality pay, due to the cost factor to the retirement system. Two responses to this: First, the entire notion of locality pay was to eliminate pay inequities between the private sector and federal employees. Hawaii and Alaska employees have been denied this benefit since 1994 and it has had a crippling impact on retirees' pay. Fairness alone demands a resolution. Second, they are not requesting that they be paid an adjustment for this time; only that they be permitted to buy into the system, in the manner already established in section 7 of the proposed legislation, so that their future retirement pay is on par with other federal employees. Under the election provision of this section, those retirees who do not want to buy in can keep their retirement the same. I can also point out that had Hawaii and Alaska been included in locality pay in 1994, as were the other 48 states, the cost would not be a concern today.

Inclusion of USPS Employees and Others: I am pleased to see that the USPS employees are included in this senate bill. The COLA community in each COLA area includes all federal employees who receive COLA/T-COLA. If the conversion is not applicable to USPS employees, their T-COLA needs to be frozen and protected permanently, as provided in the Administration's version.

DIA Employees: The Defense Intelligence Agency employees currently receive a local market pay supplement that is equivalent to DC locality pay and full COLA. I received an inquiry about how a conversion of COLA to locality pay would affect these employees. I am not aware of their pay authority and defer this question to OPM.

Opt-out Election: With the opt-out election provided for in Section 8, it would be crucial to pass some kind of legislation soon. A person who opts out will have his or her COLA frozen at the rates as of December 31, 2008. The COLA rates in Alaska are slated to decrease another 1% before December 31, 2008. The COLA rates for Hawaii are slated to decrease 1% sometime next year.

There are employees who feel they will not benefit from the conversion and would prefer continuing to receive non-taxable COLA. For example, an employee who will be transferring to the continental U.S. to work in a high locality pay area may decide to opt-out. Some FERS employees also do not see a benefit from such conversion. Some employees do not believe in the permanence of locality pay. The opt-out election allows employees to make their own decisions based on their financial situations and on their own strong beliefs.

Senate Bill 3013 leaves an employee's take-home pay largely intact and provides increased retirement benefits to employees in

COLA areas that are not available as long as the COLA program exists. It freezes COLA amounts permanently. There would be no COLA reductions as indicated in our latest COLA surveys.

If an employee does not opt-out, the employee is covered in the conversion. This appropriately protects those employees who do not understand the benefits of this conversion.

NSPS impact:

Special issues are raised by the DoD's NSPS pay system with respect to a COLA conversion to locality pay. The NSPS pay system provides that there will be no annual locality pay raises. If locality pay rates are frozen at time of implementation, there will be no yearly locality pay increase and the COLA-locality pay conversion would come to a halt. Under Section 2(c), the conversion is dependent on the yearly increases to locality pay. The conversion of COLA to locality pay must take place outside the NSPS pay system until COLA is completely converted to locality pay.

Because the NSPS pay system would eliminate all January pay raises, there would be no cushion for DoD employees, as we saw in OPM's Calculator program that included annual pay raises and used an 85% adjustment factor. There will be a negative impact on take-home pay for DoD's NSPS employees using a factor higher than 65%.

Current Retirees: As stated earlier, I ask that this subcommittee seriously consider adding some provision for current retirees. In his decision in *Matsuo vs U.S.,* Judge Pro stated that, in his opinion, the retirement inequity issue raised in that lawsuit should have been dealt with through legislation. Now would be a perfect time

to fix the retirement inequity that has been apparent to OPM since 1991.

If legislation is not possible, we will be forced to continue to seek resolution through our current lawsuit. Should we prevail in the Supreme Court, the COLA conversion to locality pay would become moot because employees in Hawai and Alaska would be entitled to locality pay – regardless of receiving COLA. We calculate the potential costs to the government as follows:

	Hawaii	**Alaska**
Back Pay – Locality Pay (1994 to 1999)	$132 million	$190 million
Back Pay – Locality Pay (2000 to 2008)	$566 million	$827 million
Back Pay COLA due on Locality Pay (1994 to 1999)	$30 million	$47 million
Back Pay COLA due on Locality Pay (2000 to 2008)	$141 million	$204 million
Increase in Retirement Benefits for Retirees Due to Locality Pay	(To be determined)	(To be determined)
Interest on Back Pay Awards	(To be determined)	(To be determined)
Total-Judgment to Plaintiffs (not including increase in retirement benefits, interest on back pay, and administrative costs)	**$869 million**	**$1,268 million (or $1.3 billion)**

We are seeking a fair and equitable retirement fix for all federal employees. We could accept Senate Bill 3013 as a "settlement" for current federal employees. For the remaining class members, the retirees, an additional provision to cover retirees could resolve our lawsuit altogether.

Conclusion:

Mr. Chairman – Thank you for this opportunity to testify before your Subcommittee. I sincerely hope our information, comments and recommendations will aide your Subcommittee in finally developing a legislation that is fair and equitable for federal employees, and hopefully retirees, in the COLA areas. If you need any additional feedback or have any questions, I will be available to offer any assistance I can.

Joyce Matsuo, President
COLA Defense Committee of Oahu, Inc.
1755 Mahani Loop
Honolulu, HI 96819-2833
Phone – (808) 841-0232

CONVERSION OF COLA TO LOCALITY PAY
CALCULATING FOR NEW COLA RATE:

(Revised 5/21/08)

FORMULA: (1+ LOCALITY PAY RATE)X = COLA RATE - .65(LOCALITY PAY RATE)
X = [COLA RATE - .65(LOCALITY PAY RATE)]/(1 + LOCALITY PAY RATE)
X = NEW COLA RATE

ASSUMPTIONS: 3-YEAR PHASE-IN PERIOD
65% ADJUSTMENT FACTOR
LOCALITY PAY RATES - PACIFIC - 20.38%
ALASKA - 27.68%
CARIBBEAN - 13.18% (RUS)

OAHU MAUI KAUAI GUAM	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	13.59%	14.23%	27.82%
2011	25.00%	20.38%	9.76%	30.14%
2012	25.00%	21.28%	9.21%	30.49%
2013	25.00%	22.18%	8.66%	30.84%
2014	25.00%	23.08%	8.12%	31.20%

HAWAII ISLAND	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	18.00%	4.39%	14.51%	18.90%
2010	18.00%	13.59%	8.07%	21.66%
2011	18.00%	20.38%	3.95%	24.33%
2012	18.00%	21.28%	3.44%	24.72%
2013	18.00%	22.18%	2.93%	25.11%
2014	18.00%	23.08%	2.44%	25.52%

ANCHORAGE FAIRBANKS JUNEAU	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	23.00%	4.39%	19.30%	23.69%
2010	23.00%	18.25%	9.42%	27.67%
2011	23.00%	27.68%	3.92%	31.60%
2012	23.00%	28.58%	3.44%	32.02%
2013	23.00%	29.48%	2.96%	32.44%
2014	23.00%	30.38%	2.50%	32.88%

RURAL ALASKA	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	18.25%	11.11%	29.36%
2011	25.00%	27.68%	5.49%	33.17%
2012	25.00%	28.58%	5.00%	33.58%
2013	25.00%	29.48%	4.51%	33.99%
2014	25.00%	30.38%	4.03%	34.41%

ATTACHMENT 1

PUERTO RICO	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	13.00%	4.39%	9.72%	14.11%
2010	13.00%	8.79%	6.70%	15.49%
2011	13.00%	13.18%	3.92%	17.10%
2012	13.00%	14.08%	3.37%	17.45%
2013	13.00%	14.98%	2.84%	17.82%
2014	13.00%	15.88%	2.31%	18.19%

VIRGIN ISLANDS	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	8.79%	17.73%	26.52%
2011	25.00%	13.18%	14.52%	27.70%
2012	25.00%	14.08%	13.89%	27.97%
2013	25.00%	14.98%	13.27%	28.25%
2014	25.00%	15.88%	12.67%	28.55%

* COLA rates for Hawaii Island and Puerto Rico are to increase to 18% and 13%, respectively, after the FR final notice process is completed by year-end.

** COLA rates for Anchorage, Fairbanks and Juneau will decrease 1% to 23% by year-end.

Note: (1) An annual increase of .9% is assumed for annual locality pay rate increases.
(2) RUS rates are used for Puerto Rico and the Virgin Islands.

ATTACHMENT 1

CONVERSION OF COLA TO LOCALITY PAY
CALCULATING FOR NEW COLA RATE:
(Revised 5/21/08)

FORMULA: (1+ LOCALITY PAY RATE)X = COLA RATE - .65(LOCALITY PAY RATE)
X = [COLA RATE - .65(LOCALITY PAY RATE)]/(1 + LOCALITY PAY RATE)
X = NEW COLA RATE

ASSUMPTIONS: 3-YEAR PHASE-IN PERIOD
65% ADJUSTMENT FACTOR
LOCALITY PAY RATES - PACIFIC - 20.38%
ALASKA - 27.68%
CARIBBEAN - 13.18% (RUS)

OAHU MAUI KAUAI GUAM	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	13.59%	14.23%	27.82%
2011	25.00%	20.38%	9.76%	30.14%
2012	25.00%	21.28%	9.21%	30.49%
2013	25.00%	22.18%	8.66%	30.84%
2014	25.00%	23.08%	8.12%	31.20%

HAWAII ISLAND	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	18.00%	4.39%	14.51%	18.90%
2010	18.00%	13.59%	8.07%	21.66%
2011	18.00%	20.38%	3.95%	24.33%
2012	18.00%	21.28%	3.44%	24.72%
2013	18.00%	22.18%	2.93%	25.11%
2014	18.00%	23.08%	2.44%	25.52%

ANCHORAGE FAIRBANKS JUNEAU	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	23.00%	4.39%	19.30%	23.69%
2010	23.00%	18.25%	9.42%	27.67%
2011	23.00%	27.68%	3.92%	31.60%
2012	23.00%	28.58%	3.44%	32.02%
2013	23.00%	29.48%	2.96%	32.44%
2014	23.00%	30.38%	2.50%	32.88%

RURAL ALASKA	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	18.25%	11.11%	29.36%
2011	25.00%	27.68%	5.49%	33.17%
2012	25.00%	28.58%	5.00%	33.58%
2013	25.00%	29.48%	4.51%	33.99%
2014	25.00%	30.38%	4.03%	34.41%

ATTACHMENT 1

PUERTO RICO	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	13.00%	4.39%	9.72%	14.11%
2010	13.00%	8.79%	6.70%	15.49%
2011	13.00%	13.18%	3.92%	17.10%
2012	13.00%	14.08%	3.37%	17.45%
2013	13.00%	14.98%	2.84%	17.82%
2014	13.00%	15.88%	2.31%	18.19%

VIRGIN ISLANDS	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	8.79%	17.73%	26.52%
2011	25.00%	13.18%	14.52%	27.70%
2012	25.00%	14.08%	13.89%	27.97%
2013	25.00%	14.98%	13.27%	28.25%
2014	25.00%	15.88%	12.67%	28.55%

* COLA rates for Hawaii Island and Puerto Rico are to increase to 18% and 13%, respectively, after the FR final notice process is completed by year-end.

** COLA rates for Anchorage, Fairbanks and Juneau will decrease 1% to 23% by year-end.

Note: (1) An annual increase of .9% is assumed for annual locality pay rate increases.
(2) RUS rates are used for Puerto Rico and the Virgin Islands.

Supplemental Testimony of Joyce Matsuo, President of the COLA Defense Committee of Oahu, Inc.

On Behalf of the Oahu and Maui COLA Defense Committees

Before the United States Senate
Committee on Homeland Security and Governmental Affairs
Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia

Thursday June 12, 2008

Non-Foreign COLA: Finding an Equitable Solution

Chairman Akaka, we are encouraged that a genuine effort is being made today by our senators to fix the retirement inequity that was created in 1994 by the implementation of FEPCA. We recognize that we cannot be made completely whole. We are asking for fairness for all employees, current and retired, affected by this long and on-going inequity.

Phase-in Period: The Office of Personnel Management (OPM) explained that a key reason for a phase-in period is to prevent a mass exodus of employees to retirement. I met many of these employees in information-sharing meetings. Many of these employees were retirement-eligible back in 2001 when we first proposed a conversion. They were still there in 2003 waiting for the second attempt. That they are still here, still waiting, indicates how important it is to them to receive a proper annuity amount that helps them to retire in a high cost-of-living area. Management tracks the number of retirement-eligibles under their supervision and should be planning for such an exodus when, and if, it happens. Management has also expressed their concern that employees have transferred to a locality pay area to earn their high-3 years and planned accordingly.

The 2003 "legislative concept" drafted by OPM provided for full applicable locality pay rates in Year 1. The conversion of COLA to locality pay would take several years to accomplish and is predicated on the government's policy of not taking away employees' pay. Full

locality pay rates at the outset avoids the following problems inherent in the buy-in provisions found in Section 7:

1. COLA has never counted towards retirement. Allowing COLA to be considered for retirement purposes has the possibility for new litigation which the government is trying to avoid.

2. An employee who is not eligible for retirement until after December 2011 will not be able to benefit from this buy-in provision at all. Also, that employee will have to work another two years after 2011 in order to benefit from his/her high-3 years with full locality pay amounts. For Oahu, where the great majority of COLA recipients work, they will receive retirement benefits on locality pay only, which is less than their 25% COLA.

3. An employee who elects to buy-in their COLA during the buy-in period January 1, 2009 through December 31, 2011 is being allowed to have their locality pay portion and their unconverted COLA amount count towards retirement. In all COLA areas, the total of these two amounts will exceed their applicable locality pay sometime during this three-year period. This is unfair to the employee described in 2 above who cannot retire within this period and who will receive retirement considerations only on locality pay even though there is still a remaining unconverted COLA amount. (See Attachment 1 – COLA and Locality Pay Rates During the Conversion.) This provision is also unfair to federal employees in the 48 states who receive additional retirement benefits on locality pay alone.

An employee making this buy-in election would contribute their share of retirement costs on the remaining COLA amount plus interest. Interest is not required because the employee would be making a current payment and not a back payment which would warrant an interest payment.

A Provision for Annuitants: We request that the Senators consider including provisions in this bill to cover the current annuitants who retired between January 1, 1994 and the present that would allow these annuitants to buy-in their high-3 years if any of these years were worked in a COLA area. We propose that the buy-in amounts be based on the locality pay rates estimated in each year, subject to a cap of the amount of COLA received in those years. This cap would only impact Alaska as their locality pay rates exceed the 25% COLA statutory cap.

One of the problems we considered in coming up with this cap is the Bureau of Labor Statistics (BLS) conducted locality pay surveys in the COLA areas in 1996, at the request of our Senators. The locality pay rate for Alaska would have been over 38% and for Hawaii and the other COLA areas, it was Rest of the United States (RUS). Under the locality pay program, as implemented by OPM, if the rate in a locality pay area decreases, pay is not decreased. The locality pay rate is not decreased but remains fixed until a subsequent survey results in an increase. There is no pay cut and there is no locality pay rate decrease. If a COLA-to-locality pay-conversion was implemented in 1996, Alaska employees would be receiving 38% locality pay today and not the 27.68% potential applicable locality pay rate estimated by OPM and contemplated by S. 3013.

It is problematic to consider the higher 38% for annuitants and 27.68% for current employees. Using COLA as a cap for the annuitants would avoid any problem created by the 1996 BLS survey that resulted in the 38% LP for Alaska. Alaska annuitants would be giving up the 13% difference (38%-25%) to receive a current legislative fix through S. 3013.

Annuitants would elect the buy-in, paying their retirement contribution amounts on their high-3 years only, plus interest. The government would pay the agencies' share.

Increases to annuity payments would be prospective.

We believe this proposal for annuitants is reasonable and fair. We are hoping to work with OPM to assess this proposal for the annuitants.

65% Adjustment Factor: The adjustment factor of 65% ensures that any negative impact on take-home pay will not be significant. Definitely, the 85% suggested in the Bush Administration's bill version will result in significant decreases in take-home pay.

USPS Employees: At the Senate hearing, we heard testimony from the USPS management that they could not support this bill if their Postal Service employees were included in the conversion of COLA to locality pay. Their primary argument is that there is no retirement inequity among the 50 states and US territories and possessions. If the Postal Service employees are not included in the conversion, their COLA must be frozen permanently as their COLA rates would drop as the COLA decreases for the General Schedule

employees. In Oahu, the conversion of COLA to locality pay will take over 15 years to accomplish. This information should help allay the Postal Service employees' fear that their Territorial-COLA would be taken away.

SES Managers: For SES managers, their COLA needs to be frozen as their pay caps eliminate them from receiving locality pay. (The number of SES managers in the COLA areas is minimal.)

S. 3013 attempts to address all the concerns expressed by employees during the fact-gathering sessions in 2007 in Hawaii and in 2008 in Alaska. The bill itself does not provide sufficient details in three key areas – (1) what happens to COLA after the third year; (2) how are special rates protected; and (3) will the COLA conversion to locality pay be properly handled under NSPS for DoD employees.

(1) Many employees believe that COLA disappears at the end of the third phase-in year. For Hawaii employees, this would mean that they would receive full locality pay of 20% and lose 5% remaining COLA. Attachment 1 is our interpretation of the conversion of COLA to locality pay. It shows a yearly conversion of COLA to locality pay that extends beyond three years. This is the same interpretation OPM shared with us in the 2003 "legislative concept" and have assumed the same interpretation for S. 3013. OPM has somewhat confirmed this in their May 29 testimony, but we would like a firm confirmation of this interpretation.

(2) We noted that the language covering special rate employees are in more general terms than that provided in the 2003 "legislative concept". OPM stated in their testimony that the details would be covered in regulations. We recommend that the detailed special rate language developed by OPM in the 2003 "legislative concept" be used in S. 3013. This level of detail in the legislation would help avoid any possible lawsuits that could stem from challenging the regulations.

(3) We heard the DoD testify that the COLA conversion will be treated properly under NSPS as a local market segment pay. We do not know what DoD defines as this local market segment – as it applies to a current locality pay area and how it would now be applied to the COLA areas. We believe a further discussion with DoD is warranted to ensure that COLA is properly converted to locality pay. Until COLA is completely converted to locality pay, any annual locality

pay increases that drives the conversion is not to be thrown into their NSPS "pool".

We recommend that the parties invited to testify at the May 29, 2008 senate hearing be provided the details of a final draft to clearly understand the provisions of S.3013 and any subsequent changes based on comments and testimonies.

Thank you for this opportunity to provide additional comments and recommendations. I am available for any questions or additional assistance.

Joyce Matsuo, President
COLA Defense Committee of Oahu, Inc.
c/o 1755 Mahani Loop
Honolulu, HI 96819-2833
Phone – (808) 841-0232

CONVERSION OF COLA TO LOCALITY PAY
CALCULATING FOR NEW COLA RATE: 65% ADJUSTMENT FACTOR
(Revised 6/11/08)

FORMULA: (1+ LOCALITY PAY RATE)X = COLA RATE - .65(LOCALITY PAY RATE)
X = [COLA RATE - .65(LOCALITY PAY RATE)]/(1 + LOCALITY PAY RATE)
X = NEW COLA RATE

ASSUMPTIONS: 3-YEAR PHASE-IN PERIOD (1 Year-1/3 RUS; 2 Year-2/3 LP; 3 Year-3/3 LP)
65% ADJUSTMENT FACTOR
LOCALITY PAY RATES - PACIFIC - 20.38%
ALASKA - 27.68%
CARIBBEAN - 13.18% (RUS)
LOCALITY PAY INCREASES .9% PER YEAR

24 years for complete conversion of COLA

OAHU MAUI KAUAI GUAM	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	13.59%	14.23%	27.82%
2011	25.00%	20.38%	9.76%	30.14%
2012	25.00%	21.28%	9.21%	30.49%
2013	25.00%	22.18%	8.66%	30.84%
2014	25.00%	23.08%	8.12%	31.20%
2015	25.00%	23.98%	7.59%	31.57%
2016	25.00%	24.88%	7.07%	31.95%
2017	25.00%	25.78%	6.55%	32.33%
2018	25.00%	26.68%	6.05%	32.73%
2019	25.00%	27.58%	5.54%	33.12%
2020	25.00%	28.48%	5.05%	33.53%
2021	25.00%	29.38%	4.56%	33.94%
2022	25.00%	30.28%	4.08%	34.36%
2023	25.00%	31.18%	3.61%	34.79%
2024	25.00%	32.08%	3.14%	35.22%
2025	25.00%	32.98%	2.68%	35.66%
2026	25.00%	33.88%	2.22%	36.10%
2027	25.00%	34.78%	1.78%	36.56%
2028	25.00%	35.68%	1.33%	37.01%
2029	25.00%	36.58%	0.90%	37.48%
2030	25.00%	37.48%	0.46%	37.94%
2031	25.00%	38.38%	0.04%	38.42%
2032	25.00%	39.28%	0.00%	39.28%

12 years for complete conversion of COLA

HAWAII ISLAND	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	18.00%	4.39%	14.51%	18.90%
2010	18.00%	13.59%	8.07%	21.66%
2011	18.00%	20.38%	3.95%	24.33%
2012	18.00%	21.28%	3.44%	24.72%
2013	18.00%	22.18%	2.93%	25.11%
2014	18.00%	23.08%	2.44%	25.52%
2015	18.00%	23.98%	1.95%	25.93%
2016	18.00%	24.88%	1.46%	26.34%
2017	18.00%	25.78%	0.99%	26.77%
2018	18.00%	26.68%	0.52%	27.20%
2019	18.00%	27.58%	0.06%	27.64%
2020	18.00%	28.48%	0.00%	28.48%

ANCHORAGE				

ATTACHMENT 1

14 years for complete conversion of COLA

FAIRBANKS JUNEAU	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	24.00%	4.39%	20.26%	24.65%
2010	24.00%	18.25%	10.26%	28.52%
2011	24.00%	27.68%	4.71%	32.39%
2012	24.00%	28.58%	4.22%	32.80%
2013	24.00%	29.48%	3.74%	33.22%
2014	24.00%	30.38%	3.26%	33.64%
2015	24.00%	31.28%	2.79%	34.07%
2016	24.00%	32.18%	2.33%	34.51%
2017	24.00%	33.08%	1.88%	34.96%
2018	24.00%	33.98%	1.43%	35.41%
2019	24.00%	34.88%	0.98%	35.86%
2020	24.00%	35.78%	0.55%	36.33%
2021	24.00%	36.68%	0.12%	36.80%
2022	24.00%	37.58%	0.00%	37.58%

15 years for complete conversion of COLA

RURAL ALASKA	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%
2010	25.00%	18.25%	11.11%	29.36%
2011	25.00%	27.68%	5.49%	33.17%
2012	25.00%	28.58%	5.00%	33.58%
2013	25.00%	29.48%	4.51%	33.99%
2014	25.00%	30.38%	4.03%	34.41%
2015	25.00%	31.28%	3.56%	34.84%
2016	25.00%	32.18%	3.09%	35.27%
2017	25.00%	33.08%	2.63%	35.71%
2018	25.00%	33.98%	2.17%	36.15%
2019	25.00%	34.88%	1.73%	36.61%
2020	25.00%	35.78%	1.28%	37.06%
2021	25.00%	36.68%	0.85%	37.53%
2022	25.00%	37.58%	0.42%	38.00%
2023	25.00%	38.48%	0.00%	38.48%

11years for complete conversion of COLA

PUERTO RICO	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	13.00%	4.39%	9.72%	14.11%
2010	13.00%	8.79%	6.70%	15.49%
2011	13.00%	13.18%	3.92%	17.10%
2012	13.00%	14.08%	3.37%	17.45%
2013	13.00%	14.98%	2.84%	17.82%
2014	13.00%	15.88%	2.31%	18.19%
2015	13.00%	16.78%	1.79%	18.57%
2016	13.00%	17.68%	1.28%	18.96%
2017	13.00%	18.58%	0.78%	19.36%
2018	13.00%	19.48%	0.28%	19.76%
2019	13.00%	20.38%	0.00%	20.38%

32 years for

VIRGIN ISLANDS	CURRENT COLA	LOCALITY PAY RATE	ADJ. COLA RATE	TOTAL
2009	25.00%	4.39%	21.22%	25.61%

ATTACHMENT 1

complete conversion of COLA

2010	25.00%	8.79%	17.73%	26.52%
2011	25.00%	13.18%	14.52%	27.70%
2012	25.00%	14.08%	13.89%	27.97%
2013	25.00%	14.98%	13.27%	28.25%
2014	25.00%	15.88%	12.67%	28.55%
2015	25.00%	16.78%	12.07%	28.85%
2016	25.00%	17.68%	11.48%	29.16%
2017	25.00%	18.58%	10.90%	29.48%
2018	25.00%	19.48%	10.33%	29.81%
2019	25.00%	20.38%	9.76%	30.14%
2020	25.00%	21.28%	9.21%	30.49%
2021	25.00%	22.18%	8.66%	30.84%
2022	25.00%	23.08%	8.12%	31.20%
2023	25.00%	23.98%	7.59%	31.57%
2024	25.00%	24.88%	7.07%	31.95%
2025	25.00%	25.78%	6.55%	32.33%
2026	25.00%	26.68%	6.05%	32.73%
2027	25.00%	27.58%	5.54%	33.12%
2028	25.00%	28.48%	5.05%	33.53%
2029	25.00%	29.38%	4.56%	33.94%
2030	25.00%	30.28%	4.08%	34.36%
2031	25.00%	31.18%	3.61%	34.79%
2032	25.00%	32.08%	3.14%	35.22%
2033	25.00%	32.98%	2.68%	35.66%
2034	25.00%	33.88%	2.22%	36.10%
2035	25.00%	34.78%	1.78%	36.56%
2036	25.00%	35.68%	1.33%	37.01%
2037	25.00%	36.58%	0.90%	37.48%
2038	25.00%	37.48%	0.46%	37.94%
2039	25.00%	38.38%	0.04%	38.42%
2040	25.00%	39.28%	0.00%	39.28%

**TESTIMONY OF SHARON WARREN, PRESIDENT, COLA DEFENSE COMMITTEE OF ANCHORAGE, INC.
ON BEHALF OF ALL ALASKA COLA DEFENSE COMMITTEES
BEFORE THE UNITED STATES SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, SUBCOMMITTEE ON THE OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA**

May 29, 2008

Good Afternoon, Chairman Akaka, Ranking Member Voinovich and Members of the Senate Subcommittee on the Oversight of Government Management, the Federal Workforce, and the District of Columbia.

My name is Sharon Warren, President of the COLA Defense Committee of Anchorage, Inc. and representing all three Alaska COLA Defense Committees—Anchorage, Fairbanks and Juneau. On behalf of the Alaska COLA Committees, I would like to thank you for allowing us to express our views regarding the proposed plan for eliminating the non-foreign area Cost-of-Living Allowance (COLA) and including the non-foreign areas in the Federal Employees Pay Comparability Act (FEPCA) locality pay program.

Established in 1985, the COLA Defense Committees in Alaska are non-profit advocacy corporations dedicated to protecting the interests of Federal and Postal employees regarding their compensation, including any allowances, differentials, or supplements to their pay. There are nearly 13,000 Federal and Postal employees in Alaska who receive COLA.

The Administration seeks to transition from the COLA program to the locality pay program in the non-foreign areas. The purpose for this change is to have a uniform approach and simplified pay structure for Federal employees, equity in pension benefits, parity on base pay increases, and improvement in recruiting and retaining employees in non-foreign areas. As

you know, COLA is not included in the calculation of retirement benefits whereas locality pay is included. This results in Alaskan retirees receiving significantly less retirement pay than their counterparts in the 48 states.

The Administration also seeks to limit their exposure to future litigation arising out of the non-foreign COLA program. The non-foreign COLA program has given rise to much controversy and several lawsuits, which have cost the United States government hundreds of millions of dollars. Currently, the Office of Personnel Management is working with non-foreign COLA Committee representatives through the Survey Implementation Committee to carry out the 2000 Caraballo Settlement Agreement. This Survey Implementation Committee has been extended several times and is due to expire December 31, 2008. I along with Denise Hernandez, President of the COLA Defense Committee of Fairbanks serve on the Survey Implementation Committee with the Office of Personnel Management to assist in implementing the settlement terms that would improve the non-foreign COLA program.

The concept of transitioning from the COLA Program to the locality pay program in the non-foreign areas has been discussed for a number of years. In 2003, all Alaska COLA Defense Committees were pursuing the concept to transition to locality pay. Finally, after four years, the proposal was included in the President's budget and submitted to Congress in May 2007. The proposal was again in the President's 2008 budget. We support the Administration's proposal to transition from COLA to locality pay. However, modifications to certain provisions of their proposal are necessary to ensure Federal and Postal employees are treated fairly and equitably.

The key elements of the Administration's proposal are:

- Discontinue COLA Surveys;

- For non-US Postal Service employees—
  - Freeze COLA rates as of date of enactment;
  - Extend locality pay to non-foreign areas (for Alaska this is a seven year phase in);
  - Offset and reduce COLA rates by 85% of locality pay percentage to reduce impact on take home pay;
  - Abolish COLA payments once rates reach zero.
- For most US Postal Service employees, freeze COLA rates as of date of enactment.

Based on the 1996 locality pay surveys in Hawaii and Alaska requested by the Alaska and Hawaii Senators, Alaska was projected to receive the highest locality pay rate in the nation. The OPM estimated Alaska's locality pay rate at 38 percent. Since 1996, the method of calculating locality pay has changed and now Alaska is estimated to have a locality pay rate of 27.68 percent.

Under the Administration's proposal there is a seven-year phase in provision. Federal employees in Alaska will not receive full locality pay rates in the first year. Instead, Alaska would receive one-seventh of the Rest of the United States (RUS) locality pay rate which is 13.18 percent (2008), or 1.9 percent. During the first year, OPM is to determine the proper locality pay rate. In the second year Alaska would receive 2/7 of the designated locality pay rate and an additional 1/7 each year thereafter until full locality pay is achieved. Employees in Alaska are being asked to work up to nine additional years in their career to achieve retirement benefits similar to those received by employees in the 48 states.

At the two March 2008 town hall meetings in Anchorage and Fairbanks, Alaska, which were sponsored by Senator Stevens to gain the

views of the Federal employees in Alaska, the overwhelming response by the employees was phasing in locality pay over seven years was not acceptable. Since 2003, Alaska Federal employees have been waiting for the opportunity to convert from COLA to locality pay. The reason provided by the Office of Personnel Management that the RUS rate should be used the first year is Alaska is not a separate locality pay area under FEPCA and it would take the government a year to determine appropriate locality pay rates for Alaska. While it is true Alaska has not been designated a separate locality pay area and specific locality pay rates therefore have not been set for Alaska, the Office of Personnel Management was nevertheless able to estimate the locality pay rate for Alaska when they provided information at Senator Akaka's request for the locality pay calculator.

The 85 percent factor used in calculating the adjusted COLA does not protect employees' take-home pay for the majority of our employees. It assumes an unrealistically low federal income tax of 15 percent, and does not account for other mandatory deductions (e.g., Social Security and Medicare taxes).

The Administration's proposal protects Postal employees pay by permanently freezing their Territorial COLA (TCOLA) at the rates in effect at the time the law is passed. The Postal TCOLA is equal to the COLA of Federal white-collar employees. Postal employees have expressed concern over being the only employees left receiving a non-taxable income (TCOLA) and becoming "low hanging fruit only to be plucked at another time." Postal employees would like to stay under the umbrella of all Federal employees in COLA areas, as they are now. Senate Bill 3013 successfully keeps Postal employees under that umbrella.

Where there are shortfalls in the Administration's proposal, Senate Bill 3013, the Non-Foreign Area Retirement Equity Assurance Act of 2008 or the Non-Foreign AREA Act of 2008) seeks to address these issues by:

- Using an adjustment factor of 65 percent instead of 85 percent to implement the "sense of Congress" that the act should not result in a decrease in the take home pay of an employee;
- Addressing the special situation of employees receiving Special Pay Rates;
- Phasing in the conversion to locality pay over a three year, rather than a seven-year period;
- Allowing Postal employees to benefit with their counterparts in the non-foreign areas regarding retirement benefits;
- Allowing employees to elect to have additional basic pay for annuity computation during the phase in period and allowing employees to pay into the Civil Service Retirement and Disability Retirement Fund; and
- Allowing employees to choose whether they want to be covered by the provisions of the act

Overall Senate Bill 3013 addresses many of the concerns expressed by employees in Alaska, except for retirees.

Both the Administration's proposal and Senate Bill 3013 are silent regarding retirement benefits for Federal employees who have retired from Federal service. Apparently, there is a reluctance to include provisions in legislation to recognize the retirement inequities experienced by retired Federal employees. I am sure Congress never intended to have such disparity of retirement benefits between the Federal employees in the non-

foreign areas and the 48 states. However, implementation of FEPCA drastically reduced the retirement benefits of Federal employees in Alaska. This impact on retired Alaska Federal employees has continued each year because the cost of living adjustments in retirement annuities are based upon the percentage of the annuity received. Federal employees who retired from Alaska were dedicated to Federal service and it cost them dearly in their retirement benefit. We recognize retirees have not paid into the retirement program. Section 7 of Senate Bill 3013 could be amended to include language for allowing retirees to pay into the Civil Service Retirement and Disability Retirement Fund or by an offset withheld from the increased retirement benefit.

The Alaska COLA Committees support Senate Bill 3013. We understand that any legislation will not be perfect for everyone. The Alaska COLA Committees believe it is important to have a fair and equitable resolution with respect to both pay compensation and the retirement inequities that have existed since the implementation of FEPCA.

Thank you again, Mr. Chairman, for the opportunity to testify before your Subcommittee, and for your time and attention to this important mater. This concludes my prepared remarks. If you need any additional feedback or have questions, we would be glad to offer our assistance.

COLA DEFENSE COMMITTEE OF GUAM
DRAWER DK
HAGATNA, GUAM 96932

TESTIMONY OF

MANUEL Q. CRUZ
PRESIDENT
COLA DEFENSE COMMITTEE OF GUAM

BEFORE THE

UNITED STATES SENATE
COMMITTEE OF HOMELAND SECURITY & GOVERNMENT AFFAIRS
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA

HEARING ON

NON-FOREIGN AREA RETIREMENT EQUITY ASSURANCE ACT OF 2008

THURSDAY, MAY 29, 2008
OAHU VETERANS CENTER
HONOLULU, HAWAII

Hafa Adai, Mr. Chairman and Members of the Subcommittee:

My name is Manuel Q. Cruz and I am the President of the COLA Defense Committee of Guam. I want to thank you for the opportunity to appear before the Subcommittee to testify on Senate Bill S. 3013, the "Non-Foreign Area Retirement Equity Assurance Act of 2008." I also want to thank you and Senator Voinovich for inviting me to this hearing.

Almost to the exact date last year (May 30, 2007), the Office of Personnel Management (OPM) sent a legislative proposal to Congress that would phase-out the Non-Foreign Cost-of-Living-Allowance (COLA) and phase-in locality pay for Federal employees in Alaska, Hawaii, Guam and the Commonwealth of the Northern Mariana Islands (CNMI), Puerto Rico, and the U.S. Virgin Islands. President George Bush proposed the change in compensation policy as part of his FY 2008 budget. It would change a pay system that is in place since 1948.

You will note in the President's proposal that locality pay will be extended to white-collar Federal employees in the COLA areas, while reducing COLA payments

gradually. The changes would be phased-in over a 7-year period. At the same time, workers would be receiving the so-called "locality" payments, which would boost salaries based on surveys of what is paid by the private sector in local markets.

While not knowing the full details of the proposal, it was felt by many of the affected white-collar workers on Guam that the 25 percent COLA that were being received at the time could be in jeopardy. Locality pay was considered, in most cases, to be not as high as COLA. Thus, it would appear that some workers may benefit under the proposal, while others could be hurt.

Since 1948, Federal employees in Guam have received COLA to ensure that their pay reflects the high cost of living. COLA is not subject to Federal or Social Security/Medicare taxes. Locality pay, on the other hand, is taxed and considered part of base pay, which is used to calculate an employee's retirement annuity. COLA is based on living costs, while locality pay is based on differences in the cost of labor. Additionally, COLA payments can be reduced, while locality pay has been increasing in the last few years.

With the introduction of the "Non-Foreign Area Retirement Equity Assurance Act of 2008," it is my understanding that COLA rates will no longer be determined based on the difference in the cost of living with Washington, D.C. , but will now be the rate in effect on December 31, 2008. The Office of Personnel Management (OPM) has been seeking slowly to phase-out the COLA system in favor of the locality pay system, but this new legislative proposal will speed up the process. The result will be that the new system will be fully in place in three (3) years rather than the seven (7) tears that was suggested by OPM.

It is also my understanding that the legislative proposal is intended to benefit all Federal employee groups whose counterparts in the U.S. Mainland currently receive locality pay. Employees who will soon be forced to retire due to age and those intending to retire in three (3) years or less will be able to buy in to the program to ensure that they may fully participate in the new system. The legislative proposal, however, does not address already retired employees.

It must be noted that Guam and the CNMI have some unique situations that may not be fully addressed by the new legislative proposal. They are:

1. **<u>Post Differential (PD)</u>**

   A Post Differential (PD) is based on environmental conditions being significantly different from the continental U.S. and used by Federal agencies for recruiting purposes. PDs are authorized for Guam and the CNMI. The PD rate for Guam and the CNMI has been set at 20 percent. Like COLA, PDs do not count toward retirement. It is not clear in the legislative proposal how PDs will be addressed. Locality pay has no effect on the price of goods either in Washington, D.C., or in the foreign areas.

2. **National Security Personnel System (NSPS)**

   The NSPS Program only applies to Department of Defense (DOD) civilian employees. The majority of Federal employees on Guam work for DOD activities. How are questions on NSPS features)local market supplement) going to be addressed? NSPS implementation apparently has no effect on COLAs, so employees continue to receive COLA at the time of conversion. But, what about locality pay?

3. **Non-Appropriated Fund (NAF) Employees**

   NAF employees do not receive locality pay. COLA is not granted to employees in NAF positions in paybands NF-1 and NF-2.

4. **CONUS COLA**

   As a requirement of their military service, members of the Uniformed Services move about the country. Many military members and their families are assigned to a variety of low, moderate, and high-cost locations. Private sector pay scales tend to reflect local living costs in U.S. locations, but military pay tables do not. Would such a COLA Program become a problem when the non-foreign COLA Program is phased-out?

5. **DODEA Schools**

   OPM claims that the change would benefit workers because locality pay, unlike COLA, counts toward retirement. However, there would be no true benefit since the locality pay in a location, such as Guam, would amount to less that DODEA employees have been receiving from their salaries alone under their current system.

In closing, I have to admit that I still have mixed feelings regarding the proposed legislative proposal. Until such time that I learn more of the various provisions and ramifications of the proposal, I have to keep an open mind regarding the matter. However, I do want point out for the record that the COLA issue will continue to be of great importance to Federal employees in the COLA areas, since it truly represents such a significant portion of their cash compensation. The fact is that although Guam and the CNMI are currently under the COLA Program, they have profoundly different economies, labor markets, climates, and access to various resources, including those purchased by the Washington, D.C. area's "typical" Federal employee household. It is possible that different solutions may be appropriate for the different areas, and that while a continuation of the COLA Program is warranted in some areas, it may not be in others. As such, I sincerely urge the Subcommittee to address problems in the COLA areas taking into consideration the unique attributes of each area.

On behalf of the COLA Defense Committee of Guam and all the Federal employees on Guam and the CNMI, thank you again, Mr. Chairman and Members of the Subcommittee for this opportunity for me to appear before you all. Si Yu'os Ma'ase! I will be happy to answer any questions you may have at this time.

Testimony
Before the United States Senate
Committee on Homeland Security and Governmental Affairs
Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia
May 29, 2008

Non-Foreign COLA: Finding an Equitable Solution

Transitioning from COLA to Locality Pay: A Vital Step to Recruiting and Retaining a Qualified Workforce in Hawaii

Statement of
Michael FitzGerald
President, Chapter 187, NAVFAC Hawaii
Federal Managers Association

1641 Prince Street ■ Alexandria VA 22314-2818 ■ Tel: (703) 683-8700 ■ Fax: (703) 683-8707
■ E-mail: info@fedmanagers.org ■ Web: www.fedmanagers.org

Chairman Akaka, Ranking Member Voinovich and Members of the Senate Subcommittee on the Oversight of Government Management, the Federal Workforce and the District of Columbia:

My name is Michael FitzGerald and I am the President of the Federal Managers Association (FMA) Chapter 187, Naval Facilities Engineering Command (NAVFAC) in Hawaii where I serve as the Utilities Supervisor for potable water. On behalf of the 200,000 managers, supervisors, and executives in the federal government whose interests are represented by FMA, I would like to thank you for allowing us to express our views regarding proposals to change the pay system for federal employees in Alaska, Hawaii and the United States Territories.

Established in 1913, FMA is the largest and oldest Association of managers and supervisors in the federal government. FMA originally organized within the Department of Defense to represent the interests of its civil service managers and supervisors, and has since branched out to include some 35 different federal departments and agencies. We are a non-profit, professional, advocacy organization dedicated to promoting excellence in government. Please note that I am here on my own time and of my own volition, representing the views of FMA and not that of NAVFAC.

Since 1948, federal employees outside of the contiguous U.S. have received a non-foreign cost of living adjustment (COLA) to ensure that their pay reflects the high cost of living in these areas. In Hawaii, this non-taxable payment can be up to 25 percent of an employee's basic pay; however, COLA is not credited towards an employee's retirement annuity. At the time, COLA was offered to employees to address growing recruitment and retention problems. Today, however, we are faced with a much different population and a situation where a COLA no longer makes sense.

Since the passage of the Federal Employee Pay Comparability Act (FEPCA) in 1990, there has been much discussion and consternation that employees in Hawaii and Alaska have not been included in the locality pay pool authorized by FEPCA. In the beginning, locality pay was rather low and a cost of living allowance seemed to offer reasonable compensation for the high cost of living in these remote states. As time went on, it became apparent that COLA recipients were at a disadvantage because locality pay is tied to basic pay for retirement purposes. This practice denies residents of Alaska and Hawaii substantial benefits for no other reason than that their residence is outside the contiguous United States.

High locality pay in the continental 48 states lures managers, high-level technicians, and engineers to leave Hawaii and Alaska to seek higher pay and an increased annuity towards the end of their careers. With the Los Angeles area offering a 25.26 percent locality adjustment and the San Francisco area offering 32.53 percent, it is easy to see why employees nearing the end of their careers would be looking to complete their final three years in these cities. Specific data to document this migration is hard to come by, but the stories are endless. In my office alone, a husband and wife have separated for their careers. The wife has gone to San Francisco to finish up her career with the General Services Administration while her husband continues to work here in Hawaii. They both plan to retire in Hawaii, but must endure a long distance relationship in order to properly plan for their retirement.

Backfilling vacant positions, especially managerial and supervisory positions, which by their nature, are held by older workers, in Hawaii becomes increasingly difficult with COLA not contributing to retirement annuity calculations. Qualified workers are reluctant to accept positions in Hawaii and jeopardize their retirement. Here at the Pearl Harbor Naval Shipyard, vacancies remain open for months and delays in hiring at this level undoubtedly impacts agency mission. Similar refusals, spread across all of the federal agencies in Hawaii and Alaska, negatively affect the federal government.

Over the years, we have seen that annuity payments for residents of Hawaii were as much as 30 percent less than their counterparts on the west coast. By 2003, there was enough interest that a working group was put together in Hawaii to study this issue and the group subsequently submitted a request to the Office of Personnel Management (OPM) to look into converting non-foreign COLA to locality pay. With each passing year, the voice for locality pay grew louder and in 2006, the Hawaii State Legislature passed House Resolution 47 in support of locality pay for Hawaii federal workers. In May 2007, at the urging of the President of the United States, OPM issued the Locality Pay Extension Act of 2007 and submitted the legislative proposal to the Senate for consideration. In his fiscal year 2008 and 2009 budget request, the President also proposed to phase in locality pay and phase out the non-foreign cost of living allowance.

We at FMA appreciate the support and attention the Administration is placing on this problem. For too long, federal employees outside the continental U.S. have been punished for their residence in these areas. However, we have serious concerns about the OPM proposal as submitted to Congress. In short, the Locality Pay Extension Act would transition federal employees in non-foreign COLA areas to locality pay over seven years by adjusting their pay every year. This would be done by increasing the

locality pay component and decreasing the COLA component each year. For computation purposes COLA would be "frozen" at the first year of inception and reduced by 85% of the difference between the original COLA rate and the yearly locality pay rate. It is our understanding that in the eyes of the Administration, the proposal offered by OPM would do three things:

- Reduce the cost of litigation associated with the COLA program;
- Lessen the budget impact that a full first year of locality pay would bring; and,
- Apply contemporary compensation practices to all federal workers.

FMA believes that the Locality pay Extension Act of 2007 does not go far enough to recognize the needs of today's hardworking federal employees outside the contiguous United States. In fact, it is our belief that the OPM proposal continues the discriminatory, illogical and possibly unconstitutional denial of full locality pay for federal employees in Alaska and Hawaii for seven years. In short, the Locality Pay Extension Act would needlessly stretch out the transition and not do enough to protect the take home pay of employees. The time for a seven year phase in was seven years ago. Today we are facing real retention and recruitment issues and we need to move up the timetable on any COLA to locality pay conversion in order to compete with not only the private sector, but also our federal counterparts on the mainland. As such, it is our belief full locality adjustments should be added to pay the first year it is authorized.

For the federal government to remain the employer of choice, we must offer a competitive salary. Locality pay takes into account the cost of labor in a given area and was originally enacted to close the gap between public and private sector wages. The Locality Pay Extension Act proposed by OPM actually *reduces* net take home pay for most federal employees in Hawaii and Alaska, since the added locality pay component also brings with it a tax burden. OPM recognizes this with a 15 percent "offset" to adjust for the added taxes, but most employees in Hawaii and Alaska fall into the 25 or 28 percent tax bracket. By applying a 15 percent offset, most employees will see less money in their paychecks than if we left the system as is. Simply put, this is unacceptable and will only exacerbate our growing recruitment problem. The federal workers in the contiguous 48 states were not asked to take a cut in pay for increased retirement benefits when FEPCA was enacted; they were given both - increased pay and increased annuity. It is only fair we do the same in this situation.

We at FMA request Congress work with OPM to develop a fair and equitable conversion from non-foreign COLA to locality pay that focuses on two key features to help with recruitment and retention:

- Implement full locality pay the first year it is authorized; and,
- Apply an offset to COLA that is at least 25 percent to minimize adverse affects to take home pay.

The Federal Managers Association proposes an alternative to the OPM plan, but one based on similar calculations. Under our proposal, the Rest of the United States (RUS) locality pay should be applied to the basic pay of federal workers in the first year of implementation, since no Hawaii locality rate currently exists. COLA for these employees would be reduced by the RUS rate multiplied by 75 percent, not 85 percent as proposed by OPM. For example, if the RUS rate was 15 percent and COLA was frozen at 25 percent as it is now, the employee would receive 15 percent taxable locality pay and a 13.75 percent COLA in the first year. Workers between GS-6 step 2 and GS-12 step 9 would see no change to their take home pay under this plan if they took the standard deduction on their taxes. Workers below the GS-6 level would see slightly more in their pay than under the current COLA system. Conversely, workers above the GS-13 level would see a manageable decrease in pay. The FMA plan targets the majority of federal workers in Alaska and Hawaii. Taking budgetary matters into consideration, the FMA proposal likely would not cost the federal government any additional money as the same Locality Pay Pool would be spread over a slightly larger population while increasing the amount of federal taxable income for Alaska and Hawaii federal employees.

After the first year of implementation, a Hawaii area locality pay should be established and the proper amount of compensation applied. We have seen some preliminary studies that put Hawaii's locality pay around 20 percent and Alaska's at 28 percent. With these rates applied in the second year, COLA should be eliminated in Alaska and greatly reduced in Hawaii. The additional taxes collected as a result of locality pay conversion would help offset increased annuity amounts and the cost of administering the pay conversion.

I would like to take a moment to address recently introduced legislation, S. 3103, the Non-Foreign Area Retirement Equity Assurance Act, introduced by Senators Akaka, Inouye, Stevens and Murkowski. This proposal was met with great excitement by our membership in Hawaii. We were

encouraged to read that several of our concerns were addressed in the bill. We congratulate the fine Senators from Alaska and Hawaii on developing a piece of legislation that not only meets, but exceeds what our members thought was possible.

As you are likely aware, the bill proposes a three year phase-in of locality pay combined with an annuity buy-in aimed at stabilizing the current retirement eligible workforce. The legislation also advises a 35 percent offset to COLA to protect the pay of all federal employees as they transition from COLA to locality pay. This is critical to retaining younger employees who have told us that they would not support any change that would adversely affect their pay check.

Additionally, we are supportive of the phase-in process of locality pay as laid out in S. 3103. During the phase-in, non-foreign COLA is adjusted based on the amount of locality pay phased in. Under the legislation, in the first year of conversion, employees would receive one-third of the locality pay percentage for the Rest of U.S. and still receive a sufficient amount of COLA to pay the additional taxes they will incur. In the second year, when a locality pay area could be established for each non-foreign area, two-thirds of the locality pay percentage approved by the President for the area would be applied, with the percentage of COLA being lowered but still offsetting increased taxes and mandatory payroll deductions. In the final, third year, full locality pay would be implemented, but a COLA portion of pay would still be authorized. This process would continue after the third year until the locality pay surpasses the offsetting COLA rate. We are encouraged that the bill expresses the sense of Congress that employees should not have a decrease in take home pay due to enactment of the legislation.

FMA's plan calls for full locality pay in the first year based on the assumption current employees would be less likely to transfer out of state to take jobs as they near retirement. They would be able to retire on their own terms, in their own homes and in their own communities. While S. 3103 would implement locality pay over three years, we believe the outcome would remain the same due to the provision which would allow employees to pay into the Civil Service Retirement and Disability Retirement Fund to cover the amount of what they would have paid if they had been covered under the legislation.

OPM has stated that a significant retirement wave would occur after three years if full locality pay was introduced right away. We at FMA believe the "retirement tsunami" has already begun. By implementing locality pay right away, agencies can prevent what otherwise would have been a mad scramble as senior leaders shuffle around and jockey for advantageous retirement positions.

Implementing full locality pay sooner rather than later will allow these outgoing leaders to focus more on succession planning and less on how they will be planning for their own retirement. Eliminating an arbitrary phase-in period will stabilize the current retirement eligible employees who make up nearly half the workforce.

The other half of the workforce, those just entering civil service, is less concerned about the "high three" and more concerned with take home pay. By increasing the offset to COLA to 35 percent, these younger workers will not be adversely impacted by a change in the pay system. Additionally, younger employees in the Federal Employee Retirement System (FERS) will see increased eligible matching funds for their Thrift Savings Plan (TSP) because their base pay will be increased by the locality pay amount. In fact, over a career, these matching funds can amount to an estimated $31,000 for a GS-9. The resulting compensation package will make the federal government more competitive in the current tight labor market. This is essential if the highly critical missions of the federal agencies in Hawaii and Alaska are to be met. In fact, the Defense Intelligence Agency employees are given a compensation package that includes the Washington D.C. locality pay *and* a COLA for the Honolulu area. Please note we are not here to advocate for both COLA and locality pay. We are simply asking for the tools that allow us to be competitive in the job market.

In recent months, we have been advised that COLA will be decreased to 24 percent for Honolulu in the next cycle. This is not because the cost of living is decreasing in Hawaii, but rather the cost of living in Washington D.C. is increasing faster. This is particularly important for our friends in Alaska who see a huge disparity between their COLA at 18 percent and the estimated locality pay of 28 percent. COLA served its purpose half a century ago. It is now outdated and acts as a barrier to federal employment. By acting now and implementing this market-oriented approach to determining local salaries, Congress can arm Hawaii and Alaska managers with one more tool to attract and retain today's highly mobile and talented workforce. Thank you for your time and consideration of our views and I look forward to answering any questions you may have.

National Association of Letter Carriers

William H. Young
President

100 Indiana Ave., NW
Washington, DC
20001-2144
202.393.4695
www.nalc.org

Fredric V. Rolando
Executive Vice President

Gary H. Mullins
Vice President

Jane E. Broendel
Secretary-Treasurer

George C. Mignosi
Asst. Secretary-Treasurer

Dale P. Hart
Director, City Delivery

Brian E. Hellman
Director, Safety & Health

Myra Warren
Director, Life Insurance

Timothy C. O'Malley
Director, Health Insurance

Ernest S. Kirkland
Director, Retired Members

Board of Trustees:
Larry Brown Jr.
Chairman
Randall L. Keller
Michael J. Gill

Affiliated with the AFL-CIO &
Union Network International

Subcommittee on Oversight of General Government, the Federal Workforce, and the District of Columbia
Chairman Daniel K. Akaka
May 29, 2008 Field Hearing
"The Non-Foreign Area Retirement Act of 2008"
Testimony of Terry Kaolulo
Hawaii State Association of Letter Carriers

Good afternoon Chairman Akaka and thank you for the opportunity to appear before your Committee today. My name is Terry Kaolulo and I have been a full time letter carrier in Kailua for 23 years. In addition, I also serve at the President of the Hawaii State Association of Letter Carriers. On behalf of letter carriers in the non-foreign areas I would like to thank you for introducing S.3013, "The Non-Foreign Area Retirement Act of 2008". It is also my understanding that the postal employees represented by other postal unions share our general support of the legislation.

Traditionally, postal employees have received a Territorial COLA or T-COLA in the non-foreign areas. This T-COLA is a percentage amount added to our base pay that is derived from a cost of living survey conducted by the Office of Personnel Management. It is a tax-free payment made to employees. However, these employees cannot factor these payments into their base pay and therefore they

do not count towards retirement. Postal employees living in the non-foreign areas are generally supportive of the approach that your legislation takes to address this issue, though our national organizations do not support area COLA's or locality pay in general. So while we can support your bill's enhancement of a long established pay differential for workers employed in non-foreign areas, we would propose an amendment to the bill defining this change as Territorial Postal Pay as it pertains to postal employees.

Bargaining unit employees of the Postal Service living in these non-foreign areas support the integration of T-COLAs into taxable base pay, as S. 3013 provides. We would also like the Territorial Postal Pay to be phased in and paid in the same manner as you propose for the other federal workers under the General Services schedule - - over a period of 3 years.

Territorial Postal Pay would be set at the same level as the locality pay established for federal employees in the non-foreign areas. A possible alternative to this pay methodology could be for postal employees to have their T-COLA completely phased into Territorial Postal Pay over the same 3 year period with 1/3 of T-COLA phased into Territorial Postal Pay each year. The phase in would include the same 65% formula used for GS employees to compensate for lost take home pay due to additional taxes.

Postal employees in the non-foreign areas realize that the price of goods has skyrocketed throughout the entire country and families

everywhere are feeling the pain. However, postal employees here still pay a huge premium for both domestic and imported goods and services compared to our co-workers on the mainland. We therefore, believe that continuation of a T-COLA or Territorial Postal Pay is not only essential to our members but also entirely justified.

We look forward to working with you to ensure that this legislative proposal is effective and a bill that postal employees in the non-foreign areas can ultimately support. Thank you for the opportunity to testify here today and I would be happy to answer any questions that you may have.

STATEMENT FOR THE RECORD OF

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA

SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

ON

S. 3013, NON-FOREIGN AREA RETIREMENT EQUITY ASSURANCE ACT OF 2008

JUNE 12, 2008

The American Federation of Government Employees, AFL-CIO (AFGE) is pleased to submit this testimony on behalf of the more than 600,000 federal employees our union represents, including thousands who live and work in numerous federal agencies and programs located in the non-foreign COLA areas.

AFGE strongly supports S. 3013, the Non-Foreign Area Retirement Equity Assurance Act of 2008, introduced by Senator Akaka (D-Hawaii), Senator Stevens (R-Alaska), Senator Inouye (D-Hawaii), and Senator Murkowski (R-Alaska). In all respects, it is superior to the legislation proposed by the Bush Administration in the President's FY 2008 Budget which also sought to shift federal employees in non-foreign COLA areas to locality pay.

S.3013 phases in locality pay over a relatively brief three-year period. This schedule for replacing COLAs with locality pay allows employees to obtain the benefits of locality pay rapidly, and pay back the federal retirement system in an affordable way. The Administration's proposal, in contrast, draws out the phase in period over seven long years. The stated reason for this lengthy phase in is the fear that a faster transition would exacerbate federal agencies' retention problems by encouraging a rush to retirement. Delaying the implementation of locality pay in order to hold federal employees "hostage" to OPM's preferred schedule of retirement for those eligible to retirement is neither fair nor respectful of federal employees. Although other localities that have been found to have pay gaps in excess of the five percent threshold have received the entire locality pay immediately upon the establishment of a new locality, we believe the transition from COLA to locality justifies a short phase in period. As such, we support the three year schedule provided in S.3013.

The legislation's formula for the gradual replacement of COLAs with locality pay is also far superior to that found in the President's proposal. The Administration would have offset each dollar of locality with a reduction of $.85 from COLA; S.3013 has a formula that is designed to ensure that employees' take home pay is not adversely affected during the transition. The $.65 offset per dollar of locality is strongly preferable, and AFGE endorses this approach. In addition to speeding the transition to locality pay, this formula also ensures that no employee's paycheck will actually decline during the transition, an important standard that AFGE members both need and appreciate, especially in light of the recent upsurge in gasoline prices and general inflation.

S.3013 also has the important virtue of making the transition to locality pay voluntary for current employees. Under the legislation, employees who choose to forego locality pay will be permitted to "lock in" the 2008 COLA rate. We strongly support making the transition to locality pay voluntary. However, there are already-approved increases in COLA rates awaiting the lengthy rulemaking process in the Office of Management and Budget (OMB) and the Office of Personnel Management (OPM) that might not be finalized in time to meet the deadline described in the legislation. We request that language be added to allow a "lock in" to include amounts provided in pending increases in non-foreign COLAs. In that way, federal employees in Puerto Rico, who are scheduled to receive an increase in their COLAs from 13 percent to 14

percent by next year at the latest, will be able to obtain the higher amount if they choose to remain in the COLA system.

Finally, S.3013 provides an opportunity for both regular employees, and employees subject to mandatory retirement ages who become eligible for retirement during the transition period to pay into the Civil Service Retirement and Disability Retirement Fund amounts, plus interest, that they would have paid if they had been covered by locality pay, so that their annuities will not be adversely affected. We strongly support this provision, which is absent from the Administration's proposal. Federal employees consider many factors when deciding the date on which to retire. In fact, the majority who already receive locality pay do not retire on the day they reach eligibility. There is no reason to deprive federal employees in non-foreign areas, who have long sought locality pay, the ability to neutralize the financial impact on their annuities of their long wait. They deserve the ability to pay into the retirement system to make themselves whole, and AFGE strongly supports the provisions of S.3013 that allow them to do so.

There are two protections missing from S.3013 that AFGE strongly urges the Committee to add to the bill. The first is a guarantee that no federal employee in any non-foreign area who chooses to participate will ever receive locality pay that is less than the amount provided to the "Rest of US" or "RUS." Second, we ask that explicit language be added that two new localities be added to the current 32 Federal Employees Pay Comparability Act (FEPCA) localities that cover the entire states of Hawaii and Alaska. The legislation is vague regarding these new localities, saying only that in the second and third years that employees would receive "applicable comparability payments approved by the President." Since the dawn of the locality pay program in 1992, funding at the Department of Labor has been cited by the President's Pay Agent as an excuse for severely limiting the number of pay localities. In 2006, the cities of Orlando, Kansas City, and St. Louis all had to be dropped in order to make room for cities with larger pay gaps relative to RUS due mainly to the budget rule that only 32 cities would be surveyed, no more. It would be wrong to "rob Peter to pay Paul" and eliminate two existing localities to facilitate the addition of Hawaii and Alaska. Likewise, it would be wrong to force federal employees in Hawaii and Alaska to remain part of RUS when preliminary data show that their pay gaps are far in excess of those in RUS. Thus, it is necessary to be explicit in requiring the addition of these two, new localities to the current roster.

The reports of the Federal Salary Council's Workgroup meetings, as well as the official reports of the Federal Salary Council since 2003 make reference to decisions to drop some localities and add others. (http://www.opm.gov/oca/fsc/index.asp) In these reports, the budget constraints that have been discussed explicitly are implicitly referred to in statements that urge the Bureau of Labor Statistics (BLS) to utilize resources that had been devoted to one set of localities to a new set. The fact that the total number of localities has not been increased since 1998 is also evidence of the fact that BLS budget constraints have limited the number of cities and regions that could become

separate localities.[1] AFGE strongly urges the addition of explicit language in the legislation that would direct the BLS to conduct surveys of Hawaii and Alaska for purposes of establishing both states as new localities under FEPCA that would not displace any existing locality.

This concludes AFGE's statement. We would be happy to answer any questions members of the Committee may have on this matter.

When locality pay began, there were 28 localities. In 1995, four cities were added and five were dropped to bring the total down to 27. In 1997, three were added; in 1998 an additional two cities were added to bring the total up the current number of 32. In 2006, three cities were dropped and three were added. The total remains 32.

LUIS G. FORTUÑO
PUERTO RICO

WASHINGTON OFFICE:
126 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-2615 FAX: (202) 225-2154

SAN JUAN OFFICE:
P.O. BOX 9023958
SAN JUAN, PR 00902-3958
(787) 723-6333 FAX: (787) 729-7738

Congress of the United States
House of Representatives
Washington, DC

COMMITTEES:
FOREIGN AFFAIRS
EDUCATION AND LABOR
NATURAL RESOURCES

RANKING MEMBER OF
SUBCOMMITTEE ON INSULAR AFFAIRS

CHAIRMAN, CONGRESSIONAL
HISPANIC CONFERENCE

REPUBLICAN POLICY COMMITTEE

CO-CHAIRMAN, CONGRESSIONAL
FRIENDS OF SPAIN CAUCUS

Statement of the Honorable
Luis G. Fortuño
Senate Subcommittee on Oversight of Government Management, the
Federal Workforce, and the District of Columbia

I would like to thank Chairman Akaka and Ranking Member Voinovich for the opportunity to present this testimony for the record regarding S. 3013, which would phase-out the cost-of-living allowances (non-foreign areas) and phase-in locality pay for federal employees in my District, as well as the US Virgin Islands, Alaska, Hawaii, Guam, and the Commonwealth of the Northern Mariana Islands. This legislation will affect more than 10, 0000 federal employees in Puerto Rico.

As you know, the Office of Personnel Management submitted a legislative proposal on May 30, 2007, entitled the "Locality Pay Extension Act of 2007" which would extend locality pay to white collar Federal Employees in the non-foreign areas, including Puerto Rico, while reducing cost-of-living allowances. Since OPM issued this proposal I have received many calls and letters from federal employees in my district expressing concerns about the impact that the phase-out may have on the Island and seeking additional information about the proposal. In order to answer their questions I invited OPM to Puerto Rico last June to participate in a town hall style meeting at which OPM representatives were able to explain the Administration's proposal and answer many questions.

The most salient concern of my constituents regards the impact, if any, the phase-out may have on their take home pay. COLA, unlike locality pay is non-taxable and is considered

non-taxable income by the Puerto Rican government. I understand that S.3013, as drafted, would minimize if not eliminate altogether, any impact on take home pay during the three year phase-out period. In light of the severe economic crisis that currently affects Puerto Rico and the difficulties the federal government has experienced in hiring and retaining employees, I believe it is critical that take home pay not be adversely affected.

Many of my constituents have also expressed concerns about the impact the phase-out might have between federal employees under the Civil Service retirement systems and the newer FERS (Federal Employees Retirement System) that includes a mandatory Thrift Savings Plan. OPM has provided some examples with numbers as to how the proposed legislation would affect an average Puerto Rican federal employee. However, these examples do not take into consideration that many federal employees in Puerto Rico are under the new retirement system, FERS, and that FICA taxes are deducted from their salaries. I would welcome an opportunity to discuss my constituents' concerns and to gain a better understanding of whether the conversion to locality pay will have a different impact on those employees in my district who are covered under the Civil Service retirement systems, and the federal employees under FERS.

I would like to take this opportunity to extend an invitation to Chairman Akaka and Ranking Member Voinovich to hold a hearing in Puerto Rico to review the proposals included in S. 3013 to better assess the impact it will have on the federal employees residing in Puerto Rico.

Thank you.

STATEMENT OF COLLEEN M. KELLEY

NATIONAL PRESIDENT

NATIONAL TREASURY EMPLOYEES UNION

MAY 29, 2008

to the

Subcommittee on Oversight of Government Management, the Federal Workforce

United States Senate

Mr. Chairman, no issue is more important to federal employees than of pay. Without proper pay and benefits, the federal government will not attract the best and brightest of the labor force. It will not have the personnel needed to perform the critical functions of government – to protect the border and ports of entry, to collect revenue, to ensure that food and drugs marketed to the public are safe and pure, to defend the right to intellectual property through trademarks and patents, and to advance the common good.

In recent years, the Congress has taken a more engaged role on this matter. In large part through your leadership, Senator Akaka, innovation has been introduced to federal employee pay and benefits, including the recognition of the need for flexibilities and special pay rates in the federal sector. NTEU has been proud to have been a partner with you, Senator Akaka, on many of these innovations and flexibilities. Properly designed and implemented, these have been of great benefit to the nation and the civil service.

However, Mr. Chairman, while recent times have seen a high level of activity, the need for innovation far pre-dates the modern-day action on that matter. As our nation concluded one of its greatest endeavors, the war against and the defeat of fascism -- with the then territories of the Pacific being the only American territory to come under direct enemy attack -- it became clear that federal employees hired or transferred to these outlying territories bore costs that mainlanders did not. In 1948, there came to be what at the time was a very sensible and necessary action. Rather than being compensated at the then uniform pay rate across the United States, civilian workers in the outlying territories were given an additional payment based on a measure of the increased cost of living in these territories. This cost of living adjustment (COLA) was in addition to the employee's base pay. Non-taxable for federal income tax or FICA taxes, it was also not counted towards federal retirement. This was termed the Non-Foreign COLA, distinct from pay systems for federal employees living outside the jurisdiction of the United States. This system remained in place following the admission of Alaska and Hawaii as states and continues as well in the territories and the Commonwealth of Puerto Rico, covering almost 50,000 federal employees.

It took the federal government 42 years to understand that within the contiguous states, there were also geographic differences that demanded various pay adjustments. In 1990, the Federal Employees Pay Comparability Act (FEPCA) was signed into law. FEPCA should not be considered the mainland equivalent of non-foreign locality pay. The development of these two methods of pay adjustment are separated by four decades of time. Needs and purposes have evolved. For example, FEPCA is not based on the cost of living but on the locality labor market. NTEU believes from an employee recruitment standpoint, locality pay better serves the goals of the civil service. Further, the exclusion of the non-foreign COLA from calculation of retirement is a great disservice to these employees.

Given that FEPCA was a significant departure from the previous geographically uniform pay rates on the mainland, it was not surprising that Congress exempted the areas under the non-foreign COLA, in essence "grandfathering" this program. But it has become increasingly clear that the non-foreign COLA is dated and in need of reform. With 18 years of experience with locality pay, it is now time to extend locality pay and retirement credit to the outlying areas. However, such an initiative must be done in a way that is fair to employees and does not make sudden, unplanned and adverse changes in their pay and compensation.

The Administration has asked for legislation that would phase in a conversion from COLA to locality pay over seven years. This proposal has many positive features. It would substantially improve retirement benefits for impacted employees. At the end of the seven year period, if the locality pay rate is less than the amount of non-foreign COLA for a particular area, employees would continue to receive the difference in non-foreign COLA and locality pay until the locality rate reaches the COLA amount. However, NTEU cannot support the Administration proposal at this time. It has several significant shortcomings that need to be corrected. Instead, we believe the Senate should use as a starting point S. 3013, the Non-Foreign Area Retirement Equity Assurance Act of 2008 introduced by Senators Akaka, Stevens, Inouye, and Murkowski.

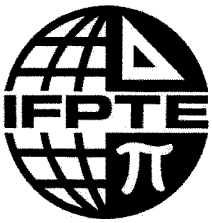
S. 3013 is a much fairer and more sensible proposal and NTEU highly commends the sponsors for introducing it. Rather than the excessively lengthy seven year phase in period, S. 3013 calls for a three year phase in period. For employees concerned as to the retirement disadvantage under COLA, it allows for a speedier transition. Yet, for federal workers who feel the transition does not benefit them, the bill also allows for a one-time, irrevocable opt-out. The Akaka bill also allows for a retirement credit buy-

back for the period of January 1, 2009 to December 31, 2011. The proposed legislation also includes provisions to guarantee that no employee would see an unfair reduction in his or her paycheck by implementing a fairer offset formula than the Administration's proposal and protecting the pay standards of those employees under special rates.

Without the features of S. 3013 that have not been included in the Administration proposal, some federal employees could actually see their compensation decreased. Cutting the pay of federal workers simply because of where they live is unfair and would cause grave harm to employee morale.

The Administration proposal and S. 3013 both make important changes regarding postal employees. NTEU does not represent postal employees and would defer to our brothers and sisters in the postal unions on this matter. We do represent the workforce at the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA). Employees at these agencies are exempt from Title V and have their own pay system. NTEU would like to work with you, Mr. Chairman, and the Subcommittee, to make sure this legislation properly addresses their situation.

Again, I want to commend you, Chairman Akaka, for your leadership on this matter. I am confident that with your guiding hand legislation can be enacted which enhances the civil service, improves recruitment and is fair to those dedicated federal employees who live in the jurisdictions addressed in this bill. Federal employees in Hawaii, the other 49 states as well as the territories are fortunate to have your leadership on civil service issues. I thank you for the opportunity to present this testimony on behalf of NTEU.



INTERNATIONAL FEDERATION OF
PROFESSIONAL AND TECHNICAL ENGINEERS
AFL-CIO & CLC

Remarks of Benjamin T. Toyama

Western Federal Area Vice President
International Federation of Professional & Technical Engineers (IFPTE), AFL-CIO & CLC
&
President
IFPTE Local 121, Pearl Harbor Naval Shipyard

Prepared For:

The Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

Hearing: Non-Foreign COLA and Locality Pay

Thursday, May 29, 2008 - 1:00 p.m. (HST)

Oahu Veterans' Center, Honolulu, HI

Testimony of Benjamin T. Toyama
Western Federal Area Vice President, International Federation of Professional and Technical Engineers, AFL-CIO, CLC

I would like to thank the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia for holding today's hearing, and for the opportunity to provide this testimony to be inserted into the official record on behalf of IFPTE. I would also like to extend a special note of appreciation to Chairman Akaka, my Senator and good friend, for his foresight in holding today's hearing in Hawaii. I know I speak for all the Civil Servants here in Hawaii, particularly those that I represent at the Pearl Harbor Naval Shipyard, in extending our appreciation to Senator Akaka for his steadfast support of the Federal workforce.

The subject of today's hearing is on non-foreign COLAs and Locality Pay, and how COLAs in non-foreign States and regions such as Hawaii and Alaska, negatively impact the income and retirement of federal workers.

IFPTE believes that providing locality pay for our non-foreign COLA members would be a huge step in the right direction in bringing conformity to the wages of workers in places such as Hawaii, Alaska, Guam and other locations. The Federal Employee Pay Comparability Act (FEPCA) passed by congress annually, is not applied to the Federal Employees that receive COLA. I don't know if it was the intent of Congress as they passed the FEPCA to discriminate against the Federal Employees in

Hawaii and Alaska, but the application of the Act really does. For over eight (8) years the General Schedule Federal Employees have "lost" 1% per year because of the lack of locality pay. The annual wage increases for the Federal Employees across the country is about 3.5%, however, the Federal Employees who receive COLA, received an average of 2.5%. This is because the FEPCA, increased the General Schedule by about 2.5% and allocated 1% of the wage increase to the locality pay of the Federal Employees.

Unfortunately, as it stands now these GS workers are prevented from collecting locality pay which has created a longtime pay and retirement inequity for non-foreign area workers. The Federal Employees in Hawaii will receive about 17% less in retirement benefits as their similarly situated counter-parts on CONUS. A 17% reduction in the retirement pay can result in retirement benefits lowered by $10K to $20K annually. In fact, it is not out of the ordinary for federal workers in Hawaii to request transfers of work assignments to the Mainland for the purposes of retirement, only to return to Hawaii several years later. This is not only extremely unfortunate that workers have to resort to these measures simply to attain a fair retirement; it is also a problem for federal agencies in Hawaii who want to maintain their skilled and experienced workforces. This is unnecessary and should be corrected.

Currently, Federal Civil Servants in the other forty-eight states get locality pay as a part of their COLA. Locality pay is calculated after comparing wages in the private sector and local governments in a particular region. However, federal employees in Alaska, the Caribbean and Pacific Islands, and Hawaii do not receive locality. They only

get the Cost of Living Adjustment (COLA), which has created a serious discrepancy in both earnings and retirement benefits for hundreds of IFPTE members in Hawaii, as well as thousands of other Civil Servants in places like Alaska and the Caribbean and Pacific islands.

IFPTE is pleased to see the recent introduction of S. 3013, the *Non-Foreign Area Retirement Equity Act.* This bipartisan bill is being championed by Chairman Akaka and jointly introduced along with Senators Inouye (HI), Stevens (AK) and Murkowski (AK). IFPTE believes that this bill will go a long way toward bringing about a solution to the non-foreign area COLA issue for thousands of Civil Servants and is pleased to endorse this legislation.

Having said that, IFPTE is keenly aware of the budgetary challenges Congress is facing, and the fiscal impact that full locality pay and COLA in non foreign areas would have. Furthermore, IFPTE is cognizant of the reality of such a proposal passing muster with the Office of Management and Budget (OMB) and the Office of Personnel Management (OPM). While full locality pay and COLA would be the optimal solution, a more realistic approach to bringing more conformity to this inequity, and one that IFPTE would support, would be to replace the COLA with locality pay for federal workers in non-foreign areas. However, such a change would have to occur within one year. While IFPTE applauds the OPM for attempting to solve this inequity, the longer five year transition period from COLA to locality pay that they advocate for would result in

countless workers seeing reductions in take home pay during that transition period. It would have to occur within one year.

IFPTE supports an immediate transition from COLA to locality pay to be fully implemented within one year in the non-foreign areas of Alaska, Hawaii and the Caribbean and Pacific islands. This transition must be designed so the Federal Employees would not lose any pay and benefits as a result of the transition.

Overseas Post Allowance for Civil Servants at Foreign Locations

In addition to non-foreign COLAs, and under the purview of the Subcommittee's jurisdiction, is the foreign location COLA inequity facing US Civil Servants abroad. IFPTE would also like to take this opportunity to briefly talk about the compensation irregularities for Civil Servants working outside of the United States. Like non-foreign areas, COLAs for federal employees in foreign areas are also being shortchanged.

As the Committee is well aware, the 72,000 federal employees working and living abroad receive Overseas Post Allowance calculated by the U.S. Department of State, Office of Allowances, under 5 USC 5924, Cost-of-living allowances. The Overseas Post Allowance is the COLA for civil servants abroad.

When Congress wrote the law pertaining to the post allowance, most of the civilians covered were individuals based in Washington when they were not living at a

foreign post. The language in that law specifically indicates that any post allowance for civilians be based on a comparison of costs at the foreign location and those in the District of Columbia. The allowance is for all U.S. Government civilian employees assigned to the foreign area, so this ensures equity. The Department of Defense (DOD) uses the same information to establish the Overseas Cost of Living Allowance (COLA) for the uniformed services members.

The Uniformed Services Members COLA is a supplement designed to equalize purchasing power between members overseas and their Continental United States (CONUS) based counterparts. The basic measurement is a comparison of the CONUS national average shopping behavior and the aggregate shopping behavior at each overseas location.

There is no justification for the establishment of two separate formula calculations, one for the military based on a national average market basket survey and one for U.S. Government civilian employees based on the District of Columbia market basket survey. U.S. Government civilians do not live and work in areas in foreign countries that the U.S. military has not gone to first. The difference in the market basket survey results in an average reduction of 25% less overseas post allowance for U.S. Government civilians than there counterparts in the Uniformed Services. This disparity in overseas COLA for Uniformed Services and U.S. Government civilians serving our nation's interest abroad should be corrected.

IFPTE is requesting that 5 USC 5924(1), be changed to read:

- **A post allowance to offset the difference between the cost of living at the post of assignment of the employee in a foreign area and the cost of living in the Continental United States (CONUS), except that employees receiving the temporary subsistence allowance under section 5923(1) are ineligible for a post allowance under this paragraph."**

We are hopeful the 110th Congress will solve both the non-foreign COLA issue, as well as the foreign COLA inequity being experienced by federal workers.

Thank you again for holding this important hearing and for the opportunity to insert this testimony into the official record.

BEFORE THE U.S. SENATE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA

STATEMENT FOR THE RECORD BY THE PUERTO RICO COLA DEFENSE COMMITTEE VICE PRESIDENT PEDRO ROMERO ON S. 3013 AND NON FOREIGN COLA AND LOCALITY PAY ISSUES

Honorable Daniel K. Akaka:

Thank you Senator Akaka for your kind and thoughtful invitation to the Puerto Rico COLA Defense Committee to offer our comments before this Subcommittee on S. 3013 and other Administration proposals to phase out the non foreign COLA in favor of locality pay. My name is Pedro Romero, and I am the Vice President of the Puerto Rico COLA Defense Committee. We regret the inability to attend the Hearings in person due to un-foreseen circumstances.

Most Puerto Rican federal workers and other federal workers residing in Puerto Rico strongly opposed the May 2007Administration proposal to phase out the non-foreign COLA in a seven-year period. Our opposition was based on the fact that the Administration proposal would not benefit federal workers close to retirement, while at the same time the take home pay of all federal workers in Puerto Rico was going to be significantly reduced due to the mandatory withholding of Puerto Rico state income tax. Under the 2007 proposal, the increased tax responsibilities would be felt immediately in Puerto Rico, despite OPM's claims to the contrary, but the retirement inequity the bill was supposed to correct, would not be corrected until after 10 years from the bill's enactment.

Another very important concern to Puerto Rican federal workers is the fact that the policy to pay a standard, across the board, RUS (rest of the US) rate to all areas that do not have an individual locality pay rate pursuant to FEPCA is not written into law or regulation, and that the current policy not to pay under the RUS locality pay rate could change in the future. Federal wages in Puerto Rico would suffer considerably if the pay agent decides to change the current policy.

We believe S.3013 is a great improvement over the May 2007 Administration proposal. Specifically, S.3013 provides for a much faster transition, and is therefore of great benefit to those federal workers who are

close to retirement. We are very pleased with the provisions of Section 8(b)2 that allows for the "grandfathering" of those federal workers that elect to stay with a frozen, non taxable COLA rate as opposed to a transition to a locality pay rate and a possibly higher retirement benefit.

However, we must point out two concerns that we recommend become amendments to S.3013:

1. Based on interim adjustments conducted by OPM pursuant to the Caraballo Settlement, for the years 2006 and 2007, Puerto Rico's non foreign COLA rate is supposed to be at 13% for 2006, and 14% for 2007. OPM has not implemented either of these adjustments, to the disadvantage of thousands of federal workers in Puerto Rico who are being paid only 10.5%, despite the results of the interim adjustment calculations. OPM must implement both COLA increases in Puerto Rico before the provisions of S.3013 are effective. In this way, federal workers opting for a frozen COLA rate will be at the 14% they should have been receiving since 2007.

2. Puerto Rican federal workers electing the transition to a locality based rate must be guaranteed by law that the RUS locality rate will always apply, that is, that Puerto Rico's locality rate will not at any time be under the RUS locality rate under law, not mere policy.

For the last 25 years the Puerto Rico COLA Defense Committee has actively advocated and protected the COLA Program in Puerto Rico. We firmly believe it is our moral and fiscal responsibility as Puerto Rico COLA Defense Committee members to request the above amendments to S.3013 so that the federal workers in Puerto Rico are not disadvantaged by any of the provisions of this law.

We thank you again for the opportunity to express our concerns and to submit these comments for the record.

Respectfully submitted,

Pedro Romero
Vice President
Puerto Rico COLA Defense Committee

May 27, 2008