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MINNESOTA CENTER for Fiscal Excellence

*Sound tax policy. Efficient spending. Accountable government.*

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## Burned Out and Turning Out

*A major, and largely behind the scenes, legislative campaign this session sought to provide an early retirement option for Minnesota teachers. A look at the history of this issue, relevant findings and lessons from benchmarking TRA against other state teacher plans and Education Minnesota's own employee plan, and the prospects for the effort as the end of session approaches.*

When the budget targets were released in March showing education to be a big winner in this year's competition for general fund support, the press release from Education Minnesota seemed remarkably subdued, even a bit alarmist. "There are parts of this budget agreement that could change the lives of students and educators and that's worth celebrating, but it would also leave thousands of veteran educators behind. The proposed investment in pension reform is extremely disappointing. We need to fix educator pensions to retain great educators who have no hope of a reasonable retirement in the current teacher pension system."

The quote indicates that in the eyes of Education Minnesota and many of its members, more money is needed in order to leave the classroom as well as enter it. Lawmakers have been inundated with letters, emails, and calls describing how the realities of the modern-day classroom – increased workloads, administrative demands, lack of autonomy, and student mental health challenges – to name just a few issues – are taking a toll on teachers.

The "fix" is lowering the retirement age at which teachers could receive their full pensions without a reduction for getting the pension early. The pension system itself (TRA) sought to allow retirements with full benefits if members were at least 60 years old and had at least 30 years of service. Education Minnesota proposed a variation on the same theme: full benefits at 62 years or 35 years of service. (Each proposal also included COLA adjustment provisions, and in the case of Education Minnesota a couple of other provisions adding to the cost.) The TRA's early retirement provision, the only one with an actuarial cost estimate accompanying it, was projected to cost about $204 million in the first-year compounding at 3% every year thereafter. However, only $600 million in one-time money out of $3.3 billion requested by the Commission Chair for pensions was included in the global budget targets. That sum is simply inadequate to deliver on the proposal, especially since these resources were also needed to address issues in other state pension systems.

From all indications, this is an issue that is not going away. We look at the history behind the issue, the comparisons being made with other state teacher funds, and what might be done.

### A Situation Developing Over Three Decades

The frustration and irritation communicated to lawmakers today has its roots in decisions made a generation ago. In 1989 Minnesota lawmakers wanted to increase retiree benefits for public employees but were split on how to do it. Some wanted higher pension formula multipliers (a.k.a. accrual rates); some wanted a better early retirement feature than currently existed at the time.[1] The Solomon-like decision was to do a little bit of both resulting in the "two tier" system that exists today. Anyone hired before July 1, 1989 would be part of the "Rule of 90" allowing retirement with full benefits if the sum of an individual's age and years of service equaled 90 or more. Anyone hired after this date ("Tier 2") received a higher formula multiplier for their first ten years of service than their Rule of 90 counterparts. However, pension benefits would be reduced if these individuals retired before the "normal retirement age" of 65 (now 66). This change applied, and continues to apply today, to the state's MSRS and PERA systems as well, not just TRA.

Even though the formula multiplier provided to Tier 2 teachers for their first 10 years of service was higher, the waiver of the early retirement benefit was more valuable effectively creating a subsidized benefit for pre-1989 employees. As the years have progressed, the inequities between the pre- and post-1989 cohorts have been compounded by Minnesota's long history of taking a rather "relaxed" approach to making its actuarially required contributions in a timely manner – all exacerbated by improper liability discounting practices which kept contribution rates lower than they should have been for the promises being made. As a result, TRA now faces about $8 billion of unfunded liabilities with less than 20 cents of every dollar of employer pension contributions available to pay for the benefits of active teachers, most of whom are now Tier 2. The rest is required to pay off pension debt.[2]

Over the years periodic interest in restoring the Rule of 90 has been met with general resistance by lawmakers. The reasons still have relevance today. It costs a lot. It creates coordination conflicts with federal retirement policy like Medicare eligibility. Retiring baby boomers mean labor markets are tight, and keeping people in the workforce rather than incentivizing them to retire is a good idea. One thing has changed. For a long time, early retirement was not an issue asking for prompt

[1] A rule of "62 and 30" was established for statewide plans in 1973. In 1982 a "rule of 90" was created for the PERA General Plan. Action in 1989 extended the rule of 90 to all state plans at the same time the current two-tier system was created.

[2] Pension Contributions by State 2022, Equable, November 10, 2022. Calculations based on actuarially determined contribution requirements. Actual state contribution policy may differ.

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attention since those who started in the public workforce after 1989 were in early-to-midcareer situations creating little demand for the provision even if it existed. As lawmakers can tell you, those days are over.

### Benchmarking Minnesota Teacher Retirement Treatment

There is no question Minnesota is an outlier both with respect to its normal retirement age for teachers of 66 (highest in the nation) and having no provisions for earlier retirements with full benefits. Comparative examples of early retirement treatment between Minnesota and other states can generate some stark differences in final pensions for the same combination of age and years of service.

However, early retirement provisions are just one of many defined benefit plan design features, all having cost considerations and entailing potential trade-offs. These other features are no less a factor in the "competitiveness" of a retirement plan. A look at our neighboring states, which have been frequently highlighted as case examples, illustrates this point:

- Wisconsin teachers can retire with a full pension at 57 with at least 30 years of service. However, their formula multiplier is 1.6% (vs. 1.9% in Minnesota) which means the system is designed to replace about 10% - 15% less wage income.
- Iowa teachers can retire under a "Rule of 88." Their formula multiplier is also slightly higher at 2%. But they do not provide a cost-of-living adjustment (COLA), ever. As their pension system says, "IPERS isn't intended to be your sole source of retirement income. We encourage our members to save for retirement."
- South Dakota has a full benefits retirement age of 65, one year earlier than Minnesota. Their employee contributions are lower, but so is their formula multiplier (1.55%).
- North Dakota teachers can retire under a "Rule of 90" but teachers pay 4 percentage points more of their salary than in Minnesota. There are also no provisions for annual COLA adjustments.

The influential "final average salary" on which the benefit is based can also vary considerably from state to state influencing benefits. We cannot find any state comparative statistics on this, which is understandable since that is a function of both individual decision-making and variations within a state based on different district total compensation designs and levels. For some highly imperfect perspective, according to the National Center for Education Statistics, in 2023 the average teacher salary is 0.2% to 19.3% higher in Minnesota compared to the states it borders.

Benchmarking also reveals interesting findings regarding equity among teachers within pension systems. The idea of uniform treatment of all teachers within a system is compelling, but different treatment of active teachers within state pension systems is ubiquitous and the norm, rather than the exception, across the country. According to the Urban Institute, since 2008, thirty-seven states that offer final average salary defined benefit pensions to teachers have changed the terms of those retirement plans so that benefits rules for teachers hired on or after January 1, 2018, differ from those for teachers hired 10 years earlier: [3]

**Different treatment of active teachers within state pension systems is ubiquitous and the norm, rather than the exception, across the country.**

- 20 states increased the age in which a teacher could retire with full benefits
- 25 states increased mandatory teacher contribution rates
- 13 states reduced the share of salary the pension replaces
- 15 states increased the number of years included in final average salary computations
- 12 states increased vesting retirements
- 6 (now 7) states have moved new teachers completely out of defined benefit plans
- Others have created retirement plan options for new teachers such as hybrid or cash balance plans.

These findings indicate that despite the diversity of plan designs, most teacher defined benefit plans share a common bond: grappling with the demographic and economic realities of maturing plans, the frequently faulty economic premises on which they have been constructed and governed, and the resulting large unfunded pension obligations. At least 18 state teacher plans need to devote even more than Minnesota's 80 cents of every dollar of employer contributions towards pension debt payments – most, if not all, of which have early retirement options. In this context, any benefit improvement is difficult to implement, and policy adjustments are often required in the other direction.

### Lessons From a Surprising Source

Is it possible to combine a high-quality defined benefit plan with an early retirement provision and do it without creating significant risk to plan health? The answer is yes, and teachers do not have to look far to find an example since they are paying for such a defined benefit plan as well as their own plan. It's the defined benefit plan for the employees of their own union, Education Minnesota.

As a private, single-employer defined benefit plan, the Education Minnesota Employees Pension Plan files actuarial information annually with the Internal Revenue Service. According to its latest filing the plan serves 380 current and former employees. Like most private defined benefit plans, 100% of the contributions come from the employer which means 100% of the contributions come from TRA membership dues.

It is considerably healthier than the TRA plan with a funded ratio (plan net assets/plan liabilities) of 101.2% compared to a TRA funded ratio of 81% (prior to the lowering of the liability discount rate to 7%). The Education Minnesota employees plan also substantially exceeds the TRA plan on both eligibility features and generosity dimensions:

- The monthly accrued benefit (formula multiplier) is 2.0% vs 1.9% for TRA.

[3] How Have Teacher Pensions Changed Since the Great Recession? Urban Institute, February 2020

- The final average compensation is based on highest 3 earning years versus highest 5 for TRA members

- Special retirement benefits – sums paid in addition to any other benefits earned under the plan – are provided to executive staff, associate executive staff and Education Minnesota officers.

- The Education Minnesota defied benefit plan has no COLA. However, the organization also offers a tax deferred contribution plan with a generous 7% employer match (also from member dues).

As for early retirement, Education Minnesota employees can retire with full benefits at age 55 with 5 years of vesting.

What explains the large difference in both health and generosity of these two plans? Part of the answer is attributable to old fashioned federal regulation. In 2006 Congress passed the Pension Protection Act – regarded as the most comprehensive reform of the nation's pension laws since enactment of the Employee Retirement Income Security Act (ERISA) in 1974.

It established new funding requirements for private sector defined benefit plans. It obligated pension plans to calculate the present value of their liabilities based on bond rates that reflected the length of time until when those liabilities would need to be paid. It reduced allowable amortization periods for unfunded liabilities. It established a new "at risk" category for defined benefit plans whose sponsors are required to make larger contributions to offset the greater liability of these plans. (The federal "at risk" threshold is 80% funded – which paradoxically is the same funding threshold many advocates have used to label public sector pension plans as "healthy.")

In short, it demanded rigorous and responsible funding practices. Education Minnesota and other private plans must operate under these requirements. In contrast, public plans operate under laws states enact that too often reflect budget conditions and political feasibility.

But the biggest influence is the law of concentrated benefits and dispersed costs. The cost of the defined benefits plan serving 380 Education Minnesota employees and retirees is supported by over 80,000 TRA active members. Our back of the envelope calculation suggests about $37 of annual member dues goes to fund Education Minnesota's employee retirement offerings. Even though the ratio of TRA members to state taxpayers seems similarly favorable, the law doesn't work the same way given the intense competition for state government resources. Which is why Pension Chair Her's introductory budget remarks that included an ask of frustrated observers for continued input on what actions to pursue came with this caveat. "Don't come to me and tell me you don't like what I did," she said. "Come to me and tell me who do you want me to take money from so that I could give it to you."

### An End of Session Surprise?

We will soon find out if those words were taken to heart, and if so, who/what the sacrificial lambs are. With just three weeks left in the session, the Pension Commission has added a meeting to hold an informational hearing on HF3294 introduced on May 1 and appears to be Education Minnesota's "Plan B" proposal for Tier 2 teachers. For plans coordinated with Social Security it would:

- Reduce the normal retirement age to 64

- Increase employee contributions (after June 30 of this year by an additional 0.5% (above an already scheduled increase of 0.25%) to 8.25%

- Increase employer contributions (for plans coordinated with Social Security) after June 30 of this year by an additional 1.0% (above an already scheduled increase of 0.2%) to 9.75%

- Create a fresh 30-year amortization period for unfunded liabilities (2053).

- Provide some to be determined additional amount of general education aid to help cover the cost.

Our rough estimate of additional general education aid to cover the additional employer cost of this proposal is $60 million per year. Advocates are almost certainly buttonholing both Education Finance committee chairs to squeeze that money out of their existing bills. Since neither the House or the Senate Education Finance Committees have heard this bill, we presume it will require some type of rules suspension, floor amendments, or other process maneuvers to get this enacted.

The fate of early retirement may still be in limbo but we do know the claims of teachers having "no hope of having a reasonable retirement" is hyperbole of the worst kind. The TRA pension plan in coordination with Social Security is constructed to replace about 85% of a career teacher's average five highest earning years for life and is backed by Minnesota taxpayers. If that seems "unreasonable," it may be because the union is comparing TRA against the defined benefit plan it offers its own employees. Education Minnesota may want to consider a goodwill gesture of cutting back on those special executive retirement bonuses or even a small, albeit symbolic, dues cut to demonstrate some recognition of its dues-paying members' contributing to their own defined benefit plan while paying for another.

In solidarity, of course. ■

## State Contract Negotiations: Nothing Transformational Here

*The biennial budget is taking shape, but a major element – state labor contract agreements – won't be determined until after the constitutional deadline. From all indications, satisfying economic interests and keeping labor peace will consume the negotiations while discussions of ideas to improve efficiency, performance, and accountability in government human capital management get left behind.*

In early April, Governor Walz attended the season opener, a rarity by the state's chief executive. This one, however was filled with suits rather than uniforms and one where disputes are settled by arbitrators rather than umpires. It was the Minnesota Association of Professional Employees (MAPE) kickoff to the 2023-2025 contract negotiations in which the union presented its initial proposals directly to the Governor. Contract negotiation season is now in full swing, and MAPE is just one of several unions now negotiating with the Labor Relations Division of MMB to establish the workforce rules and terms and conditions of employment for the upcoming biennium.

Collective bargaining contracts can have a major influence on the effectiveness, efficiency, and accountability in the delivery of government services. Although the mission of both parties is to serve the public good, it is a mistake not to recognize collective bargaining

is at its core a competitive exercise pitting the private interests of labor against the broader public interest of taxpayers as represented by management. As the 1995 Brandl/Weber report to Governor Carlson, An Agenda for Reform, observed:

"Government employees are interested in their jobs, their incomes, their raises, their advancement, their pensions, their security in the workplace. These interests are represented at the Legislature, effectively, by wealthy and powerful organizations, which are themselves private. These interests are legitimate. But they are not public interests. It makes no difference that they do not take the form of a business corporation. They are private interests."

For this reason, transparency in public sector collective bargaining is essential to understand how well that balance between public and private interests is struck. Absent insights into how the negotiations evolved, taxpayers have little ability to evaluate what provisions/changes government representatives believed were needed to better advance the public interest or to what degree those provisions were secured or sacrificed in the outcome. The fact that, unique to government, management's existence at the bargaining table can be a function of the financial support from the other side of the table adds to the need for transparency.

To MAPE's tremendous credit, the union has continued its commitment to what it has called in the past "radical transparency" by making its initial proposals publicly available along with initial proposals put forward by MMB.

### MMB: Rocking the Boat…Ever So Gently

Weighing in at 31 pages with 105 change items, MMB's "comprehensive package" might suggest state interest in putting some new ideas regarding government workforce organization, design and management on the table, perhaps along the lines of the National Academy of Public Administration's guidance and recommendations on meeting the human capital needs of government in the 21st century. On inspection those expectations immediately evaporate.

A large number of changes are technical in nature like the type of language changes in author's amendments needed to get a legislative bill in order. An equally large number are minor administrative process related adjustments and actions (e.g., requiring a written notice here, establishing a time limit there). Another category might be described as office operating rule tweaks like no longer having to provide space on office bulletin boards for exclusive use of the union and putting a 5-minute time limit on distributing union newsletters during work hours. Much of the package strikes a reader as large amounts of disposable fodder for negotiations or conversely potential management "success counts" on minor, uncontroversial items.

**Going forward, if the opening MAPE position is ratified, the compounding effect of steps with the annual wage adjustments would result in a 31% two-year wage increase for step-eligible members.**

There are a few more impactful proposals addressing greater management discretion, flexibility, and control in various areas of workforce management. Many are modest, but some others tread on issues likely to be the subject of more animated discussion. Unsurprisingly, these are around filling position vacancies and dealing with layoffs and recall. As it did in the last contract cycle, MMB again is looking to adjust bumping rights and exercise some greater control over how positions are filled and how layoffs are managed. Interestingly, MMB is proposing some new language in a couple of circumstances dealing with personnel moves that states, "the employer must determine the employee to be qualified." The apparent absence of that in past contract language is rather disconcerting.

### MAPE: "Time to Catch Up"

Unlike MMB's administrative and process-focused proposal content, MAPE's nine proposals cut directly to the chase and center primarily on private worker interests. The exception is new workforce management policy regarding telecommuting which has proven to be quite popular. MAPE is proposing a default approval of an employee's telecommuting request unless management can demonstrate its unsuitability.

Benefit-related provisions include expanded granting of sick and bereavement leave use to extended family or individuals employees recognize as family; bump in vacation accrual rates; a doubling of the maximum employer match to the states deferred compensation plan ($250 to $500); and formalization of the pilot student loan payment reimbursement as a talent attractor/retainer. State health care is coalition bargained across state employee bases and negotiated separately.

The eye-catching proposal is wage adjustments. MAPE is seeking an 11% increase the first year of the new biennial contract and 10% increase in the second year. The 11% first year increase matches the difference between MAPE wage growth over its last two contract periods and private sector wage growth over that same period as reported by the Federal Reserve's Employment Cost Index. (That may be a coincidence but we doubt it.) Compounded, that is a 22% wage increase for the FY24-25 biennium.

However, that does not include "step" increases which are granted each year (largely by default)[4] on an employee's work anniversary. Step increases are provided annually for achieving a satisfactory level of performance; exceeding performance standards is not considered. Historically steps run at around 3.6% per year. Because of compounding effects, MAPE employees that were step eligible over all four years of the last two contracts saw their wages grow 5.2% more than the private sector during this four-year period.

On the other hand, employees at the top of their job class's pay scale with no step increases – which presumably would include some of the most experienced and productive profes-

[4] Providing steps does *not* require an affirmative notification or action by management. Instead, refusing a step increase requires a manager to give the employee a written notice that the step increase is to be withheld because of less than satisfactory performance. If that notification is not given to the employee prior to the employee's anniversary date, the step increase is automatically granted. Any withholding of a step increase is grievable/arbitrable. Historically, well over 90% of step-eligible employees receive their step increase.

sionals in the state workforce – experienced wage growth less than half of the private sector wage gains and a little over a third of their colleagues. For a compensation system singularly and slavishly devoted to establishing equity across 1500 state job classes, the compensation inequities that can result are remarkable.

Addressing the situation of those already at the top of pay scales is undoubtedly a factor behind the proposed 10% increase in the second year of the contract. But under the state's classified system, a rising tide must lift all boats. Going forward, if the opening MAPE position is ratified, the compounding effect of steps with the annual wage adjustments would result in a 31% two-year wage increase for step-eligible members. Unless the cohort makeup of the union has significantly changed recently, that increase would – indiscriminately – accrue to well over half of the 16,000 employees represented by the union.

Human resource experts have identified certain employment conditions and circumstances in which step-based compensation design is best used. The first is strict management and administration of compensation expense, which likely appeals to the state. Others are:

- Majority of jobs are routine and task-oriented doing the same thing every day.
- Performance/skill variation levels of most jobs are minimal—in other words, it's difficult to tell the difference between someone doing extremely well and average.
- Management cannot make appropriate distinctions among employee performance/skill levels for most jobs

It would be interesting to survey Minnesota's government professionals to see if they believe these bullets accurately describe their activities and responsibilities.

## "Let's Keep it Just Between Us"

At the same time negotiation sessions are taking place, both the House and Senate have included provisions in their respective omnibus state government bills to essentially remove the Legislature from any review and oversight of collective bargaining agreements. Under the proposed language:

- the MMB commissioner would no longer have to regularly advise the Legislative Coordinating Commission (LCC) on the progress of collective bargaining activities
- the LCC would no longer make recommendations to MMB as it deems appropriate on negotiations
- the MMB commissioner would no longer have to submit to the LCC negotiated collective bargaining agreements, arbitration awards, compensation plans, or salaries for legislative approval or disapproval.
- This is about simplifying contract ratification. But aside from concerns about reduced oversight, it also makes the state contract development and review processes that much more immune to addressing potential reform needs.

The state is about to embark on one of the greatest expansions of government programming in its history resulting in literally thousands of new hires (if budget change requests are accurate). As the demand for both the quantity and quality of government public services increases, the more relentless and aggressive government must be in pursuing innovation and implementing efficiency and productivity improvements. Otherwise, costs explode, taxes increase, and the state business climate deteriorates. Human capital management is a foundation of this pursuit. We need state government to recognize this and we need unions to recognize their true power lies in the talent, commitment and professionalism of individual members. ■