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Early retirement for state workers: Money-saver, or costly sweetener?

Governor David Paterson is proposing an early-retirement option for the state and its local governments that he says is "designed to achieve cost-savings for public employers and to avoid layoffs of public employees in this time of fiscal need." [1]

However, based on past experience and the available information on the governor's bill, it's not clear that the plan will actually save any money in the long run.

Between 1983 and 2002, New York's state Legislature approved 10 early retirement bills for state employees. [2] The most recent, in 2002, attracted 5,562 participants and added $249 million in pension costs, which were financed over a five-year period. [3]

In theory, these added costs were offset by workforce savings. But state officials have never done a cost-benefit analysis of any of the 10 incentive plans. As a result, they are unable to prove that any net savings actually resulted from these plans.

It's not clear that lasting savings resulted from any of the 10 early retirement programs enacted by the state since 1983. Short-term savings can to be offset by pension costs and by the continuing expense of employer-provided health insurance coverage for state retirees.

This report examines past programs offered between 1983 and 2009, focusing on these questions:

- Has early retirement saved money?
- What has been the impact on the pension system?
- How have past incentives been structured?
- Should retirement incentives be available to all employees, or targeted by management?

Employees of New York State, its local governments and school districts are eligible for defined benefit (DB) pension plans that provide retirees with a steady stream of income based on their career longevity (measured in "service credits"), retirement age and peak salary. Monthly pension payments are exempt from state income tax and from federal payroll tax. The state Constitution guarantees that public pensions cannot be "diminished or impaired."

Most current state employees are members of the Tier III and IV pension plans.[4] Their pensions are based on their final average salary (FAS), which reflects the average of their three highest consecutive years of wages, usually just before retirement.

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After reaching the five-year "vesting" point, state employees (except those hired after January 1, 2010) can retire with full pension if (a) they are at least 62 years old, or (b) they are at least 55 and have at least 30 years of service credit. A permanent, partial discount of benefits applies to employees who retire before age 62 with less than 30 years of service credit.

Civilian employees with fewer than 20 years of service credits receive 1/60 of their salary (1.66 percent) for each year of service. Those retiring with 20 to 30 years receive 1/50 (2 percent) for each year of service. Those with over 30 years of service receive 2 percent for each of the first 30 years and 3/200 (1.5 percent) for each year over 30 years.

Typical retirement incentives

New York's early retirement programs have generally taken two approaches to increasing pensions: offering extra service credits, or reducing the minimum retirement age. Governor Paterson's proposal includes both elements. Under Part A, a state employee would be eligible for an additional month of service credit for each year of service (up to 36 months) if they work in job titles specifically targeted for the benefit. Under Part B, an employee could retire with full benefits at age 55 with only 25 years of service. [5]

For the retirees, both plans can translate into a significant increase in what already are generous retirement benefits, compared to what is available to the vast majority of private-sector employees. To illustrate the impact on individual employees, consider the following illustration of how the governor's plans would affect government retirees with a final average salary (FAS) of $60,000 at different service-credit levels.

Proposed Part A Early Retirement
Up to 36 months of added service credit

Employee Retiring at age 62, FAS= $60,000

Current Service Credit*	Current Pension	Adjusted Service*	New Pension	Added Annual Benefit total	Added Annual Benefit percent
19	$18,924	20.58	$24,696	$5,772	30.50%
25	$30,000	27.08	$32,496	$2,496	8.30%
27	$32,400	29.25	$35,100	$2,700	8.30%
31	$36,900	33.58	$39,222	$2,322	6.30%

* Years

As shown, an employee with 19 years of service credit, just below the 20-year threshold that would boost the FAS percentage, would have the most to gain from the offer of added service credit. To be sure, because eligibility for the early retirement will also be based on seniority within targeted titles, the benefit will flow to relatively few employees who haven't already passed the 20-year mark. But even an employee with 31 years of experience can be eligible for a pension bump of more than 6 percent.

The percentage gain in pension benefits can be even larger for employees who are eligible for "55-25" benefits, as shown below.

Proposed Part B Early Retirement
"55-25" plan

Employee with 25 years service credit, FAS = $60,000

Retirement Age	Current Law Penalty	Current Law Pension	Part B Pension	Added Annual Benefit total	Added Annual Benefit percent
55	27%	$21,900	$30,000	$8,100	37.00%
58	18%	$24,600	$30,000	$5,400	22.00%
60	12%	$26,400	$30,000	$3,600	13.60%

Other key features of the governor's proposal include the following:

- In Executive Branch agencies, eligibility for Part A is determined by the "appointing authority" – i.e., targeted at the employer's discretion. Part B, the 55-25 plan, is not targeted, beyond the exclusion of workers considered essential to health and safety. Positions vacated by employees claiming Part A benefits must be eliminated.
- Legislative and Judicial employees (except elected officials and judges) would qualify for pension sweeteners if their employers opt into the plan, but the bill language does not restrict the refilling of any vacated jobs.
- Local governments and school districts can opt into the early retirement plan for workers who are members of the state Employee Retirement System (ERS).
- Early retirement would not be offered to law enforcement officers or to persons in jobs deemed vital to health, safety and raising revenues.
- The bill's fiscal note does not say how much the incentive will save—or cost. It calculates added pension costs at about 60 percent of final average salary for Part A; and 110 percent of FAS for Part B.
- Added pension costs will be amortized—in effect, borrowed from the retirement system--over five years beginning in 2011-12. The bill does not indicate the interest rate at which these costs must be repaid.

The bill doesn't calculate the dollar value of added pension costs. However, a conservative estimate based on participation in the 2002 plan suggests they would exceed $325 million.[6]

Early retirement as a disincentive

Early retirement bills can act as a powerful retirement disincentive once employees get the sense their benefits might be sweetened if they stay put for a while longer. Indeed, the president of the Public Employees Federation (PEF) recently advised members to postpone their retirements in case the Legislature approves a retirement package. [7]

Theoretically, early retirement saves money by making it easier to clear older, higher-paid employees from the payroll. The savings depend on how the plan is financially structured, whether vacated jobs are refilled, retirees' relative ages and health insurance costs. State employees retire at an average age of 58, according to the Department of Civil Service. [8] Thus, the sweeteners may go to "early" retirees who were planning to retire anyway—raising long-term pension expenses unnecessarily.

"Savings" unknown

In 1995, a report by Comptroller Carl McCall examined four incentives offered between 1983, and 1995. [9] It cited the Cuomo administration's misgivings in 1984: "Our analysis of the 1983 State retirement incentive program casts doubt on its success." More than 8,000 state workers took advantage of the incentive. Yet Cuomo officials found themselves predicting the workforce actually would grow by 3,000 employees between March 31, 1983 and March 31, 1985. [10]

The 1983 incentive was available to all service-eligible employees. Subsequent incentives were targeted, requiring managers to eliminate vacated positions. The targeted nature the 1990, 1991 and 1995 plans "proved to be more effective," according the 1995 report. The report does not document total savings or costs.

The incentives required the state to make extra pension payments, the highest being 80 percent of each participant's final average salary (FAS) in 1983. Added pension costs were amortized over five years--except in 1990 when the state made a lump sum payment.

Six retirement incentives have been offered since 1996. The comptroller's office can document that those plans added $575 million in costs to Employees Retirement System and lured 16,295 state workers into retirement. The 2002 plan persuaded 5,562 state workers to retire, costing the pension system $249 million. Additional costs were incurred on behalf of university employees belonging to defined-contribution retirement plans and other state employees in the Teachers Retirement System.

"The Office of the State Comptroller has not done an analysis of how much money, if any, early retirement programs save," an agency official wrote in 2008.[11] A spokesman recently reiterated that. Also in 2008, a Division of the Budget (DOB) official told the Empire Center that DOB had no information on savings from early retirement programs. [12]

To entice employees to retire in 1983, the state offered three additional years of service credit. Subsequent programs, which applied only to targeted jobs, were less generous. For example, the 1990 program offered one month of service credit for each year of service, not to exceed three years of credit.

In addition to up to 36 month of service credit, the 1991 program, which began in mid-December 1990, granted eligibility for reduced benefits to employees who were age 50 and older and had at least 10 years of service. So did the 1995 program. Between 1995 and 2002, the state offered retirement programs every year but 2001, leading employees to anticipate them as a rite of spring.

The 2002 program was aimed at employees 55 or older, who received up to 36 months of additional service credit. A second provision, known as "55-25,"allowed employees age 55 with 25 years of service to retire without penalty. University employees belonging to defined-contribution retirement plans received cash payments worth up to 45 percent of final average salary.

2006 Pataki veto

In his 2006 budget, Pataki proposed a targeted early retirement incentive. The Legislature, bending to union pressure, rejected it. Instead lawmakers passed a more inclusive "55-25" plan.

Pataki vetoed the bill, saying it would cost "$11 million per year for the next 17 years (a total of $187 million), plus an additional $8 million" for university faculty participating in defined-contribution. The measure, he said, "would fail to include many of the important safeguards included in prior retirement incentive bills," such as limiting the incentive to targeted positions. Pataki also objected to stretching the incentive over two years. [13]

2009 Buyout plan

In March 2009, Governor Paterson threatened to lay off nearly 9,000 state workers if their unions failed to agree to $250 million worth of concessions.

Three months later, the Civil Service Employees Association (CSEA) and Public Employees Federation (PEF)--the two largest unions--walked away with a far better deal. Paterson pledged not lay off union members before Dec. 31, 2010, if the unions did not oppose modest pension changes for future employees enrolled in a new defined-benefit pension "tier." In addition, state workers—regardless of age or years of service--would receive $20,000 if they agreed to retire or quit their jobs.

The buyout was to be available for up to 4,500 employees, but only 1,000 took advantage of it. One reason was state agencies were required to abolish the jobs of employees accepting buyouts. As a result, many willing workers were not offered them. For exam-

ple, PEF maintained a list of 1,000 members whom, it said, would have been willing to accept the severance package. [14]

Targeted discretion vs. come-one, come-all

Deciding who qualifies for early retirement is a contentious issue. Public employee unions favor offering incentives to anyone who has reached minimum age or service levels. Managers, who can't replace departing employees, seek greater discretion to limit the program to targeted positions.

Unions blast targeted incentives are unfair, allowing managers to indulge in favoritism. Managers, however, say an open-door policy can create workforce nightmares. As a State University at Albany official observed in 1983, "If I were a labor leader or governor of the state, I'd say let's opt for early retirement. However, from a management perspective, the problem is the people retire from the wrong places."[15]

For example, 41 SUNY at Albany maintenance workers retired in 1983, taking with them knowledge of the vagaries of the campus power plant. When the air conditioning system conked out during a heat wave, it took their less experienced replacements three days to repair it, imperiling lab animals, scientific experiments and computer programs and equipment.[16]

Similar stories abounded across the state, leading Governors Cuomo, Pataki and Paterson to restrict participation in future retirement programs. The 2002 plan, for example, wasn't open to all. It excluded employees in critical public health and safety jobs. That meant caregivers at psychiatric hospitals and corrections officers were excluded—while white-collar workers in Albany cubicles might qualify.

By allowing managers to target specific jobs, the measure was intended to allow them to rationally streamline their workforces.

However, the 2002 law did not require agencies to eliminate jobs. That language, found in earlier plans, was dropped from the enacted legislation.

"We are unable to determine if these retirees were ultimately replaced on the payroll," a budget official said six years later. "The thinking at the time was that a permanent reduction could be achieved through the incentive program and a strict enforcement of a hiring freeze."

The 1983 program was open to employees of the Legislature and Judiciary, which could refill vacated positions. Executive Branch agencies could not. In subsequent years, the Judiciary, State University and Legislature often refilled positions, negating much of the savings.

Even among Executive Branch agencies, mandates that a job be eliminated for a number of years are not foolproof. "There are no retirement police," says one observer, who argues wily bureaucrats can find ways around the ever vigilant Division of the Budget.

Leaving jobs vacant may not be an option in many cases. Therefore, savings can be limited. In instances where there is a small differential in salaries, retirement sweeteners can be expensive. If a $35,000-a-year laborer retires and is replaced by one making $30,000, the apparent $5,000 savings effectively vanishes when the retiree's added pension costs and continuing employer-paid health insurance premiums are considered in the equation.

— Lise Bang-Jensen

Endnotes

[1] Governor's Program Bill Number 249 (2010). http://www.ny.gov/governor/bills/pdf/gpb_249.pdf
[2] Pension sweeteners were offered to state employees in 1983 (Chapter 17 of the Laws of 1983), 1990 (Chapter 210 of the Laws of 1990), 1991 (Chapter 935 of the Law of 1990), 1995 (Chapter 12 of the Laws of 1995), 1996 (Chapter 30 of the Laws of 1996), 1997 (Chapter 41 of the Law of 1997), 1998 (Chapter 47 of the Laws of 1998), 1999 (Chapter 70 of the Laws of 1999), 2000 (Chapter 86 of the Laws of 2000) and 2002 (Chapter 69 of the Laws of 2002), according to the Office of State Comptroller.). Some of plans also included incentives for local government and school employees. In 2009, state employees were offered $20,000 severance payments (regardless of age) if they left their jobs.
[3] Office of State Comptroller (OSC) letter, Feb. 29, 2008.
[4] Those eligible for Tier III and IV were hired between June 30, 1973 and December 31, 2009.
[5] Program Bill #249, *ibid.*
[6] This estimate assumes the same number of participants in 2010 as 2008. Using state payroll figures showing average wages increased 31 percent between January 2002 and January 2010, it calculates pension costs would increase from $249 million to $326 million.
[7] "25/55 retire option in mix," Albany *Times Union*, April 14, 2010.
[8] New York State Department of Civil Service, "Workforce Management Report 2009," page 1.
[9] State Comptroller H. Carl McCall, "A report on New York State Retirement Incentive Programs: 1983, 1990, 1991, 1995," Nov. 1995.
[10] *Ibid.*
[11] OSC, letter, Feb. 29, 2008.
[12] Division of the Budget (DOB), email, Dec. 2008.
[13] Governor George Pataki, Veto Message Number 226 of 2006.
[14] "State buyout fails to hit goal," Albany *Times Union*, March 5, 2010.
[15] "Early retirements disrupting SUNYA; Overtime problems on the rise," Albany *Knickerbocker News,* June 1, 1983, p. 1.
[16] DOB, *ibid.*