March 21, 2023

The FERS Cost-of-Living-Adjustment (COLA) and the Equal COLA Act (H.R. 866)

The Equal COLA Act, H.R. 866, was introduced on February 8, 2023. This bill, which has also been introduced in prior Congresses, would make changes to the cost-of-living-adjustment (COLA) under the Federal Employees' Retirement System (FERS). Specifically, the Equal COLA Act would remove the cap for the FERS COLA under current law, which reduces the COLA when the change in the measure of inflation is above 2%. Thus, under the Equal COLA Act, the FERS COLA calculation would be the same as the COLA for Social Security benefits and retirement benefits under the older Civil Service Retirement System (CSRS). The Equal COLA Act would not make any changes to the age at which nondisabled FERS retirees begin to receive COLAs, which is generally age 62 under current law.

Background on FERS

FERS covers most civilian federal employees first hired in 1984 or later. The Federal Employees' Retirement System Act of 1986 (FERS Act; P.L. 99-335; June 6, 1986) created FERS as a three-part retirement package. FERS includes (1) Social Security; (2) the FERS basic annuity, a defined benefit (DB) plan that provides a monthly payment in retirement; and (3) the Thrift Savings Plan (TSP), a defined contribution (DC) plan similar to the 401(k) plans provided by many private sector employers, to which the government and most employees contribute.

The Social Security Amendments of 1983 (P.L. 98-21; April 20, 1983) served as the primary impetus for the creation of FERS. Under P.L. 98-21, all federal employees hired after December 1983 were covered by Social Security and required to make Social Security contributions. The older CSRS system was first created in 1920 under the Civil Service Retirement Act of 1920 (P.L. 66-215; May 22, 1920). CSRS covers most civilian federal employees hired before 1984 and generally does not include Social Security coverage. Instead, CSRS provides a standalone DB annuity payment. Congress determined that adding Social Security coverage on top of CSRS would be duplicative in terms of retirement benefits and contributions. Thus, Congress decided to create a new retirement plan for federal employees that was fully integrated with Social Security. This effort led to FERS.

There were two additional policy goals addressed in the creation of FERS: (1) reducing the costs of federal retirement borne by the federal government and (2) fully funding those costs through required contributions. (Unlike FERS, CSRS was not designed to be fully funded and accrued a large unfunded liability as additional benefits were promised over time.)

For more information on CSRS and FERS, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*.

FERS COLA: Current Law

COLAs protect the purchasing power of retirement benefits from being eroded by inflation in the prices of goods and services. FERS, like Social Security and CSRS, includes an automatic COLA, which is based on the rate of inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). COLAs for Social Security, CSRS, and FERS are all determined using the change in the average monthly CPI-W during the third quarter (July to September) of the current calendar year and the third quarter of the base year, which is the last previous year in which a COLA was applied. The "effective date" for these COLAs is December, but they first appear in the benefits issued during the following January.

COLAs under FERS, unlike Social Security COLAs or CSRS COLAs, are limited if the change in inflation is greater than 2.0%. If the rate of inflation during the measurement period is between 2.0% and 3.0%, the COLA under FERS is 2.0%. If inflation is greater than 3.0%, then the COLA for FERS benefits is equal to the change in the CPI-W minus one percentage point. Thus, the FERS COLA is sometimes referred to as being subject to a *cap* or as a *diet COLA*. For example, from the third quarter of 2021 (the current base year) to the third quarter of 2022, the CPI-W increased by 8.7%. Therefore, paid out beginning January 2023, the CSRS COLA is 8.7% and the FERS COLA is 7.7%.

Additionally, nondisabled retirees under the age of 62 do not receive FERS COLAs unless they are subject to the special provisions for law enforcement officers (LEOs) and related personnel (i.e., subject to a mandatory retirement age). Survivors and disabled retirees are eligible for COLAs under FERS regardless of age. CSRS COLAs do not have an age requirement.

Authority for the FERS COLA is set out under Title 5, Section 8462, of the *U.S. Code*. For more information, including historical CSRS and FERS COLAs, see CRS Report 94-834, *Cost-of-Living Adjustments for Federal Civil Service Annuities*.

For more information on Social Security COLAs, see CRS Report 94-803, *Social Security: Cost-of-Living Adjustments*.

Legislative Rationale for the FERS COLA

The FERS COLA—both the capped COLA calculation and the age 62 requirement for nondisabled retirees—was viewed by some as a legislative compromise aimed at cost concerns in the creation of FERS under P.L. 99-335. The less generous COLA under FERS was considered as part of the bigger retirement package, which included Social Security and TSP.

For example, in the congressional consideration of the FERS COLA, which was eventually enacted under the FERS Act, Representative Michael Barnes of Maryland argued:

> Finally, there may be some alarm that this agreement does not provide full COLA, and in fact provides only COLA minus 1 for retirees after age 62. Anyone who reads those provisions as capitulation on the commitment we've maintained to Federal retirees to protect their benefits from inflation would be gravely mistaken.
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> This is not an invitation to erode future COLAs. In the context of the overall retirement plan, an indexed Social Security Program, coupled with interest earning, tax-sheltered savings, can provide annuity growth more than capable to keeping place with rising costs. But again, the risk and the burden of achieving the requisite level of savings falls to the employee (*Congressional Record*, vol. 132 [May 22, 1986], p. H3227).

Similarly, in the deliberation leading up to the FERS Act, Senator Thomas Eagleton of Missouri stated:

> The results of those final efforts are before us today. The Federal unions, who exhibited statesmanship throughout the entire process, receded on some highly important points, such as a cost equivalent to the civil service retirement system and a guaranteed full COLA for retirees. The unions fully support today's conference report. The administration, which had hoped for a lower over-all cost than the bill achieved, an increase in the Federal retirement age, and an accrual formula based on high-5 salary, rather than high-3, also swallowed hard and it, too, fully supports the report. The House and Senate conferees fully support the bill, and my reading from staffers and colleagues is they can't wait to join the new system (*Congressional Record*, vol. 132 [May 20, 1986], p. S6200).

The Equal COLA Act (H.R. 866)

In the 118th Congress, Representative Gerry Connolly introduced the Equal COLA Act as H.R. 866. The Equal COLA Act has been introduced in prior Congresses by Representative Connolly as H.R. 304 in the 117th Congress, H.R. 1254 in the 116th Congress, and H.R. 7165 in the 115th Congress. In the 117th Congress, Senator Alex Padilla also introduced the Equal COLA Act as S. 4221. (All House-introduced versions of the bill are identical. The one Senate-introduced version is substantively similar but would have been effective 90 days after enactment rather than upon enactment, as under the House versions.)

The Equal COLA Act would change the formula used to calculate the FERS COLA. In particular, it would remove the cap for the FERS COLA under current law that reduces the COLA when the change in the measure of inflation is greater than 2%. Thus, under the Equal COLA Act, the FERS COLA calculation would be the same as the COLA for Social Security benefits and CSRS benefits. The Equal COLA Act would not make any other changes. It would not change the age at which nondisabled FERS retirees generally begin to receive COLAs, which is age 62 under current law. The changes under H.R. 866 and earlier House versions of the Equal COLA Act would apply to FERS COLAs made after enactment for all FERS retirement benefits.

At this time, no version of the Equal COLA Act has been reported out of committee or scored by the Congressional Budget Office. In general, to the extent that the CPI-W change for a given year is greater than the current FERS COLA cap (i.e., greater than 2%), the bill would increase federal expenditures out of the Civil Service Retirement and Disability Fund (CSRDF), the federal trust fund that finances CSRS and FERS benefits. This bill would also trigger an increase in agency contributions to FERS, which are intragovernmental transfers to the CSRDF, to the extent that the *dynamic normal cost* for FERS increases under this proposal. (The dynamic normal cost is the amount, expressed as a percentage of payroll that must be set aside each year to fully fund pension benefits for workers who continue to accrue new benefits, including the effects of employee pay raises, COLAs, and changes in the rate of interest.)

Arguments in favor of the Equal COLA Act portray the bill as addressing the perceived unfairness of differences in COLAs across federal retirement systems (i.e., a lower COLA for FERS in comparison with CSRS), particularly in times of rapidly increasing inflation. Whether the current COLA provides adequate inflation protection for FERS retirees may present a question for policymakers. Yet the deliberation surrounding the creation of FERS indicates that some policymakers suggested the capped FERS COLA would be sufficient for retirees in conjunction with Social Security and TSP benefits.

Arguments against the bill include concerns with the additional costs of the proposal, which would apply to all FERS retirees and their survivors. As reported in the FY2021 *Civil Service Retirement and Disability Annual Report* (most recently available), there are approximately 1.1 million FERS annuitants, including 985,000 retirees and 87,000 survivors receiving FERS benefits.

For additional information on the funding of FERS, see Office of Personnel Management, FY2021 *Civil Service Retirement and Disability Annual Report*, https://www.opm.gov/about-us/budget-performance/other-reports/fy-2021-csrdf-annual-report.pdf.

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