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Comparing Retirement Benefits Provided by Private Firms and State and Local Governments

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Comparing public- and private-sector retirement benefits is becoming a national pastime. Attention to these comparisons is apt to grow as competition for state and local government dollars intensifies and taxpayer scrutiny deepens. This growing interest is evidenced by recent newspaper and magazine articles. As the nation's demographics change to include a more mobile workforce and as baby boomers age, pension issues will grow in importance. National policy discussions already abound concerning the adequacy of pension plan funding, investment of pension plan assets, and the floundering national savings rate.

State and local governments now hold one-quarter of total pension assets, or 51.1 trillion in trust for 13 million public employees. These governments are accountable to the taxpayers for prudently managing these systems and setting employee benefit levels. Balancing the goals of providing and securing adequate retirement benefits within boundaries acceptable to taxpayers is a constant challenge to public entities. To meet these objectives, it is important to understand public-sector benefit policies and the design differences between public- and private-sector plans.

Governments at all levels are exploring new pension policies. The federal government is looking at expanding individual retirement accounts. Many state and local governments are exploring alternatives to defined benefit plans. Regardless of the changes that are bound to occur, fair treatment of employees and taxpayers must be the overriding policy objectives.

This research bulletin provides public-sector officials and other interested parties with a basis for meaningful comparative analysis based on recent research conducted by the Bureau of Labor Statistics, the Wyatt Company, and other pension professionals.¹ It begins with a discussion of retirement benefit coverage and the different plan provisions used to provide retirement benefits in the public and private sectors. It then turns to a discussion of the differences in replacement ratios (i.e., the percent of preretirement earnings replaced by retirement income) between the sectors and examines the impact of inflation on the replacement ratios. The paper concludes with a discussion of the costs of retirement benefits, both to employers and employees.²

Retirement Benefits

Comparisons of retirement benefits in the public and private sectors must examine all mechanisms through which the benefits are offered, including defined benefit plans, defined contribution plans, and Social Security. Since public- and private-sector employers provide retirement benefits using substantially different mixes of these mechanisms, examining any single mechanism in isolation will skew the comparison.

Nearly all public- and private-sector employees are covered under at least one of these mechanisms, the majority are covered by at least two, and some (mostly in the private sector) are covered by all three. As shown in Exhibit 1, 90 percent of full-time state and local government employees are covered by defined benefit plans, 75 percent are covered by Social Security, and 9 percent are covered by defined contribution plans. In the private sector, 63 percent are covered by defined benefit plans, 36 percent are covered by defined contribution plans, and all are covered by Social Security.

Defined Benefit Plans

In addition to differences in employee coverage under defined benefit plans in the public and private sectors, there are also differences in the formulas used to determine benefits under the plans. For example, the fixed percent of an employee's salary (i.e., the benefit factor) differs between the public and private sectors.³ As shown in Exhibit 1, the average benefit factor was 1.83 percent for full-time state and local government employees covered by Social Security, compared with about 1.5 percent for full-time private-sector employees.⁴

The methods used to determine the earnings base for calculating retirement benefits also differ between the public-and private-sector plans. For full-time private-sector employees covered by defined benefit plans, Exhibit 1 shows that 65 percent are covered by plans that use "terminal" earnings (i.e., average earnings during the three or five years before retirement), 11 percent are covered by plans that use "career earnings" (i.e., earnings over the full period of employment), and the remaining 25 percent are covered by plans that use a "dollar amount" formula (i.e., a formula that specifies a fixed dollar amount to be paid during retirement for each month of service.) Public-sector defined benefit plans, on the other hand, use terminal earnings formulas almost exclusively.

Key Findings

- About 90 percent of full-time state and local government employees are covered by defined benefit plans, 75 percent are covered by Social Security, and 9 percent are covered by defined contribution plans. For comparable private-sector employees in medium and large firms, 63 percent are covered by defined benefit plans, 36 percent are covered by defined contribution plans, and all are covered by Social Security.
- While state and local defined benefit plans appear to have more generous provisions than their private-sector counterparts, the additional retirement income provided by private-sector defined contribution plans, coupled with greater Social Security coverage in the private sector, tends to offset this difference.
- Only 4 percent of private-sector employees contribute to their defined benefit plans, compared with 75 percent of state and local employees. Moreover state and local employee contributions are substantial, typically between 5 and 7 percent of pay.
- Two-thirds of full-time state and local government employees were in defined benefit plans that offered a post-retirement cost-of-living adjustment within the last five years, compared with only 28 percent of their private-sector counterparts.
- There is essentially no difference in total compensation for similar work in the public and private sectors, and apparent differences are the result of the different mix of skills used in the two sectors. Total compensation in the public and private sectors grew at almost exactly the same rate between 1989 and 1994.
- Bureau of Labor Statistics data indicate that state and local government employers pay an average 12.4 percent of total compensation for retirement benefits versus 8.9 percent in the private sector. This 3.5 percent difference matches the percent of additional wages, salaries, and supplemental pay paid to private-sector employees. A 1992 Chamber of Commerce survey, however, suggests that retirement costs may be nearly as expensive for comparable private-sector employers.

Social Security

Social Security plays a major role in providing retirement benefits to most workers in the United States. Social Security coverage for employees in the private sector is required and almost universal. In the early years of Social Security, however, state and local governments could choose to exempt their employees from coverage, and many did.⁵ Exhibit 1 shows that approximately 25 percent of state and local government employees are not covered by Social Security.

Social Security coverage affects pension benefits in several ways. According to William Wiatrowski, an economist at the Bureau of Labor Statistics, the formulas for calculating benefits from, and required contributions to, defined benefit plans differ depending on whether the workers have Social Security coverage. Wiatrowski reports that the average benefit factor for state and local government workers covered by Social Security was 1.83 percent, compared with 2.18 percent for those not covered by Social Security. In addition, state and local government employees with Social Security coverage made smaller contributions (5.11 percent of earnings) than their noncovered counterparts (7.55 percent).

This suggests that state and local governments whose workers are not covered by Social Security typically provide a higher level of defined benefit to compensate partially for the retirement

benefit not provided by Social Security. Since both the employer and employees are not contributing to Social Security, both have additional funds to enhance the defined benefit package. It also should be noted that many police and firefighters are not covered by Social Security. Given the unique nature of their jobs, these employees typically have shorter benefit accumulation periods, and consequently somewhat higher benefit factors.

Another way in which Social Security affects pension benefits is through “plan integration.” Under plan integration, defined benefit plans are allowed to explicitly adjust benefits to take Social Security into account. For example, under one form of plan integration, a lower rate (e.g., 1.0 percent) is applied to employee earnings under a set integration level (e.g., \$25,000) and a higher rate (e.g., 1.5 percent) is applied to earnings over that level. This typically results in lower benefits for employees covered by plans with such integration features.⁶ The fact that Social Security integration is common in the private sector and rare among state and local governments may partially explain the differences in the average benefit factors between public- and private-sector plans.⁷ (See Exhibit 1.)

Exhibit 1 Benefit Provisions in Public- and Private-Sector Retirement Plans		
	Public Employers (1990)	Private Employers (1989)
Number of full-time employees (mil.)	12.9	40.5
Percent of FT employees covered by:		
Defined benefit plans	90%	63%
Social Security	75	100
Defined contribution plans	9	36
Average benefit factor (% of earnings)—all	1.9	1.5
Covered under Social Security	1.83	1.5
Not covered under Social Security	2.18	NA
Methods used to determine earnings base*		
Terminal earnings - final year	x	0
Terminal earnings - 3 years	69	10
Terminal earnings - 5 years	19	52
Terminal earnings - other period	12	3
Career earnings formula	x	11
Dollar amount formula and other	x	25
Percent of employees in plans integrated with Social Security*	8	63
Postretirement cost-of-living adjustments*		
In plans offering COLA		
during previous 5 years	66	28
Automatic COLA	50	6
Ad hoc COLA	16	22
Employee contributions*		
Plan costs wholly paid by employer	25	96
Plan costs partially paid by employer	75	4

Public refers to state and local governments; private refers to medium and large private firms. Numbers may not sum to 100 due to rounding.
* Percent of active participants in defined benefit plans.
x The value is less than 0.5%.

Sources: U.S. Bureau of Labor Statistics. *Employee Benefits in State and Local Governments*, 1990. U.S. Bureau of Labor Statistics. *Employee Benefits in Medium and Large Firms*, 1989. Wislowski. "On the disparity between private and public pensions." *Monthly Labor Review*, April 1994.

Defined Contribution Plans

Defined contribution plans also provide retirement income. Although there are several types of defined contribution plans, they typically provide benefits based on amounts contributed to the plan by employers and employees. Such a plan might require the employer and employee to place 3 percent of the employee’s salary in an account at the end of each pay period, and the

accumulated contributions, plus interest earned, would constitute the source of the employee's benefits from that plan. Often, the employee directs the investment of the account by choosing from a menu of investment alternatives selected by the employer. Unlike defined benefit plans, however, employers are not liable for amounts other than their annual contribution, even if the funds available at retirement are not sufficient to provide an adequate retirement income.

Defined contribution plans are a relatively new development, with most of the growth occurring after 1970. Interest in defined contribution plans, however, seems limited largely to the private sector. As shown in Exhibit 1, 36 percent of private-sector employees are covered under defined contribution plans, compared with only 9 percent in the public sector.⁸ Benefit specialists at the Wyatt Company suggest that the difference may be partly due to federal regulations which prohibit state and local governments from offering new 401(k) plans and treating 457 plans as nonqualified plans under the Internal Revenue Code.⁹ In addition, public-sector employers may have more difficulty changing their retirement plans since many states have laws prohibiting changes in retirement benefits for active and retired employees.

Replacement Ratios

Replacement ratios (i.e., the percent of preretirement earnings replaced by sources of retirement income) are a key concept in the discussion of retirement benefits. Recently, the American Society of Pension Actuaries' (ASPA) National Retirement Income Policy Committee addressed the issue of determining appropriate replacement ratios in a publication on national retirement income policy. In its discussion, the committee argued that retirement policy should ensure that the income from all sources throughout retirement provides the same standard of living as that enjoyed in the later years of full-time employment.¹⁰

In presenting its views, the committee explained that, because of changes in the tax status of retirees and reductions in business-related expenses after retirement, appropriate replacement ratios will be less than 100 percent. The committee went on to recommend replacement ratios ranging from 85 percent for individuals with preretirement earnings of \$20,000 or less to 73 percent for individuals with earnings of \$100,000 or more.¹¹

The presentation of appropriate replacement ratios is offered to provide a frame of reference for the following discussion rather than to advocate specific ratios as such. Ultimately, agreement over appropriate replacement ratios is decided in the labor markets when employees accept the conditions of employment. Nevertheless, it is useful to have benchmarks against which to measure the retirement benefits currently provided by private- and public-sector employers.

As part of its research, the Bureau of Labor Statistics (BLS) periodically examines the replacement ratios provided by public- and private-sector retirement plans. Selected data from these studies are reported at the top of Exhibit 2, which shows that retirement income from defined benefit plans replaces about 52 percent of earnings for public-sector employees covered by Social Security, 60 percent of earnings for public-sector employees not covered by Social Security, and 31 percent of earnings for employees of medium and large private firms. When Social Security benefits are added to benefits from the defined benefit plans, the combined replacement ratios increase for public-sector employees covered by Social Security and for employees of medium and large firms.

These ratios do not tell the whole story, however. As was emphasized at the beginning of this bulletin, all sources of retirement income must be examined when making comparisons between retirement benefits offered by private- and public-sector plans. Given that the BLS data do not include replacement income from defined contribution plans, they do not provide a complete picture of the replacement ratios provided to public- and private-sector retirees.

Retirement income from defined contribution plans was included in a recent study by the Wyatt Company comparing a sample of five state retirement plans to a database of medium and large private-sector plans.¹² Selected results from this study are presented in the middle of Exhibit 2. The study found that while the state employee retirement plans had more generous defined benefit provisions than the private plans, total retirement income under the state employee retirement plans was less than that under the private plans. The difference between the two was entirely a function of additional retirement income resulting from defined contribution plans. It should be noted that many of the larger private-sector employers offer both defined benefit and defined contribution plans.¹³

The Wyatt study is one of the few recent studies that compares replacement ratios from all sources of retirement income (i.e., Social Security, defined benefit plans, and defined contribution

plans). The state systems used in the comparison, however, reflect somewhat lower state and local retirement benefits than are reported by the BLS. When BLS numbers are substituted in the analysis, the replacement ratios increase, but the relative ranking of replacement ratios between the public and private sectors remains the same, as shown at the bottom of Exhibit 2.¹⁴

Exhibit 2			
Replacement Ratios Provided by Public- and Private-Sector Plans			
	Public Employees w/ Soc. Sec.	Public Employees w/o Soc. Sec.	Private Employees
Bureau of Labor Statistics Data			
Retirement at age 65			
Defined benefit plan only			
\$20,000 w/30 years of service	51.9%	60.0%	31.3%
\$35,000 w/30 years of service	52.1	59.8	29.4
\$55,000 w/30 years of service	52.3	59.8	29.8
Defined benefit plan + Social Security			
\$20,000 w/30 years of service	94.0	60.0	72.3
\$35,000 w/30 years of service	83.4	59.8	59.0
\$55,000 w/30 years of service	73.2	59.8	49.4
Wyatt Study Data*			
New employee, retirement at age 65 earning \$35,000 w/20 years of service			
Social Security	28.0%	NA	28.0%
Defined benefit	29.0	NA	22.0
Defined contribution	0.0	NA	18.0
Total	57.0	NA	68.0
Earning \$35,000 w/30 years of service			
Social Security	25.0	NA	25.0
Defined benefit	46.0	NA	32.0
Defined contribution	0.0	NA	30.0
Total	71.0	NA	87.0
Wiatrowski Study Data			
Retirement at age 65, earning \$35,000 w/30 years of service			
Social Security	32.1%	0.0%	32.1%
Defined benefit	54.9	65.4	32.1
Defined contribution**	0.0	0.0	30.0
Total	87.0	65.4	94.3
Public refers to state and local governments; private refers to medium and large private firms.			
* State data for Wyatt study obtained from five large state retirement systems. Defined contribution plan replacement ratios calculated assuming employees contribute 3.5% of pay; employers provide a two-thirds match; salary increases annually at 6%; investment return is 8% per year; and that the account is converted to an 8% annuity.			
** Defined contribution data added from Wyatt study by author.			
Sources: U.S. Bureau of Labor Statistics. <i>Employee Benefits in State and Local Governments</i> , 1990. U.S. Bureau of Labor Statistics. <i>Employee Benefits in Medium and Large Firms</i> , 1989. The Wyatt Company. "Government Employee Retirement Plans: How Do They COMPARE?" <i>COMPARISON</i> , November 1992. Wiatrowski. "On the disparity between private and public pensions." <i>Monthly Labor Review</i> , April 1994.			

Inflation and Cost-of-Living Adjustments

Inflation is a fact of life. Although less troubling in the early 1990s than it has been in other decades, inflation, even at low rates, results in substantial losses of purchasing power when continued over decades. In its discussion of national retirement income policy, the ASPA's National Retirement Income Policy Committee argued that retirement income should be inflation-adjusted to provide the same standard of living throughout retirement.¹⁵

To compensate for the effect of inflation, some employers provide cost-of-living adjustments (COLAS) to retirees. These adjustments can be provided in a number of ways, from automatic increases that are fully indexed for inflation to ad hoc increases that are provided at the discretion of the employer. Social Security benefits and the benefits of many state and local defined benefit

plans offer COLAS to retirees. Such COLAS are much less prevalent among private-sector defined benefit plans.

Exhibit 1 shows that 66 percent of full-time state and local government employees with defined benefit plan coverage were in plans offering COLAS to retirees at least once during the prior five years. Fifty percent were in plans providing automatic increases, and 16 percent were in plans providing ad hoc increases. Automatic increases were typically based upon the Consumer Price Index and subject to a maximum level (usually about 3 percent). In the private sector, 28 percent of full-time employees in medium and large firms were in plans providing COLAS to retirees at least once during the prior five years. Most of these plans provided ad hoc increases.

Exhibit 3
Impact of Inflation on Replacement Ratios in Public and Private Plans

Replacement rates for newly hired employee who will retire at age 65 with \$35,000 after 30 years

	Public Employees w/ Soc. Sec.	Private Employees
At Retirement		
Social Security	25.0%	25.0%
Defined benefit	46.0	32.0
Defined contribution	0.0	30.0
Total	71.0	87.0
10 years after retirement*		
Social Security	25.0	25.0
Defined benefit	38.0	24.0
Defined contribution	0.0	20.0
Total	63.0	69.0
20 years after retirement*		
Social Security	25.0	25.0
Defined benefit	31.0	18.0
Defined contribution	0.0	14.0
Total	56.0	57.0
% reduction after 10 years**		
Social Security	0.0	0.0
Defined benefit	17.4	25.0
Defined contribution	NA	33.3
Total	11.3	20.7
% reduction after 20 years**		
Social Security	0.0	0.0
Defined benefit	32.6	43.8
Defined contribution	NA	53.3
Total	21.1	34.5

Public refers to state and local governments; private refers to medium and large private firms.
 * Assuming 4 percent annual inflation
 ** Author's calculations based on Wyatt data.

Source: The Wyatt Company. "Government Employee Retirement Plans: How Do They COMPARE?" COMPARISON, November 1992.

The Wyatt Company examined the impact of inflation on retirement income 10 and 20 years after retirement and found that inflation has a greater impact on private-sector benefits than on the benefits of state and local government retirees. Selected results from this study are shown in Exhibit 3. Overall, the Wyatt study shows the purchasing power of public-sector retirees falling 21 percent over 20 years, compared with a 34 percent decline for private-sector retirees.

The Wiatrowski study supports this finding and indicates that, because of the COLAS, public-sector employees' retirement income is better able to keep pace with inflation. For private-sector workers, however, the purchasing power of their retirement income declines because their employer pension payment remains essentially unchanged.¹⁶ This may make them more dependent on federal entitlement programs as they grow older.

Retirement Benefit Costs

In the same way that employees have a right to expect their retirement plans will provide adequate retirement income, employers have a right to make choices that allow them to provide the benefits in cost-effective ways. In the private sector, managers must answer to stockholders who will withdraw capital from inefficient firms. In the public sector, administrators must answer to public officials who ultimately answer to the taxpayers.

Total Compensation Costs

Although this bulletin focuses on the costs that retirement benefits impose on employers and employees, it would be good to step back and examine retirement benefits in the context of the total compensation. This provides a better perspective on the trade-offs made in the private and public sectors.

At first glance, total compensation costs between state and local governments and private industry appear vastly different. In a comparative study of total compensation costs, BLS economists Bradley R. Braden and Stephanie L. Hyland reported that in March 1992, employee compensation costs (wages plus employer-provided benefits) averaged \$23.49 per hour worked in state and local governments and \$16.14 in private industry – a difference of almost 50 percent.¹⁷

In presenting this information, however, the authors warn that comparisons based on this aggregate data are misleading and that the differences in compensation costs between the public and private sectors are largely the result of the variation in work activities and occupational structures of the two sectors. To quote the authors:

“Certain activities that are required in government, such as public education and safety, call for a large proportion of white-collar professionals and highly skilled service occupations. In contrast, certain industries, such as manufacturing, wholesale trade, and retail trade, are unique to the private sector and require occupations with comparatively lower compensation costs, such as sales. When certain industries common to both sectors are examined, such as health services, total compensation costs are similar.”¹⁸

The authors support their argument with comparisons of compensation costs for similar activities in the public and private sectors. For example, as shown in Exhibit 4, executive, administrative, and managerial occupations (which account for about one in six white-collar employees in each sector) had average hourly compensation costs that were virtually identical. In addition, compensation costs were similar for administrative support, construction, transportation and public utilities, and health services employees when compared across both sectors.

It is also interesting to note that the total compensation has grown at about the same rate in both the public and private sectors. The middle section of Exhibit 4 shows that for the five-year period between June 1989 and June 1994, total compensation grew 21.4 percent for state and local government employees, compared with 22.0 percent in the private sector.

Employer Cost of Retirement Benefits

In their study of total compensation costs, Braden and Hyland also present data showing the components of compensation, including wages and salaries, supplemental pay (i.e., overtime, shift differentials, etc.), paid leave, insurance (i.e., life and health insurance), retirement and savings (i.e., defined benefit and defined contribution plans), Social Security, and other forms of

compensation. The bottom section of Exhibit 4 presents these costs as a percentage of total compensation and shows that the average costs of retirement benefits (i.e., retirement, savings, and Social Security) amount to 12.4 percent of total compensation for state and local government employers, compared with 8.9 percent for private firms. Thus, when viewed in terms of total compensation, state and local governments appear to spend 3.5 percent more on retirement benefits than do private-sector employers.

Exhibit 4		
Employer Costs of Compensation in the Public and Private Sectors		
	Public Employers	Private Employers
Total compensation (\$/hour worked)		
All workers	\$23.49	\$16.14
By occupational group		
Executive, administrative & managerial	29.86	29.42
Administrative support & clerical	15.03	13.69
By industry division		
Construction	16.89	18.91
Transportation and utilities	22.95	22.91
Health services	18.42	16.77
Growth of total compensation (% change from June 1989 to June 1994)		
All workers	21.4%	22.0%
By occupational group		
Executive, administrative & managerial	23.4	21.3
Administrative support & clerical	23.3	23.5
By industry division		
Construction	NA	20.2
Transportation and utilities	NA	19.8
Health services	25.2	27.1
Components of compensation* (as a % of total compensation)		
Wages & salaries	69.8%	71.8%
Supplemental pay	0.9	2.4
Paid leave	7.7	6.8
Insurance	7.8	6.9
Retirement & savings	7.8	2.9
Social Security	4.6	6.0
Other	1.4	3.2
Detail: retirement, savings and Social Security	12.4	8.9
Detail: wages, salaries and supplemental pay	70.7	74.2
Public refers to state and local governments; private refers to private firms. * Author's calculations from Braden and Hyland data.		
Sources: Braden and Hyland. "Cost of Employee Compensation in Public and Private Sectors." <i>Monthly Labor Review</i> , May 1993. U.S. Bureau of Labor Statistics. News, Employment Cost Index—September, 1994.		

Interestingly, private-sector employees receive 74.2 percent of total compensation in the form of wages, salaries, and supplemental pay, compared with 70.7 percent for state and local government employees. Consequently, the 3.5 percent differential between retirement costs in the public and private sectors could reflect employer and employee trade-offs between current pay and future benefits.

It should be noted, however, that the BLS cost data are not strictly comparable between public- and private-sector employers, since the private-sector database includes a larger percent of employers that do not offer retirement plans. Consequently, among private-sector employers that offer retirement plans, the average cost of these plans may be considerably higher. This is supported by a 1992 Chamber of Commerce survey, which shows that the cost of retirement benefits averaged 16.6 percent of payroll (11.8 percent of total compensation) for companies paying these benefits.¹⁹

Exhibit 5 Employee Contributions for Retirement Benefits in the Public and Private Sectors			
	Public Employees w/ Soc. Sec.	Public Employees w/o Soc. Sec.	Private Employees
Average employee contributions (as a % of pay)			
Social Security	6.2%	0.0%	6.2%
Defined benefit plan	5.1	7.6	0.0
Total	11.3	7.6	6.2

Public refers to state and local governments; private refers to medium and large private firms.
Source: Wiatrowski. "On the disparity between private and public pensions." *Monthly Labor Review*, April 1994.

Employee Costs of Retirement Benefits

The above comparison of retirement plan benefits and employer costs fails to include employee contributions. Exhibit 1 shows that only 4 percent of private-sector workers are required to contribute toward the cost of their defined benefit pension, compared with 75 percent of state and local government employees.²⁰

As shown in Exhibit 5, state and local employee contributions are substantial, averaging about 5.1 percent of earnings in 1990 for employees covered by Social Security and 7.6 percent for those not covered by Social Security. Furthermore, when contributions for Social Security are added to contributions for defined benefits, employee contributions amounted to 11.3 percent for state and local employees covered by Social Security, 7.6 percent for state and local employees not covered by Social Security, and 6.2 percent for employees of medium and large private firms (all of which was for Social Security).

As a general principle, it is not unreasonable to expect that employees who contribute more toward their retirement benefits will receive a greater benefit than those who do not contribute. In studying this question, Wiatrowski found that, among state and local government employees, this was the case. Employees who contributed between 0.1 percent and 4.0 percent of earnings received benefits averaging 1.70 percent of terminal earnings multiplied by years of service; those who contributed 4.01 percent to 6.0 percent received benefit factors averaging 1.83 percent; and those who contributed 6.01 percent to 8.0 percent received benefit factors averaging 2.13 percent.

For More Information

*Additional information about public employee retirement systems may be obtained from the Public Pension Coordinating Council's **Survey of State and Local Government Employee Retirement Systems** and the PENDAT database, which contain detailed information about the administration, investments, benefits, actuarial assumptions, and funded status of approximately 300 state and local retirement systems. Both the survey report and the database may be purchased from the Government Finance Officers Association, 180 N. Michigan Avenue, Suite 800, Chicago, IL 60601 (312)977.9700.*

The Public Pension Coordinating Council was formed in 1990 to assist the public employee retirement community. The council is composed of representatives from four national associations whose members are directly involved in the administration of public employee retirement systems: the Government Finance Officers Association, the National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and the National Council on Teacher Retirement. In addition to its survey of public employee retirement systems, the council sponsors the Public Pension Principles Achievement

Award program, designed to promote high professional standards for public employee retirement systems and to publicly commend systems that adhere to those standards.

End Notes

1. Throughout the analysis, comparisons are made between retirement benefits offered to employees of state and local governments and benefits offered to employees of medium and large firms (i.e., firms with 100 or more employees). Given that the majority of public-sector employees work for governments with more than 100 employees, such comparisons are appropriate.
2. The variety and complexity of retirement plan provisions makes it impossible to compare public and private-sector benefits without substantial simplification. Consequently, while the summary statistics presented in this paper are believed to reflect key differences between public- and private-sector retirement plans, they do not (and cannot) fully capture all of the differences between the two sectors.
3. Defined benefit plans typically provide retirement benefits through formulas based on a fixed percent (or “factor”) of the employee’s final earnings multiplied by years of service. Such a formula might specify that an employee would receive 1.75 percent of the average earnings received during the last five years of employment, multiplied by the number of years of employment. Under this formula, an employee who retired after 30 years of service with average earnings of \$35,030 during the five years before retirement would receive \$18,375 annually from the defined benefit plan (i.e., 1.75 percent x 30 years x \$35,000) or 52.5 percent of his or her final average earnings. This simplified example does not include adjustments resulting from early retirement or the selection of joint and survivor retirement options.
4. Although the average benefit factor was 1.90 percent for all full-time state and local government employees, its use in this context would be misleading since it includes state and local plans that do not contribute to Social Security. The next section discusses Social Security coverage in more detail.
5. In 1986, amendments to Social Security required state and local government employees hired on or after April 1, 1986, to participate in Medicare. In 1991, further changes required all state and local government workers not covered by employer pension arrangements to participate in Social Security for services performed after July 1, 1991.
6. William J. Wiatrowski. “On the disparity between private and public pensions.” *Monthly Labor Review*, April 1994, p. 5.
7. One reason public retirement plans rarely integrate with Social Security may be that most public plans require employee contributions.
8. Many different types of defined contribution plans are offered, including money purchase plans, savings and thrift plans, profits sharing plans, and stock-ownership plans. While all are offered in the private sector, public sector defined contribution plans are generally money-purchase plans.
9. The Wyatt Company. “Government Employee Retirement Plans: How Do They Compare?” *Comparison*, November 1992, p. 24.
10. National Retirement Income Policy Committee. *National Retirement Income Policy Research Papers*. Arlington, VA: American Society of Pension Actuaries, 1994, p. 3.
11. National Retirement Income Policy Committee, p.15. In presenting its findings, the committee noted that replacement ratios will be affected by marginal tax rates and any changes thereof. Therefore, they recommend the standardization of a methodology for calculating adequate replacement ratios, rather than fixing the ratios themselves.
12. The Wyatt Company. “Government Employee Retirement Plans: How Do They Compare?” *Comparison*, November 1992, p. 23. The 1991 Wyatt database included information on 828 employers with more than 11.2 million employees. The average employer had approximately 13,500 employees; the median employer had 2,800 employees. The five state plans included in the study were California, Florida, Illinois, New York, and Texas.
13. The Wyatt Company. *1993 Statistical Supplement*, Washington, DC, 1994. This survey shows that of 656 large private-sector employers, 70 percent offered both defined benefit and defined contribution plans, 6 percent offered only defined benefit plans, and 24 percent offered only defined contribution plans.
14. The replacement income provided by payments from a defined contribution plan are a function of investment income and subject to uncertainty. Consequently, the retirement income derived from defined contribution plans will depend on future investment markets and may be substantially less than predicted.
15. National Retirement Income Policy Committee, p. 3.

16. Wiatrowski, p. 7.
17. Bradley R. Braden and Stephanie L. Hyland. "Cost of employee compensation in public and private sectors." *Monthly Labor Review*. May 1993. p. 14.
18. Braden and Hyland, p. 14.