

**Minnesota Public Sector Compensation
Part 2**

**Frozen Assets in Public Sector Compensation:
Issues in Promoting Results-Oriented Workforce
Reform**

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MTA Research Associate Lori Milanowski, MTA Research Director Aaron Twait and MTA Executive Director Mark Haveman are the authors of this report.

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About the Minnesota Taxpayers Association

The Minnesota Taxpayers Association was founded in 1926 for the purpose of disseminating factual information that will educate and inform all Minnesotans about Minnesota tax and spending policies. For over eighty years, the Association has advocated for the adoption of sound fiscal policies through its research efforts, publications, and meetings.

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Executive Summary

Executive Summary

This report is the second of a two part series examining Minnesota public sector compensation. Part 1 of this investigation, *Minnesota Public Sector Compensation: Costs, Trends and Comparisons with the Private Sector* examines how government employee compensation elements compare with analogous jobs in the private (i.e. non-government) sector.

In Part 2 we identify the types of compensation-related spending driven by common employee contract provisions and state mandates that have weak or non-existent relationships with public sector outcomes. We estimate the cost of these provisions and mandates and quantify the amount of existing compensation spending that could be used in different ways to better compensate for productivity and performance.

State and local government (including school district) compensation systems place a strong emphasis on protecting public sector employees from patronage and the undue influence of political loyalty in workforce decision-making. They also place a significant premium on equity in public sector compensation. These issues still have relevance to public sector workforce policies. However, there is growing concern that this system is increasingly unresponsive to a budgetary environment that demands greater flexibility, managerial discretion, and a results-based orientation.

Funding to implement a “productivity focused” public sector compensation system is hindered because existing state mandates and contract provisions “lock in” significant amounts of compensation-related spending. This report describes this committed spending as “frozen assets” since compensation reform could free these resources to be used with greater effect.

It is imperative to note the estimates contained in this report should *not* be viewed as potential budget savings. While some operational savings might be realized in compensation system redesign, much of this spending could be expected to continue in an alternative compensation system.

Findings on “Frozen Assets” in Salary Provisions

- Contracts with public employees generally provide that employees’ salaries should be linked to length of public employment tenure. This results in negotiated salary increases (“steps”) provided to employees on the anniversary of their hiring date, and so a portion of salaries are based on longevity. In 2009 we estimate \$2.5 billion in state and local government payroll was attributable to “step” or “longevity” pay.
- Cost of living adjustments or “COLAs” are negotiated annual increases in the pay scale that affect all employees regardless of merit. Although the state and many local governments suspended COLAs in recent contractual agreements due to economic conditions, they are a staple of the public compensation system. We estimate that a 2% COLA, which is common by historical standards, would generate an additional \$240 million in state and local government payroll under 2009 costs.
- Compensation for additional education credentials is unique to teacher contracts and provides the opportunity to earn additional salary for performing the same work by

Frozen Assets in Public Sector Compensation

advancing personal education. In 2009 we estimate \$438 million in teacher compensation was attributable to additional pay for earning a masters degree.

Findings on Frozen Assets in Benefit Provisions

- Governments in Minnesota typically provide employees with health insurance benefits that are more generous than those found in the private sector – both in terms of cost (as Part 1 of this investigation indicates, public employers generally contribute a higher share of the premiums than do private employers) and in terms of the generosity of the benefits. In 2009 we estimate \$275 million in state and local government spending was attributable to employer health insurance spending beyond what is made on average by private sector employers to cover their employees.
- Minnesota public employees participate in defined benefit pension plans which guarantee a retirement income stream for life. The state requires governments to make contributions to cover both the current liabilities incurred in a given year and at least a portion of any unfunded liabilities. In 2009 we estimate that \$319 million in state and local government spending was attributable to retirement contributions beyond what is made by private sector employers in an average 401(k) match.
- Minnesota governments offer “other post employment benefits” or OPEB which includes all benefits except pensions that are promised to retirees. One OPEB benefit mandated by the state allows early retirees to continue in the employer-sponsored medical and dental insurance plans indefinitely and to remain in the active employee health care pool; thus driving up insurance rates for government employers. Other units of government, most notably school districts, have OPEB legacy costs stemming from promises regarding long-term retiree health care. In 2009 we estimate that \$219 million in state and local government spending was attributable to funding these obligations.

Findings on Other State Labor Related Mandates

- Prevailing wage laws regulate compensation for government-financed public construction projects by requiring contractors to pay government-designated wage and benefit rates. These rates are generally higher than the rates normally paid for such work in the area. We estimate the cost of this mandate to state government in fiscal year 2008 was between \$96.1 million and \$126.8 million, and between \$210.9 million and \$278.2 million to local governments
- State pay equity or “comparable worth” law seeks to ensure that job classes dominated by females are compensated fairly. Unlike “equal pay for equal work” laws ensuring gender-neutral compensation for a particular job position, pay equity mandates “equal pay for equally-valued work” where the value of a job to government is determined by a rating system which involves substantial subjectivity and is oblivious to labor markets. The cost of compliance with the mandate cannot be determined although the initial cost of establishing pay equity was estimated to be 4% of government payroll.
- Aggregate value of benefits law prevents local governments from unilaterally reducing the value of group insurance benefits for employees covered by a collective bargaining agreement. It also prevents local governments from unilaterally increasing deductibles or co-pays while maintaining current benefit levels or decreasing the type of benefit. The provision does not impose a cost per se to governments but reduces flexibility to manage cost structures.

Executive Summary

Conclusions

Based on our analysis of public sector compensation costs, trends and private sector benchmarking (Part 1) and this examination of the nature and structure of compensation-related spending in state and local government, we conclude the following:

Disparities between public and private sector compensation levels are symptomatic of more fundamental problems in the design of public sector compensation systems.

The double imbalance in public sector compensation highlighted in Part 1 of this report is a function of a flawed compensation system that has important implications for the cost and quality of government service delivery going forward. To meet public expectations of government in the future, critical knowledge, skill sets, and capabilities must be aggressively recruited, competitively paid, and developed as core “assets” within government; and high levels of performance must be rewarded. If this cannot be done because 1) highly bureaucratic and inflexible job classification and valuation systems create barriers; 2) equity trumps performance considerations in establishing compensation; and 3) resources are not available due to premiums paid elsewhere in the public sector labor force; then needed productivity gains in the public sector will not materialize.

Current compensation system design and state mandates create a significant opportunity cost for delivering government services and fulfilling government obligations in a cost effective manner.

We estimate that governments in Minnesota dedicated at least \$4 billion in calendar year 2009/fiscal year 2009 to public sector compensation features with weak or no relationships to public sector outcomes. “Freeing” at least some of these resources is necessary to design compensation systems that support improvements in public sector productivity.

Compensation is only one dimension of a larger set of essential public sector human resource management reforms.

Minnesota’s relatively low grade in a national human resource management report suggests greater efforts are necessary to transform human resource management in government from a highly administrative function to a strategic asset emphasizing development of human capital, workforce planning, and workforce process redesign.

Recommendations

1. Improve taxpayer understanding of public sector compensation by increasing visibility of key labor provisions and their budgetary implications.

State and local governments should:

- Provide detailed “object code”¹ spending information from an all funds perspective to better allow taxpayers to identify and quantify relevant trends in public sector compensation.
- Prominently feature and describe employee health plan details, premium costs, and cost sharing provisions in budget documents.

¹ Delineation of government spending by type (e.g. salaries, purchased services, etc.) rather than by function or program (e.g. parks and recreation)

Frozen Assets in Public Sector Compensation

- Provide detailed descriptions of step increases, cost of living adjustments and projected spending implications over the life of the employment contracts.
- To the extent possible, isolate, quantify, and report the cost impact of labor-related state mandates including comparable worth compliance, implicit rate subsidies for early retiree health care, and prevailing wage law compliance.

In addition:

- Results of binding arbitration decisions should be more prominently reported, and the state should conduct a biennial assessment of award trends compared to private sector wage and compensation trends.
- Labor arbitrators should be required to consider the total compensation and prevailing benefit levels offered in the private sector to help make sure that future public sector compensation and benefit decisions do not become grossly out of line with the private sector.

2. Reform public pensions to reduce cost pressures on government operations and the current degree of taxpayer risk.

The findings of the forthcoming 2011 report by the three statewide pension funds on the feasibility, sustainability, financial impacts, and other considerations of alternative retirement plan designs should provide valuable information on reform options.

In the meantime efforts should be directed toward further pension stabilization efforts. Chief among these would be the total elimination of upward adjustments in public sector retiree's pensions until their retirement plans achieve full funding.

3. Reform compensation practices and human resource laws to improve government flexibility and reward performance and productivity.

- Government entities should eliminate the use of “step and lane” compensation systems which are based on very prescriptive, narrow job classifications and equally constrained pay grades. In its place governments should adopt “broad banding” strategies in which the number of job classifications are drastically reduced but accompanied by very large increases in salary ranges. Such a system would significantly improve the ability of managers to both recognize and reward high performing workers. Also, by increasing the flexibility of managers to reassign workers, such an approach would reduce barriers to government redesign.
- State employee performance evaluations should be strengthened and compensation should be formally linked to them. A recent national study was critical of the lack of oversight and accountability in state mandated employee performance appraisals noting that 20 percent of state classified employees did not receive an annual performance appraisal despite a Minnesota state policy requiring one. Without a formal linkage to compensation performance evaluation systems are little more than a bureaucratic exercise.
- State pay equity/comparable worth law should be repealed. Its purpose is outdated, and requiring governments to correct perceived “errors” in labor markets based on bureaucratic and subjective assessments of the relative value of government jobs is an unnecessary and costly mandate.

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4. Reform Minnesota's prevailing wage regime so that the prevailing wage more closely reflects average wages and test claims that the use of prevailing wage results in higher-quality construction.

We recommend the following three changes to the state's prevailing wage regime:

- That median wage data the widely-used Department of Employment and Economic Development (DEED) survey of wages be used as the definition of prevailing wage for public construction projects in Minnesota. The current survey methodology provides for voluntary responses and does not produce results with any degree of statistical reliability. Moreover, using the modal calculation often results in prevailing wage rates which equal union pay rates, which may or may not be representative of local pay rates for construction work.
- That DEED develop and administer on a regular basis a similar survey to be used to determine the fringe benefits portion of the prevailing wage rates.
- That alternative methods of determining prevailing wage rates be tested on specific construction projects and compared to comparable public construction projects in the state which use the existing prevailing wage regime, in order to compare costs and test over the long-term claims that projects built using prevailing wage are of higher quality.

5. Link any future tax increases and revenue enhancements to these reforms.

Strong historical familiarity and comfort with the existing system combined with entrenched interests suggest that major reform of public sector compensation and human resource management systems is unlikely to be adopted absent truly extraordinary circumstances. Nevertheless, the supply of future tax revenues does represent a potentially valuable source of leverage for reform – indeed; it is likely the only leverage. If tax increases are deemed appropriate and necessary in the future, their adoption should be conditioned on the adoption of reforms in the areas identified above. Such a quid pro quo arrangement would communicate to taxpayers that any additional tax burden they assume would be matched with important structural reforms promising greater returns from taxpayer dollars.

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Introduction

I. Introduction

Discussions over the cost of government swiftly move to the cost of labor, as government at all levels is a labor intensive enterprise. In 2010 the Minnesota Chamber of Commerce and NAIOP Minnesota commissioned the Minnesota Taxpayers Association to conduct an examination of state and local government employee compensation levels and design.

The purpose of this investigation is to examine state and local employee compensation and evaluate the impact on public service delivery and budget sustainability. We conducted an examination of total employee compensation among state and local government employees to answer the following questions:

- How does Minnesota's state and local government workforce compare to the rest of the nation in terms of size and compensation?
- How do government employee salary, health, and retirement packages compare with comparable jobs in the private sector? What is the magnitude of any public sector compensation premiums in these areas?
- What are the cost trends in employee compensation and how do these trends compare to revenue and tax base trends and projections?
- What types of compensation-related spending driven by contract provisions, state laws, and mandates have weak or inconsistent relationships with public sector outcomes? What are the opportunity cost implications of these provisions?

Part one of this investigation, *Minnesota Public Sector Compensation: Costs, Trends and Comparisons with the Private Sector* addressed the first three questions. This report examines the final research question.

Purpose of this Study

Minnesota public sector compensation is heavily influenced by civil service and collective bargaining laws. The current system places a strong emphasis on protecting public sector employees from patronage and the undue influence of political loyalty in workforce decision-making. It also places a significant premium on ensuring equity and fairness in public sector workforce compensation. Although the current system is rooted in addressing societal concerns that existed many decades ago, the objectives it promotes still have relevance to public sector workforce management today.

However, there is growing concern that this system is increasingly unresponsive to 21st century economic and budget realities. In presentations on Minnesota's budgetary and economic future, Minnesota's state economist and state demographer describe the three keys to continuing Minnesota's historical economic success as "productivity, productivity, productivity." While their comments are directed toward the private sector economy, this same message is also very applicable to public service delivery and fulfillment of the general obligations of state and local government. The need for public sector productivity enhancements suggest several new design considerations in compensation systems such as greater management flexibility and administrative discretion, results-based compensation design, and greater ability to hire and retain workers with essential and scarce qualifications.

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Funding necessary to implement a results-oriented or “productivity focused” public sector compensation system would have to come from existing state and local resources. However, such redesign efforts are hindered because the structural characteristics of public sector compensation systems, state mandates, and common public sector contract provisions “lock in” significant amounts of compensation-related spending. This reduces government flexibility to allocate budget resources in ways that obtain maximum value from tax dollars.

This issue is compounded by the likelihood that Minnesota governments will face significant budget pressures over the next quarter century. The report from the highly respected Minnesota State Budget Trends Study Commission forecasts that state government will face a long-term structural budget problem, with the main concern being the rapid growth in health care costs as the Baby Boom generation retires. The report predicts that under current law, state government revenue will grow 3.9% per year between 2008 and 2033, while total spending will grow by 5.4%.

Data from the U.S. Bureau of Economic Analysis indicates that total state and local Minnesota government employee compensation grew 4.4% per year between 1992 and 2009 – faster than projected revenue growth through 2033. Although current spending patterns could be maintained over time if revenues grow faster than expected, either through higher economic growth or higher taxes, it seems unlikely that revenue growth will reach 5.4% per year. It may prove very difficult to sustain these historical levels of public employee compensation growth as employee compensation begins to compete more and more with other spending priorities.

Although the Budget Trends Study Commission looked only at state spending and revenues, history suggests that the state will pass some of its financial problems on to local governments, making it more difficult for them to finance this level of compensation growth as well.

This leads us to ask: how much compensation spending is dedicated in contract provisions and state mandates unrelated to performance? How much current compensation-related spending could be repurposed with potentially greater effect? In this report we estimate the cost of various compensation-related features in state and local government that have weak or inconsistent relationships with public sector outcomes.

Our report examines the following areas and is organized as follows:

Section II examines salary-related compensation spending

Section III examines benefit-related compensation spending

Section IV examines other state mandates affecting labor related costs

Section V presents conclusions and recommendations

Appendix A provides detail on the methodologies employed for developing the cost estimates

It is imperative to note the estimates contained in this report should *not* be viewed as potential budget savings. While some operational savings might be realized in compensation system redesign, much of this spending would be expected to continue in an alternative compensation system.

Introduction

Readers should also note that this report and the accompanying estimates covers the entire public sector workforce in Minnesota except where noted. This is different from Part One which benchmarked public sector compensation with private sector position counterparts but analyzed only those state and local employees in job positions with clear private sector analogues. The time period is also slightly different: this report (Part 2) is based on calendar year 2009 or fiscal year 2009 (whichever is most appropriate); Part 1 of this report examined calendar year 2008 for local units of government and calendar year 2010 for state government.

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Costs Associated With Salary-Related Contract Provisions

II. Costs Associated With Salary-Related Contract Provisions

Summary of Findings

Payroll Attributable to Step Increases (“Longevity Pay”)

State Government	\$466 million
Local Government	\$1.225 billion
School Districts (Teachers only)	\$795 million

Cost Attributable to Cost of Living Adjustments (“COLA”) at 2%

State Government	\$55 million
Local Government	\$101 million
School Districts (Teachers only)	\$84 million

Payroll Attributable to Additional Education Credentials

Masters Degree (Teachers only)	\$438 million
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Introduction

This section examines three salary-related contract provisions: payroll attributable to tenure or longevity (commonly referred to as “step increases”); annual cost of living adjustments provided to public employees; and payroll attributable to higher education attainment. Each provision contains a brief description and explanation followed by our estimate of the amount of government spending currently dedicated to these provisions (See Appendix A for additional details on methodology employed).

COLA provisions are negotiated by individual governments in contracts and vary both between governments and from year to year, making it impossible to estimate the amount of current salary expense linked to historical COLAs. Moreover, in response to the state budget challenges, state bargaining parties agreed to no COLAs in 2010 as did many other local governments and school districts. However, since they have been and continue to be a routine feature of public sector employment, we provide an annual estimate based on a hypothetical 2% increase to illustrate the magnitude of the cost impact.

Step Increases (“Longevity Pay”)

Explanation of the Contract Provision

Contracts with public employees generally provide that employees’ salaries should be linked to length of public employment tenure. Steps are negotiated salary increases provided to employees on the anniversary of his or her hiring date, and so are based on longevity – “each year you are employed in this job, you will get x% more pay.”

Step increases are typically capped between 7-20 years of service, depending on the government entity and type of employment. Even after an employee has reached the maximum “step,” some employment contracts (common in MNSCU and school district agreements) provide an additional longevity stipend at notable employment milestones – for example, at 20 and 25 years of service.

Among state employment contracts, step increases typically have averaged in the 3% range and are relatively uniform within the same union contract (different union groups have historically negotiated different step increases). Teacher contracts typically demonstrate greater variation. Importantly, step increases are in addition to any negotiated broad based cost of living adjustments.

As discussed in the introduction to this report, the estimates below should **not** be interpreted as potential budget savings. Public employees should be compensated for productivity and job performance improvements, and experience is a likely contributor to these improvements. The estimates below reflect how much salary expense is rooted in a system that simply equates tenure with performance and experience. As a result, the amount reflects resources that might be freed to support an alternative compensation system design.

Cost of Contract Provision – State Government: \$466 million

We estimate the share of state payroll attributable to longevity pay using data from Minnesota Management and Budget’s *Executive Branch Total Compensation Report* for 2010. Our analysis of the report’s payroll data suggests that approximately 19.1% of state payroll is attributable to longevity; i.e. that if employees in the various job classes were each paid at the lowest listed full-time salary, total payroll would be 80.9% of current levels.

Data from the U.S. Census Bureau’s *2009 Annual Survey of Government Employment* indicates that annual state payroll, less higher education (which is beyond the scope of this study) was \$2.442 billion for calendar year 2009. If 19.1% of payroll is attributable to longevity pay, then we estimate the cost to the state for longevity pay in calendar year 2009 was approximately \$466.0 million.

Cost of Contract Provision – Local Governments: \$1.225 billion

We estimate the share of local government payroll attributable to longevity pay using data from the *Minnesota Local Government Salary and Benefits Survey*.² The data is primarily for 2008, although since local governments are able to update data continuously, some data could be for 2009. Our analysis of the payroll data in that report suggests that approximately 27.7% of local government payroll is attributable to longevity pay; i.e. that if employees in

² Coordinated and sponsored by the League of Minnesota Cities, the Association of Minnesota Counties, and the Association of Metropolitan Municipalities.

Costs Associated With Salary-Related Contract Provisions

the various job classes were each paid at the minimum listed full-time salary, total payroll would be 72.3% of what is actually awarded.

Data from the U.S. Census Bureau's *2009 Annual Survey of Government Employment* indicates that annual local government payroll, less K-12 education was \$4.426 billion for calendar year 2009. If 27.7% of payroll is attributable to longevity pay, then we estimate the cost to local governments for longevity pay in calendar year 2009 was approximately \$1.225 billion.

Cost of Contract Provision – School Districts (Teachers only): \$794.7 million

Data from the *Schools and Staffing Survey* for 2007-08 indicates that the average teacher salary in Minnesota was \$50,582. As calculated above, we estimate that the salary increment for a master's degree, on an average basis, is 13.3%. Therefore, the average salary less master's increment is \$44,642.

The *Schools and Staffing Survey* indicates that the average base salary for a Minnesota teacher with a bachelor's degree and 2 or fewer years of teaching experience was \$33,830 in 2007-08. We estimate, then, the average salary increment for longevity to be 32.0% (\$44,642/\$33,830).

Data from the Minnesota Department of Education Program Finance Division's *Minnesota School Finance Trends* report for FY 1997-FY 2009 states that total payroll for regular instructors, career and technical instructors, and special education instructors was \$3.718 billion for fiscal year 2009. We estimate that total payroll, less incremental pay for a master's degree, was \$3.281 billion for FY 2009. If the overall increment for longevity is 32.0% above the pay for a beginning teacher, then we estimate the cost to schools for pay for longevity in fiscal year 2009 was approximately \$794.7 million.

Annual Cost of Living Adjustment

Explanation of the Contract Provision

When negotiating with public employers, employee unions often negotiate for changes in the pay scale that affect all employees. Typically referred to as “cost of living” adjustments (COLA), these pay increases take effect on a certain day, often the first day of the new calendar or fiscal year. Although all employees are eligible for the COLA, the COLA is not always uniform for all employees.

COLAs are a common feature in state, local government, and school district contracts with their employees. COLAs are generally not tied to a specific measure of inflation, such as the Consumer Price Index; but are instead determined as part of the bargaining process. In fact, a public employer with multiple unions will often have multiple COLAs, since a slightly different arrangement may be negotiated with each union.

Importantly, COLAs affect more than just the cost of salaries. Increasing salaries also increases the cost of fringe benefits that are tied to salary levels; primarily employer costs for Social Security, Medicare, and public pensions. These additional costs often fly under the radar when COLAs are discussed at public meetings or in the press.

In theory, COLAs serve a useful purpose: to protect the purchasing power of public employee salaries over time. However, this is undermined by the fact that COLAs are not tied to any sort of inflation measure and are simply a product of labor-management negotiations. There is, of course, no correlation between the amount of COLA provided to employees and any sort of productivity gain. Moreover, across-the-board cost of living salary adjustments are unusual in the private sector, where salary adjustments are more likely to be based on formal job evaluations and performance measures.

Cost of Contract Provision – State Government: \$55.0 million

COLAs in the State of Minnesota’s contracts with its unions are generally awarded on the first day (July 1) of each fiscal year. We examined union contracts from fiscal year 2002 through fiscal year 2011; in five of the new fiscal years during that period the state awarded COLAs ranging on average from 2.0% to about 3.3%. In four of the new fiscal years during that period no COLA was awarded, including the fiscal years beginning July 1, 2009 and July 1, 2010.

Data from the U.S. Census Bureau’s *2009 Annual Survey of Government Employment* indicates that annual Minnesota state government payroll, less higher education (which is beyond the scope of this study) was \$2.442 billion for calendar year 2009. Although state employees did not receive a COLA during 2009, we will use 2009 payroll to demonstrate potential COLA costs. Had state employees received even a 2.0% COLA on July 1, 2009, the potential cost in salary to the state would have been \$48.8 million on an annualized basis.

However, as noted above, additional pay generates additional Social Security, Medicare, and pension costs. If the cost for these benefits is, on average, 12.65% of payroll (7.65% for Social Security and Medicare plus roughly 5.0% for pensions); then the additional fringe benefit cost generated by a 2.0% COLA would have been \$6.2 million. Therefore, we estimate the total cost to the state for a 2.0% COLA on July 1, 2009 would have been \$55.0 million on an annualized basis.

Costs Associated With Salary-Related Contract Provisions

Cost of Contract Provision – Local Governments: \$101.5 million

Local governments typically award COLAs on the first day of their fiscal year, which coincides with the first day (January 1) of the calendar year. It is difficult to determine an average COLA for local governments across Minnesota, with 87 counties and over 850 cities (not to mention the various townships and special districts), many of which do not post the contracts they enter into with their employees. Reviewing a limited number of city contracts indicates that recent COLAs, when granted, have generally ranged between 2.0% and 3.0%.

Data from the U.S. Census Bureau's *2009 Annual Survey of Government Employment* indicates that annual Minnesota local government payroll less K-12 education was \$4.426 billion for calendar year 2009. As with our state government analysis, we will use 2009 payroll to demonstrate potential COLA costs even though many local government employees may not have received a COLA in 2009. If local government employees had received even a 2.0% COLA on average, the total potential salary cost would have been \$88.5 million on an annualized basis.

However, as noted above, additional pay generates additional Social Security, Medicare, and pension costs. If the cost for these benefits is, on average, 14.65% of payroll (7.65% for Social Security and Medicare plus roughly 7.0% for pensions); then the additional fringe benefit cost generated by a 2.0% COLA would have been \$13.0 million. Therefore, we estimate the total cost to local governments (except schools) for a 2.0% COLA in calendar year 2009 would have been \$101.5 million on an annualized basis.

Cost of Contract Provision – School Districts (Teachers only): \$84.3 million

Schools typically award COLAs to teachers on a fiscal year basis. It is also difficult to determine an average COLA for the over 330 school districts across Minnesota. We will assume for the sake of argument that a 2.0% COLA for school districts is both reasonable and conservative.

Data from the Minnesota Department of Education Program Finance Division's *Minnesota School Finance Trends* report for FY 1997-FY 2009 states that total payroll for regular instructors, career and technical instructors, and special education instructors was \$3.718 billion for fiscal year 2009. If teachers across the state received even a 2.0% COLA between fiscal year 2009 and fiscal year 2010 (i.e. – at some point during the summer of 2009), the total potential salary cost would have been \$74.4 million on an annualized basis.

However, as noted above, additional pay generates additional Social Security, Medicare, and pension costs. If the cost for these benefits is, on average, 13.34% of payroll (7.65% for Social Security and Medicare plus roughly 5.69% for pensions); then the additional fringe benefit cost generated by a 2.0% COLA would have been \$9.9 million. In total then, we estimate the cost to school districts for a 2.0% COLA during calendar year 2009 for their teachers would have been \$84.3 million on an annualized basis.

Increases in Pay Based on Additional Educational Credentials or Experience

Explanation of the Contract Provision

Teacher contracts are unique in the public sector in that they generally provide teachers the opportunity to earn additional salary for performing the same work by earning additional educational credentials. These credentials can take the form of additional credits – often college or university courses but in some cases approved educational or professional development activities – that do not result in an additional degree. Such credentials can also take the form of an advanced degree – (i.e. Master’s degree, Education specialist degree, or Doctoral degree). This is a distinctive feature in public employment – other public sector employees generally are not awarded additional salary for performing the same work simply by advancing their own education.

Earning additional credits or degrees is a good indicator of how well teachers themselves perform as students. However, in and of themselves these advanced degrees may not yield additional results in the classroom. Several studies show no link between earning a master’s degree and classroom effectiveness at all.³

Cost of Contract Provision – School Districts (Teachers only): \$437.5 million

Using data from the *Schools and Staffing Survey* for 2007-08 administered by the National Center for Education Statistics (a part of the United States Department of Education’s Institute of Education Sciences) we estimate the average salary increment for Minnesota teachers that is attributable to a master’s degree is an additional 22.8% above the pay for a teacher with only a bachelor’s degree.

Data from the *Schools and Staffing Study* indicates that 58.3% of Minnesota teachers have an advanced degree (master’s degree or above). Given this information, we estimate that 13.3% of total payroll (22.8% master’s increment times 58.3% of all teachers with advanced degrees) is attributable to pay for an advanced degree.

Data from the Minnesota Department of Education Program Finance Division’s *Minnesota School Finance Trends* report for FY 1997-FY 2009 states that total payroll for regular instructors, career and technical instructors, and special education instructors was \$3.718 billion for fiscal year 2009. If the increment for a master’s degree is 13.3% above the pay for a bachelor’s degree, then we estimate the cost to schools for pay for a master’s degree in fiscal year 2009 was approximately \$437.5 million.

Note that the available data is insufficient to measure the costs associated with pay for additional credits which do not generate an advanced degree. We also note that this is a conservative estimate for the true cost of salary increases for advanced degrees because it does not consider the additional increments awarded to educators who earn advanced degrees beyond a master’s degree (i.e. educational specialist or doctoral degree).

³ Increasing the Odds: How Good Policies Can Yield Better Teachers (Washington, D.C.: National Council on Teacher Quality, 2005).

Costs Associated With Benefit-Related Contract Provisions and Mandates

III. Costs Associated With Benefit Related Contract Provisions and Mandates

Summary of Findings

Public Sector Premiums Related to Health Insurance Costs

State Government	\$64 million
Local Government	\$116 million
School Districts (Teachers only)	\$95 million

Public Sector Premiums Related to Defined Benefit Retirement Plan Costs

State Government	\$36 million
Local Government and Schools (except teachers)	\$180 million
School Districts (Teachers only)	\$103 million

Public Sector Costs for Other Post-Employment Benefits

State Government	\$28 million
Selected Local Governments	\$80 million
Selected School Districts	\$111 million

Introduction

This section of the report addresses health and retirement benefits, which are integral parts of any public-sector or private-sector total compensation package. It is not appropriate to assume that the entire public sector cost of these provisions are “frozen assets”. Our analysis examines the additional cost of these benefits in the public sector relative to private sector norms.

Such an approach suggests a normative judgment that the private sector is the appropriate benchmark and may trigger concerns about measuring a “race to the bottom” and comparisons based on the lowest common denominator. However, as Part 1 of our report described, benefits spending is a function of both generosity of benefits and the cost sharing between employees and employers. In this analysis we are measuring higher public employer benefit cost which reflects compensation related spending that could be used for different compensation purposes.

Public Sector Premiums Related to Health Insurance Costs

Explanation of the Contract Provision

Minnesota's state government, local governments and school districts typically provide health insurance benefits to their employees that are more generous than those found in the private sector – both in terms of cost (public employers generally contribute a higher share of the premiums than do private employers) and in terms of the generosity of the benefits offered through the plan.

Cost of Contract Provision – State Government: \$64.1 million

Data from the U.S. Census Bureau's *2009 Annual Survey of Government Employment* indicates that Minnesota state payroll, less higher education (which is beyond the scope of this study) was \$2.442 billion for calendar year 2009. The Bureau of Labor Statistics' *Employer Costs for Employee Compensation* suggests that employer health insurance costs for state and local government employees nationwide for calendar year 2009 was equal to 14.8% of payroll. Therefore, we estimate the state's health insurance costs for its employees in 2009 to be \$362.1 million.

Using information from the Medical Expenditure Panel Survey administered by the U.S. Department of Health and Human Services' Agency for Healthcare Research and Quality, we calculate that public sector employers in the West North Central Census region⁴ have 21.5% higher health care premium costs than do private sector employers in establishments where at least 75% of the employees are full-time. If the increment for public sector health care costs is 21.5%, then we estimate the incremental cost to the state of more expensive health benefits is \$64.1 million in calendar year 2009.

Cost of Contract Provision – Local Governments: \$116.0 million

Data from the U.S. Census Bureau's *2009 Annual Survey of Government Employment* indicates that Minnesota local government payroll, less K-12 education, was \$4.425 billion for calendar year 2009. The Bureau of Labor Statistics' *Employer Costs for Employee Compensation* suggests that employer health insurance costs for state and local government employees nationwide for calendar year 2009 was equal to 14.8% of payroll. Therefore, we estimate local governments' health insurance costs for their employees in 2009 to be \$656.2 million.

Using information from the Medical Expenditure Panel Survey administered by the U.S. Department of Health and Human Services' Agency for Healthcare Research and Quality, we calculate that public sector employers in the West North Central Census region⁵ have 21.5% higher health care premium costs than do private sector employers in establishments where at least 75% of the employees are full-time. If the increment for public sector health care costs is 21.5%, then we estimate the incremental cost to the state of more expensive health benefits is \$116.0 million in calendar year 2009.

⁴ Includes Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota; MEPS does not provide public sector health insurance costs on a state-by-state basis.

⁵ Cf Footnote 4

Costs Associated With Benefit-Related Contract Provisions and Mandates

Cost of Contract Provision – Teachers: \$95.4 million

Data from the Minnesota Department of Education Program Finance Division's *Minnesota School Finance Trends* report for FY 1997-FY 2009 states that total payroll for regular instructors, career and technical instructors, and special education instructors was \$3.718 billion for fiscal year 2009. The Bureau of Labor Statistics' *Employer Costs for Employee Compensation* suggests that employer health insurance costs for state and local government employees nationwide for fiscal year 2009 was equal to 14.5% of payroll. Therefore, we estimate schools' health insurance costs for their teachers in 2009 to be \$539.3 million.

Using information from the Medical Expenditure Panel Survey administered by the U.S. Department of Health and Human Services' Agency for Healthcare Research and Quality, we calculate that public sector employers in the West North Central Census region⁶ have 21.5% higher health care premium costs than do private sector employers in establishments where at least 75% of the employees are full-time. If the increment for public sector health care costs is 21.5%, then we estimate the incremental cost to the state of more expensive health benefits is \$95.4 million in fiscal year 2009.

⁶ Cf Footnote 4

Public Sector Premiums Related to Defined Benefit Retirement Plan Costs

Explanation of the Provision

Minnesota's public employees generally participate in a defined benefit pension plan on a mandatory basis. State employees participate in the Minnesota State Retirement System (MSRS), teachers⁷ participate in the Teachers Retirement Association of Minnesota (TRA), and other local government employees (including school district employees without a teaching license) participate in the Public Employees Retirement Association of Minnesota (PERA). State government sets the terms for each plan, including the level of benefit and amount of contributions required from employees and the employing units of government.

In a "defined benefit" pension plan the retirement benefit is defined using a formula; the public plans in Minnesota calculate the benefit as follows:

Benefit = Average of five highest annual earnings (times) number of years of service (times) multiplier (1.7% for the MSRS and PERA general plans, 1.9% for TRA)

These defined benefit pension plans offer a retirement income stream for the lifetime of the employee or his/her spouse, depending on how the benefit is structured. The income stream is also adjusted upward on an annual basis. The "post retirement adjustments" currently range from 0.0% for TRA (although they will begin again on January 1, 2013 at 2.0%) to 1.0% for PERA-General and 2.0% for MSRS-General. All three pensions will offer 2.5% annual adjustments in the pension benefit when the market value of their assets reaches 90% of their accrued liabilities.

Defined benefit plans differ from "defined contribution" plans where the contributions to a retirement vehicle, such as a 401(k) are defined, not the ultimate benefit. The overall benefit is instead determined on an individual basis based on such factors as the amount of assets in the retirement vehicle, age at retirement, and life expectancy after retirement.

Pension plans are a common fringe benefit in the private and public sectors, so it is unrealistic to assume that the entire cost of public sector pension plans are "frozen assets". What our analysis does is estimate the difference in cost between pension plans provided to public employees and those provided in the private sector. The most common private sector retirement benefit is a defined contribution plan – according to the U.S. Department of Labor, 55% of employees in medium and large private establishments⁸ participated in defined contribution pension plans in 2009, compared to 32% of employees in such establishments who participated in defined benefit plans. Therefore, the private sector benchmark will be a defined contribution plan with an employer match of 3% (which our research indicates is a reasonable average). We will further assume that the maximum match is reached for each employee.

There are two distinct figures that need to be measured as part of the overall retirement contribution "frozen asset" cost:

- **Normal Cost:** the additional liability incurred by providing the defined benefit plan to employees for the upcoming year – this includes administrative expenses.

⁷ Except for teachers in the Saint Paul and Duluth school districts, which maintain separate pension plans.

⁸ The Department of Labor's Bureau of Labor Statistics states that this dataset is representative of combined full-time and part-time employees in private industry.

Costs Associated With Benefit-Related Contract Provisions and Mandates

- **Amortization Cost:** additional cost necessitated by underfunded pension plans, it represents the amount of money that needs to be paid into the pension plan above and beyond the normal cost in order to eliminate at least a portion of the plan's unfunded liabilities by the target amortization date (June 30, 2040 for the MSRS General Plan; June 30, 2031 for the PERA General Plan; and June 30 2037 for TRA⁹). Note that the state may require only partial payment of amortization costs.

Cost of Provision – State Government – MSRS-General Plan only: \$35.7 million (\$23.9 million in normal cost, \$11.7 million in amortization costs)

Normal Cost – according to the July 1, 2008 actuarial valuation, the normal cost for the MSRS-General Plan for the 2008-09 fiscal year was 8.01% of payroll, or \$190.6 million. Contributions are split evenly between employees and employers, so the employer share of the normal cost is 4.01% of payroll, or \$95.3 million.

If the increment for public sector employer retirement contributions for the normal cost is 1.01% of payroll (4.01% under the current system less the 3.0% match prevalent in the private sector), then we estimate the incremental cost to the state for the normal cost portion of retirement benefits is \$23.9 million in fiscal year 2009.

Funded Amortization Cost – according to the July 1, 2008 actuarial valuation, the amortization cost for the MSRS-General Plan for this 2008-09 fiscal year was 4.38% of payroll, or \$104.2 million. Contributions are split evenly between employees and employers, so the employer share of the normal cost is 2.19% of payroll, or \$52.1 million.

By law, public employer contributions to MSRS-General were 4.50% of payroll for fiscal year 2008-09. Since the normal cost was 4.01% for the employer, only 0.49% of payroll (\$11.7 million) of the amortization cost was financed. Defined contribution plans do not have amortization costs. Therefore, if the increment for public sector employer retirement contributions for the normal cost is 0.49% of payroll, then we estimate the incremental cost to the state for the amortization cost portion of retirement benefits is \$11.7 million in fiscal year 2009.

Cost of Provision – Local Governments (including school district costs for non-teachers) – PERA-General Plan only – \$179.7 million (\$47.7 million in normal costs, \$132.0 million in amortization costs)

Normal Cost – according to the July 1, 2008 actuarial valuation, the normal cost for the 2008-09 fiscal year was 7.93% of payroll, or \$392.5 million. We assume that contributions are split evenly between employees and public employers, so the public employer share of the normal cost is 3.96% of payroll, or \$196.3 million.

If the increment for public sector employer retirement contributions for the normal cost is 0.96% of payroll (3.96% under the current system less the 3.0% match prevalent in the private sector), then we estimate the incremental cost to local governments for the normal cost portion of retirement benefits is \$47.7 million in fiscal year 2009.

Funded Amortization Cost – according to the July 1, 2008 actuarial valuation, the amortization cost for the 2008-09 fiscal year was 6.29% of payroll, or \$311.2 million. By

⁹ Minnesota Statutes 2010 § 356.215 Subd. 11 (b) (vii)

Frozen Assets in Public Sector Compensation

law, public employer contributions to PERA were 6.63% of payroll for fiscal year 2008-09. Since the normal cost was 3.96% for the employer, only 2.66% of payroll (\$132.0 million) of the amortization cost was financed by the public employer. Defined contribution plans do not have amortization costs. Therefore, if the increment for public sector employer retirement contributions for the normal cost is 0.49% of payroll, then we estimate the incremental cost to local government for the amortization cost portion of retirement benefits is \$132.0 million in fiscal year 2009.

Costs Associated With Benefit-Related Contract Provisions and Mandates

Cost of Provision – Teachers: \$103.3 million (\$58.4 million in normal costs, \$44.9 million in amortization costs)

Normal Cost – according to the July 1, 2008 actuarial valuation, the normal cost for the 2008-09 fiscal year was 9.01% of payroll, or \$347.7 million. We assume that contributions are split evenly between employees and public employers, so the public employer share of the normal cost is 4.52% of payroll, or \$173.8 million.

If the increment for public sector employer retirement contributions for the normal cost is 1.52% of payroll (4.52% under the current system less the 3.0% match prevalent in the private sector), then we estimate the incremental cost to schools for the normal cost portion of retirement benefits for teachers is \$58.4 million in fiscal year 2009.

Funded Amortization Cost – according to the July 1, 2008 actuarial valuation, the amortization cost for the 2008-09 fiscal year was 6.04% of payroll, or \$232.3 million. By law, public employer contributions to TRA were 5.69% of payroll for fiscal year 2008-09. Since the normal cost was 4.52% for the employer, only 1.17% of payroll (\$44.9 million) of the amortization cost was financed by the public employer. Defined contribution plans do not have amortization costs. Therefore, if the increment for public sector employer retirement contributions for the normal cost is 1.17% of payroll, then we estimate the incremental cost to local government for the amortization cost portion of retirement benefits is \$44.9 million in fiscal year 2009.

More About Unfunded Liabilities

Most of this report deals with the current cost of various features of public sector compensation. However, as we note above, the state can allow itself and local governments to underfund public pension amortization costs. In fact, the actuarial valuations from July 1, 2008 predicted that employees and employers would pay only 23% of the total annual amortization requirements for MSRS-General, 75% of the total amortization requirements for PERA-General, and 45% of the total amortization requirements for TRA for fiscal year 2009.

Forecasting future amortization costs accurately is nearly impossible, since the unfunded liabilities are themselves predicated on assumptions about the future. Such assumptions include an 8.5% annual return on each pension plan's investment portfolio and various forecasts related to salary growth, life expectancy, and future economic performance. For example, unfunded liabilities (and therefore amortization costs) decrease if investment markets perform better-than-expected or salary growth is lower-than-expected. Conversely, unfunded liabilities increase (and therefore amortization costs) if pension plan participants live longer than expected or the economy perform worse than forecasted. Again, these are just selected examples of how deviation from the assumptions about the future impact unfunded liabilities.

Although it's difficult to know just how much of the current unfunded liabilities will eventually translate into additional contributions to Minnesota's public pension funds, they represent a significant potential future cost to taxpayers. They essentially shift the cost of providing benefits today onto the taxpayers of tomorrow. To provide additional color and context for this report, therefore; we are providing information about the total unfunded liabilities in Minnesota's largest public pension plans.

Frozen Assets in Public Sector Compensation

Minnesota's public pension plans, like most others across the country, have significant unfunded liabilities. The unfunded liabilities for large statewide general employee plans for the endpoints of the 2008-09 fiscal year were as follows:

Table 1: Unfunded Liabilities in Statewide Minnesota General Employee Plans, July 1, 2008 and July 1, 2009

Pension Plan	Unfunded Liabilities (millions)		Change
	July 1, 2008	July 1, 2009	
MSRS-General	\$981.1	\$1,482.4	\$501.3
PERA-General	\$4,680.9	\$5,640.9	\$960.0
TRA	\$4,003.9	\$5,232.4	\$1,228.5
All Statewide General Employee Plans	\$9,665.9	\$12,355.7	\$2,689.8

As the table demonstrates, unfunded liabilities for these three large statewide pension plans increased by about \$2.7 billion over fiscal year 2009. Will taxpayers be on the hook for the entire unfunded liability of nearly \$12.4 billion? Probably not. Better-than-expected market returns (above 8.5%) or gains related to other assumptions could reduce this figure. But taxpayers should expect to finance at least some portion of these liabilities over the next thirty years.

Costs Associated With Benefit-Related Contract Provisions and Mandates

Public Sector Costs for Other Post Employment Benefits

Explanation of the Contract Provision

Minnesota school districts, other local governments, and state government offer their employees “other post employment benefits” (OPEB) as part of their compensation package. OPEB includes all benefits that are promised to retirees except pensions, and so can take many forms. Generally OPEB involves health or dental insurance provisions.

The state mandates one form of OPEB for all government employers in Minnesota; a provision called the “implicit rate subsidy”. Public employers in Minnesota are required by law to allow retiring employees to continue to participate in the employer-sponsored health care plan. Because the retired employees are pooled with current (and on average, much younger) employees, the retirees drive up the cost of the health insurance provided by the public employer since health care costs, and therefore premium rates, go up as people age. This policy not only drives up the overall cost of health insurance for public employers, but also allows retirees to purchase insurance at lower rates than they would otherwise be eligible for if they were pooled only with other retired (and therefore, older) individuals. This is a significant cost for governments in Minnesota – in a study by the State Auditor¹⁰ of school districts for fiscal year 2008, at least 37% of all OPEB liabilities, and possibly closer to 40%, were related to this implicit rate subsidy. It’s not clear whether this implicit rate subsidy constitutes the same share of OPEB for cities, counties, and other local governments, but this study offers at least some sense of the magnitude of the subsidy.

In addition, some units of government in Minnesota have offered or currently offer other forms of OPEB. One notable form of OPEB is the promise of lifetime health care to employees; in many cases either partially or fully subsidized. Such benefits were not particularly costly in the 1950s or 1960s, but with the increase in both life expectancies and health care costs many governments which have offered this benefit are now struggling to pay for it. Compounding this issue is the fact that employees who have been awarded the benefit cannot have it taken away from them, as it is essentially a contractual obligation on the part of the government. In essence, these OPEB costs are frozen assets that cannot be “thawed”.

Historically, governments have recognized OPEB costs on a “pay-as-you-go” basis rather than prefunding the benefit at the time when the cost is incurred, in the same way that defined benefit pension plans are funded. However, “pay-as-you-go” financing obscures the true cost of the benefits, since current employees will also generally have access to some level of OPEB benefits upon their retirement. Realizing this, the Governmental Accounting Standards Board now requires governments to measure and report the liabilities associated with OPEB benefits. One provision requires governments to have their OPEB liabilities determined on an actuarial basis. Actuaries attempt to determine what the total liabilities of a pension or OPEB plan are at fixed dates in time, using a combination of data regarding those persons who have earned benefits and assumptions about how demographic and economic conditions will change over future years.

Information relating to OPEB costs can generally be found in the notes to the *Comprehensive Annual Financial Report* (CAFR) that government entities issue annually. These CAFR

¹⁰ http://www.osa.state.mn.us/reports/gid/2009/opeb/OPEB_liabilities_report.pdf

Frozen Assets in Public Sector Compensation

documents provide information on the yearly contributions the government made for OPEB during the previous year, and in many cases also provide information on any actuarial valuations that have been done regarding the OPEB liabilities.

Cost of Provision – State Government: \$28.0 million

According to the state's 2009 CAFR, the state spent \$28.0 million on its OPEB liabilities during fiscal year 2009. The state does not pre-fund its OPEB liabilities on an actuarial basis, but instead makes good on them on a pay-as-you-go basis..

Cost of Provision – Selected Local Governments: \$80.1 million

Given the large number of local units of government (87 counties, 854 cities, 1,788 townships and 456 special districts as of 2007¹¹), a complete cataloging of OPEB costs is not feasible. However, we have collected data from the calendar year 2009 *Comprehensive Annual Financial Reports* for 9 of the 10 most populous Minnesota counties in 2009 (we have included 2008 data for Stearns County) and for the 25 most populous cities in Minnesota in 2009.¹² These ten counties represent 64.1% of Minnesota's total population; these 25 cities represent 46.8% of total Minnesota city population (excluding those people who live outside of city limits).

According to the 2009 CAFRs for these 35 local governments, their combined OPEB costs for 2009 were \$80.1 million. Most of these governments also do not pre-fund their obligations but instead operate on a pay-as-you-go basis.

Cost of Provision – Selected School Districts (all employees): \$145.2 million

Given the large number of school districts in Minnesota, it is not feasible to determine OPEB costs for each individual district. However, we have collected data from the fiscal year 2009 *Comprehensive Annual Financial Reports* for 22 of the 25 school district with the largest number of students, as measured by the Minnesota Department of Education's *Minnesota School Finance Trends 1997-2009* report.¹³ These 22 districts represent 43.1% of the total 2008 fall enrollment.

According to these 2009 school district CAFRs, their combined OPEB costs for 2009 were \$145.2 million. These costs are significantly higher than those for the state and for the large cities and counties. This is an important point. School districts, unlike other units of local government in Minnesota, have the ability to issue non-tax-exempt bonds to pay for their OPEB liabilities. The 2008 law which authorized OPEB bonding allowed school districts to issues such bonds without voter approval, and many school districts took advantage of this provision to issue OPEB bonds during the 2008-09 school year. As a consequence, many districts made very large contributions to their OPEB trusts. A subsequent change to the law in 2009 now requires school districts to obtain voter approval prior to the issuance of OPEB bonds.

OPEB bonding is essentially an arbitrage strategy – governments assume that they can invest the proceeds from a sale of OPEB bonds and earn a higher rate of return on those investments than they will pay in interest on the bonds. If this works, the government makes a tidy profit which partially or entirely funds the OPEB liabilities. The risk associated with this strategy is

¹¹ U.S. Census Bureau, *2007 Census of Governments*.

¹² Population estimates provided by the Minnesota State Demographer's Office.

¹³ Financial statements were not immediately available for the North Saint Paul-Maplewood-Oakdale, White Bear Lake, and Mankato school districts.

Costs Associated With Benefit-Related Contract Provisions and Mandates

that the investments do not earn a higher rate of return than the interest rate paid on the bonds, leaving the government both on the hook for payments to the OPEB bond holders and with continuing OPEB liabilities. Whether or not this strategy will ultimately prove successful for school districts remains to be seen.

More About Unfunded Liabilities

Like defined benefit pension plans, OPEB plans can and do have unfunded liabilities. As with unfunded pension liabilities, it's important to understand the extent of unfunded OPEB liabilities even if they do not show up as a current compensation cost. In some ways, it's more important to provide information about unfunded OPEB liabilities because the state and most local governments in Minnesota do not pre-fund them; instead relying on pay-as-you-go funding.

Government entities responsible for managing OPEB plans generally do not have actuarial valuations performed every year – it seems as though the norm is to have them done every two or three years, so it is difficult to compile good multi-year information. However, as Table 2 indicates, the 58 OPEB plans described in this study had, at last count, nearly \$2.6 billion in unfunded liability.

Table 2: Unfunded Liabilities in Minnesota OPEB Plans Cited in This Study, Various Actuarial Valuation Dates

Level of Government	<u>Unfunded Liabilities (millions)</u>
State of Minnesota	\$755.0
Selected large cities and counties	\$1,136.0
Selected large school districts	\$698.3
Subtotal	\$2,589.3

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Other State Mandates

IV. Other State Mandates

Introduction

This section addresses three compensation-related state mandates that directly or indirectly affect public service delivery. In some cases, the costs are again directly related to compensation – generally by requiring higher salaries and wages than might otherwise be necessary. Other costs are indirect and largely immeasurable, since they pertain to restrictions or limitations on human resource management. This section of the report describes three of these provisions, and where possible, estimates their cost.

Prevailing Wage Laws

Explanation of the Mandate

Prevailing wage laws govern compensation for public construction projects financed by the federal government and by many states, including Minnesota. These laws require contractors working on publicly-financed construction projects to pay government-designated wage and benefit rates that are “prevailing” in the area in which the construction is occurring. Rates are determined for each job classification (i.e. electrician, carpenter, roofer, et cetera) by surveying contractors active in Minnesota.

Minnesota, along with California, uses a method for determining prevailing wages that differs from other states and the federal government. Given a class of workers with five survey responses of hourly wages of \$7.00, \$9.00, \$12.00, \$12.00 and \$13.00; most states and the federal government would set the prevailing wage at \$10.60 per hour, the average of the five salaries. Minnesota and California, however, set the prevailing wage at the “mode” – that number which is most frequently reported. Using the modal method, the prevailing wage for this class of workers in Minnesota would be \$12.00. The use of the modal method for determining prevailing wage increases the likelihood that large-scale collectively-bargained wage rates become the prevailing wage, since these rates tend to be uniform within a specific job class.

The Minnesota Taxpayers Association performed contract research for the Associated Builders and Contractors of Minnesota in 2004 and 2005 regarding Minnesota’s prevailing wage laws. This research compared the Department of Labor and Industry-determined prevailing wages in various locales across the state against the average wages for the same or substantially similar job classes for the overall construction industry, using Department of Employment and Economic Development survey data. Based on our findings, we concluded that the prevailing wage requirement added between 8.0% and 11.1% to the cost of public construction projects in Minnesota; largely because the prevailing wage rates are almost always equivalent to union wage rates, which tend to be higher than those rates paid to non-union workers.

Proponents of prevailing wage laws assert that such provisions actually reduce construction costs because the higher wages paid under prevailing wage draw more highly skilled workers to these projects than would otherwise be the case. Proponents cite three specific savings related to the use of more highly skilled workers

- Skill levels are correlated with job productivity. Higher job productivity results in decreased project times and wasted materials, offering savings on wage and materials costs.
- Skill levels are inversely correlated with accident rates. Lower accident rates reduce costs by reducing the amount of time needed to complete projects and reducing or eliminating costs related to injured laborers.
- Skill levels are correlated with the quality of the final product. A higher-quality final product will have a longer useful life with fewer maintenance and repair costs, resulting in long-term savings as well.

The prevailing wage program, as it stands, may in fact produce savings related to these items. Unfortunately, no research is readily available to substantiate these claims. We would encourage the state to grant selected exemptions to the prevailing wage regime to allow similar public construction projects to be completed by workers using prevailing wage and those not using prevailing wage, so that these claims can be tested and any savings quantified.

Other State Mandates

Estimated Cost for All Minnesota Governments: \$307.0 to \$405.0 million

According to the Census Bureau's *2008 Annual Survey of State and Local Government Finance*, in fiscal year 2008 state government had \$1.395 billion in construction costs and local governments (including schools) had \$3.061 billion in construction costs. Given a public sector premium of 7.4% to 10.0% for construction costs, we estimate that the cost of this mandate in fiscal year 2008 to state government was between \$96.1 million and \$126.8 million and to local governments (including schools) was between \$210.9 million and \$278.2 million.

Pay Equity/Comparable Worth Laws

Explanation of the Mandate

The State of Minnesota mandates that all units of government adhere to the principle of “pay equity”. This concept transcends the notion of “equal pay for equal work”, where persons with similar qualifications performing similar duties must be similarly compensated, regardless of gender, race, or other such factors. Advocates of pay equity argue that when different jobs of equal value to an organization are compared, workers in job classes dominated by women are paid less than workers in job classes dominated by men. Conceptually, pay equity argues for “equal pay for equally-valued work”.

Pay equity requires that jobs be evaluated to determine their value to the employer (in this case, government). The state uses a system developed by a management consulting firm known as the Hay Group (the “Hay System”), which assigns points to each job based on four factors:

- Know-how (knowledge and skills needed in the position)
- Problem-solving (original thinking skills)
- Accountability for actions and consequences
- Working conditions (effort, disagreeableness, hazards)

Each job title in state government undergoes a Hay evaluation and is assigned a Hay value representing that occupation’s relative value to government. The following is a sample of jobs and their Hay values from May 2009:

Table 3: Hay Values for Selected Job Titles, May 2009, State of Minnesota

Job Title	Hay Value
Food Service Supervisor	353
Attorney 1	332
Physical Therapist 1	314
Dietitian 1	275
Engineer 1 Graduate	275

Once Hay values have been assigned to each job, various compliance tests are performed using statistical analysis to determine if the state is complying with the pay equity requirements. The state has traditionally handled noncompliance matters through general wage adjustments and within the collective bargaining agreements with its unions.

Estimated Cost for All Minnesota Governments: Unknown

Regardless of the arguments for or against Minnesota’s pay equity mandate, it is clear that this policy, which guarantees that female-dominated job classes will be paid no less than male-dominated job classes of “equal worth”, imposes a cost on state government. Unfortunately, that cost is extraordinarily difficult to quantify. A study estimated that the initial cost of pay equity was approximately 4% of the state’s payroll.¹⁴ However, we cannot estimate the current costs of the mandate itself or cost of compliance with the available data.

¹⁴ Pay Equity - The Minnesota Experience; Commission on the Economic Status of Women, June 1985

Other State Mandates

Aggregate Level of Benefits Provisions

Explanation of the Mandate

Under the Minnesota Public Employment Labor Relations Act, local units of government, including schools¹⁵, are not allowed to reduce the value of group insurance benefits for employees that are covered by a collective bargaining agreement (i.e. – unionized employees) without the union’s agreement.¹⁶ Importantly, the courts have ruled that “benefits” includes the level of deductibles and co-payments (although not the total premium amounts).¹⁷ This provision essentially prevents the state from taking one of two actions unilaterally:

- It prohibits the state from increasing deductibles or co-payments while maintaining current benefit levels.
- It prohibits the state from decreasing the type or value of the current benefit (for instance, ending coverage of a certain service)

It is important to understand that this legal provision does not prevent local governments from decreasing employee benefits. Non-unionized employees are exempt from this law, and unionized employees can experience benefit cuts if their union agrees to the cut.

Estimated Cost for All Minnesota Governments: Unknown

This provision does not impose a cost per se to local governments. However, it does provide public employers with far less flexibility to reduce benefit costs during economic downturns than private employers have. Given that public unions are generally unlikely to agree to benefit cuts without something in return, this provision represents a real, but unquantifiable, opportunity cost by requiring local governments to direct scarce resources in bad economic times toward employee benefits when, given the option, it would likely redirect those resources to other areas. However, we cannot estimate the current costs of the mandate with the available data.

¹⁵ It is not clear to us at this time whether this provision also applies to state government negotiations with its unions.

¹⁶ Minnesota Statutes 2010 §471.6161 Subd 5

¹⁷ Lepak, Scott. “Negotiating Changes in Group Health Insurance”, *Minnesota Cities* (published by the League of Minnesota Cities, February 2004).

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Conclusions and Recommendations

V. Conclusions and Recommendations

Part 1 of this investigation examined how Minnesota's state and local government workforce compares to the rest of the nation in terms of size and compensation; how government employee salary, health, and pension packages compare with comparable non-government jobs; and cost trends in employee compensation with regard to revenue and tax base trends and projections. Part 2 of this investigation examined the opportunity costs related to contract provisions, state laws, and mandates that have weak or inconsistent relationships with public sector outcomes. Our findings in these two parts lead us to draw the following conclusions and make the following recommendations.

Conclusion: Disparities between public and private sector compensation levels are symptomatic of more fundamental problems in the design of public sector compensation systems.

The double imbalance in public sector compensation highlighted in Part 1 of this report suggests that the public sector over compensates some positions relative to the private sector while under compensating others. Value judgments about whether efforts to make working conditions in government and the private sector more similar are inherent to such compensation comparisons. Many argue such attempts are necessary based on arguments of greater efficiency and sustainability. Many others argue government has an obligation to maintain some higher standard of model employment.

Regardless of the value judgments, this discrepancy reflects a flawed compensation system that has important implications for the cost and quality of government service delivery going forward. Critical knowledge, experience, skill sets, and capabilities must be aggressively recruited, competitively paid and developed as core "assets" within government; and high levels of performance must be rewarded. If this cannot be done because 1) highly bureaucratic and inflexible job classification and valuation systems create barriers; 2) equity trumps performance considerations in establishing compensation; and 3) resources are not available due to premiums paid elsewhere in the public sector labor force; then needed productivity gains in the public sector will not materialize.

The economic and budget realities of the 21st century will require higher levels of flexibility, adaptability, and accountability with respect to public sector human resource management. There is a growing tension between these demands and the current public sector compensation system design.

Conclusion: Current compensation system design and related state mandates create a significant opportunity cost for delivering government services and fulfilling government obligations in a cost effective manner.

We estimate that governments in Minnesota dedicated at least \$4 billion in calendar year 2009/fiscal year 2009 to public sector compensation features with weak or no relationships to public sector outcomes. "Freeing" at least some of these resources is necessary to design compensation systems that support improvements in public sector productivity.

One area of special concern is spending associated with retirement benefits. Minnesota has avoided many of the costly mistakes in defined benefit plan administration and oversight that are currently plaguing other states. Nevertheless, the significant amount of resources that

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must be redirected away from government operations to pay for the ongoing cost of these benefits and amortize unfunded liabilities increasingly impacts state and local service delivery.

Moreover, there is growing concern that the primary workforce-related argument for their use within the public sector – recruitment and retention of essential employees – is no longer as valid as it may have been in the past and may increasingly become a liability in the future.¹⁸ The highly back-ended nature of retirement compensation makes offering competitive salaries much more difficult. In addition, increasing employee contributions to pension funds to preserve their viability reduces take home pay – exacerbating household income issues. Should the expected investment returns (8.5% per year) fail to materialize, further contribution requirements will be needed. For example, in 2014 entry level teachers in Minnesota, like their longer-tenured counterparts, will have 7.5% of their pay redirected to support a benefit they will not realize for decades. Given that these individuals have in many cases large amounts of school debt on top of other demands for their household income, traditionally make much less than longer-tenured counterparts, and also have the least job security; it is difficult to conceptualize a system more ill-suited to attracting top talent.

Conclusion: Compensation is only one dimension of a larger set of essential public sector human resource management reforms.

Public sector human resource management involves much more than just compensation system design. Many states have invested considerable time and resources in transforming historically centralized and highly administrative-oriented human resource functions that emphasized proper documentation and processing of paperwork into very decentralized and responsive strategic assets for the state emphasizing development of human capital, workforce planning, and workforce process redesign. Although an analysis of the areas and opportunities for upgrading public sector human resource management systems are far outside the scope of this investigation, they are no less critical. It is worth noting in the Pew Center on the States' *2000 Government Performance Project* that ranked state management systems, Minnesota received its lowest grade in human resources management and placed in the bottom half of the country. Progress in several areas has been made but the state still received only a B- grade in the most recent 2008 report.

Recommendation: Improve taxpayer understanding of public sector compensation by increasing visibility of key labor provisions and their budgetary implications.

Ultimately the “right” level of compensation for public employees is best determined by citizens through their elected officials. As a result, taxpayers should have a full and complete understanding of the costs labor-related provisions impose on government service delivery and their tax price implications. We recommend the following:

¹⁸ See “Pensions Blamed for Costing Schools New Talent” *Education Week* April 29, 2009 for a discussion of this issue as it applies to teacher recruitment.

Conclusions and Recommendations

1. State and local governments should:
 - Provide detailed “object code”¹⁹ spending information from an all funds perspective to better allow taxpayers to identify and quantify relevant trends in public sector compensation.
 - Prominently feature and describe employee health plan details, premium costs, and cost sharing provisions in budget documents.
 - Provide detailed descriptions of step increases, cost of living adjustments and projected spending implications over the life of the employment contracts.
 - To the extent possible, isolate, quantify, and report the cost impact of labor-related state mandates including comparable worth compliance, implicit rate subsidies for early retiree health care, and prevailing wage law compliance.
2. Results of binding arbitration decisions should be more prominently reported, and the state should conduct a biennial assessment of award trends compared to private sector wage and compensation trends.
3. Labor arbitrators should be required to consider the total compensation and prevailing benefit levels offered in the private sector to help make sure that future public sector compensation and benefit decisions do not become grossly out of line with the private sector.

Recommendation: Reform public pensions to reduce cost pressures on government operations and the current degree of taxpayer risk.

The 2010 omnibus pension legislation included a legislative directive calling for a study of various retirement plan alternatives for Minnesota’s public employees. According to the legislation, the study must include “analysis of the feasibility, sustainability, financial impacts, and other design considerations of these retirement plans.” The fund directors of the major statewide pension funds (PERA, MSRS and TRA) are currently developing the report, which is to be delivered to the Legislative Commission on Pensions and Retirement by June 1, 2011.

Although this report will not make recommendations, it should provide critical information to embark on necessary pension reforms. Importantly, it should provide key cost and transition information associated with the adoption of alternatives to current defined benefit plans such as defined contribution and hybrid (part defined benefit, part defined contribution) plans. It is important to note that an immediate transition to alternative retirement plans for new public sector hires is not necessarily a panacea for unfunded pension problems. Such a move introduces the possibility of large bailouts in future years as payouts accelerate while contributions to these “closed funds” gradually dwindle. As a result, any transition should require conditional taxpayer protection measures.

In the meantime efforts should be directed toward further pension stabilization efforts. Chief among these would be the total elimination of upward adjustments in public sector retirees’ pensions until their retirement plans achieve full funding.

¹⁹ Delineation of government spending by type (e.g. salaries, purchased services, etc.) rather than by function or program (e.g. parks and recreation)

Recommendation: Reform compensation practices and human resource laws to improve government flexibility and reward performance and productivity.

Governments in Minnesota currently direct considerable sums of money to compensation features with little or no relationships to the outcomes that taxpayers desire. To better align compensation, performance and results we recommend the following:

1. Government entities should eliminate the use of “step and lane” compensation systems which are based on very prescriptive, narrow job classifications and equally constrained pay grades. Such systems reduce government ability to maximize returns from taxpayer dollars. In its place governments should adopt “broad banding” strategies in which the number of job classifications are drastically reduced but accompanied by very large increases in salary ranges. Such a system would significantly improve the ability of managers to both recognize and reward high performing workers. If agency leaders believe a particular employee is sufficiently valuable, they would have much greater latitude to engineer a salary package that improves their retention efforts. Also, increasing the flexibility of managers to reassign workers to duties that may be more appropriate to their talents, interests, or skills will reduce barriers to government redesign.²⁰

2. Compensation should be linked to strengthened government performance evaluation systems. According to a 2009 Pew Center report:

Performance appraisal instruments are developed by (Minnesota) agencies and require adherence to statewide policies, but because there is no administrative oversight or accountability on the development of agency instruments, not all of the state’s policies are followed. For example, nearly 20 percent of classified employees did not receive an annual performance appraisal, despite a statewide policy requiring one.²¹

As this finding suggests, without a formal linkage to compensation such performance evaluation systems become little more than a bureaucratic exercise

3. The state’s pay equity/comparable worth law should be repealed. Its purpose is outdated, and requiring governments to correct perceived “errors” in labor markets based on bureaucratic and subjective assessments of the relative value of government jobs is an unnecessary and costly mandate.

Recommendation: Reform Minnesota’s prevailing wage regime so that the prevailing wage more closely reflects average wages and test claims that the use of prevailing wage results in higher-quality construction.

We recommend the following three changes to the state’s prevailing wage regime:

1. That median wage data the widely-used Department of Employment and Economic Development (DEED) survey of wages be used as the definition of prevailing wage for public construction projects in Minnesota. The current survey methodology provides for voluntary responses and does not produce results with any degree of statistical reliability. Moreover,

²⁰ For additional information on reforms and design approaches various other states have adopted, see “Civil Service Reform in the States – Personnel Policy and Politics at the Subnational Level”, State University of New York Press, 2006.

²¹ “People Forward: Human Capital Trends and Innovations” Pew Center on the States, 2009

Conclusions and Recommendations

using the modal calculation often results in prevailing wage rates which equal union pay rates, which may or may not be representative of local pay rates for construction work.

2. That DEED develop and administer on a regular basis a similar survey to be used to determine the fringe benefits portion of the prevailing wage rates

3. That alternative methods of determining prevailing wage rates be tested on specific construction projects and compared to comparable public construction projects in that state which use the existing prevailing wage regime, in order to compare costs and test over the long-term claims that projects built using prevailing wage are of higher quality

Recommendation: Link any future tax increases and revenue enhancements to needed reforms.

While this recommendation is more political than policy-oriented, it is no less important. Strong historical familiarity and comfort with the existing system combined with entrenched interests suggest that major reform of public sector compensation and human resource management systems is unlikely to be adopted absent truly extraordinary circumstances. Nevertheless, the supply of future tax revenues does represent a potentially valuable source of leverage for reform – indeed it is likely the only leverage. We recommend that if future tax increases be deemed necessary, their adoption be conditioned on the adoption of reforms in the areas identified above. Such a quid pro quo arrangement would communicate to taxpayers that any additional tax burden they assume would be matched with structural reforms promising greater returns from taxpayer dollars.

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Appendix A

Appendix A: Details Underlying “Frozen Assets” Costs

Teacher Pay Based on Additional Educational Credentials or Experience

Table 4: Average Salary increment for Minnesota Teachers for Master’s Degree

Item	Years of Teaching Experience				Total
	<5	6-10	11-20	>20	
Average base salary for teachers with bachelor’s degree ²²	\$34,800	\$39,840	\$46,140	\$51,890	
Average base salary for teachers with master’s degree ²³	\$43,200	\$49,930	\$56,750	\$61,830	
Salary increment for master’s degree by cohort	24.1%	25.3%	23.0%	19.2%	
Teachers by years of experience, share of total ²⁴	20.8%	20.4%	35.3%	23.6%	
Salary increment for master’s degree, weighted total	5.0%	5.2%	8.1%	4.5%	22.8%
Share of Minnesota teachers with advanced degree ²⁵					58.3%
Salary increment for master’s degree as share of total payroll					13.3%

Table 5: Estimated Minnesota Teacher Payroll Attributable to Salary Increment for Master’s Degree, FY 2009

Item	Total (millions)
Total salary for Minnesota teachers, FY 2009 ²⁶	\$3,718.4
Total salary for Minnesota teachers, FY 2009, less master’s increment	\$3,280.6
Total salary for Minnesota teachers attributable to master’s increment, FY 2009	\$437.5

²² Source: National Center for Education Statistics’ *Digest of Education Statistics: 2009*, Table 76.

²³ Source: National Center for Education Statistics’ *Digest of Education Statistics: 2009*, Table 77.

²⁴ Source: National Center for Education Statistics’ *Digest of Education Statistics: 2009*, Table 67 – for teachers with 3-9 years of experience, we assume that there are an equal number of teachers in each year and allocate them accordingly into 3-4 years of experience and 5-9 years of experience.

²⁵ Source: National Center for Education Statistics’ *Digest of Education Statistics: 2009*, Table 67

²⁶ Source: Minnesota Department of Education Program Finance Division’s *Minnesota School Finance Trends* report, lines 110 and 113.

Frozen Assets in Public Sector Compensation

State Employee Pay Based on Longevity (Tenure in Public Employment)

Table 6: Estimated Minnesota State Government Payroll Attributable to Longevity

Item	Total (millions)
Total March 2009 Pay ²⁷	\$398.8
March 2009 Higher Education Pay ²⁸	\$195.2
March 2009 Pay less Higher Education	\$203.5
Annual 2009 Pay less Higher Education	\$2,442.4
Share of Payroll Attributable to Longevity ²⁹	19.1%
2009 Payroll Attributable to Longevity	\$466.0

Local Government Employee Pay Based on Longevity (Tenure in Public Employment)

Table 7: Estimated Minnesota Local Government Payroll Attributable to Longevity

Item	Total (millions)
Total March 2009 Pay ³⁰	\$826.2
March 2009 K-12 Education Pay ³¹	\$457.7
March 2009 Pay less K-12 Education	\$368.8
Annual 2009 Pay less K-12 Education	\$4,425.6
Share of Payroll Attributable to Longevity ³²	27.7%
2009 Payroll Attributable to Longevity	\$1,224.8

Teacher Pay Based on Longevity (Tenure in Public Employment)

Table 8: Estimated Minnesota State Government Payroll Attributable to Longevity

Item	Total
Average Minnesota Teacher Salary 2007-08 ³³	\$50,582
Average salary increment for master's degree	13.3%
Average Minnesota Teacher Salary 2007-08 less master's increment	\$44,642
Average base salary for Minnesota teacher with bachelor's degree and 2 or fewer years teaching, 2007-08 ³⁴	\$33,830
Payroll increment for Longevity	32.0%
Total salary for Minnesota teachers, FY 2009, less master's increment ³⁵	\$3,280.6 million
Total salary for Minnesota teachers, FY 2009, less master's increment and less longevity increment	\$2,486.2 million
FY 2009 Payroll Attributable to Longevity	\$794.7 million

²⁷ Source: Census Bureau 2009 Annual Survey of Government Employment (preliminary).

²⁸ Ibid.

²⁹ Data from Minnesota Management and Budget's Executive Branch Total Compensation Report for 2010, calculations by MTA.

³⁰ Source: Census Bureau 2009 Annual Survey of Government Employment (preliminary).

³¹ Ibid.

³² Data from Salary and Benefits Survey administered by the League of Minnesota Cities and Association of Minnesota Counties, calculations by MTA.

³³ Source: National Center for Education Statistics' *Digest of Education Statistics: 2009*, Table 79

³⁴ Source: National Center for Education Statistics' *Digest of Education Statistics: 2009*, Table 76

³⁵ Cf Table 5.

Appendix A

Cost of Health Insurance – State Government Employees

Table 9: Health Insurance Costs as Share of Payroll, All State and Local Govts, 2009

Item ³⁶	Employer Cost per Hour, 2009				
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Average
Wages and Salaries	\$25.97	\$26.01	\$26.24	\$26.11	\$26.08
Paid Leave	\$3.24	\$3.27	\$3.05	\$2.99	\$3.14
Supplemental Pay	\$0.34	\$0.34	\$0.34	\$0.33	\$0.34
Subtotal – Takehome Pay	\$29.55	\$29.62	\$29.63	\$29.43	\$29.56
Health Insurance	\$4.31	\$4.34	\$4.43	\$4.45	\$4.38
Health Insurance Costs as Share of Payroll					14.8%

³⁶ Source for all data: *Employer Costs for Employee Compensation*, U.S. Department of Labor's Bureau of Labor Statistics

Frozen Assets in Public Sector Compensation

**Table 10: Employer Cost of Health Insurance Premiums, Private Sector Employers
Where at Least 75% of Workforce is Full-time, Single Plans, 2008**

State	Single Plan Premium Cost – 2008 ³⁷			Total Employment ³⁸	Pct Share	Weighted Total – Employer Cost
	Total	Employee Share	Employer Share			
Iowa	\$4,060	\$719	\$3,341	1,317,121	14.73%	\$492
Kansas	\$4,135	\$772	\$3,363	1,185,777	13.26%	\$446
Minnesota	\$4,390	\$793	\$3,597	2,517,356	28.15%	\$1,013
Missouri	\$4,191	\$991	\$3,200	2,472,902	27.66%	\$885
Nebraska	\$4,463	\$1,026	\$3,437	805,791	9.01%	\$310
North Dakota	\$3,847	\$736	\$3,111	304,906	3.41%	\$106
South Dakota	\$4,201	\$809	\$3,392	337,816	3.78%	\$128
Total						\$3,380

**Table 11: Employer Cost of Health Insurance Premiums, Private Sector Employers
Where at Least 75% of Workforce is Full-time, Family Plans, 2008**

State	Family Plan Premium Cost – 2008 ³⁹			Total Employment ⁴⁰	Pct Share	Weighted Total – Employer Cost
	Total	Employee Share	Employer Share			
Iowa	\$10,791	\$2,402	\$8,389	1,317,121	14.73%	\$1,236
Kansas	\$11,525	\$2,840	\$8,685	1,185,777	13.26%	\$1,152
Minnesota	\$13,575	\$3,196	\$10,379	2,517,356	28.15%	\$2,922
Missouri	\$11,690	\$2,946	\$8,744	2,472,902	27.66%	\$2,418
Nebraska	\$11,420	\$3,126	\$8,294	805,791	9.01%	\$747
North Dakota	\$11,107	\$3,491	\$7,616	304,906	3.41%	\$260
South Dakota	\$11,475	\$3,432	\$8,043	337,816	3.78%	\$304
Total						\$9,039

**Table 12: Calculation of Incremental Health Care Premiums for Public Sector
Employers, West North Central Census Region, 2008**

Item	Employer Cost, Health Care Premiums		
	Single Plan	Family Plan	Total
Public Sector Cost ⁴¹	\$4,650	\$10,012	
Private Sector Cost ⁴²	\$3,380	\$9,039	
Incremental Cost, Public Sector	37.6%	10.8%	
Weighted Public Sector Incremental Cost Where 60% of Participants are in Family Plans and 40% are in Single Plans	15.0%	6.5%	21.5%

³⁷ Source: Medical Expenditure Panel Survey administered by the U.S Department of Health and Human Services' Agency for Healthcare Research and Quality

³⁸ Source: U.S. Census Bureau, *County Business Patterns* 2008

³⁹ Source: Medical Expenditure Panel Survey administered by the U.S Department of Health and Human Services' Agency for Healthcare Research and Quality

⁴⁰ Source: U.S. Census Bureau, *County Business Patterns* 2008

⁴¹ Source: Medical Expenditure Panel Survey administered by the U.S Department of Health and Human Services' Agency for Healthcare Research and Quality

⁴² Cf Table 10 and Table 11

Appendix A

Table 13: Employer Costs for Health Insurance Attributable to Public Sector Increment, Minnesota State Government, Calendar Year 2009

Item	Total (millions except where noted)
Total March 2009 Pay ⁴³	\$398.8
March 2009 Higher Education Pay ⁴⁴	\$195.2
March 2009 Pay less Higher Education	\$203.5
Annual 2009 Pay less Higher Education	\$2,442.4
Health Insurance Costs as Share of Payroll, All State and Local Governments, 2009 ⁴⁵	14.8%
Estimated 2009 Health Insurance Costs	\$362.1
Increment for Public Sector Health Insurance Costs ⁴⁶	21.5%
Estimated 2009 Health Insurance Costs less Public Sector Increment	\$298.1
2009 Health Insurance Costs Attributable to Public Sector Increment	\$64.1

Table 14: Employer Costs for Health Insurance Attributable to Public Sector Increment, Minnesota Local Governments, Calendar Year 2009

Item	Total (millions except where noted)
Total March 2009 Pay ⁴⁷	\$826.2
March 2009 K-12 Education Pay ⁴⁸	\$457.7
March 2009 Pay less K-12 Education	\$368.8
Annual 2009 Pay less K-12 Education	\$4,425.6
Health Insurance Costs as Share of Payroll, All State and Local Governments, 2009 ⁴⁹	14.8%
Estimated 2009 Health Insurance Costs	\$656.2
Increment for Public Sector Health Insurance Costs ⁵⁰	21.5%
Estimated 2009 Health Insurance Costs less Public Sector Increment	\$540.1
2009 Health Insurance Costs Attributable to Public Sector Increment	\$116.1

⁴³ Source: Census Bureau *2009 Annual Survey of Government Employment* (preliminary).

⁴⁴ Ibid.

⁴⁵ Cf Table 9

⁴⁶ Cf Table 12

⁴⁷ Source: Census Bureau *2009 Annual Survey of Government Employment* (preliminary).

⁴⁸ Ibid.

⁴⁹ Cf Table 9

⁵⁰ Cf Table 12

Frozen Assets in Public Sector Compensation

Table 15: Health Insurance Costs as Share of Payroll, All State and Local Govts, Fiscal Year 2009

Item ⁵¹	Employer Cost per Hour, FY 2009				
	Quarter 3, 2008	Quarter 4, 2008	Quarter 1, 2009	Quarter 2, 2009	Average
Wages and Salaries	\$25.77	\$25.87	\$25.97	\$26.01	\$25.91
Paid Leave	\$3.25	\$3.21	\$3.24	\$3.27	\$3.24
Supplemental Pay	\$0.35	\$0.34	\$0.34	\$0.34	\$0.34
Subtotal – Takehome Pay	\$29.37	\$29.42	\$29.55	\$29.62	\$29.49
Health Insurance	\$4.21	\$4.25	\$4.31	\$4.34	\$4.28
Health Insurance Costs as Share of Payroll					14.5%

Table 16: Employer Costs for Health Insurance Attributable to Public Sector Increment, Minnesota School Districts – Teacher Costs Only, Fiscal Year 2009

Item	Total (millions except where noted)
Total salary for Minnesota teachers, FY 2009 ⁵²	\$3,718.4
Health Insurance Costs as Share of Payroll, All State and Local Governments, FY2009 ⁵³	14.5%
Estimated 2009 Health Insurance Costs	\$539.3
Increment for Public Sector Health Insurance Costs ⁵⁴	21.5%
Estimated 2009 Health Insurance Costs less Public Sector Increment	\$443.9
2009 Health Insurance Costs Attributable to Public Sector Increment	\$95.4

⁵¹ Source for all data: *Employer Costs for Employee Compensation*, U.S. Department of Labor's Bureau of Labor Statistics

⁵² Source: Minnesota Department of Education Program Finance Division's *Minnesota School Finance Trends* report, lines 110 and 113.

⁵³ Cf Table 15

⁵⁴ Cf Table 12

Minnesota Taxpayers Association
85 East Seventh Place
Suite 250
Saint Paul, Minnesota 55101