Old Assumptions, New Realities

Citizens
Budget
Commission

The Truth About Wages and Retirement Benefits For Government Employees

Most government workers are paid more than their private sector counterparts, so more generous and expensive retirement benefits are no longer justified.

Introduction

For decades the popular image of government employment has involved the trade-off of lower wages for job security and relatively generous retirement benefits. That image, while still widespread, is no longer the reality.

Wages and fringe benefits in the public sector now exceed those in the private sector for many comparable job titles. And retirement benefits are more expensive than ever and still growing rapidly.

Between fiscal year 2000 and 2004, for instance, the City's contributions to employee pension funds more than tripled from $615 million to $2.3 billion. In fiscal year 2005 the City contributed $3.2 billion to the pension funds and paid about $927 million for health insurance for retirees. The City's payments for health insurance both for workers and for retirees have been growing at double-digit rates.

The new realities are:

- In most cases, public-sector workers have higher wages than their private-sector counterparts. Generous retirement benefits are no longer required to attract municipal workers.
- New York City's retirement benefits are far more generous than those of private employers and of other state and local governments. This is true of both pensions and health insurance benefits.
- Continuing outdated practices is highly expensive. Some of the enormous resources allocated to outdated retirement benefits would be better spent on other priorities such as enhancing public services or bringing taxes more in line with those of the cities with which New York competes for jobs and residents.

These realities are described more fully in this report, which summarizes a more detailed study prepared by the Citizens Budget Commission, "The Case for Redesigning Retirement Benefits for New York's Public Employees." That study was released in 2005 and is available on the Commission's website, www.cbcny.org.

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization committed to influencing constructive change in the finances and services of New York State and New York City governments.

This report presents policies approved by the CBC's Budget Policy Committee. The Budget Policy Committee is co-chaired by Karen Daly and Heather L. Ruth.

Old Assumptions, New Realities: The Truth About Retirement Benefits for Municipal Employees in New York City was written by Charles Brecher, Research Director; Elizabeth Lynam, Deputy Research Director; and Sheila Spiezio, Research Consultant. Dr. Brecher is also a professor at New York University's Wagner School.

NEW REALITY #1

Most Government Workers Are Paid More Than Their Private Sector Counterparts

Since the depression of the 1930s, the popular image of government employment has included job security, wages that lag those of private enterprise, and relatively generous retirement benefits. People opted for public-sector employment because they were willing to trade the relatively low salary for the combination of job security and a respectable pension.

These elements of the popular image may have been accurate three-quarters of a century ago, but conditions have changed in recent years. The collective bargaining rights won by government workers beginning in the 1950s have led to a contemporary situation in which public employees in most occupations are paid comparable or even higher wages than their private-sector counterparts. At the same time, public employees in New York also have received improved pension and health insurance benefits that make their retirement packages even more attractive, relative to most private-sector jobs, than was the case earlier.

The old assumptions are no longer true. Current wages and fringe benefits in the public sector now exceed those in the private sector for most comparable job titles.

THE EVIDENCE ABOUT WAGES

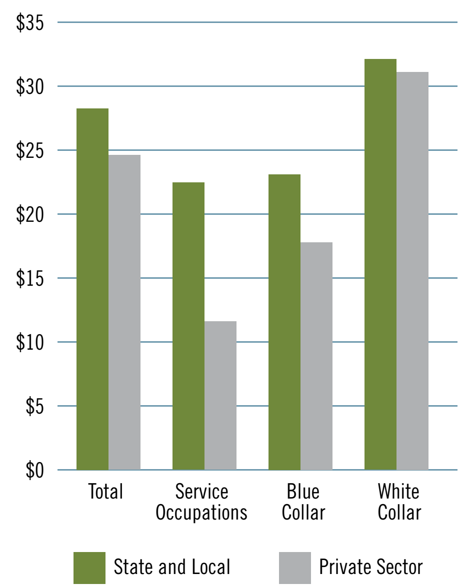
The data supporting this conclusion derive from two types of studies. National studies provide comparative compensation for broad categories of workers in the public and private sectors. More detailed – and perhaps more relevant – studies of specific occupations in specific regional labor markets, notably the New York metropolitan area, show the wages of workers in equivalent jobs in each sector.

The latest national studies – relying on data for 2004 – show that among public employers, total compensation costs, including fringe benefits – averaged $35.16 per hour, 47 percent higher than the total private-sector average of $23.90 per hour. Isolating each component of compensation showed that public-sector wages and salaries were 42 percent higher and fringe benefits were 61 percent higher.

Broad national comparisons do not consider local cost-of-living differences or take into account different occupational mixes. However, the finding holds true even when comparisons are made for more specific occupations within the New York region.

The hourly earnings of state and local government employees across broad occupational groups within the greater New York City region exceed those of private-sector employees by an average of 15 percent

Mean Hourly Earnings
State and Local Government vs.
Private Sector Workers
Broad Occupational Groups
in the Regional Labor Market
April 2004



Source: United States Department of Labor, Bureau of Labor Statistics, New York-Northern New Jersey-Long Island, NY-NJ-CT-PA, National Compensation Survey, April 2004, Bulletin 3125-21, December 2004, <http://www.bls.gov/ncs/ocs/sp/ncb10668.txt> (Acccessed March 22, 2005).

Results of New York City Civil Service Exams for Selected Uniformed Positions

Uniformed Position	Number Passing Exam	Ratio of Number Passing Exam to Avg Annual Hires
Firefighter		
2002 Exam	7,548	10:1
Police Officer		
Total 2004 Exams	23,998	11:1
Correction Officer		
Total 2002 Exams	3,981	10:1
Sanitation Officer		
2003 Exam	22,315	47:1

Note: Average annual hires are a five-year average for fiscal years 2000-2004.

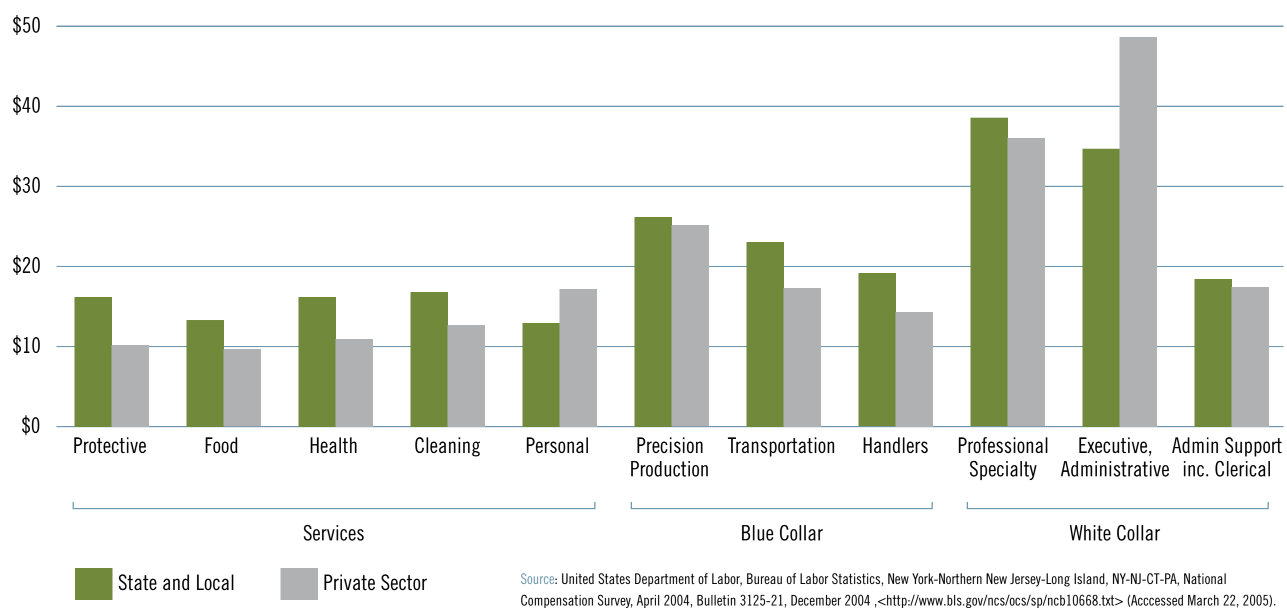
Sources: Civil Service list data provided by the New York City Department of Citywide Administrative Services; hiring data provided by the New York City Office of Management and Budget.

– $28.26 to $24.62. Blue-collar workers are paid 30 percent more in the public sector. In white-collar occupations, the state and local government workers' advantage was smaller (just 3 percent.)

Comparisons of more specific job categories also show higher wages for public-sector workers. Public employees in the service industries, including health and food services, have earnings substantially higher than their private-sector counterparts. Blue-collar workers in the public sector, such as materials movers, equipment cleaners and laborers, earn about 33 percent more than similar workers in the private sector. Only executives and some professional occupations, such as engineers and architects, earn more in the private sector.

No private-sector occupations are fully comparable to public uniformed services, but the adequacy of uniformed services' compensation is supported by the City's ability to attract a sufficient supply of candidates for these occupations. More than ten people pass the relevant exam for each opening in the police and fire departments, and for sanitation workers the ratio is an extraordinary 47-to-one. This evidence indicates that the current compensation is adequate and that adjustments in some part of the compensation package including retirement benefits are possible without harming the ability to hire in a competitive labor market.

Mean Hourly Earnings: State and Local Government vs. Private Sector Workers
Selected Occupations in the Regional Labor Market, April 2004



Source: United States Department of Labor, Bureau of Labor Statistics, New York-Northern New Jersey-Long Island, NY-NJ-CT-PA, National Compensation Survey, April 2004, Bulletin 3125-21, December 2004 ,<http://www.bls.gov/ncs/ocs/sp/ncb10668.txt> (Acccessed March 22, 2005).

NEW REALITY #2

New York City's Retirement Benefits Are Exceptionally Generous

City retirees' benefits are more generous than the norm in both the private and public sectors. This is true for pensions and health insurance.

City workers' pensions are relatively generous in two fundamental ways. First, they have "defined benefit" pension plans, while most private-sector workers have "defined contribution" plans. A defined benefit plan guarantees a retiree a specific pension amount, usually a percentage of the final years' wages, for the remainder of his or her life. By contrast, a defined contribution plan – like a 401(k) – provides a retiree a sum equal to what has been contributed over the life of the plan plus all earnings on those investments. In the latter case, an employer typically makes contributions on behalf of the worker.

Second, their defined benefit plans have provisions that yield larger and quicker benefits than many other public-sector defined benefit plans.

The health insurance benefits provided by the City to its retirees are also more generous than those provided by large private employers, the federal government and most other states and localities. For City retirees and their dependents, the City pays the full premium of insurance policies that are comparable to those provided to full-time workers. For retirees age 65 or over, the City pays the full cost of Medicare Part B premiums.

THE EVIDENCE ABOUT PENSION BENEFITS

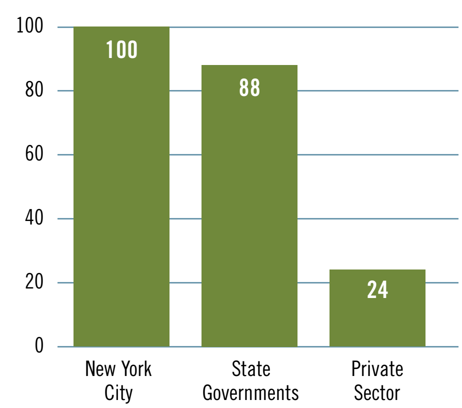
Virtually all full-time employees of the City of New York can belong to a defined benefit pension plan. Five different plans cover different types of workers, with the police, firefighters, teachers and others each having separate plans. More than 250,000 people currently receive retirement benefits from one of these plans.

Defined benefit plans are increasingly rare in the private sector. Only about one-fourth the employees of large private firms are in defined benefit plans, and this proportion has been shrinking in recent years.

Even when compared to other public-sector pension plans, the City's plans have unusually generous features:

- **Required worker contributions are relatively low.** The required contributions from City workers vary depending on their plan, date of hire, years of service and other factors, but relatively few contribute more than 3 percent of their salary. In contrast, among public-sector defined benefit plans nationally, about 74 percent of those who contribute must contribute more than 3 percent.

Percent of
New York City, State Governments,
and Private Sector Employees
Enrolled in Defined Benefit Pension Plans



Sources: State governments data from the United States Government, Bureau of Labor Statistics, Employee Benefits in State and Local Governments, 1998, December 2000. Private Sector data from U.S. Department of Labor, BLS, National Compensation Survey: Employee Benefits in Private Industry, March 2003. <http://www.bls.gov.ncs/ebs.>.

- **Benefits are based on a formula that includes overtime earnings, a practice that is rare for other public-sector plans.** Only 6 percent of full-time employees of state and local governments are allowed to include overtime in their salary base for pension purposes.

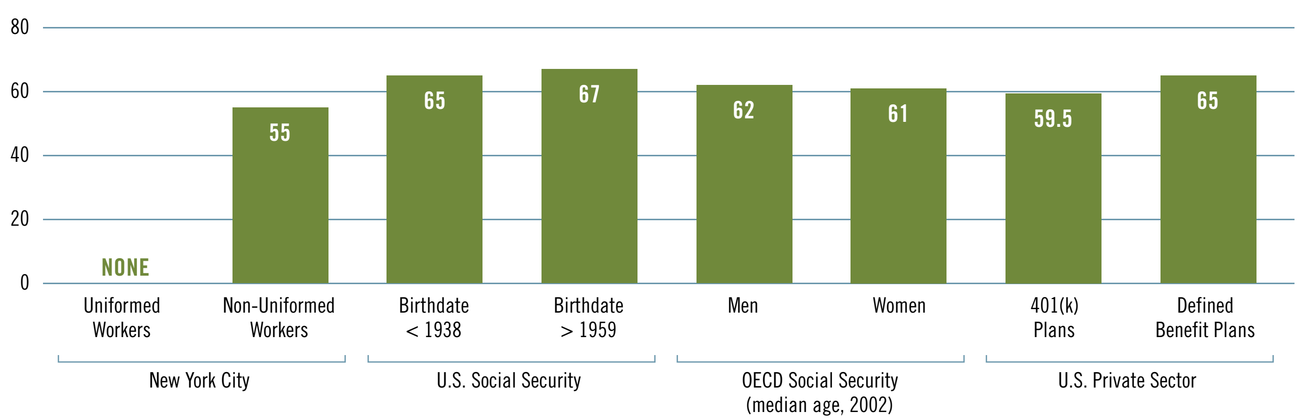
- **Workers who retire with a disability can have their pension benefits significantly enhanced, a practice not used by most other public systems.** Some City plans define disabilities in ways that allow an unusually large percentage of uniformed workers to qualify for these added benefits. For example, in 2002 fully 43 percent of all retired firefighters were classified as having a job-related disability.

The minimum age and service requirements of the City plans are generally comparable to those of other state and local systems. However, there is no minimum age requirement for police and firefighters, and the requirement for others (age 55) is well below that of the federal Social Security system, of federally tax-deferred private 401(k) plans, and even of most European public-sector retirement systems.

THE EVIDENCE ABOUT RETIREE HEALTH INSURANCE

For City retirees and their dependents, the City pays the full premium of insurance policies that are comparable to those provided to full-time workers. For retirees age 65 or over, the City pays the full cost of Medicare Part B premiums. These practices are uncommon for private- and public-sector employers.

Minimum Age Requirement for Receiving Pension Benefits



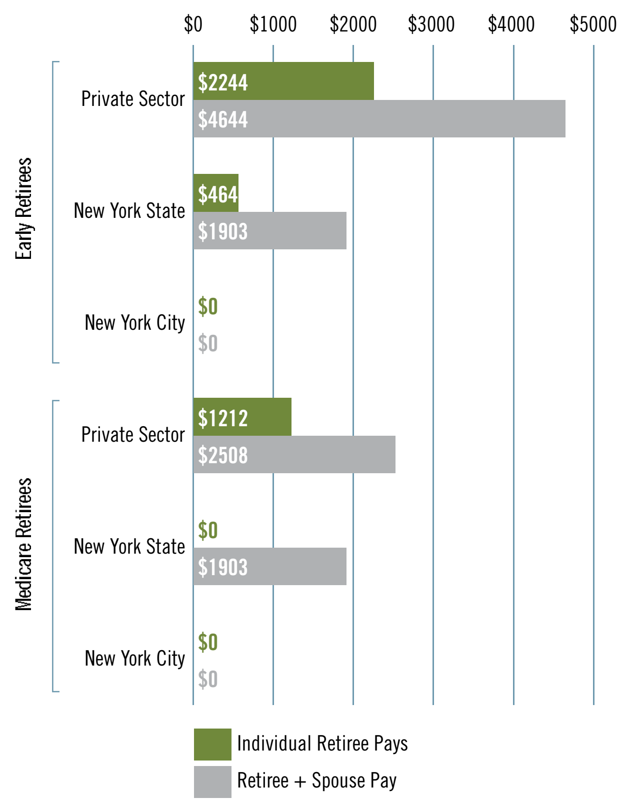
Sources: Social Security data from the Social Security Administration, <http://www.SSA.Gov. OECD data from John Turner, Social Security Pensionable Age in OECD Countries, 1949-2035, AARP Public Policy Institute, October 2005. Private Sector 401 K data from the United States Department of the Treasury, Internal Revenue Service, Tax Topic 558-Tax on Early Distributions from Retirement Plans, <http://www.irs.gov/taxtpoics/tc558.html>. Private Sector defined benefit data are for the majority of private sector employees enrolled in a defined benefit plan and are from the U.S. Bureau of Labor Statistics, Employee Benefits in Medium and Large Private Establishments, 1997, <http://www.bls.gov.ncs/ebs>.

Among large private employers (200 or more workers), only 38 percent offer retirees health insurance benefits. Even the largest employers (1,000 or more workers) who offer insurance rarely pay the full bill – less than 10 percent paid the full premium, more than one-fifth paid no part of the premium, and the employer's average share of the premium was about 60 percent. Only 9 percent of large private employers pay any share of Medicare Part B premiums.

For retirees from federal service, the government pays 75 percent of the premium cost and no part of Medicare Part B premiums. Among the 50 states, only 16 pay the full premium cost; in 12 states the employer pays no part of the premium cost. Only six states pay any portion of Medicare Part B premiums.

The "free" health insurance available to City retirees and their families is a marked contrast to the contribution towards health insurance premiums required in the private sector. Among the largest private firms, a retiree under age 65 would have to pay more than $2,200 annually toward his or her insurance and more than $4,600 annually toward coverage for the retiree and spouse. Among retirees over age 65 and eligible for Medicare, the comparable figures are $1,200 and $2,500.

Average Required Health Insurance Contribution for Retirees of New York City, New York State and Large Private Sector Employers 2004



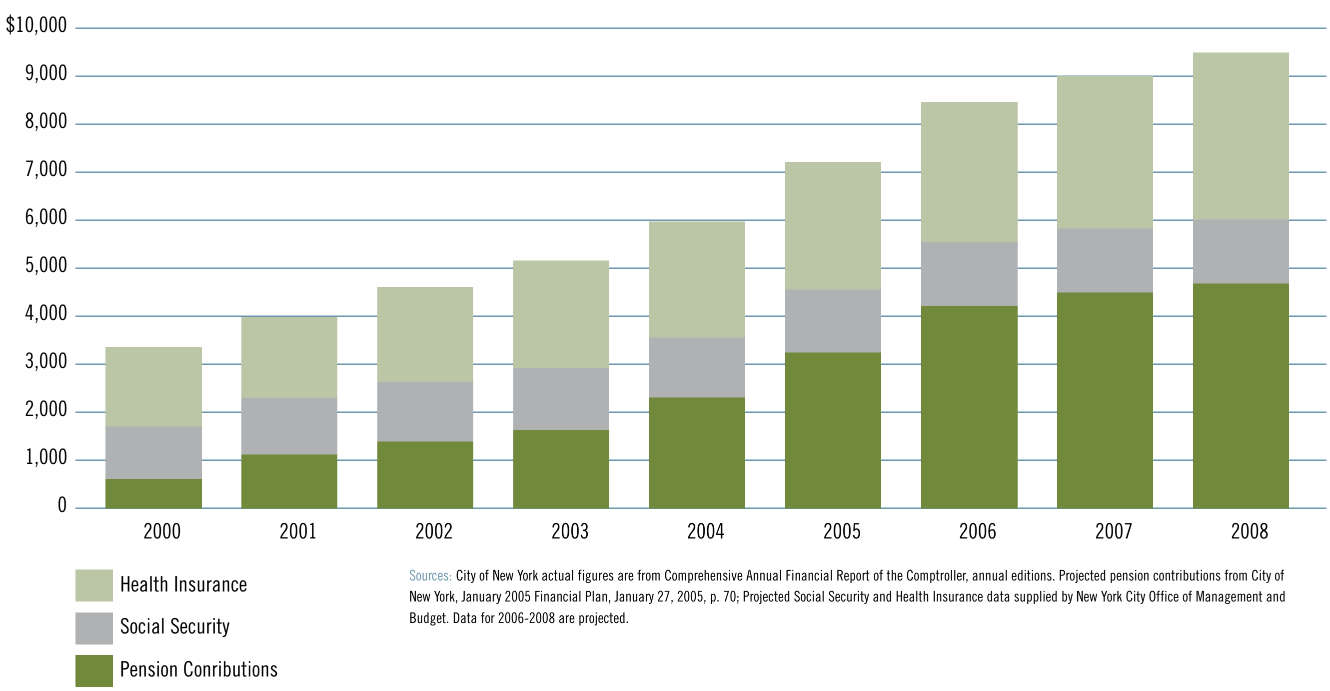
Sources: New York City data from New York City, Office of Labor Relations. New York State data, showing range for individual and spouse based on date of retirement, from New York State Civil Service website:www.cs.state.ny.us. Large Private Sector Employer data from: Current Trends and Future Outlook for Retiree Health Benefits: Findings from the Kaiser/Hewitt 2004 Survey on Retiree Health Benefits, The Henry J. Kaiser Family Foundation, December 2004.

NEW REALITY #3

Continuing Outdated Benefits Is Highly Expensive

Over the next four years, the City's costs for its workers' retirement benefits and health insurance are expected to increase 59 percent to reach nearly $10 billion. These rapidly growing costs are troublesome because they divert resources from other more desirable purposes. As retirement benefits consume a larger share of the City's budget, less money is available for services such as education or police protection or for tax reductions that could stimulate job growth.

Cost of Selected Fringe Benefits
New York City
(dollars in millions)



Sources: City of New York actual figures are from Comprehensive Annual Financial Report of the Comptroller, annual editions. Projected pension contributions from City of New York, January 2005 Financial Plan, January 27, 2005, p. 70; Projected Social Security and Health Insurance data supplied by New York City Office of Management and Budget. Data for 2006-2008 are projected.

Changes for the Future: What New Yorkers Should Demand

The City can save substantial amounts for taxpayers and still secure a qualified and competitive labor force by redesigning their retirement benefits. Both pension and health insurance benefits should be revamped.

PENSION REFORM
THE LONG-RUN SOLUTION: CONVERSION TO A DEFINED CONTRIBUTION PLAN

Efforts to change pension benefits must recognize their protected status. To alter the benefits of current employees or retirees requires an amendment to the State Constitution, and that requires action by two successive legislatures and a voter referendum.

In contrast, the pension benefits of the newly hired are not constitutionally protected and can be changed legislatively. Changes in pension benefits for future workers would yield fiscal gains slowly, but the service to the future fiscal health of the City would be enormous.

The long-run goal of pension reform should be to convert from defined benefit to defined contribution plans. Eventually, all City workers should have defined contribution plans, and the current system should fade away.

The case for shifting to defined contributions rests on two fundamental points. First, defined contribution plans facilitate worker mobility, while defined benefit plans typically reward (and even require) longevity. Greater portability is good for the workers, and good for society, because a mobile workforce is increasingly essential in a modern economy.

Second, defined benefit plans create a political dynamic that gives unique advantages to civil servants. Unionized workers have advantages in two ways:

- They can seek pension enhancements via collective bargaining, but when they fail in bargaining they get a second chance by going directly to the State Legislature. The Legislature can and does enact benefit enhancements over the opposition of the mayor, with whom the union would otherwise have to bargain. Such “end runs” around collective bargaining are common and expensive.

- The State Legislature controls the benefits, but does not pay for them. Legislators have political incentives to support union demands, but need not face the taxpayers in raising the money to pay for them. A better balance would be to keep benefit terms confined to collective bargaining, thereby keeping the decisions about the level of benefits in the hands of those who pay for them. A defined contribution system could do this.

PENSION REFORM
AN INTERMEDIATE-TERM SOLUTION: A NEW "TIER"

If conversion of new workers to defined contribution plans cannot be authorized in the near future, political leaders should have a "Plan B." Less dramatic changes to the existing system may be a politically necessary interim step. This strategy would create a new defined benefit plan for newly hired workers. Five changes should be given priority in the new plan:

1. **Increase required employee contributions.** Currently, the most common requirement is 3 percent for ten years. In most other systems, employee contributions are larger and last longer. The New York City systems should require a higher percentage contribution, and not limit it to ten years.

2. **Raise the minimum age requirement for retirement**. Currently, police and firefighters have no minimum age, and for most other workers it is 62 for full benefits and 55 for reduced benefits. The federal Social Security system has raised its age threshold for full benefits to 67 while keeping the criteria for reduced benefits at 62. The New York system should adopt similar age thresholds, perhaps with a lower minimum (but some minimum) for police officers and firefighters.

3. **Base pension benefits on the more standard definition of final average salary.** Currently the systems define final average salary (FAS) in ways that inflate benefits, deviate from the goal of replacing a reasonable share of a worker's base salary, and are far more generous than the practices of other large employers. The FAS should be based on five years' experience and should take into account only base salary, excluding overtime and other supplements.

4. **Define work-related disabilities more rigorously.** The current system permits workers to claim disabilities at the time of retirement and defines work-related disability, especially for certain uniformed workers, in ways that broaden access to this benefit without clear evidence of a work-related cause. These provisions should be revised to set more rigorous standards.

5. **Eliminate the variable supplements available to some retired uniformed workers.** These annual payments or "Christmas bonuses," soon to be $12,000, supplement already generous pensions, create inequities between New York City and other uniformed workers in the State, and contradict the principle that pension payments should be a regular and predictable source of income for retirees.

RETIREE HEALTH INSURANCE REFORM

The City provides both early retirees and those over 65 (and their families) with health insurance. Each group should continue to receive such benefits, but under terms that more closely resemble the practices of other large employers. Two changes are required:

1. **Require retirees to pay 50 percent of the premium for health insurance for themselves and their dependents.** This contrasts with the current practice of no required contribution for City retirees. A typical single City retiree would face an out-of-pocket cost of about $1,450 annually (if under age 65) or $800 annually (if over 65). Had this policy been in effect in fiscal year 2004, the City would have saved about $325 million. Since the premiums are projected to grow rapidly, future savings will be even greater.

2. **Stop reimbursing retirees for Medicare Part B premiums.** This practice is out of line with benefits provided by other large employers and contradicts the philosophical and cost-saving goals behind the premium requirement established by Congress as part of Medicare's design. In 2004, this change would have required retirees to pay about $67 monthly, and would have saved the City $131 million.

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