CITIZENS BUDGET COMMISSION

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CBC CALLS FOR REDESIGN OF RETIREMENT BENEFITS FOR EMPLOYEES OF NEW YORK CITY AND NEW YORK STATE

Taxpayers Are Unnecessarily Paying For Benefits That Are Dramatically More Generous Than Those Of The Private Sector Or Other Governments

New York, NY – April 29, 2005 – The Citizens Budget Commission (CBC) today released a 50-page report (available at www.cbcny.org/RetirementBenefits.pdf) that examines the retirement benefits – health insurance and pension payments – for employees of the City of New York and the State of New York. It includes a description of current benefits, a comparison to benefits provided by other large private and public employers, and recommendations for redesigning these retirement benefits.

FINDINGS. The report's three major findings are:

- ***Retirement benefits are a large and rapidly growing expense for the City and the State.*** For the City, required contributions to pension funds tripled, rising from $615 million in fiscal year 2000 to $2.3 billion in fiscal year 2004; they are projected to double again by fiscal year 2008, reaching $4.7 billion. Similarly, required pension fund contributions from the State jumped from $218 million in 2000 to $592 million in 2004, and are projected to double to nearly $1.4 billion in 2008. Employer health insurance payments for workers and retirees have been growing at or near double-digit rates in recent years, and the combined cost of this benefit for the City and State will rise 50 percent from $4.2 billion in 2004 to $6.3 billion in 2008. While some of the growth in pension contribution is related to the stock market decline of 2000-20001, retirement benefits will remain a significant expense in coming years.

- ***The benefits provided by the City and State are more generous than those provided by large private employers, the federal government and most other states and localities.***

  Health Insurance. For City retirees and their dependents, the City pays the full premium cost of insurance policies that are comparable to those provided full-time workers. For most State retirees, the State pays 100 percent of the premium cost of a comprehensive insurance policy for individuals and 86 percent of the cost for a family. For the most recently hired workers, the State pays 90 percent of the cost of an individual policy and 82 percent of the cost of a family policy. For retirees age 65 or over, the State and the City pay the full cost of Medicare Part B premiums.

In contrast, among large (200 or more workers) private employers, only 38 percent offer retirees health insurance benefits. Among the largest (1,000 or more workers) employers, 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 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, New York is one of only 16 who pay the full premium cost; in 12 states the employer pays no part of the premium cost. New York is among only six states that pay any portion of Medicare Part B premiums.

***Pension Benefits*.** City and State employees participate in defined benefit pension plans, while the majority of employees of large private sector firms participate in defined contribution plans. Only about one-fourth of the employees of large private firms are in defined benefit plans, and this proportion has been shrinking in recent years. Compared to other public-sector pension plans with defined benefits, New York City's and State's are relatively generous in the limited employee contribution they require, the inclusion of overtime in calculating benefits, and the frequent granting of disability status to some uniformed workers.

- ***Generous pension benefits for City and State workers can no longer be justified on the ground that these workers' wages are lower than in the private sector, because for most occupations (managers and professionals are the notable exceptions) wages in the public sector are higher than in the private sector.*** According to recently released 2004 data from the U.S. Department of Labor's Bureau of Labor Statistics, the hourly earnings of state and local government employees exceed those of private-sector employees in the greater New York City region by an average of 15 percent – $28.26 to $24.62. This wage data, which includes hourly earnings but excludes fringe benefits, undermines the longstanding myth that the public sector must provide unusually generous fringe benefits packages in order to compensate for higher private-sector salaries.

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

Health insurance for retirees. The City and State provide 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:

- **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 and more modest current contributions from State 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 and the State about $275 million. Since the premiums are projected to grow rapidly, future savings will be even greater.

- **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 and State $131 million and $88 million, respectively.

Pension benefits. 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. This is a rare process, requiring a major political effort. Given the formidable obstacles and the tradition of protecting existing pension benefits, a constitutional change is not warranted.

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 only slowly, but the service to the future fiscal health of the City and State would be enormous. The long-run goal of pension reform should be to convert from defined benefit to defined contribution plans. Eventually, all City and State workers should have defined contribution plans, and the current system should fade away.

In recommending a shift to defined contribution plans, the CBC does not necessarily envision an employer contribution (as a share of payroll) that is significantly less than the long-term average under defined benefit plans. The amount should be subject to collective bargaining. The case for shifting to defined contributions rests on two other fundamental points.

First, defined contribution plans facilitate worker mobility, while defined benefit plans typically reward (and even require) longevity. Under a defined contribution plan, benefits can be vested almost immediately, and the benefits are not disproportionately greater as one approaches retirement age. This is good for the workers and for society, because a mobile workforce is increasingly essential in a modern economy.

Second, defined benefit plans create a political dynamic that places the taxpayers in double jeopardy. Unions have two advantages: (a) 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 or governor, with whom the union would otherwise have to bargain. Such "end runs" around collective bargaining are common and expensive. (b) Because the State Legislature controls the benefits but does not pay for them (at least in the case of the City), workers have a political advantage in gaining their support. Legislators have political incentives to support union demands, but need not face the taxpayers in raising the money to pay for them.

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. Five such changes should be given priority:

- **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 systems should require a higher percentage contribution, and not limit it to ten years.
- **Raise the minimum age requirement for retirement.** Currently, police and firefighters have no minimum age, and for most other workers it is 62 or 57 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.
- **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.
- **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 New York City, 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.
- **Eliminate the variable supplements available to some retired New York City 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 sources of income for retirees.

"The retirement benefits of New York City and State are out of line," said CBC President Diana Fortuna. "The taxpayers should no longer be required to pay these excessive costs."

"Paying for such expensive systems is no longer necessary to attract a qualified workforce," said Charles Brecher, CBC's Research Director. "If changes are made now, the payoff for taxpayers will be dramatic in the long-run."

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