Coalition to Preserve Retirement Security

CPRS

Retirement Insecurity:

The Unintended Consequences of Mandatory Social Security Coverage

Introduction

The question of mandatory coverage – as opposed to voluntary coverage – has surfaced from time to time since the early 1960s. Most recently, the idea of forcing Social Security coverage on State and local governments and their new employees has been advanced by organizations with an apparent bias against public employee retirement benefits – many funded by the Laura and John Arnold Foundation. Among other things, these reports have suggested that current plans don't work for most teachers; that Social Security offers better protection against inflation; and that expanding Social Security would lessen reliance on state pension plans.

Inherent in most of these reports, is the idea that State and local governments should abandon their defined benefit retirement plans and replace them with a combination of Social Security and a defined contribution plan that shifts all of the risk to individual public employees. Despite the fact that most employees will ultimately be left with a less secure retirement, these reports frequently argue their recommendations are offered to benefit public safety workers, teachers, and other dedicated public employees. They tend to gloss over the true impact on State and local budgets and the inevitable confusion and instability that would result for current and future public employees.

These reports often suggest the Federal government is in a better position to decide how State and local government officials can best manage their public workforce and provide compensation, including disability, retirement, and survivor benefits. However, while the Federal government has struggled to find a way to reform Social Security to preserve its long-term sustainability while meeting the increasing retirement security needs of millions of Americans, most State and local governments have enacted responsible reforms that balance the interests of public workers and the taxpayers who fund the pension promises. Since State and local governments may choose to participate in Social Security, it's not at all clear why a Federally mandated, one-size-fits-all option would be good public policy.

One report actually suggested the cost of mandatory coverage on State and local budgets "would be trivial." While we can certainly debate the definition of trivial, a series of independent studies done by The Segal Company – most recently in 2011 – shows the cost to the 50 states would be in excess of $53 billion over the first five years of mandatory coverage. This amount has increased by 100% since the first study was done in 1999. A state-by-state analysis is provided on the back of this paper. To better understand the impact of mandatory Social Security coverage on one pension system, we've highlighted the impact on the California Teachers Retirement System (CalSTRS), the Nation's largest teachers' retirement system.

Finally, reports frequently tout the impact that mandatory coverage would have on the long-term sustainability of Social Security; however, a closer look suggests otherwise. In 2013, the Social Security actuaries estimated that extending coverage to all new State and local workers would reduce the deficit by 0.15 percent of taxable payroll over the next 75 years and would extend the life of the trust fund by only one year.

Notwithstanding a series of agenda-driven studies, there are consequences associated with a massive Federal mandate on State and local government. While many may be unintentional, they will have a profound impact on the retirement security of millions of working Americans. This paper is intended to highlight those consequences.

Mandatory coverage will undermine retirement security for millions of public workers – including a majority of police officers and firefighters and nearly half of the Nation's teachers.

State and local pension systems, as contrasted with Social Security, are pre-funded defined benefit programs that guarantee retirement security for their members. These plans provide disability benefits (including critical protection for public safety officers), death benefits, options that protect spouses and dependent children, and often cost-of-living adjustments.

To respond to mandatory Social Security coverage, State and local government employers would need to decide how to finance the increased payroll taxes through tax increases, cuts in existing benefits and/or reductions in workforce or public services. Mandatory coverage would most likely result in separate or restructured tiers for new hires. Although it would be possible, it's unlikely the new tiers, including the addition of Social Security, would provide nearly the protection provided by the current plans. In addition, the existing plans would experience a reduction in employee and employer contributions which are an essential part of their long-term actuarial funding plan.

Investment income is essential to providing retirement security. National studies show that investment income funds up to 70% of the average retirement benefit. The loss of contributions from employees and employers which would be diverted to Social Security, together with the loss of investment income on those funds, would be catastrophic over time. These losses would ultimately destabilize public plans and would likely result in reduced benefits for current members and retirees as well.

Millions of public employees in non-covered systems have placed their faith and their future in their pension plans. It is absolutely critical to maintain the stability, confidence, security, and trust of those public employees.

Mandatory coverage will increase the cost of keeping current pension promises.

Shifting contributions to Social Security and away from current programs would leave public plans with significant funding challenges – perhaps this helps explain why some anti-defined benefit advocates have come to support mandatory Social Security coverage.

The assets contributed to a public plan to fund future benefits are invested. The investment returns earned on these assets help in a major way to cover the cost of future benefit obligations. Reduced contributions will result in lower investment earnings and will further compound funding concerns. As contributions to the public plans decrease, the associated investment earnings will be lower, requiring government (taxpayers) to make up the difference in order to maintain current benefit levels.

Advocates for mandatory coverage rarely – if ever – honestly account for the impact of the mandate on current plan participants or the funding of current plan legacy costs.

Mandatory coverage is a massive unfunded Federal mandate on State and local government.

Proponents of mandatory coverage typically seek to minimize its negative impact by suggesting that only 13 (some reports site 15) states have non-covered employees. However, non-covered employees can be found in all 50 states according to data from the Social Security Administration. It's estimated that 75% of all public safety officers (police, fire, and correctional personnel) are exempt from Social Security. Additionally, it's estimated that approximately 40% of America's public school teachers are also exempt. Nationally, it's estimated that 6.5 million public workers are not covered by Social Security.

As a result, a Federal mandate of this magnitude will likely raise taxes, reduce services and/or undermine the retirement security of millions of public workers throughout all 50 states.

According to research done by the Segal Company, the cost of this mandate has been steadily increasing since it was first calculated in 1999. In fact, the most recent cost estimate - $53 billion over a five year period – represented a 100% increase from the 1999 report.

Mandatory coverage threatens the ability of State and local governments to address unique public sector workforce requirements.

Governments employ individuals in job categories that are unique to the public sector. An average workforce includes police, firefighters, corrections officers, teachers, highly specialized health care professionals, judges and legislators, along with many other job categories. Some of these groups require retirement arrangements that fit their unique career risks and responsibilities. The best example is public safety workers – police, firefighters, and corrections officers. The retirement systems for these workers have been specifically designed and funded to provide for their highly specialized needs.

To underscore the challenges associated with addressing this diversity, it's important to note that proponents of mandatory coverage never address the specific benefit design and funding challenges associated with protecting the unique needs of public safety workers and other high risk public sector professionals and their survivors.

CalSTRS Study Says Mandatory Social Security Would Hurt Schools and Educators

Under a Social Security structure, members´ and employers´ choices would be to pay more or get less.

California public educators and school districts would have to either pay more for their retirement or settle for lower benefits if Social Security were offered to them, according to an analysis conducted by the independent consulting actuary Milliman for the California State Teachers' Retirement System (CalSTRS).

The study looked at two ways to implement mandatory Social Security for future members: maintain current benefit levels and maintain current benefit cost.

Under the level benefit approach, contributions would jump by up to 12.4 percent of pay, divided up between members and employers. In dollar terms, that amounts to an immediate $1.8 billion annual increase.

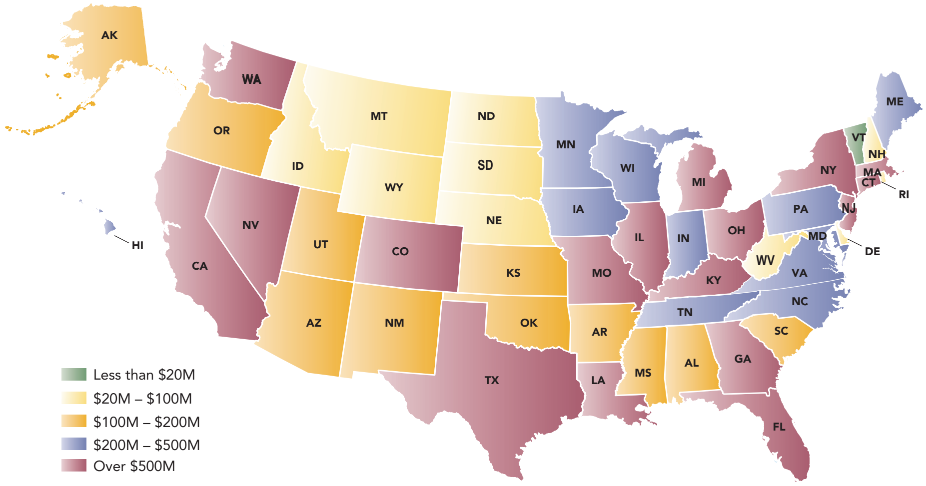
Under the level cost approach, members and employers would not pay more, but would see a 33-percent reduction in the retirement benefit from current levels. That would reduce the pension's average replacement of pre-retirement income from 61 percent currently to 43 percent under the new structure.

A separate CalSTRS study compared CalSTRS with 11 other public teacher defined benefit pensions that do not include Social Security. CalSTRS was found to be not overly generous, falling in the middle of the pack, between Texas and Kentucky. The measure was the ratio of replacement of pre-retirement income each plan offered. Texas replaces 58 percent and Kentucky replaces 63 percent of their members' pre-retirement income.

The Milliman analysis attributes the detrimental impact on CalSTRS members and employers to the divergent designs of the two plans. While Social Security benefits are determined by a formula that pays relatively higher amounts to workers with lower wages, CalSTRS benefits are paid in direct proportion to income.

Based on June 7, 2011 Press Report

Cost of Social Security for States, Localities, and New Employees for the First Five Years of Mandatory Coverage



Coalition to Preserve Retirement Security

The Coalition to Preserve Retirement Security (CPRS) is the leading voice and preeminent organization in Washington, D.C., dedicated to opposing efforts to force public employers and their workers to participate in the Social Security program. CPRS members include major public employee retirement systems and national, state and local employee, employer and retiree organizations. Our mission is to protect the current structure of public sector retirement plans.

State-by-State Cost Analysis of Mandatory Social Security For Years 2010-2014

State	Employees Not Covered by Social Security	Five-Year Cumulative Employee & Employer SS Tax
Alabama	30,300	$ 194,224,354
Alaska	22,300	$ 194,975,037
Arizona	18,200	$ 142,968,614
Arkansas	19,600	$ 113,521,370
California	1,405,500	$ 15,066,500,284
Colorado	297,700	$ 2,395,781,831
Connecticut	79,400	$ 755,019,589
Delaware	4,000	$ 32,500,058
Florida	131,900	$ 982,961,184
Georgia	188,500	$ 1,228,924,886
Hawaii	35,300	$ 279,124,104
Idaho	8,900	$ 58,433,670
Illinois	441,000	$ 3,644,114,235
Indiana	49,500	$ 333,757,084
Iowa	31,700	$ 238,626,205
Kansas	23,300	$ 148,610,248
Kentucky	97,300	$ 600,558,206
Louisiana	233,100	$ 1,487,858,712
Maine	55,300	$ 361,697,710
Maryland	44,300	$ 398,194,929
Massachusetts	459,400	$ 3,973,324,246
Michigan	91,800	$ 778,372,961
Minnesota	34,300	$ 289,378,234
Mississippi	20,200	$ 114,352,445
Missouri	129,100	$ 800,773,746
Montana	9,800	$ 63,774,817
Nebraska	9,100	$ 62,827,522
Nevada	130,600	$ 1,200,729,984
New Hampshire	12,100	$ 89,540,574
New Jersey	55,000	$ 546,238,725
New Mexico	18,700	$ 119,694,674
New York	57,100	$ 525,263,170
North Carolina	58,300	$ 395,053,821
North Dakota	9,400	$ 64,471,375
Ohio	827,900	$ 6,323,620,141
Oklahoma	27,300	$ 163,165,458
Oregon	24,300	$ 195,782,026
Pennsylvania	60,400	$ 461,281,626
Rhode Island	10,900	$ 96,550,743
South Carolina	27,400	$ 176,025,421
South Dakota	5,800	$ 34,838,126
Tennessee	47,500	$ 304,368,187
Texas	939,000	$ 6,331,503,655
Utah	21,000	$ 156,516,277
Vermont	1,300	$ 9,346,203
Virginia	40,100	$ 295,508,827
Washington	68,500	$ 628,479,406
West Virginia	13,100	$ 76,192,424
Wisconsin	60,000	$ 468,596,665
Wyoming	7,400	$ 53,135,375
Total	6,493,900	$ 53,457,059,162

Source: Prepared by The Segal Company for the Coalition to Preserve Retirement, September 2011

Source of statistics on number of uncovered workers in each state based on Social Security Administration, Office of Research Evaluation and Statistics, Social Security and Medicare Coverage of Workers from their State and Local Government Employment in 2008.

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