



July 2005

REPORT
On Universal Social Security Coverage of State and Local Worker
to
The American Federation of State County and Municipal Employees
The Coalition to Preserve Retirement Security

The purpose of this report is to assess the initial five-year cost of universal Social Security participation to state and local governments and their new employees. It estimates the employer and employee cost of Social Security coverage for newly hired workers for the first five years of coverage will reach \$44 billion. This increased cost in payroll taxes will be felt in every state.

It is estimated that over the first five-year period the cumulative number of nonparticipating state and local workers will grow to 6.6 million. This number is based on 2001 data provided by the Social Security Administration (SSA)¹. To determine the potential number of new hires a 9 percent annual turnover rate was used to determine the level of hires in each of the five years. An annual cost was then calculated using the Social Security Tax Rates and a cumulative cost of \$44 billion for public employers and their new employees was determined for the five-year period. Table 1 provides a state-by-state cost estimate.

An earlier estimate, done in 1999, resulted in a five-year estimate of \$26 billion². The key drivers of the increased cost are growth in the total number of uncovered of nearly 38 percent or 1.8 million and the rise in estimated average pay for new hires. It should be noted that SSA estimates the number of uncovered using a sampling technique, which may not reflect actual numbers. However, this is the single most reliable source for this data. The increase in the number of new hires may be attributed more to SSA's enhanced reporting efforts than to an overall increase in the state and local government workforce which has remained relatively stable at around the 14 million mark. Clearly, however, like other employers, the public sector will be replacing an ever increasing number of workers as the baby boomer generation moves into retirement. This demographic shift would further exacerbate the cost of mandatory coverage to states and localities.

¹ Social Security Administration, Continuous Work History Sample, 1 percent sample, Table 1-8—Estimated Social Security Coverage of Workers with State and Local Government Employment, 2001.

² The Segal Company, The Cost Impact of Mandating Social Security for State and Local Government, May 1999

What impact will mandatory coverage have on existing public retirement plans and public workers?

- ◆ ***Mandatory coverage will cost states, localities and public workers \$44 billion in the first five years to buy only a short-term extension of Social Security solvency.*** It must be recognized that this short-term cash injection results in long-term liabilities to the Social Security system. Moreover, this mandate will disrupt the current funding and benefit structure of existing public employee retirement plans as employers and employees adjust to paying the Social Security contribution. It should be noted that many of these plans were established either prior to Social Security or during the period after its establishment when states and localities were prohibited from participation.
- ◆ ***Mandatory coverage will raise the cost of maintaining current benefit levels.*** Shifting contributions to Social Security and away from current programs could leave public plans with significant underfunding problems. Underfunding is estimated to average 7.5 percent of payroll³. This would happen, for the most part, because public plans have prefunded their future benefit obligations. The assets contributed to a public plan to fund these future benefits are invested. The investment returns earned on these assets help in a major way to cover the costs of future benefit obligations. As contributions to the public plan decrease, the associated investment earnings will be lower, requiring governments to make up the difference in order to maintain current benefit levels.
- ◆ ***Mandatory coverage will likely result in reduced public plan benefits and the ability of employers to replace retiring baby boomers in the workplace.*** Communities will have to decide how to finance the increased new hire payroll and pension costs through tax increases, cuts in existing benefits and/or reductions in workforce and services. The taxpayers in each jurisdiction will be the ultimate decision makers as to how to absorb the cost. Recent history indicates that raising taxes is difficult and unpopular. It is highly likely, therefore, that unless taxes are increased or spending reductions made, benefit levels will be reduced to accommodate this new cost. The cost estimate contained in this report is for new hires for the first five years of universal coverage using an annual turnover rate of 9 percent. As the working population moves toward retirement turnover rates are likely to increase exacerbating costs over the next ten to twenty-five year period.
- ◆ ***Mandatory coverage will affect more than newly hired public employees.*** If mandatory coverage results in separate or restructured tiers for new hires, the existing defined benefit plans will experience a reduction in employer and employee contributions, which are an essential part of their actuarial funding. Reduced contributions will result in lower investment earnings and will further compound funding concerns (over a 20 year-period ending in 2002, over 60 percent of public plan benefits were funded by investment returns). The end result would be a destabilizing of the existing plans on which current workers and retirees depend. Lower funding would not only have an impact on retirement benefits, but could affect disability and survivor benefits as well. In addition, governments will be burdened with the cost of operating new plans or tiers. These costs include employee communications, actuarial

³ The Segal Company, The Cost Impact of Mandating Social Security for State and Local Government p. 10, May 1999

reviews and plan complexities. As administrative costs are generally paid out of investment earnings, these increased costs could eat further into plan assets.

- ♦ ***Mandatory coverage ignores the diverse work-force requirements of the public sector.*** Governments employ individuals in job categories that are unique to the public sector. An average jurisdiction's workforce includes police, firefighters, corrections officers, teachers, judges and legislators, along with many other job categories. Some of these groups require retirement arrangements that fit their unique career patterns. The most often cited example is public safety workers—police, firefighters, corrections officers. The retirement systems for these workers have been designed and funded to provide for their highly specialized needs.
- ♦ ***Current law contains benefit guarantees for public-sector employees.*** Public sector employees have a minimum benefit guarantee under existing federal law. In 1990, Congress required Social Security participation for all public employees NOT covered by a comparable state or local government pension plan. The result of this law is that public employers, at a minimum, must maintain plans that produce a benefit that is comparable to Social Security. Since nearly 75% of public-sector workers are participating in Social Security, the remaining 25%, an estimated 5 million public sector workers, are protected by this comparability standard.

Universal coverage will require public employers to restructure their retirement plans, divert necessary funding away from these plans, raise operational costs and reduce the flexibility that public employers need to design retirement options for their diverse workforce. Moreover, the \$44 billion in new cost will compete with the funding of necessary public services and programs.

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Table 1
State-by-State Cost Analysis of Mandatory Social Security

State	Employees not covered by Social Security	Annual number of employee terminations (%)	Average annual pay for New Hires	First Year Employer SS Tax	First Year Employee and Employer	Two year cumulative	Three year cumulative	Four year cumulative	Five year cumulative
Alabama	26,000	2,340	\$ 32,255	\$ 4,679,508	\$ 9,359,016	\$ 28,638,588	\$ 58,425,527	\$ 99,332,923	\$ 152,001,196
Alaska	44,000	3,960	\$ 59,404	\$ 14,584,904	\$ 29,169,808	\$ 89,259,612	\$ 182,098,359	\$ 309,596,905	\$ 473,751,282
Arizona	41,000	3,690	\$ 40,598	\$ 9,288,042	\$ 18,576,083	\$ 56,842,815	\$ 115,964,915	\$ 197,159,266	\$ 301,696,992
Arkansas	23,000	2,070	\$ 30,498	\$ 3,914,166	\$ 7,828,332	\$ 23,954,697	\$ 48,869,931	\$ 83,086,852	\$ 127,141,137
California	1,468,000	132,120	\$ 30,838	\$ 252,606,458	\$ 505,212,916	\$ 1,545,951,522	\$ 3,153,892,668	\$ 5,362,131,843	\$ 8,205,239,780
Colorado	263,000	23,670	\$ 42,304	\$ 62,082,770	\$ 124,165,540	\$ 379,946,553	\$ 775,128,218	\$ 1,317,844,371	\$ 2,016,591,418
Connecticut	92,000	8,280	\$ 52,245	\$ 26,820,515	\$ 53,641,029	\$ 164,141,550	\$ 334,864,854	\$ 569,324,858	\$ 871,192,113
Delaware	4,000	360	\$ 41,890	\$ 934,974	\$ 1,869,947	\$ 5,722,039	\$ 11,673,521	\$ 19,846,889	\$ 30,370,101
Florida	173,000	15,570	\$ 37,321	\$ 36,026,993	\$ 72,053,986	\$ 220,485,198	\$ 449,811,420	\$ 764,752,765	\$ 1,170,239,747
Georgia	181,000	16,290	\$ 34,045	\$ 34,385,141	\$ 68,770,282	\$ 210,437,064	\$ 429,312,241	\$ 729,900,818	\$ 1,116,908,610
Hawaii	51,000	4,590	\$ 42,004	\$ 11,953,465	\$ 23,906,930	\$ 73,155,204	\$ 149,243,789	\$ 253,738,779	\$ 388,276,078
Idaho	13,000	1,170	\$ 37,131	\$ 2,693,492	\$ 5,386,983	\$ 16,484,168	\$ 33,629,320	\$ 57,175,328	\$ 87,490,813
Illinois	489,000	44,010	\$ 47,811	\$ 130,458,996	\$ 260,917,993	\$ 798,409,058	\$ 1,628,832,753	\$ 2,769,281,294	\$ 4,237,608,792
Indiana	54,000	4,860	\$ 37,881	\$ 11,414,407	\$ 22,828,814	\$ 69,856,170	\$ 142,513,435	\$ 242,296,080	\$ 376,766,235
Iowa	35,000	3,150	\$ 37,730	\$ 7,368,683	\$ 14,737,366	\$ 45,096,338	\$ 92,000,952	\$ 156,416,621	\$ 239,351,794
Kansas	29,000	2,610	\$ 35,541	\$ 5,751,228	\$ 11,502,455	\$ 35,197,513	\$ 71,806,377	\$ 122,082,551	\$ 186,813,125
Kentucky	89,000	8,010	\$ 38,079	\$ 18,910,969	\$ 37,821,938	\$ 115,735,131	\$ 236,111,014	\$ 401,427,226	\$ 614,271,849
Louisiana	261,000	23,490	\$ 29,271	\$ 42,629,696	\$ 85,259,392	\$ 260,893,740	\$ 532,248,807	\$ 904,909,766	\$ 1,384,710,751
Maine	67,000	6,030	\$ 36,706	\$ 13,722,750	\$ 27,445,500	\$ 83,983,231	\$ 171,334,025	\$ 291,295,783	\$ 445,746,545
Maryland	40,000	3,600	\$ 46,874	\$ 10,462,318	\$ 20,924,635	\$ 64,029,383	\$ 130,626,220	\$ 222,085,875	\$ 339,840,181
Massachusetts	442,000	39,780	\$ 45,487	\$ 112,187,033	\$ 224,374,067	\$ 686,584,645	\$ 1,400,699,988	\$ 2,381,418,392	\$ 3,644,093,337
Michigan	94,000	8,460	\$ 50,013	\$ 26,232,725	\$ 52,465,449	\$ 160,544,275	\$ 327,526,061	\$ 556,847,714	\$ 852,099,342
Minnesota	44,000	3,960	\$ 44,707	\$ 10,976,498	\$ 21,952,996	\$ 67,176,169	\$ 137,045,971	\$ 233,000,498	\$ 356,541,953
Mississippi	26,000	2,340	\$ 29,867	\$ 4,333,175	\$ 8,666,350	\$ 26,519,031	\$ 54,101,423	\$ 91,981,241	\$ 140,751,508
Missouri	128,000	11,520	\$ 34,776	\$ 24,838,348	\$ 49,676,697	\$ 152,010,692	\$ 310,116,715	\$ 527,248,987	\$ 806,806,786
Montana	13,000	1,170	\$ 36,590	\$ 2,654,237	\$ 5,308,474	\$ 16,243,930	\$ 33,139,210	\$ 56,342,061	\$ 86,215,732
Nebraska	17,000	1,530	\$ 36,942	\$ 3,504,292	\$ 7,008,583	\$ 21,446,265	\$ 43,752,483	\$ 74,386,356	\$ 113,827,468
Nevada	100,000	9,000	\$ 45,857	\$ 25,588,249	\$ 51,176,498	\$ 156,600,083	\$ 319,479,523	\$ 543,167,287	\$ 831,165,283
New Hampshire	13,000	1,170	\$ 37,779	\$ 2,740,508	\$ 5,481,016	\$ 16,771,908	\$ 34,216,337	\$ 58,173,353	\$ 89,018,011
New Jersey	49,000	4,410	\$ 54,434	\$ 14,883,404	\$ 29,766,807	\$ 91,086,431	\$ 185,825,248	\$ 315,933,225	\$ 483,447,245
New Mexico	22,000	1,980	\$ 33,882	\$ 4,159,329	\$ 8,318,658	\$ 25,455,095	\$ 51,930,888	\$ 88,290,979	\$ 135,104,595
New York	68,000	6,120	\$ 52,679	\$ 19,988,591	\$ 39,977,182	\$ 122,330,176	\$ 249,565,552	\$ 424,302,135	\$ 649,275,486
North Carolina	46,000	4,140	\$ 36,329	\$ 9,324,990	\$ 18,649,981	\$ 57,068,941	\$ 116,426,235	\$ 197,943,585	\$ 302,897,173
North Dakota	10,000	900	\$ 36,081	\$ 2,013,309	\$ 4,026,618	\$ 12,321,452	\$ 25,136,970	\$ 42,736,949	\$ 65,396,921
Ohio	820,000	73,800	\$ 29,271	\$ 133,932,378	\$ 267,864,757	\$ 819,666,156	\$ 1,672,199,318	\$ 2,843,011,526	\$ 4,350,432,245
Oklahoma	32,000	2,880	\$ 31,615	\$ 5,645,199	\$ 11,290,398	\$ 34,548,618	\$ 70,482,567	\$ 119,831,858	\$ 183,369,070
Oregon	27,000	2,430	\$ 42,832	\$ 6,453,007	\$ 12,906,014	\$ 39,492,402	\$ 80,568,373	\$ 136,979,372	\$ 209,608,534
Pennsylvania	71,000	6,390	\$ 45,058	\$ 17,850,943	\$ 35,701,887	\$ 109,247,773	\$ 222,876,168	\$ 378,925,830	\$ 579,839,769
Rhode Island	14,000	1,260	\$ 48,644	\$ 3,800,067	\$ 7,600,134	\$ 23,256,410	\$ 47,445,357	\$ 80,664,844	\$ 123,434,933
South Carolina	30,000	2,700	\$ 34,048	\$ 5,699,606	\$ 11,399,213	\$ 34,881,591	\$ 71,161,866	\$ 120,986,777	\$ 185,136,349
South Dakota	7,000	630	\$ 26,879	\$ 1,049,890	\$ 2,099,779	\$ 6,425,324	\$ 13,108,291	\$ 22,286,233	\$ 34,102,832
Tennessee	47,000	4,230	\$ 34,306	\$ 8,997,118	\$ 17,994,236	\$ 55,062,363	\$ 112,332,620	\$ 190,983,772	\$ 292,247,130
Texas	836,000	75,240	\$ 34,826	\$ 162,460,689	\$ 324,921,378	\$ 994,259,415	\$ 2,028,386,683	\$ 3,448,588,132	\$ 5,277,097,497
Utah	23,000	2,070	\$ 38,472	\$ 4,937,456	\$ 9,874,912	\$ 30,217,231	\$ 61,646,113	\$ 104,808,444	\$ 160,379,946
Vermont	2,000	180	\$ 33,675	\$ 375,815	\$ 751,630	\$ 2,299,988	\$ 4,692,200	\$ 7,977,505	\$ 12,207,336
Virginia	43,000	3,870	\$ 38,116	\$ 9,145,613	\$ 18,291,226	\$ 55,971,153	\$ 114,186,639	\$ 194,135,907	\$ 297,070,590
Washington	63,000	5,670	\$ 49,513	\$ 17,405,973	\$ 34,811,946	\$ 106,524,555	\$ 217,320,535	\$ 369,480,348	\$ 565,386,107
West Virginia	15,000	1,350	\$ 31,736	\$ 2,656,275	\$ 5,312,550	\$ 16,256,404	\$ 33,164,658	\$ 56,385,327	\$ 86,281,938
Wisconsin	62,000	5,580	\$ 45,118	\$ 15,608,997	\$ 31,217,993	\$ 95,527,059	\$ 194,884,566	\$ 331,335,541	\$ 507,016,173
Wyoming	10,000	900	\$ 34,433	\$ 1,921,349	\$ 3,842,698	\$ 11,758,656	\$ 23,988,811	\$ 40,784,891	\$ 62,409,844
Total	6,617,000	595,530	\$1,964,391.43	\$1,362,054,537.00	\$2,724,109,074.00	\$8,335,773,766.43	\$17,005,795,716.24	\$28,912,625,860.64	\$44,242,669,671.56

Number not Covered: Based on Social Security Administration, Continuous Work History Sample, 1 percent sample, Table 1-8 -- Estimated Social Security Coverage of Workers with State and Local Government Employment, 2001. This is the data that the SSA provided to AFSCME.

Assumptions: We assumed a 9% termination rate which includes retirements, death and job turnovers and a 3% salary increase rate over the 5 year period.

Salary Rates: Based on the New Hire Pay Rates from the U.S. Bureau of the Census, 1997 Statistical Abstract of the United States Government adjusted to 2004 using a 3% salary rate increase per year. We estimated the 2004 Average Annual Pay for New Hires by projecting forward 7 years (1997 + 7 = 2004), the same 3% salary rate increase used in the 5 year cost projection.

Table 2
State-by-State Cost Analysis of Mandatory Social Security

State	Employees not covered by Social Security	Five- year cumulative Employee and Employer SS Tax
Alabama	26,000	\$ 152,001,196
Alaska	44,000	\$ 473,751,282
Arizona	41,000	\$ 301,696,992
Arkansas	23,000	\$ 127,141,137
California	1,468,000	\$ 8,205,239,780
Colorado	263,000	\$ 2,016,591,418
Connecticut	92,000	\$ 871,192,113
Delaware	4,000	\$ 30,370,101
Florida	173,000	\$ 1,170,239,747
Georgia	181,000	\$ 1,116,908,610
Hawaii	51,000	\$ 388,276,078
Idaho	13,000	\$ 87,490,813
Illinois	489,000	\$ 4,237,608,792
Indiana	54,000	\$ 370,766,235
Iowa	35,000	\$ 239,351,794
Kansas	29,000	\$ 186,813,125
Kentucky	89,000	\$ 614,271,849
Louisiana	261,000	\$ 1,384,710,751
Maine	67,000	\$ 445,746,545
Maryland	40,000	\$ 339,840,181
Massachusetts	442,000	\$ 3,644,093,337
Michigan	94,000	\$ 852,099,342
Minnesota	44,000	\$ 356,541,953
Mississippi	26,000	\$ 140,751,508
Missouri	128,000	\$ 806,806,786
Montana	13,000	\$ 86,215,732
Nebraska	17,000	\$ 113,827,468
Nevada	100,000	\$ 831,165,283
New Hampshire	13,000	\$ 89,018,011
New Jersey	49,000	\$ 483,447,245
New Mexico	22,000	\$ 135,104,595
New York	68,000	\$ 649,275,486
North Carolina	46,000	\$ 302,897,173
North Dakota	10,000	\$ 65,396,921
Ohio	820,000	\$ 4,350,432,245
Oklahoma	32,000	\$ 183,369,070
Oregon	27,000	\$ 209,608,534
Pennsylvania	71,000	\$ 579,839,769
Rhode Island	14,000	\$ 123,434,933
South Carolina	30,000	\$ 185,136,349
South Dakota	7,000	\$ 34,102,832
Tennessee	47,000	\$ 292,247,130
Texas	836,000	\$ 5,277,097,497
Utah	23,000	\$ 160,379,946
Vermont	2,000	\$ 12,207,336
Virginia	43,000	\$ 297,070,590
Washington	63,000	\$ 565,386,107
West Virginia	15,000	\$ 86,281,938
Wisconsin	62,000	\$ 507,016,173
Wyoming	10,000	\$ 62,409,844
Total	6,617,000	\$ 44,242,669,672

Source: Prepared by The Segal Company for The American Federation of State County and Municipal Employees (AFSCME), AFL/CIO and for the Coalition to Preserve Retirement, July 2005

Source of statistics on number of uncovered workers in each state based on Social Security Administration, Continuous Work History Sample, 1 percent sample, Table 1-8 – Estimated Social Security Coverage of Workers with State and Local Government Employment, 2001. This is the data that the SSA provided to AFSCME.

