

The Comparability Of Pension And
Other Post-Retirement Benefits Between
Public Sector And Private Sector Employees

A Report Mandated By Laws Of Minnesota 1999,
Chapter 250, Article 1, Section 2, Subdivision 4

Legislative Commission on
Pensions and Retirement

January 15, 2000



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Speaker of the House
463 State Office Building
100 Constitution Avenue
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Senator Allan H. Spear
President of the Senate
120 Capitol
75 Constitution Avenue
St. Paul, MN 55155-1606

Re: Letter of Transmittal for Commission Report

Dear Representative Sviggum and Senator Spear:

Herewith transmitted is a report on the comparability of pension and other post-retirement benefits between public sector and private sector employees.

The report was mandated by Laws 1999, Chapter 250, Article 1, Section 2, Subdivision 4.

The Commission hopes that this report provides useful information to the Legislature.

Sincerely,

A handwritten signature in cursive script that reads "Harry Mares".

Harry Mares
Representative, District No. 55A
Chair, Legislative Commission on Pensions and Retirement

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Executive Summary

Study Approach

The Legislative Commission on Pensions and Retirement conducted a comparison of pension and post-retirement benefit coverage between public sector employees and private sector employees by reviewing recent relevant retirement benefit coverage literature and by assembling the results of calculated hypothetical retirement annuities from various Minnesota public sector and private sector retirement arrangements requested to provide information by the Commission.

Review And Summary Of Pension Benefit Practice Literature

- Pension Benefit Coverage Is A Well-Established Part Of Employment Compensation.

While pension benefit coverage has grown as part of employment compensation, its provision is probably based in employer managerial decisions to gain specific employment goals and in employer responses to broader societal views. Employer-sponsored pension plans began in the public sector in 1857 and in the private sector in 1875, and now cover one-half of the civilian non-agricultural workforce or more. The number of employer-sponsored pension plans has increased to more than 700,000 plans, with most of the pension plans in the private sector.

- Pension Benefit Coverage Is Most Common For Governmental Employees And Full-Time Private Sector Employees

Pension plan participation has also grown to 84 million employees, with the greatest participation among governmental employees, sizable participation among full-time private sector employees, and the least participation among part-time private sector employees.

- Historically Predominant Defined Benefit Plan Approach Shifting To Defined Contribution Plan Approach

Defined benefit pension plans have historically predominated, and continue to predominate, in the public sector. That same pattern generally holds true for the largest private sector employers. For smaller private sector employers and for supplemental pension coverage for larger private sector employers, defined contribution pension plans are significant in number and are growing. In total, there are 12 times more private sector defined contribution pension plans than there are private sector defined benefit plans. Although there are substantially more defined contribution pension plans than defined benefit pension plans, the concentration of defined contribution plans in small employers and the concentration of defined benefit plans in large employers translates into comparable total numbers of plan participants.

- Defined Contribution Plan Growth Due To Changing Economic Factors And Perceptions

Defined contribution plans have become prevalent in the private sector for a variety of factors and perceptions, including changing federal tax code regulation, ease of administration, increased benefit portability, lower employer cost, and the predictability of future employer funding levels.

- Part-Time Employees And Employees Of Small Private Sector Firms Continue To Lack Pension Coverage

Among part-time employees and for small private sector employers (under 100 employees), especially non-unionized employers in the service or retailing industries, pension coverage becomes less frequent. Uncertain business revenue, high employee turnover, lack of employee interest, pension plan administrative costs, and governmental regulatory burdens are the reasons cited for a lack of pension coverage.

- Interest In Defined Contribution Plans By Government Sector Growing

Governmental employers are beginning to consider the creation of defined contribution pension plans, in order to appeal to older workers, part-time employees, and employees seeking flexible benefit coverage, and in order to implement greater pension portability, but the shift to defined contribution pension plans in the public sector remains slow.

- Out-Transitioning Remains Optimal Defined Benefit Plan Function

Defined benefit plans attempt to address benefit adequacy concerns and function to remove older or less efficient employees from the workforce in a humane or socially-responsible manner, although these plans risk the creation of unfunded pension liabilities and future funding burdens and are not portable if employees become mobile.

- Employee Flexibility And Self-Reliance Are Optimal Defined Contribution Features

Defined contribution plans allow for greater individual responsibility in saving for retirement, investing, and handling distributions, are better in providing pension portability, better control employer pension cost, and are less expensive to administer. Participants in defined contribution plans may not make adequate member contributions, may be unduly conservative in their investment practices, and may use plan accumulations for purposes other than retirement.

- Public Sector And Private Sector Relative Generosity Difficult To Quantify

While there are considerable differences in quantifying the relative generosity of public and private sector employment compensation and benefit practices, commentators generally agree that compensation costs are greater in the public sector than in the private sector. Commentators frequently point to the differences in the occupational mix between the public and private sectors, among other factors, to explain the data differences.

- Growing Response To Demands For Earlier Retirement Ages

Although age 65 is the historical age for the beginning of retirement, as a surrogate for determining worker incapacity and loss of productivity, a retirement lifestyle has developed in recent decades, many workers seek to retire at ages earlier than age 65, and that employers have accommodated that desire by permitting retirement before age 65.

- Typical Private Sector Defined Benefit Plan Provides Adequate Retirement Benefit

Retirement benefit adequacy is the receipt of a benefit that replaces pre-retirement income in the range of 60-70 percent and the typical private sector defined benefit plan and Social Security will provide an adequate benefit at age 62 or age 65.

- Retiree Health Coverage Is Growing Benefit Practice

Retiree health benefit coverage is a need resulting from earlier retirement and growing life expectancies and employers are increasingly accommodating this need with partially or wholly employer-funded medical care benefit coverage for retirees.

Comparison Of Calculated Minnesota Pension Plan Hypothetical Benefit Amounts

- Minnesota Larger Employer Pension Practices Parallel Identified Recent National Trends

In a sampling of 47 Minnesota retirement benefit arrangements of large employer, largely white collar employees, local pension practice parallels the trends identified in the literature review. Defined benefit plans are the most prevalent type of pension coverage, although most of these arrangements include defined contribution plan coverage. Based on benefit amounts, the defined benefit plans provide the most significant amount of total benefits, although the defined contribution benefits can be significant. Employee and employer contribution practices vary. A majority of retirement arrangements did not provide post-retirement adjustments, did not recognize service previously covered by another pension plan, infrequently or never offered early retirement incentives, and did not provide pre-retirement benefit counseling. The employer is the most common source of the payment of pension administrative costs. Most retirement arrangements also did not provide post-retirement medical insurance coverage that was wholly or partially subsidized by the employer.

