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BENEFITS IN BALANCE

**BENCHMARKING PUBLIC SECTOR
EMPLOYEE BENEFITS IN MICHIGAN**

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Benefits in Balance: Benchmarking Public Sector Employee Benefits in Michigan

By James Hohman

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Contents

Executive Summary.....	iii
Introduction	1
Description of Benefits.....	3
Insurance Benefits	3
Retirement Benefits.....	5
Retiree Health Insurance Coverage	8
Paid Leave	9
Supplemental Pay	10
Government-mandated Benefits.....	11
Benchmarking Public and Private Sector Benefits	12
Testing the Assumptions	15
Implementing ‘Benefits in Balance’	16
Incentives.....	17
Statutory Mandates	18
Constitutional Requirements	19
The Savings	19
Conclusion.....	20
About the Author	21
Acknowledgements.....	21
Endnotes	22

Executive Summary

Since 2000, the cost of state and local government employment benefits in Michigan has outpaced those typically found in the private sector. The more government spends on these benefits, the less it can spend providing services to Michigan residents. Benchmarking these costs to more closely resemble private sector averages would do much to free up cash to support government services, while simultaneously allowing taxpayers to keep more of their own resources.

This analysis of government statistics finds that if the cost of the average benefits package for Michigan government employees was the same as the average in Michigan's private sector, the state and its subsidiary governments would save \$5.8 billion annually.

Most full-time employees receive benefits packages that include paid leave, retirement savings plans, insurance coverage and other cash benefits like bonuses and extra pay for holiday work. These are in addition to benefits that state and federal statutes require employers to pay for, such as Social Security and unemployment insurance.

The largest gap in cost between state and local government employers in Michigan and those in the private sector were for insurance benefits. If Michigan governments averaged spending what the private sector does on health insurance benefits, the state would save \$3.24 billion annually. Private sector employers tend to provide insurance coverage that requires less costly premiums and also tends to require employees to contribute more toward the cost of these insurance benefits compared to government employers.

Retirement benefits make up the next largest contributor to the large difference in public and private sector employment benefits in Michigan. The consistent underfunding of defined-benefit pension plans among state and local governments caused the costs of these benefits in the public sector to soar. Transitioning to more cost-effective defined-contribution plans and benchmarking costs to private sector averages could potentially save \$1.46 billion annually when fully implemented.

Differences in the cost of providing employees with paid leave for vacation time, sick leave and other time off from work also contributes to the overall gap in benefits between Michigan's public and private sectors. Government employers in Michigan spend about \$1.14 billion more providing paid leave to employees than private sector employers do in Michigan on average.

This analysis also found that Michigan's state and local government employees receive less in "nonproduction bonuses," such as Christmas bonuses and company stock, than their counterparts in the private sector on average. Benchmarking these benefits would cost state and local governments \$84 million annually.

While the level of benefits provided to public sector employees is most often determined at the discretion of local government officials — such as school boards and city councils — there are several different options legislators should consider in order to bring public sector benefits more in line with private sector averages in Michigan.

For example, legislators should continue to financially incentivize local government entities to reduce the costs of their employees' benefits and more closely aligning them to private sector averages. The state has offered additional revenue-sharing money to local municipalities and additional state aid to school districts that meet some benefits requirements in the past, and it should continue and expand this practice.

The state could also simply mandate limits to the benefits that local governments are able to offer. Current law already does this to a limited extent by capping the amount some government employers can pay for health insurance premiums. Likewise, retirement benefits provided to state, school and other government employees are mandated by state statute, and thus can be changed by new state statutes.

Other options for legislators include introducing a constitutional amendment to be put to voters which would mandate that state and local government employees not receive benefits that exceed certain private sector averages.

The savings from putting public sector benefits in balance with private sector averages in Michigan could result in significant positive outcomes for Michigan taxpayers and residents. The less government revenue is tied up in paying for expensive employee benefits, the more is available to provide residents with the government services that they use. Alternatively, the savings from these changes could also more directly benefit taxpayers if paired with reductions in tax rates that allow taxpayers to keep more of their earnings.

Introduction

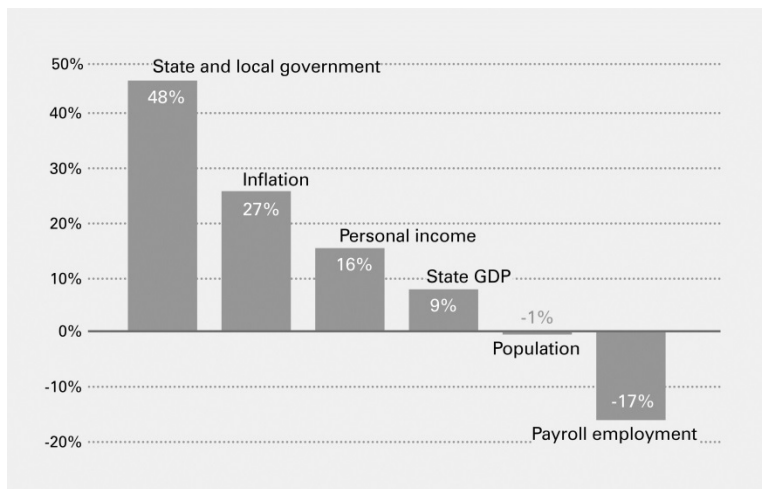
The size of state and local governments, as measured by total government expenditures, generally grows in tandem with population and the economy. The more people who live in a state and the more resources being exchanged in a state economy, the more governments can tax and the more governments can spend. But over the last decade, Michigan broke from this pattern to a certain degree. The cost of government increased, while the resources required to support this larger government failed to keep pace, leaving Michigan stuck in a cost spiral.

Total state and local government spending in Michigan increased by 48 percent from 2000 to 2010, climbing from \$65.5 billion to \$91.0 billion.¹ Yet little else increased as much in Michigan over this same period:

- ◆ The state's population fell by about 1 percent.²
- ◆ State gross domestic product increased by only 9 percent.³
- ◆ Total state personal income grew by 16 percent.⁴
- ◆ Payroll employment fell 17 percent, from 4.68 million jobs to 3.86 million.⁵

A summary of these statistics is shown in Graphic 1.

Graphic 1: Government spending, inflation and private sector resources, 2000-2010



Source: U.S. Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis.

Some traditional government cost-drivers increased over this period. For example, Medicaid enrollment increased 72 percent, and unemployment insurance outlays skyrocketed from \$809 million in 2000 to \$6.7 billion in 2010.* Inflation rose nationally by 27 percent, too.† But some important cost-drivers were down:

- ♦ Enrollment in K-12 public schools dropped about 6 percent.⁶
- ♦ Violent crime fell by 12 percent and property crime by 24 percent.⁷
- ♦ State and local government employment shrunk by about 7 percent, declining from about 621,000 jobs to 578,300.⁸

So, what is primarily fueling the increased expense of state and local governments in Michigan? The answer is the rising costs of compensating government employees. Despite the drop in the number of state and local government employees, total compensation for government employees increased 33 percent from 2000 to 2010.‡ Total payments for wages and salaries increased about 26 percent, but the cost of employment benefits increased about 60 percent.§ These rising expenditures are a significant contributor to Michigan's cost spiral.

This study explores the employment benefits commonly offered by the state government and local governments in Michigan, and compares the average level of these benefits to those found in Michigan's private sector. It also calculates the potential savings of benchmarking average public sector benefits to that of the private sector average in Michigan, and suggests means for policymakers and government officials to do so.

* Not all the increase in government expenditures in Michigan from 2000 to 2010 can be explained by the aforementioned significant increase in transfer payments such as unemployment insurance. Total government spending still increased by 31 percent over this period even when not counting spending on unemployment insurance and other transfer payments such as payments on social services and income maintenance. This suggests that employment costs in areas such as education, public safety, environment and housing, government administration, transportation, liquor activities, and other spending categories drove up the cost of Michigan government. "State and Local Government Finances by Level of Government and by State: 1999-2000," (U.S. Census Bureau), <http://goo.gl/DPD2br> (accessed Sept. 18, 2013); "State and Local Government Finances by Level of Government and by State: 2009-2010," (U.S. Census Bureau), <http://goo.gl/Ow7Qd> (accessed Sept. 18, 2013). "State of Michigan Comprehensive Annual Financial Report: Operating Indicators by Function," (Michigan Department of Management and Budget, 2009), <http://goo.gl/omcQN> (accessed Sept. 18, 2013); "State of Michigan Comprehensive Annual Financial Report: Operating Indicators by Function," (Michigan Department of Management and Budget, 2013), 261, <http://goo.gl/9IP6N> (accessed Sept. 18, 2013).

† The Bureau of Labor Statistics also compiles a regional price index for the Detroit-Flint-Ann Arbor area, the only regional tabulation available for a Michigan area. This index increased 21 percent from 2000 to 2010. "Consumer Price Index for All Urban Consumers," (U.S. Bureau of Labor Statistics), <http://www.bls.gov/cpi/> (accessed Sept. 18, 2013).

‡ The use of the Bureau of Economic Analysis's compensation measures may undercount the total level of compensation due to accounting for the costs of pension and other post-employment benefits. Author's calculations based on "Bureau of Economic Analysis Regional Economic Accounts: State Annual Personal Income and Employment," (U.S. Bureau of Economic Analysis, 2013), <http://bea.gov/regional> (accessed Sept. 18, 2013).

§ The BEA's definition includes only employer payments for employer benefits administered outside of payroll. Author's calculations based on "Bureau of Economic Analysis Regional Economic Accounts: State Annual Personal Income and Employment," (U.S. Bureau of Economic Analysis, 2013), <http://bea.gov/regional> (accessed Sept. 18, 2013).

Description of Benefits

The major benefits typically offered to employees — both public and private sector — are for insurance, paid retirement, paid leave and government-mandated benefits. Other benefits can include bonuses and company stock options, but these are less likely to be offered to employees.⁹

State and local government employees — those employed by public schools, public universities, community colleges, cities, villages, townships, counties, state government and all other governmental entities — receive employment benefits through a complex interplay of state mandates, management discretion, collective bargaining agreements and local governing board agreements. The following describes each type of these benefits in more detail.

Insurance Benefits

Health insurance coverage is provided to most full-time employees in both the public and private sector. According to the Bureau of Labor Statistics, 70 percent of private sector jobs nationally provide access to employer-sponsored health insurance benefits, and 73 percent of private sector employees participated in these health insurance plans when offered in 2012.¹⁰ State and local governments tend to provide access to a greater extent, with employer-sponsored health insurance coverage offered for 87 percent of government jobs. About 84 percent of government employees nationally participate when offered these insurance benefits.¹¹

While not available on a state-by-state basis,¹² the East North Central region (Michigan, Ohio, Indiana, Illinois and Wisconsin) has slightly higher access to these benefits in the private sector (72 percent) and slightly lower access in state and local governments (80 percent).¹³

In Michigan, there are some guidelines on the insurance benefits that state and local government officials can provide their employees, and benefits are subject to collective bargaining when employees are unionized. Outside of those stipulations, government employers are free to provide insurance benefits at their discretion.

State government employees — the 47,809 full-time equivalent employees¹⁴ subject to the constitutional protections of the Civil Service Commission — have their insurance coverage determined through both executive action and collective bargaining. Although the CSC has primary responsibility for determining wages and benefits for public employees (subject to budgetary approval for increases in compensation),¹⁵ it defers decisions about the specifics of insurance coverage to the collective bargaining process for unionized employee groups.*

State employees have a variety of options for medical plans, depending on their hire date and union affiliation.¹⁶ Most plans require employees to pay between 10 percent and 20 percent of the insurance premium. The annual cost to the state government for medical insurance

* Seventy-one percent of the state's civil service workforce is unionized. "Thirty-Third Annual Workforce Report: Fiscal Year 2011-12," (Michigan Civil Service Commission), 5-2, <http://goo.gl/KcF18> (accessed Sept. 18, 2013).

premiums per employee ranged from \$3,637 for the least expensive single plan to \$15,847 for the most expensive family plan in fiscal 2013.¹⁷

Some state employees, typically those covered by a different insurance plan (through a spouse's employer, for example), elect not to receive medical insurance benefits. These employees receive a "rebate" of \$1,300 annually and may still choose to enroll in the state's "catastrophic health plan," at no cost to themselves. This catastrophic plan cost the state \$822 per employee annually in fiscal 2013.¹⁸

In fiscal year 2012, the state spent about \$556 million in employer-paid medical insurance costs, or \$11,637 per FTE employee.*

State employees are also offered dental, vision, long-term disability and life insurance coverage, which costs state government an additional \$107 million for all workers who participate.¹⁹

Most of the 186,000 FTE school district employees also tend to receive generous health insurance benefits.²⁰ School districts, charter public schools and other government educational providers are able to offer benefits at their discretion, but are subject to collective bargaining when employees are unionized. New state mandates also require employer contributions to be capped or for employees to contribute at least 20 percent of the premium's cost.²¹

According to a 2009 survey of Michigan conventional school districts, average teacher health insurance premiums for full-family plans were 39 percent more expensive than Michigan private sector averages and required employees to contribute less to their share of premiums.²² In 2011, the most commonly purchased health insurance plan cost districts on average \$7,210 for single coverage, \$16,173 for two-person and \$17,692 for full family.²³

As with school districts, universities and local governments may offer insurance benefits at their discretion, subject to collective bargaining when employees are unionized.† No survey or study to this author's knowledge has been done to estimate the average health insurance costs for these government entities.

Compared to Michigan's public sector employers, private sector employers in Michigan spend less on average providing health insurance benefits for their employees. According to the Kaiser Family Foundation, average full-family insurance premiums in Michigan costs \$14,458 annually in 2011, with private sector employers covering \$10,988, or 76 percent, of the cost.²⁴

* Note that this cost is different from the average medical insurance premium. This figure is the total employer costs of all the state's insurance plans, including lower-cost single- and dual-coverage and catastrophic insurance plans, per FTE, including employees that may not be offered medical insurance benefits. Author's calculations based on Michigan Civil Service Commission FOIA response for FY 2012 Certified Aggregate Payroll, email correspondence with James Hohman, Feb. 4, 2013.

† There are some limitations on the level of benefits offered to employees in Michigan's local governments. For instance, MCL § 46.12a guides a county's health insurance and pension provisions, and outside of some bounds (for instance, that circuit court stenographers be covered under retirement plans if offered) counties have fairly substantial latitude in crafting employment benefits packages.

Retirement Benefits

State and local government retirement benefits are dictated by statute in some instances, but local governments and some state universities are free to offer whatever retirement benefits they choose. Separate laws mandate the main retirement benefits offered to public school employees (including community college and some public university employees),²⁵ state police,²⁶ state employees,²⁷ judges²⁸ and legislators.²⁹ There are additional state rules for the retirement benefits offered to certain local police and fire employees.³⁰ The state constitution also prevents the mitigation of earned pensions and requires governments to set money aside to pay for benefits as they are earned.³¹

With 241,629 members in just the school employee and state employee retirement systems alone, the majority of government employees in Michigan are in state-managed retirement plans.³²

There was a state-run municipal retirement system, but it became an independent nonprofit in 1996.³³ Even prior to this, not every local government was a member of that system and local government units — cities, villages, townships and counties and whatever subsequent authorities and agencies they create — are free to offer whatever retirement benefits they choose, subject to collective bargaining when employees are unionized.

Regardless of whether or not a retirement system is managed locally or by the state, the majority of them are defined-benefit pension systems, where employees receive annuities paid upon retirement based on a formula. These formulas typically involve factors such as the number of years employed, average salary (over a certain period) and a prescribed multiplier.³⁴

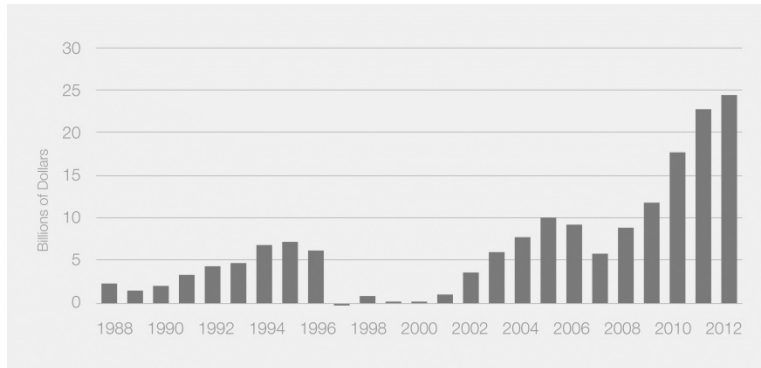
Michigan's constitution requires that all government employers set aside money necessary to cover the costs of the retirement benefits earned by employees.³⁵ Government employers accomplish this by pre-funding retirement benefits. They hire actuarial firms to estimate the amount of money necessary to cover the annual retirement benefit earned. This money is set aside and invested in the market and the investment funds provide a return. These savings and returns are used to pay for the costs of pension payments to retirees.

Most government entities in Michigan have not saved enough to cover all the costs of the retirement benefits earned by their employees and retirees. In order to cover this shortfall (called an unfunded liability), government employers need to make an additional payment to their retirement systems. The total expense of a pension system, then, are the costs required to cover the retirement benefits earned in a year — the normal costs — plus the costs to catch up on any unfunded liabilities. Unfunded liabilities do not have to be immediately paid off as they develop — they can be amortized and repaid over an extended period of time, typically up to 30 years.*

* For instance, Michigan's largest pension system is paying off its unfunded liabilities over the next 25 years. "Michigan Public School Employees' Retirement System: Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2012," (Michigan Office of Retirement Services, 2013), 37, <http://goo.gl/NwCb6> (accessed Sept. 23, 2013).

Amortization payments on unfunded liabilities are a major and volatile expense of government pension plans. For example, the Michigan Public School Employees' Retirement System, the largest state-run pension system, currently carries \$24.3 billion in unfunded liabilities, and the amortization payments amount to 18.64 percent of contributing employers' payroll. As market returns rise and fall, the actuarial value of pension fund investments correspondingly rise and fall as well, changing the amortization payments. Graphic 2 shows MPSERS' unfunded liabilities over time.

Graphic 2: Unfunded Liabilities in MPSERS, 1988-2012



Source: 1996-2012 MPSERS Comprehensive Annual Financial Reports, MPSERS 2012 Annual Actuarial Valuation Report.

The state government employee pension plan, the Michigan State Employees' Retirement System, cost the state \$23,512 per active member in fiscal 2012.* This covered the normal and amortization payments divided by the number of working employees in the system. The plan is only 60 percent funded so the costs to catch up are substantial.³⁶

The costs of the MSERS pension plan per active member tend to be higher than other pension systems. For instance, MPSERS costs only \$7,371 per active member to prefund pension benefits and make amortization payments.³⁷ This plan is 65 percent funded.³⁸ The Municipal Employees' Retirement System of Michigan, which offers a variety of pension benefit options, costs an average \$7,957 per active member,³⁹ though there is substantial volatility in the required contributions as a percent of payroll for each employer.⁴⁰

New state government employees are offered participation in a defined-contribution pension system instead of a defined-benefit one. All employees hired on or after March 31, 1997 are offered retirement benefits where the state automatically puts in 4 percent of employees' salaries and matches employee contributions up to an additional 3 percent of their salaries.⁴¹ As of 2012,

* Author's calculations based on data from "Michigan State Employees' Retirement System: Comprehensive Annual Financial Report for the Fiscal Year Ended September 30, 2012," (Michigan Office of Retirement Services, 2013), 45, <http://goo.gl/7qUqY> (accessed Oct. 1, 2013). This estimation may be high because the state's actuaries believe that the normal cost is about \$95 million while the amortization payment required is \$417 million. This is also high relative to the normal costs because the plan was closed in 1997 and active members have been gradually decreasing, meaning that larger payments are necessary to defray the costs of retirement benefits that they are accruing. For more information, see: "Michigan State Employees' Retirement System: Annual Actuarial Valuation Report, September 30, 2012," (Gabriel Roeder Smith & Company, 2013), D-1.

the state had 32,749 participants in its defined-contribution plan and there were 17,860 active members in its closed-out, defined-benefit retirement system.⁴²

Retirement benefits in the private sector are different from those commonly found in Michigan's public sector. A 2010 survey of major Michigan private sector employers found that only 25 percent offer participation in a defined-benefit pension plan and none offered a plan based on final average compensation, which is typically used in public sector pension formulas.⁴³ Moreover, the 25 percent that did offer defined-benefit pension plans were "cash-balance" plans, which do not base pensions on an employee's final compensation — which tends to be more generous — but on contributions made on behalf of that employee over time.

The majority of private sector retirement benefits are offered through defined-contribution retirement plans. In these types of plans both employees and employers make contributions to an individual, tax-favored account. These funds are generally managed by employees, and employees accumulate the benefits of investing these funds. Employees can then use these funds upon their retirement.

All of the Michigan companies surveyed in 2010 offered defined-contribution plans to new employees.⁴⁴ While these plans can be designed to be as expensive as employers wish — subject to limitations of tax preferences — they also put the risk for investment return onto the employee, who becomes responsible for selecting plans that meet his or her individual risk preference.*

In 2012, only 19 percent of private sector workers nationally had access to defined-benefit pension systems and 59 percent of workers had access to a defined-contribution retirement system.⁴⁵ In the same year, 83 percent of state and local government employees had access to defined-benefit retirement system, while 31 percent had access to a defined-contribution system.†

In addition to differing in the types of retirement benefits they offer, the private and public sectors differ in the portion of employees to whom they offer such benefits and in the portion of their employees who make use of them. In 2013, 64 percent of private sector employees nationally were offered retirement benefits, and 49 percent participated. For state and local government employees, 89 percent were offered access to retirement benefits, with 85 percent participating.⁴⁶

* Defined-benefit plans are not entirely risk free from an employee's perspective; they contain inherent political risk, for example. If government managers do not properly fund pension systems, there may not be enough assets to pay the benefits that employees have earned. Bankrupt cities have defaulted on pension payments and bankruptcy judges have lowered pension benefits. Whether pension benefits in Detroit will be mitigated is subject to a bankruptcy judge's ruling. For more on this, see: Cate Long, "The real history of public pensions in bankruptcy," (Reuters, 2013), <http://goo.gl/7U6HIB> (accessed Oct. 2, 2013).

† The figures can add up to more than 100 percent if employees are offered optional participation in both defined-benefit and defined-contribution plans. "National Compensation Survey Custom Data Report," (U.S. Bureau of Labor Statistics), www.bls.gov/ncs (accessed Apr. 16, 2013).

Much, but not all, of the access disparity can be explained through the use of part-time employment, considering that part-time employees are less likely to have access to retirement benefits.* Private sector employers make greater use of part-time employment, with about 19 percent of jobs defined as less than 35 hours of work per week. This same figure is only 14 percent for state and local government jobs.⁴⁷ In many defined-benefit pension systems, all employees participate regardless of whether they work full time or part time.[†]

Retiree Health Insurance Coverage

In addition to annual pension payments, government retirement systems also typically provide health insurance coverage for retirees. The mechanism for funding these benefits is different from pension benefits. Instead of being prefunded, retiree health insurance tends to be funded on a pay-as-you-go basis.[‡] In other words, governments simply pay these bills as they come due. Retirement systems typically include an assessment on employee payroll to pay these insurance costs.

The Michigan Supreme Court has ruled that retiree health insurance benefits are not subject to the protections offered to pension benefits in the Michigan Constitution.⁴⁸ Government managers are not under any obligation to prefund or pay these benefits.[§] In addition, state courts have also ruled that these benefits cannot be paid by requiring current employee contributions.^{**} Effectively, these benefits can be cut at the discretion of government managers and state policymakers.

All workers and retirees — including government employees — over 65 are eligible for Medicare, an entitlement program that provides health insurance to the elderly in the United States.

* Nationally, 37 percent of part-time employees have access to retirement benefits, while 78 percent of full-time employees are offered these benefits. "Employee Benefits in the United States - March 2013," (U.S. Bureau of Labor Statistics, 2013), 6, <http://goo.gl/YNrFM> (accessed Oct. 3, 2013).

† While all employees are participants, part-time employees earn only a portion of a year's service. For instance, a full-year service credit in MPERS requires 1,020 hours worked in a year — less than half of the standard 2,080 hour full-time work year. If the employee worked less than 1,020 hours in a year, their service credit is pro-rated for that period. "How You Earn Service Credit," (Michigan Office of Retirement Services), <http://goo.gl/OaxCBj> (accessed Sept. 6, 2013).

‡ Because these benefits are not prefunded, they can become a challenging burden when the cost of the insurance coverage and the number of retirees increase faster than an employer's payroll, from which these benefits are generally funded. According to the Census Bureau, active members in Michigan's state and local government pension systems is down 126,960 members from 2002 to 2011, a 27.5 percent decline, while the number of retirees is up 104,095 members, a 42.7 percent increase. "Annual Survey of Public Pensions: State & Local Data," (U.S. Census Bureau, 2002), <http://goo.gl/KUoeD> (accessed May 14, 2013); "Annual Survey of Public Pensions: State & Local Data," (U.S. Census Bureau, 2011), <http://goo.gl/qnywS> (accessed May 14, 2013).

§ State policymakers have begun the attempt to prefund these benefits for public school and state employee plans. By prefunding these benefits, they are setting some money aside that is assumed to grow from investment gains, mitigating some of the demands of the present cost of future benefits. For example, see: "Michigan Public School Employees' Retiree Health Benefits: Annual Actuarial Valuation Report, September 30, 2011", (Gabriel Roeder Smith & Company, 2012), A-2.

** AFT Michigan v State, 297 Mich App 597 (2012).

Members and retirees in the state and school retirement system are provided health insurance benefits in retirement both before and after they become eligible for Medicare. These systems pay up to a maximum of 80 percent of the medical insurance premium for pre-Medicare coverage and up to 100 percent of post-Medicare coverage.⁴⁹

Medical care insurance premiums for pre-Medicare retirees in fiscal 2013 cost the state \$7,050 per member and double that if a spouse is included in the coverage. Total state costs for post-Medicare insurance premiums ranged from \$4,178 to \$16,211 per retiree in fiscal 2013, depending on family size and whether those covered are eligible for Medicare.⁵⁰

Local governments are free to offer whatever retiree health benefits they choose, subject to collective bargaining when employees are unionized.

Employer-sponsored health insurance benefits for retirees is rare in the private sector. Of the 24 major Michigan private sector employers surveyed in 2010, only three (13 percent) offered employer-subsidized insurance coverage for retirees.* A 2012 national survey of employers by the human resources consulting company Mercer found that only 24 percent of employers with more than 500 employees provide health insurance coverage to pre-Medicare retirees and just 17 percent provided coverage to post-Medicare retirees.⁵¹

Paid Leave

Employees typically receive some compensation for times when they are not working. This can take the form of sick leave, personal days or vacation. There is also paid leave for employees to recognize certain religious and national holidays. These benefits are offered commonly in both the private and public sectors, but the specifications are determined by employers, subject to collective bargaining when employees are unionized.

Whether an employee is offered such paid leave benefits is often highly contingent on whether he or she is a full- or part-time worker. As shown in Graphic 3, 87 percent of full-time employees nationwide (including both private sector and government workers) have access to paid vacation leave, while 88 percent are offered paid holiday leave. For part-time workers, though, these benefits are offered to only 34 percent and 38 percent of employees, respectively. Sick leave is available to 78 percent of full-time employees and only 26 percent of part-time employees.⁵²

* Some employers allowed former employees to continue insurance coverage in retirement, but required these retirees to pay for the full cost of the premium. Richard C. Dreyfuss, "Michigan's Public-Employee Retirement Benefits: Benchmarking and Managing Benefits and Costs," (Mackinac Center for Public Policy, Oct. 25, 2010), 12, <http://goo.gl/ukNPw> (accessed Oct. 1, 2013).

Graphic 3: Access to Paid Leave by Work Status, 2013

Work Status	Vacation	Holiday	Sick Leave
Full time	87%	88%	78%
Part time	34%	38%	26%

Source: Bureau of Labor Statistics.

State employees in Michigan receive 12 days of paid leave for holiday vacation on odd-numbered years and 13 on even-numbered years.⁵³ Some state government jobs need to be performed during holidays and employees receive extra pay for working on these days.⁵⁴

A unique benefit is given to teachers, professors and other employees whose schedules are determined by an academic calendar. The breaks between the end and start of school years is not treated as paid leave by employers, but rather as a regular employment term. Most salaried school employees may receive paychecks as normal compensation during this time off from work.

Supplemental Pay

Employees often receive pay in addition to their regular wage or salary, such as overtime pay, merit-based awards, bonuses, profit-sharing, stock options or other forms of compensation.

Some state government jobs in Michigan are eligible for overtime and other pay premiums. For instance, state police officers who work with explosives earn \$104 more in their biweekly paychecks.⁵⁵ In 2012, the state paid \$42,044 for this premium.⁵⁶ Other pay premiums are available for state employees, who, for example, work out-of-state or perform duties that are considered to be more dangerous.⁵⁷

The most common form of supplemental pay for government employees is overtime. Some employees are eligible for overtime and receive a “time-and-a-half” premium (a 50 percent higher pay rate) for any hours worked above and beyond 40 hours per week or for working on holidays.⁵⁸ The state paid \$35.3 million providing this benefit in fiscal 2012.⁵⁹

Local government units can offer supplemental pay benefits at their own discretion, subject to collective bargaining when employees are unionized.

Just as in the public sector, overtime and paid leave are common forms of supplemental pay in the private sector. But private sector employers are more likely to provide pay bonuses that are unrelated to an individual’s direct work, like profit-sharing and Christmas bonuses. Nationally, these “nonproduction bonuses” accounted for 51 cents per hour of average compensation in the private sector in 2012 compared to just 12 cents per hour in state and local governments.⁶⁰

Government-mandated Benefits

There are a series of mandatory employment benefits managed by government and applicable to nearly all employees, public and private. Entitlement programs like Social Security and Medicare are paid for by taxing employer payroll. Employers must set aside 6.2 percent of payroll to the federal government for Social Security and 1.45 percent for Medicare.*

Not all state and local governments in Michigan are covered by Social Security. Under section 218 of the Social Security Act, states can sign an agreement with the federal government to cover its state and local government employees and opt out of some of the requirements of this federal law.⁶¹ Unfortunately, it is difficult to determine how many government employees in Michigan do not participate in Social Security. Michigan's administrator of its section 218 agreement explains:

If a political entity does not offer a retirement plan that is at least equivalent to that of a [S]ocial [S]ecurity benefit, they may fall under mandatory [S]ocial [S]ecurity coverage and do not need a 218 agreement.

At this point we have 991 modifications to Michigan's 218 agreement; however some modifications cover hundreds of entities. It would take a substantial amount of time and research to estimate how many employees, and even then it may not be accurate ...⁶²

All employees receive unemployment insurance benefits, which provide temporary payments in the event of involuntary employment severance. However, there is a difference between how these benefits are paid for between state and local government entities, private nonprofits and for-profit private sector employers. For-profit private sector employers are required to make regular payments to a unemployment insurance fund while government entities and private nonprofits may be "reimbursing employers," only paying for unemployment insurance benefits as they are claimed.⁶³

Unemployment insurance is provided by both the state and federal government. The federal government charges employers 6 percent of wages per employee up to \$7,000.† Michigan's rates ranged from 0.06 percent of payroll to 10.3 percent of payroll in 2010, depending on the employer's experience and their use of the system.⁶⁴

Michigan state law requires all employers to provide workers' compensation insurance to all employees.⁶⁵ These benefits provide medical and short-term disability benefits to employees that are injured while at work. Unlike unemployment insurance, these benefits are administered by private insurers (large employers may self-insure) instead of through the state government.⁶⁶

* The Social Security payroll tax does not have to be paid on incomes above \$113,700. "Social Security and Medicare tax rates; maximum taxable earnings," (U.S. Social Security Administration, 2013), <http://goo.gl/e0Buz> (accessed Oct. 2, 2013). Also note that both rates doubled for self-employed persons.

† Employers can receive substantial credits against these payments if they promptly pay state unemployment insurance. "Unemployment Insurance Tax Topic," (U.S. Department of Labor, 2012), <http://goo.gl/YDtT9> (accessed July 9, 2013).

Benchmarking Public and Private Sector Benefits

This section describes the methodology used to compare the average amount of employment benefits provided to public sector and private sector employees in Michigan. Due to limitations in the availability of certain data, several assumptions were required.

With the exception of retirement benefits, benefit payments for Michigan's state employees were assumed to be representative of statewide averages for all government employees. For a large chunk of the state's government workforce, the CSC provides detailed pay and benefit information that this study relies upon, which includes paid leave payments, health insurance, legally required benefits* and other cash payments and services.⁶⁷

The public school retirement system — MPSERS — was used as the benchmark for average costs for retirement benefits in Michigan's public sector.[†] MPSERS' costs roughly track with those of the Municipal Employees' Retirement System of Michigan, another major government pension system, though at slightly lower rates. Although there are a number of different retirement plans that state and local government employees participate in (some of which are less and others more expensive than MPSERS), MPSERS and MERS cover the majority of these employees. MPSERS is the state's largest retirement system, thus considered to be an adequate approximation for the whole, even if it does not reflect the experience of each government employee.

To get an average annual payment for benefits in the public sector, the estimates for insurance, legally required benefits, paid leave and other cash payments for state employees were divided by the total number of full-time equivalent state employees.⁶⁸ This was added to the estimate of MPSERS per-employee payments made in 2012.⁶⁹

Costs for retiree health insurance were excluded from the calculation as these pay-as-you-go benefits are not included as part of an employee's regular compensation package. Further, government employers can reduce these benefits at their discretion, and they are not a legally binding obligation of governments.

Private sector estimates on the costs of employment benefits come from the East North Central region used in the Bureau of Labor Statistics' "Employer Costs for Employee Compensation" reports. This region is made up of Michigan, Ohio, Indiana, Illinois and Wisconsin. A Michigan-

* These include federally required payments for Social Security, Medicare and unemployment insurance. It does not include benefits required by state statutes for government employee retirement systems, such as retirement benefits for school employees.

† Using the state employee retirement system — MSERS — to estimate these average costs was also considered. MPSERS was chosen, however, because of the special status of the retirement benefits offered to state employees: the large expense and the attempt to prefund OPEB. The normal costs of retirement services were not used as the approximation for total costs because these amounts have been insufficient to ensure that the state's pension funds have enough assets to cover the benefits earned. It is possible to recalculate these costs under more conservative assumptions. However, this would be an estimate that would not guide current policy. Under current policy, the state will be paying off unfunded liabilities for the next 24 years, essentially a long-term cost.

only report is unavailable. These databases provide statistics on paid leave, supplemental pay, insurance, retirement and legally required benefits.*

The ECEC report provides the average private sector benefit costs on a per-hour basis. When annualizing was required, these figures were multiplied by 2,080, the typical number of work-hours in a full-time job (40 hours per week for 52 weeks).†

The annual difference between the public and private sector proxies was multiplied by the number of state and local government full-time employees in Michigan, as recorded by the U.S. Census Bureau.⁷⁰

Based on these calculations, the total benefits in state and local governments in Michigan exceeded those averages in the private sector by \$5.8 billion. In other words, government employers in Michigan could save a collective \$5.8 billion annually if they offered employment benefits that mirrored those provided on average by Michigan's private sector employers.

Graphic 4: Government Savings From Benchmarking Benefits by Type, 2012

Employment Benefit	Difference
Insurance	\$3,236,800,000
Retirement	\$1,463,700,000
Paid Leave	\$1,136,100,000
Supplemental Pay	-\$84,000,000
Total	\$5,752,600,000

* The ECEC data on retirement costs does not include retiree health care costs. For definitions and methodology of the private sector estimates, see www.bls.gov/ncs. Note that the calculation for public sector employment benefits also does not include retiree health care costs.

† According to the U.S. Census Bureau's Current Population Survey, the average work week for all workers in 2012 was 38.5 hours. The private sector uses a greater proportion of part-time workers: 19 percent of private sector jobs require less than 35 hours of work per week, compared to 14 percent for state and local government employees. "Table 19: Persons at work in agriculture and nonagricultural industries by hours of work," (U.S. Bureau of Labor Statistics, 2013), <http://goo.gl/Bhv9vy> (accessed Oct. 8, 2013); Senior Policy Analyst at The Heritage Foundation James Sherk, email correspondence with James Hohman using data from the Current Population Survey, April 24, 2013.

The largest difference between public and private sector employment benefits is in insurance benefits. If provided at average private sector rates, insurance benefits for state and local government employees would cost taxpayers \$3.24 billion less (see Graphic 4). Given public sector employers' tendency to use less part-time labor,⁷¹ purchase fewer consumer-driven health plans* and provide insurance coverage to a larger share of their employees,⁷² gaps between public and private sector insurance coverage ought not be surprising.

Since research suggests that the type of insurance coverage offered to employees has little to do with the health outcomes of recipients, insurance coverage offered employees is primarily a decision concerning cost management.⁷³ While there have been some reductions in public sector health insurance costs in Michigan, these costs still significantly exceed private sector averages. With no clear productivity gains from these increased expenses, government managers, policymakers and taxpayers should question the value of these added costs of government services.

The next largest difference is in retirement benefits. Taxpayers could save \$1.46 billion if state and local government employers provided retirement benefits that were similar to private sector averages. The greater incidence of defined-benefit plans with extraordinary unfunded liabilities and the use of retiree health insurance coverage carry these benefits well above the benefits in the private sector.

Paid leave also leaves a substantial mark in the difference with a \$1.14 billion difference between the public and private sector averages. As mentioned earlier (see "Paid Leave"), this does not include the unique time off offered to school employees. However, the cost of providing sick, holiday and vacation time does add to the difference.[†]

State and local government employees receive smaller supplemental pay benefits, however. If they were offered benefits at private sector averages, governments would need to spend \$84 million more on compensation such as overtime pay and bonuses. It is often remarked that private sector employees receive bonuses unavailable to public sector employees, and this finding supports that theory.

* Consumer-driven health plans give consumers a greater role in making decisions about the medical services they receive, thereby creating incentives to be more frugal health care shoppers. While the term can refer to various arrangements, it is most often applied to high-deductible insurance policies that may include contributions to a tax-deferred health savings account that can be used to cover the cost of services below the deductible. These plans tend to offer coverage at lower premiums. "Employer Health Benefits: 2013 Annual Survey," (The Henry J. Kaiser Family Foundation, Health Research & Educational Trust, 2013), Exhibit 5.3, <http://goo.gl/5466lu> (accessed Sept. 12, 2013).

† The cost of paid leave is based on average wages. Providing paid leave to higher-paid employees is more expensive than providing the same benefit to lower-paid ones. If state and local government employees in Michigan have higher average wages than those reported in the private sector, the cost for the same amount of paid leave would necessarily cost government employers more. In other words, even if the number of paid leave days used by private and public sector employees in Michigan is similar, the total costs of this benefit could still be higher in the public sector.

Testing the Assumptions

This analysis assumes that the ECEC East North Central region statistics are an appropriate proxy for the average cost of private sector benefits in Michigan. This assumption was tested using the Bureau of Economic Analysis report on “supplements to wages and salaries.” This report includes employers’ payments for retirement, insurance and legally required benefits, but does not include the value of paid leave or other supplement benefits that may be offered in the private sector.⁷⁴

Using these data to calculate the average level of benefits per employee suggests that the ECEC East North Central region statistics are an appropriate proxy for average private sector employment benefits in Michigan.* From 2005 to 2012, there was never more than a 3 percent difference between the average cost of benefits for private sector employees in Michigan and the average cost of benefits for private sector employees across the entire East North Central region.†

To check whether state government employee benefits are indicative of total state and local government employee benefits as a whole, state government health insurance costs were compared to school employee health insurance costs. Data from a survey of school district health insurance costs collected by the Mackinac Center in 2009 was used for this comparison.

This survey of every school district in the state found that the average full-family insurance premium purchased by public schools for all employee groups cost about \$15,460 in 2009. Since family health insurance premiums increased 22 percent from 2009 to 2013, using the average state employee health insurance costs as a proxy for all government workers seems reasonable (in fact, conservative), especially considering that the 186,000 FTE school employees make up the single largest chunk of government employees.⁷⁵

Finally, as stated above (see “Retirement Benefits”), the costs for MPSERS is roughly equivalent to MERS, suggesting that using average MPSERS’ costs is an appropriate approximation of retirement benefit costs of Michigan government employees.

* The calculation used total payments for supplements to wages and salaries for private sector employees in Michigan, Ohio, Indiana, Illinois and Wisconsin. These were divided by the average annual, non-seasonally adjusted payroll employment in those states, according to the Bureau of Labor Statistics’ Current Employment Statistics survey. “State and Metro Area Employment, Hours & Earnings,” (U.S. Bureau of Labor Statistics, 2013), <http://www.bls.gov/sae> (accessed July 9, 2013).

† Unfortunately, these proxies were only available at the aggregate level — data are not available to check the voracity of each individual benefit (insurance, retirement, etc.).

Implementing ‘Benefits in Balance’

Leveling the average public sector employment benefits to private sector averages is important for several reasons. Tax revenues are best used to provide valuable services to taxpayers, but the more governments spend on employment benefits, the fewer services they can provide. There is also the issue of fairness to taxpayers. It is difficult to justify a policy that both costs taxpayers more and provides them with fewer services. And finally a question of sustainability — perpetual increases in the costs of government coupled with reduced public services will eventually drive away taxpayers.

Benefits are only a portion of an employee’s compensation package, with the other portion being wages and salaries. Comparisons between public and private sector wages are slightly more difficult because wages are much more receptive to changes for market conditions, while benefits packages are much more likely to be offered to all or nearly all members of an employee group.

Still, some analyses explore differences in total compensation. A paper from Andrew Biggs and Jason Richwine, for example, found that public school teachers — the most common government employee — receive wages comparable to skilled workers in the private sector, but receive more generous benefits packages.⁷⁶

Regardless, fixing the increasing costs of government employment benefits is vital to containing the costs of government. As shown above, the average costs of wages increased only modestly while the cost of benefits have skyrocketed. And indeed, as policymakers address the costs of benefits, more money may be available to be provided by way of wages and salaries.

In theory, since most local government and school district officials are free to offer and negotiate for any level of employment benefits they see fit, leveling the benefits between public and private sector employees would not require significant changes to state policy. Public sector employers could simply start negotiating with unions and changing their employment terms, benchmarking the employment benefits they offer with private sector averages. This would go a long way toward achieving the \$5.8 billion savings identified above.

Despite this fact, the Legislature may need to take a more active approach in leveling the cost of benefits in Michigan’s public sector. After all, this wide disparity between public and private sector employment benefits in Michigan was largely created by local government officials; it is difficult to imagine these same officials suddenly reversing this trend all on their own.

The Legislature could use any of three methods to reduce the disparity between public and private sector benefits in Michigan: incentives, statutory mandates and constitutional requirements. These are discussed in the following sections.

Incentives

To a limited extent, state policymakers have already begun using incentive-based programs to encourage local government entities to reduce the cost of their employment benefits. Both the Economic Vitality Incentive Program for municipalities and other local governments and the Best Practices Incentive for K-12 public schools are examples of these.

The EVIP provides extra revenue-sharing payments to local municipalities that meet the state's requirements for accountability and transparency, consolidation of services and employee compensation.⁷⁷ The terms pertaining to employee compensation include the following:

- ♦ Capping retirement contributions (for both defined-benefit and defined-contribution plans) for new hires to 10 percent of base salary.*
- ♦ Using a pension formula that includes at least a three-year average salary, not more than 240 hours of paid leave and a multiplier that does not exceed 1.5 percent (or 2.25 percent if the employee is not offered other post-employment benefits, such as retiree health insurance coverage).†
- ♦ Requiring new employees to contribute at least 20 percent to the costs of their health insurance premiums, or that insurance costs are “competitive” with the main insurance plan offered to state government employees.‡

The Best Practices Incentive for K-12 public schools was used for the 2011-2012 school year to encourage local government officials to reduce the cost of the health insurance coverage they provide employees. School districts and charter public schools could earn an additional \$100 per pupil if they met four out of five “financial best practices,” one of which required employees to pay at least 10 percent of their health insurance premiums.⁷⁸

* If the employee is one of the employees in the state that do not participate in Social Security, then retirement contributions are capped at 16.2 percent. PA 200 of 2012 § 952(3)(c)(i)(A)

† An extra 0.75 percentage points are added to the multiplier if the employee is not part of social security or offered retiree health insurance benefits. PA 200 of 2012 § 952(3)(c)(i)(B)

‡ PA 200 of 2012 § 952(3)(c)(ii)(D). The state's current employer annual premium costs of its PPO plan range from \$5,060 to \$15,847, depending on the type of plan, bargaining unit and hiring date of the employee. Calculation based on rates listed in "Employee Benefits: Insurance Rates - Rates for 2012-2013," (Michigan Civil Service Commission, 2013), <http://goo.gl/vnGnM> (accessed Sept. 18, 2013). The local governments can also receive this portion of the EVIP if it certifies that it does not offer its employees any health insurance. PA 200 of 2012 § 952(3)(c)(ii)(B).

The Legislature could do more, however. Below are some ideas for lawmakers to consider along these lines:

- ♦ Create a “financial best practice” program that includes reducing employment benefit costs for community colleges, state universities and other subsidiary government units that do not participate in EVIP.
- ♦ Survey local government units for paid leave and supplemental pay policies to see whether incentive programs could work to reduce the cost of these benefits as well.

Statutory Mandates

The Legislature may need to use a heavier hand with regard to certain employment benefits offered to government employees and mandate certain levels via statute. This is especially the case when state law defines minimum retirement benefits for government employees, such as those for school employees. Reforming and benchmarking these benefits to private sector averages would require policy change at the state level.

An example of a statutory benefits mandate is the Publicly Funded Health Insurance Contribution Act of 2011.⁷⁹ It caps government-employer contributions for health insurance or mandates 20 percent health insurance premium-sharing for all government employees.⁸⁰ The act is optional for local governments with a two thirds vote of its governing board, but required for all public school districts.⁸¹

The Legislature should consider the following policies along these lines to move closer to parity between public and private sector employment benefit costs:

- ♦ Statutory reform to MPSERS and MSERS, the state’s largest retirement systems.⁸²
- ♦ Require community colleges, state universities and other local government entities currently not subject to the Publicly Funded Health Insurance Contribution Act of 2011 to comply with its mandates.
- ♦ Eliminate the option of local governments to comply with the Publicly Funded Health Insurance Contribution Act of 2011.
- ♦ Cap what local governments can provide by way of paid leave, retirement benefits and other employment benefits, similar to how the Publicly Funded Health Insurance Contribution Act of 2011 caps health insurance costs.
- ♦ Make a portion of state funding to local government entities contingent on meeting certain employment benefits benchmarks.

Constitutional Requirements

Even if the Legislature deployed a mixture of both incentives and mandates, it seems unlikely that these policies would be perfectly effective in the long term. It is more likely that the Legislature would have to continually re-evaluate these incentives and mandates, making the balance of benefits between Michigan's public and private sectors a constant issue. To alleviate some of this concern, the Legislature should consider policies that would work to actually prevent this imbalance from developing in the first place.

Perhaps the best way to achieve a more permanent balancing of public and private sector benefits would be through initiating a constitutional amendment.* The following are ideas for such amendments:

- ♦ Prohibit the total cost of benefits provided to employees at subsidiary government units from exceeding a certain private sector index.
- ♦ Prohibit the future use of defined-benefit pension systems at all levels of state and local government.†

The Savings

It is important to remember that the savings from these types of reforms will not accumulate all at once. For instance, even though the Publicly Funded Health Insurance Contribution Act began capping what can be spent on health insurance benefits, this law does not apply to government employers operating under a current collective bargaining agreement with their employees. Since these agreements cover multiple years (typically about three years), it will take several years for local government officials to begin realizing savings from this law. Similarly, savings from reforms to state-run pension systems would only accrue slowly over time.⁸³

Legislators can implement these policies to accrue savings to the state budget, local governments or to taxpayers. A substantial amount of state tax revenue is redirected to local governments in the form of state aid payment to schools, appropriations to colleges and universities, and revenue-sharing payments to local governments, so adjusting payments in conjunction with implementation can change the direct beneficiaries of implementing this policy.⁸⁴

One approach would be to allow these savings to accrue directly to the state and subsidiary governments, enabling them to use these savings to improve or expand the services they provide

* Michigan legislators can place something on the ballot, to be voted on in a statewide general election, with a two-thirds vote in the both the House and the Senate. Mich Const 1963, Article XII, Sec. 1-2.

† There may be some apparent conflict between this idea and Article IX, Sec. 24 of the Michigan Constitution, which protects the pension benefits earned by employees. An amendment could continue to pay down the state unfunded liabilities, but transition new employees to defined-contribution retirement systems benchmarked to private sector averages. This would have the added benefit of preventing retirement benefits from being underfunded.

taxpayers. Theoretically then, taxpayers could be provided with \$5.8 billion worth of more state and local government services.

The state could make use of these savings in other ways, too. By adjusting the level of payments made to subsidiary governments, legislators could obtain some of these savings at the state level. This would allow state government to improve and expand some of its services, such as its transportation infrastructure.

The Legislature could also allow some of this \$5.8 billion in savings to accrue to taxpayers. If policymakers were to reduce overall spending, at both the local and state levels, in response to balancing public sector employment benefits to private sector averages, taxes on private individuals could be reduced proportionately — without loss in quality or quantity of government services.

Finally, these options are not mutually exclusive — the state could actually produce all three. In other words, Legislators could use the \$5.8 billion in savings to expand local government services, improve state government services and simultaneously put money back into taxpayers' pockets.

Conclusion

Average public sector employment benefits have been out of line with private sector averages for a while.⁸⁵ These disparities exist at all levels of government in Michigan. Considering as many employment benefits for which data are available — insurance coverage, retirement benefits, paid leave and supplemental pay — there is an estimated \$5.8 billion gap between what public sector employers pay for employment benefits on average compared to what private sector employers pay on average. This gap, if left unaddressed, will continue to divert taxpayer resources from their primary purpose — provision of government services — and contribute to the ongoing government cost spiral in Michigan.

About the Author

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