

# **The Future of Public Employee Retirement Systems**

EDITED BY

Olivia S. Mitchell and Gary Anderson

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## Chapter 6

# **Benefit Cost Comparisons Between State and Local Governments and Private Industry Employers**

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*Ken McDonnell*

It is often argued that compensation patterns for public sector employees are higher than in the private sector. This chapter examines some of the reasons for the observed differences in total compensation costs between US state and local government employers and private industry employers. We examine compensation costs by industry, occupation, union status, and employee benefit participation.

The evidence seems to be broadly supportive of the general point. For instance, overall total compensation costs were 51.4 percent higher among state and local government employers (\$39.50 per hour worked in 2007) than among private industry employers (\$26.09 per hour worked in 2007); see Tables 6-1 and 6-2. Total compensation costs consist of two major categories: wages and salaries, and employee benefits. For both of these categories, state and local government employer costs were higher than those of private industry employers: 42.6 percent higher for wages and salaries, and 72.8 percent higher for employee benefits.

## **Changes over time**

**Participation Rates.** From 1998 to 2007 there was very little change in participation rates among full-time employees in state and local governments. In 1998, 86 percent of full-time employees participated in health insurance. By 2007, this percentage had declined but only slightly to 82 percent; see Table 6-2. For other insurance benefits such as life and disability, participation rates increased in a range of 2 to 5 percentage points. Participation among full-time employees in retirement/savings plans showed little change from 98 percent in 1998 to 95 percent in 2007. Participation increased for full-time employees in defined contribution (DC) plans from 14 percent in 1998 to 21 percent in 2007 while it declined but only slightly in defined benefit (DB) plans, from 90 percent in 1998 to 88 percent in

TABLE 6-1 Employer costs for employee compensation<sup>a</sup> and percentage of full-time employees participating<sup>b</sup> in employee benefit programs: state and local governments: 1998 and 2007

<i>Employee Benefit Program<sup>b</sup></i>	<i>1998</i>			<i>2007</i>		
	<i>Total Compensation Costs (\$/hour)</i>	<i>% of Total Compensation Costs</i>	<i>% Participation</i>	<i>Total Compensation Costs (\$/hour)</i>	<i>% of Total Compensation Costs</i>	<i>% Participation</i>
<b>Total compensation costs</b>	27.28	100.0	c	39.50	100.0	c
<b>Wages and salaries</b>	19.19	70.3	c	26.26	66.5	c
<b>Total benefits</b>	8.10	29.7	c	13.24	33.5	c
<b>Paid leave</b>	2.11	7.7	c	3.07	7.8	c
Vacations	0.72	2.6	67	1.08	2.7	69
Holidays	0.69	2.5	73	0.99	2.5	76
Sick	0.53	1.9	96	0.76	1.9	95
Other	0.16	0.6	c	0.24	0.6	c
<b>Supplemental pay</b>	0.23	0.8	c	0.35	0.9	c
Overtime and premium <sup>d</sup>	0.11	0.4	c	0.18	0.4	c
Shift differentials	0.05	0.2	c	0.07	0.2	c
Nonproduction bonuses	0.07	0.3	33	0.10	0.3	33
<b>Insurance</b>	2.15	7.9	c	4.50	11.4	c
Life	0.05	0.2	86	0.07	0.2	88
Health	2.05	7.5	86	4.35	11.0	82
Short-term disability	0.02	0.1	20	0.03	0.1	25
Long-term disability	0.03	0.1	34	0.04	0.1	38

<b>Retirement and savings</b>	1.94	7.1	98	3.04	7.7	95
Defined benefit	1.80	6.6	90	2.73	6.9	88
Defined contribution	0.14	0.5	14	0.31	0.8	21
<b>Legally required benefits</b>	1.63	6.0	c	2.29	5.8	c
Social Security and Medicare	1.28	4.7	c	1.75	4.4	c
OASDI <sup>e</sup>	1.00	3.7	c	1.34	3.4	c
Medicare	0.28	1.0	c	0.41	1.0	c
Federal unemployment insurance	<sup>f</sup>	<sup>g</sup>	c	<sup>f</sup>	<sup>g</sup>	c
State unemployment insurance	0.04	0.1	c	0.05	0.1	c
Workers' compensation	0.30	1.1	c	0.49	1.2	c

*Notes:* Because of rounding, sums of individual items may not equal totals.

<sup>a</sup> Data are representative of all employees and includes all employers whether the employer offers a type of benefit or not.

<sup>b</sup> Includes workers covered but not yet participating due to minimum service requirements. Does not include workers offered but not electing contributory benefits.

<sup>c</sup> Data not available.

<sup>d</sup> Includes premium pay for work in addition to the regular work schedule (such as overtime, weekends, and holidays).

<sup>e</sup> Stands for Old-Age, Survivors, and Disability Insurance.

<sup>f</sup> Cost per hour worked is \$0.01 or less.

<sup>g</sup> Less than 0.05 percent.

*Source:* US Department of Labor (1998, 2007*a*, 2000, 2008).

TABLE 6-2 Employer costs for employee compensation<sup>a</sup> and percentage of full-time employees participating<sup>b</sup> in employee benefit programs: private industry

<i>Employee Benefit Program<sup>b</sup></i>	<i>Total Compensation Costs (\$/hour) (1997)</i>	<i>% of Total Compensation Costs (1997)</i>	<i>% Participation (1996/97)</i>	<i>Total Compensation Costs (\$/hour) (2007)</i>	<i>% of Total Compensation Costs (2007)</i>	<i>% Participation (2007)</i>
<b>Total compensation costs</b>	17.97	100.0	c	26.09	100.0	c
<b>Wages and salaries</b>	13.04	72.5	c	18.42	70.6	c
<b>Total benefits</b>	4.94	27.5	c	7.66	29.4	c
<b>Paid leave</b>	1.14	6.3	c	1.76	6.8	c
Vacations	0.57	3.2	90	0.90	3.5	90
Holidays	0.39	2.2	84	0.58	2.2	88
Sick	0.13	0.7	53	0.22	0.8	68
Other	0.05	0.3	c	0.06	0.2	c
<b>Supplemental pay</b>	0.51	2.9	c	0.78	3.0	c
Overtime and premium <sup>d</sup>	0.21	1.1	c	0.27	1.0	c
Shift differentials	0.05	0.3	c	0.07	0.3	c
Nonproduction bonuses	0.26	1.4	43	0.44	1.7	52
<b>Insurance</b>	1.09	6.1	c	1.99	7.6	c
Life	0.05	0.3	74	0.04	0.2	69
Health	0.99	5.5	70	1.85	7.1	64
Short-term disability	0.03	0.2	42	0.05	0.2	45
Long-term disability	0.02	0.1	32	0.04	0.1	37
<b>Retirement and savings</b>	0.55	3.0	62	0.92	3.5	60
Defined benefit	0.26	1.4	32	0.43	1.7	23
Defined contribution	0.29	1.6	47	0.49	1.9	50

<b>Legally required benefits</b>						
Social Security and Medicare	1.62	9.0	c	2.21	8.5	c
OASDI <sup>c</sup>	1.08	6.0	c	1.55	5.9	c
Medicare						
Federal unemployment insurance	0.87	4.8	c	1.24	4.8	c
State unemployment insurance	0.21	1.2	c	0.31	1.2	c
Workers' compensation	0.03	0.2	c	0.03	0.1	c
	0.12	0.6	c	0.16	0.6	c
	0.39	2.2	c	0.48	1.8	c

*Notes:* Because of rounding, sums of individual items may not equal totals.

<sup>a</sup> Data representative of all employees and includes all employers whether the employer offers a type of benefit or not.

<sup>b</sup> Includes workers covered but not yet participating due to minimum service requirements. Does not include workers offered but not electing contributory benefits.

<sup>c</sup> Data not available.

<sup>d</sup> Includes premium pay for work in addition to the regular work schedule (such as overtime, weekends, and holidays).

<sup>e</sup> Stands for Old-Age, Survivors, and Disability Insurance.

<sup>f</sup> Cost per hour worked is \$0.01 or less.

<sup>g</sup> Less than 0.05 percent.

*Source:* US Department of Labor (1997, 2007*a*, 1999*a*, 1999*b*, 2007*c*).

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2007. For leave benefits, there was a modest increase in participation rates in the range of 1 to 3 percent.

Participation rates among full-time employees in private industry showed an increase in leave benefits, particularly in paid sick leave plans which increased from 53 percent of full-time employees in 1996/97 to 68 percent by 2007; see Table 6-2.<sup>1</sup> Participation in health insurance declined from 70 percent in 1996/97 to 64 percent in 2007 and in life insurance from 74 percent to 69 percent. For disability insurance, both short-term and long-term, participation rates increased in a range of 3 to 5 percent. Among retirement/savings plan participation the overall percentage change was slight, from 62 percent in 1996/97 to 60 percent in 2007, yet the participation rate change by plan type was significant, particularly in DB plans which experienced a decline of 9 percentage points from 32 percent in 1996/97 to 23 percent in 2007.

**Benefit Costs.** For both state and local governments and private industry, benefit costs increased as a percentage of total compensation with the percentage increase for state and local governments greater. From March 1998 through September 2007 benefit costs, as a percentage of total compensation among state and local governments, increased from 29.7 percent to 33.5 percent while in private industry benefit costs increased from 27.5 percent to 29.4 percent (from March 1997 through September 2007; see Tables 6-1 and 6-2). For both employer types, the main driver in benefit cost increases was health benefits. For state and local governments, health benefits increased from 7.5 percent of total compensation to 11.0 percent, from March 1998 through September 2007 while for private industry health benefits increased from 5.5 percent of total compensation to 7.1 percent from March 1997 through September 2007.

## Work force comparisons

A primary explanation for differences in total compensation costs between state and local government employers and private industry employers is that of their respective work forces differences in compensation. This is evident from a comparison of data arrayed by industry and occupation group.<sup>2</sup>

**Industry Groups.** State and local government workers are highly concentrated in the education sector. This grouping includes teachers and university professors, two categories of employees with high unionization rates and high compensation costs. Table 6-3 shows that 52.7 percent of all state and local government employees were employed in this sector, in 2007, and total compensation costs for the education sector were \$42.48 per hour worked. By contrast, the private industry group with the largest



TABLE 6-3 Employment and total compensation costs, by industry group and union membership, state and local governments and private sector: 2007

	State and Local Government		Private Sector	
	Employment	Total Compensation Costs (\$/hours)	Employment	Total Compensation Costs (\$/hours)
Total	19.39 million	39.50	116.35 million	26.09
Education	52.7%	42.48	Construction	29.39
Hospitals	5.4	33.62	Manufacturing	30.82
General administration	31.1	36.53	Trade, transportation, and utilities	22.41
Local government utilities	1.2	<sup>a</sup>	Information	39.11
Local government transportation	1.3	<sup>a</sup>	Financial activities	34.95
Other	8.2	<sup>a</sup>	Services	24.91
			Professional and business services	30.44
			Education and health services	27.55
			Leisure and hospitality services	11.59
Members of a Union <sup>b</sup>	36.2%	45.00	Other services	21.87
Non-Union Workers <sup>b</sup>	63.8	34.50	Members of a Union <sup>b</sup>	35.92
			Non-Union Workers <sup>b</sup>	24.94

<sup>a</sup> Data not available.<sup>b</sup> Data for 2006.Sources: Department of Labor (2007*a*, 2007*b*), U.S. Department of Commerce (2008), and unpublished data from the U.S. Department of Labor.

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number of workers was services, accounting for 47.9 percent of all private-sector workers. Here total compensation costs for services were \$24.91 per hour worked.

Another factor affecting total compensation costs is union membership. Union presence in an industry tends to be positively correlated with total compensation costs and benefit participation. Table 6-3 shows that 7.4 percent of private industry workers were members of a union in 2006, compared with 36.2 percent of workers in state and local governments. Among private industry employers total compensation costs for unionized workers were \$35.92 per hour worked compared with \$24.94 per hour worked for non-unionized workers in 2007.

**Occupation Groups.** The concentration of occupations among state and local government employers is also quite different from private industry employers. Table 6-4 shows that a large percentage of state and local government employees in 2007 were concentrated in teachers (27.0%) and in service occupations (31.8%). Teachers had the highest total compensation costs among state and local government employers, \$53.39 per hour in 2007. By comparison, the largest percentage of private industry workers was among sales and office occupations (27.3%) and service occupations (25.7%) where compensation costs were low, \$20.86 per hour worked for sales and office and \$13.00 per hour worked for service workers.

The largest gap in compensation costs between state and local government and private industry workers was among service occupations. The total compensation costs for these workers in state and local governments were \$30.74 per hour in 2007 compared with \$13.00 per hour in the private sector. This difference is due primarily to the type of occupations in the services category. Among state and local governments, the US Department of Labor Bureau of Labor Statistics (BLS) categorizes police and firefighters among the service occupations. Police and firefighters have a high participation rate in a DB plan. Among private industry employers, occupations such as waiters/waitresses and cleaning and building services functions are categorized as service occupations, and these jobs traditionally have low wages.

### **Public–Private differences in employee benefit costs**

As noted earlier, benefit costs of state and local government employers were 72.8 percent higher than those of private industry employers in 2007. Next we review factors contributing to this difference.

**Benefit Costs.** The two most important voluntary benefit programs provided by employers are health insurance and a retirement/savings plan. Important cost disparities exist for these two benefits comparing state and

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TABLE 6-4 Employment and total compensation costs in state and local governments and private sector by occupation group, ages 16 and older

	<i>State and Local Governments</i>		<i>Private Sector</i>	
	<i>Employment (2006)</i>	<i>Total Compensation Costs (\$/hour) (2007)</i>	<i>Employment (2006)</i>	<i>Total Compensation Costs (\$/hour) (2007)</i>
Total	18.48 million	39.50	118.35 million	26.09
Management, professional and related	13.4%	48.35	18.0%	46.22
Professional and related	7.2	47.95	9.3	43.21
Teachers <sup>a</sup>	27.0	53.39	2.2	39.28
Sales and office	14.1	27.00	27.3	20.86
Service	31.8	30.74	25.7	13.00
Natural resources, construction, and maintenance	5.3	34.34	18.8	29.57
Production, transportation, and material moving	3.1	30.86	6.9	22.64

<sup>a</sup> Includes postsecondary teachers; primary, secondary, and special education teachers, and other teachers and instructors.

Sources: Author's tabulations from the Current Population Survey March 2007 Supplement, EBRI (2007) and unpublished data from the U.S. Department of Labor.

local government employers, and private industry employers. Tables 6-1 and 6-2 indicate the average cost for health insurance benefits for state and local government employers was \$4.35 per hour, compared with \$1.85 per hour for private industry employers, a difference of 235 percent.

The difference is even larger for retirement/savings plans, which benefits cost state and local government employers \$3.04 per hour worked versus \$0.92 per hour worked for private-sector employers, a difference of 330 percent. One reason for this divergence is that DB retirement plans are more prevalent among state and local governments than they are in private industry.

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**Participation.** Another reason for the observed difference in benefit costs is that state and local government employees are more likely to participate in employee benefit programs than are their private industry counterparts. Health insurance participation rates among full-time employees in state and local governments were significantly higher than rates among full-time employees in private industry as is depicted in Tables 6-1 and 6-2.

The disparity is larger for retirement and savings plans. Virtually all full-time employees in state and local governments participated in some type of retirement/savings plan, versus about 60 percent of full-time employees in private industry. Further, the majority of public sector workers have a DB plan and these DB plans tend to be more expensive to provide than DC plans. The administrative burdens and costs of operating DB plans is often cited by corporate plan sponsors as a major disincentive to operating this type of retirement plan (VanDerhei and Copeland 2001).

## Conclusion

Observed differences in compensation costs between public and private-sector employers are summarized. One explanation for these differences distinctions has to do with the different concentrations of workers by industry and occupation. Another relates to the composition of the benefit package and benefit participation rates. State and local government retirement and health insurance costs are two to three times those of private employers.

### *Data Appendix*

The datasets used in this study include the following:

For compensation costs: US Department of Labor (DOL) (1997). *Employer Costs for Employee Compensation-March 1997*. Washington, DC: Bureau of Labor Statistics; US Department of Labor (DOL) (1998). *Employer Costs for Employee Compensation-March 1998*. Washington, DC: Bureau of Labor Statistics; and US Department of Labor (DOL) (2007a). *Employer Costs for Employee Compensation-September 2007*. Washington, DC: Bureau of Labor Statistics.

For benefit participation private industry: US Department of Labor (DOL) (1999a). *Employee Benefits in Medium and Large Private Establishments, 1997*. Washington, DC: Bureau of Labor Statistics; US Department of Labor (DOL) (1999b). *Employee Benefits in Small Private Establishments, 1996*. Washington, DC: Bureau of Labor Statistics; and US Department of Labor (DOL) (2007c). *National Compensation Survey: Employee Benefits in Private*

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*Industry in the United States, March 2007*. Washington, DC: Bureau of Labor Statistics.

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For employment by industry: US Department of Labor (DOL) (2007b). *Employment and Earnings, December 2007*, 54(12). Washington, DC: Bureau of Labor Statistics.

For employment by occupation: Employee Benefit Research Institute (EBRI) (2007). *EBRI Estimates from the Current Population Survey, March 2007 Supplement*. Washington, DC: Employee Benefit Research Institute.

## Notes

<sup>1</sup> To obtain an accurate comparison of benefit participation among full-time employees in private industry, the author combined data from the BLS Survey on Small Private Establishments with the BLS Survey on Medium and Large Private Establishments. This made the comparison with the 2007 data more accurate because the 2007 is representative of small, medium, and large private establishments. Data in the 2007 Bulletin are reported for full-time employees but not for full-time employees by firm size.

<sup>2</sup> Readers should be aware that the term 'service' is not used in the same way for the industry groupings and occupation groupings: that is, not all service workers are employed in the service industries.

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