

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

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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- <i>Caraballo</i>	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 Hawaii 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 aid 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.

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