McClatchy Washington Bureau

Print This Article

Posted on Sun, Mar. 06, 2011

Why employee pensions aren't bankrupting states

Kevin G. Hall | McClatchy Newspapers

last updated: July 12, 2011 06:46:28 AM

WASHINGTON — From state legislatures to Congress to tea party rallies, a vocal backlash is rising against what are perceived as too-generous retirement benefits for state and local government workers. However, that widespread perception doesn't match reality.

A close look at state and local pension plans across the nation, and a comparison of them to those in the private sector, reveals a more complicated story. However, the short answer is that there's simply no evidence that state pensions are the current burden to public finances that their critics claim.

Pension contributions from state and local employers aren't blowing up budgets. They amount to just 2.9 percent of state spending, on average, according to the National Association of State Retirement Administrators. The Center for Retirement Research at Boston College puts the figure a bit higher at 3.8 percent.

Though there's no direct comparison, state and local pension contributions approximate the burden shouldered by private companies. The nonpartisan Employee Benefit Research Institute estimates that retirement funding for private employers amounts to about 3.5 percent of employee compensation.

Nor are state and local government pension funds broke. They're underfunded, in large measure because — like the investments held in 401(k) plans by American private-sector employees — they sunk along with the entire stock market during the Great Recession of 2007-2009. And like 401(k) plans, the investments made by public-sector pension plans are increasingly on firmer footing as the rising tide on Wall Street lifts all boats.

Boston College researchers project that if the assets in state and local pension plans were frozen tomorrow and there was no more growth in investment returns, there'd still be enough money in most state plans to pay benefits for years to come.

"On average, with the assets on hand today, plans are able to pay annual benefits at their current level for another 13 years. This assumes, pessimistically, that plans make no future pension contributions and there is no growth in assets," said Jean-Pierre Aubry, a researcher specializing in state and local pensions for the nonpartisan Center for Retirement Research at Boston College.

In 2006, when the economy was humming before the financial crisis began, the value of assets in state and local pension funds covered promised benefits for a period of just over 19 years.

At the bottom of Aubry's list is Kentucky, which would have enough assets to cover 4.7 years. Other states do much better: North Carolina local government pensions are funded to cover 19 years of promised benefits; Florida's state plan could cover 17 years; and California's plans about 15 years.

"On the whole, the pension system isn't bankrupting every state in the country," Aubry said.

States having the biggest problems with pension obligations tend to be struggling with overall fiscal woes — New Jersey and Illinois in particular. Many states are now wrestling with underfunding because they didn't contribute enough during boom years.

Most state and local employees government across the nation have defined-benefit plans that promise employees either a percentage of their final salary during retirement or some fixed amount. The Bureau of Labor Statistics estimates that 91 percent of full-time state and local government workers have access to defined-benefit plans.

Several states_ including Florida, Georgia, Ohio, Colorado and Washington_ have adopted competing defined-contribution plans, or a hybrid plan that provides government employees both a partial defined benefit in retirement and a supplementary defined-contribution plan.

Defined-contribution 401(k) plans divert on a tax-deferred basis a portion of pay, generally partially matched by the employer, into an account that invests in stocks and bonds. In 1980, 84 percent of workers at medium and large companies in the U.S. had a defined-benefit plan like those still predominate in the public sector. By last year, just 30 percent of workers in these larger companies were covered under such plans.

Defenders of the public pension system say anti-government, anti-union elected officials and interest groups have exaggerated the problem to score political points, and that as the economy heals, public pension plans will gain value and prove critics wrong.

"There's a window that's closing as market conditions improve and interest rates rise, the funding of these plans is going to look better than depicted by some," insisted Keith Brainard, the director of research for the National Association of State Retirement Administrators in Georgetown, Texas.

Critics of public sector pensions paint the problem with a broad brush.

"Unionized government workers have tremendous leverage to negotiate their own wages and benefits. They funnel tens of millions of dollars to elect candidates who will sit across from them at the negotiating table," said Thomas Donohue, the chief executive of the U.S. Chamber of

Commerce, in a Feb. 24 blog post. "This self-dealing has resulted in ever-increasing wage and benefit packages for unionized government workers that often far outstrip those for comparable private-sector workers."

In a Feb. 23 radio interview, Rep. Devin Nunes, R-Calif., called federal stimulus efforts to rescue the economy "essentially a federal bailout of public employee unions." Nunes described money owed to state pensioners as a crisis "about ready to happen."

Except that two out of every three public-sector workers aren't union members.

The Bureau of Labor Statistics reported in January that 31.1 percent of state public-sector workers were unionized in 2010, compared with 26.8 percent of federal government employees. The highest percentage of unionization, 43.3 percent, was found in local government, where police officers and firefighters work. Teachers can fall into either state systems or local government.

Ironically, in Wisconsin, where Republican Gov. Scott Walker is trying to weaken public-sector unions and reduce pension benefits, he's exempted police and firefighters, who are among the most unionized public employees. And Wisconsin's public-sector pension plan still has enough assets today to cover more than 18 years of benefits.

The most recent Public Fund Survey by the National Association of State Retirement Administrators showed that, on average, state and local pensions were 78.9 percent funded, with about $688 billion in unfunded promises to pensioners. Critics suggest that the real number is at least $1 trillion or higher, using less-optimistic market assumptions.

The unfunded liabilities would be a problem if all state and local retirees went into retirement at once, but they won't. Nor will state governments go out of business and hand underfunded pension plans over to a federal regulator, as happens in the private sector. State and local governments are ongoing enterprises.

The flow of employees into retirement matches up with population trends in states, with Northeastern states with declining populations, particularly Rhode Island, seeing more stress on their pension systems than Southern and Western states, where there's been vibrant population growth.

Another misperception tied to the pension debate is that while the private sector has shed jobs during the economic crisis, state and local government employment has grown — and pensions along with it.

Since September 2008_ when state and local government employees numbered 19,385,000 and the economic crisis turned severe — the governments' payrolls shrunk by 407,000, to 18,978,000 this January, according to Bureau of Labor Statistics data.

When calculating from December 2007 _ the month that the National Bureau of Economic Research determined was the start of the Great Recession _ state and local government employment has fallen by 703,000 jobs amid a downturn that cost the nation more than 8 million jobs overall.

"The down economy has had an effect, and the loss of employment outside the public sector has created a contrast" said Brainard, of the National Association of State Retirement Administrators.

Also fueling backlash is the perception that state and local workers don't contribute to their own retirement funds the way private sector workers do.

Three states have non-contribution public pension plans _ Florida, Utah and Oregon. About a third of Connecticut state workers don't contribute to their pensions, while most new employees do. Missouri until recently had a non-contribution policy for state workers, as did Michigan until 1997. Michigan workers hired before 1997 still don't pay toward their pensions, and some teachers in Arkansas don't have to contribute toward theirs. Tennessee doesn't require contributions from most workers and employees in the state higher education system.

Those notable exceptions aside, most states require employee contributions. The midpoint for these contributions for all states and the District of Columbia is 5 percent of pay, according to academic and state-level research. That contribution rate climbs to 8 percent for the handful of states whose workers or teachers are prohibited from paying into the federal Social Security program.

By comparison, private-sector workers shoulder a bit more of the burden.

In its data for 2010, Fidelity Investments, the largest administrator of private-sector 401(k) retirement plans, showed employee contribution rates in its plans averaged 8.2 percent of pre-tax pay.

Separately, the Employee Benefits Research Institution estimates that most private-sector employers match up to 50 percent of employee contributions up to the first 6 percent of salary.

The utility or burden of either type of retirement plan depends on whether the plan is measured by what it delivers to an individual, or by how much it delivers to all workers receiving retirement benefits from their employer.

"It really comes down to what you are attempting to do," said Dallas Salisbury, the president of the nonpartisan Employee Benefit Research Institute.

Viewed through the lens of an employee, defined-benefit plans are more cost-effective at providing a pre-determined level of benefits to an employee. But the shortcoming of these plans is that they reward seniority. For workers with a shorter tenure, they're far less generous in retirement.

This fairness issue is one reason why 401(k) plans have grown steadily in prominence since the mid-1980s. From the payroll perspective of an employer, these defined-contribution plans produce at least some retirement income for the greatest number of employees, and the plans can move with employees who change jobs.

ON THE WEB

BLS data on unionization

Research on pensions, budgets

Projections of pension funding

How long states can fund their pensions

Public Fund Survey Scorecard

MORE FROM MCCLATCHY

Obama administration 'hostile to oil states,' Alaska Gov. Parnell says

State budget battles fuel debate about who pays

Something GOP doesn't want to cut: Funding for NASCAR

McClatchy's probe into roots of financial crisis, a Pulitzer finalist

To ask a question about this story or any economic question, go to McClatchy's economy Q&A

For more McClatchy politics coverage visit Planet Washington