FREEDOM FOUNDATION OF MINNESOTA

ISSUE BACKGROUNDER: PUBLIC AND PRIVATE SECTOR COMPENSATION IN MINNESOTA

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The Need for Reform

In an era of economic distress – high unemployment, perennial state budget deficits, soaring property taxes – it is not only appropriate, but necessary, for state and local government to acknowledge the economic realities facing its taxpayers, and to control spending accordingly. Considering that approximately half of the $2.2 trillion that state and local governments spend annually in the US is for public employee compensation, taking compensation "off the table" is simply not an option.

Minnesota is not alone in simultaneously confronting short-term solvency challenges as well as long-term systemic reform opportunities.

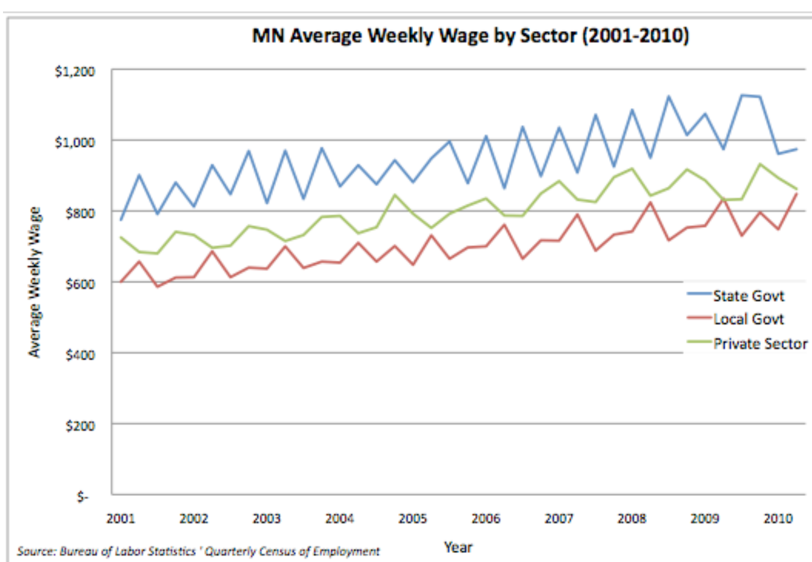
Governors and legislators across the nation are exploring or enacting aggressive government reforms, with public sector pay and benefits often leading the way. The New Hampshire legislature is considering increasing the retirement age (and required years of service) as well as adjusting pension formulas to address their unfunded liabilities.[i] Lawmakers in Delaware have introduced legislation that would eliminate automatic cost-of-living adjustments (COLAs) for current employees with at least five years of service.[ii] And among the many reforms proposed by New Jersey Governor Chris Christie are raising the retirement age by three years, rolling back a previous 9-percent pension increase, and increasing employee contributions to 8.5 percent.[iii]

Employers across Minnesota have been forced to streamline operations, reduce legacy costs, and fundamentally reform the way they do business. It is time for state and local governments to do the same.

Divergent Trajectories: Employment and Compensation Levels in the Public and Private Sectors

Currently, average total compensation for state and local government employees in Minnesota is $69,901, making Minnesota's public sector employees the highest paid in the Midwest and the 11th highest in the nation. Furthermore, state government is the largest employer in Minnesota.

Session Weekly recently reported: "Add in employees of the University of Minnesota, the Minnesota State Colleges and Universities system and a handful of other state-level entities, and the state's payroll swells to a total of nearly 76,000 people. That's roughly 3 percent of all working people in Minnesota."[iv]



And despite the deep recession, the State of Minnesota and its ancillary entities have actually grown in recent years, adding approximately 2,700 employees between 2006 and 2009. During the same time period, Minnesota businesses shed over 108,000 jobs.

On top of the contrast in employment levels is a similar disparity in wages and salaries. State government workers in Minnesota make average annual wages of $55,822, not including health or retirement benefits, compared to $45,260 for private sector employees. While public employees collect significantly higher wages than their private sector counterparts, U.S. Bureau of Labor Statistics (BLS) data show that full-time private sector workers actually put in 12.3 percent more hours at their jobs.[v]

THE BENEFITS GAP

Public employee unions and their advocates often downplay the significance of the public-private wage gap by suggesting that government workers tend to have a higher level of education than their private sector counterparts.[vi]. However, it is more difficult to explain the profound gap between public and private sector employee benefits, in terms of access as well as the cost and quality of benefits.

Consider the following 2010 BLS data for employees working in the seven-state "West North Central" region, which includes Minnesota.

	Private Industry	**State/Local Government**	**Gap (+/-)**
Access to retirement benefits	69%	89%	20%
Access to defined-benefit retirement plan	19%	77%	58%
Access to medical care benefits	70%	84%	14%
Access to dental care benefits	45%	53%	8%
Employer share of health premium	80%	90%	10%
Access to life insurance benefits	61%	77%	16%
Access to short-term disability	31%	12%	-19%
Access to long-term disability	32%	56%	24%
Paid sick leave	62%	89%	27%
Paid vacation	76%	56%	-20%

Paid vacation is one of the few benefits that remain more common in private industry, offered to 76% of private sector workers compared to 56% of state and local government workers. However, as BLS explains, public sector data in this area is heavily skewed by the nature of public education employment, as well as inconsistent reporting methodology: "Primary, secondary, and special education teachers typically have a work schedule of 37 or 38 weeks per year. Because of this work schedule, they are generally not offered vacation or holidays. In many cases, the time off during winter and spring breaks during the school year is not considered vacation days for the purposes of this survey."[vii]

According to Mark Haveman of the Minnesota Taxpayers Association, "for every new dollar of basic education aid entering the system to support increasing enrollment, about 75 cents is going out to support underfunded pensions."[viii]

PUBLIC PENSIONS: DEFINED BENEFITS, UNDERSTATED COSTS

The vast majority of Minnesota's full-time state and local government employees are afforded a benefit that few in the private sector have seen in recent decades: a defined-benefit pension plan. The Minnesota Center for Public Finance Research described a defined benefit plan as, "one that has fixed retiree benefits that are pre-determined based on an established formula."[ix] The use of defined benefit plans among Minnesota public employees plays an important role in the size of the taxpayers' liability because the formula-based benefits are guaranteed to members. [x]

Minnesota public employee pensions are determined using an average of the highest five successive annual salaries, offering an inflated benefit when measured against career average annual earnings. By contrast, private pension plans often use a lower-cost approach by calculating benefits based on career-average pay or employee pay over the last five years of work.[xi] Public employees also receive retirement benefits longer than private employees as public workers are at times qualifying for retirement as young as 50 or 55.[xii]

Minnesota is among only five states whose pension funding is assumed based on an unrealistic 8.5 percent return on its fund balances compared to other states that have lowered their expectations from 8 to 7.77 percent.[xiii] For example, the Minnesota Teachers Retirement Association pension has an officially stated funding gap of $5,232,394 meaning that the pension is funded at 77%. However, after adjusting for the discount rate and the market value, the funding gap increases significantly to $16,573,312 with only 49% of the pension funded.[xiv]

Currently, the MSRS (state employees) has 30,000 beneficiaries with an average monthly benefit of $1,600; PERA (local employees) has 76,500 recipients with an average monthly benefit of $1,300; and the TRA (teachers) has 56,000 recipients with an average monthly benefit of $2,300.[xv]

Although private sector employees have endured significant benefit reductions in recent years, the public sector has, for the most part, avoided such cuts. However, even a recent bipartisan legislative solution that called for a reasonable reduction of public employee cost of living adjustments has brought about a lawsuit from retirees.[xvi]

CONCLUSION

In the midst of the current Minnesota state budget crisis that arrived on top of a prolonged and far-reaching recession, it would be easy for legislators to kick the reform can down the road and leave it for future policymakers. The good news is that while in the midst of dealing with one of the largest and most difficult budget deficits, some Minnesota legislative leaders are rising to the occasion and proposing several different sorts of public employment reform models. Minnesota's aging workforce population combined with a lengthy list of promised pension, healthcare and other retiree benefits, has forced this issue to the surface along with several creative solutions that would help fashion a more sustainable future for the state and its taxpayers.

Policymakers should use the current state budget emergency as a time to revisit costly state mandates that often exacerbate the budget woes of local government. Prime examples of mandates that dramatically affect the cost of local government would include employee-mandated cost-of-living adjustments (COLA) and teacher tenure provisions. These costly state mandates should be part of a wholesale review of current state statutes and employee contract provisions with a healthy eye towards reform.

In addition to state mandates and mandatory contract provisions, legislators should be looking at the totality of employee benefits. Benefits provided to government employees in Minnesota tend to be much more generous than those provided private sector employees. Governors and legislative leaders across the country are developing new paradigms of public employee compensation. The time is right in Minnesota to do the same: policymakers should seek and develop new and better ways of providing government services while fulfilling our social compact with state residents.

Without a commitment to reform, Minnesota taxpayers will continue to be forced to fund an outdated, inflexible and unaffordable public sector workforce. Minnesota policymakers should use this opportunity to provide true leadership in developing a newly restructure public employee paradigm that will be a model for other states and sustainable well into our state's future.

A Note about Sources

Data in this report originates from three sources: the Bureau of Economic Analysis, the Bureau of Labor Statistics, and Minnesota Management and Budget. Each of these entities has its own methodology for data collection and its own reporting standards. In order to maintain the integrity of the source data, the Freedom Foundation of Minnesota chose not to standardize data for greater conformance (e.g. units of measurement, geographic regions, etc).

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