REPUBLICAN GOVERNORS
PUBLIC POLICY COMMITTEE

Pension Reform Catalogue

RGPPC Regulatory Finance and Budget committee chairmen Governors Nikki Haley and Scott Walker have determined that pension reform will be the first priority of the committee. As such, the RGPPC staff has contacted several think tanks on behalf of the chairmen requesting a partnership in this endeavor. The following is a catalogue of the information we have collected as result of the partnerships. This report will continue to evolve and grow as we continue to do research and partner with future think tanks.

The following are the think tanks and their work on pension reform. At the end of this report you will find the contact information for the RGPPC staff and think tanks. Please feel free to contact us with any question or comments you may have.

Cato

State and Local Pension Plans: Funding Status, Asset Management, and a Look Ahead

Goldwater

Defusing the Pension Bomb: Making Retirement Plans Solvent for All Public Workers

Mercatus

The Crisis in the Public Sector Pension Plans, A Blueprint for Reform in New Jersey

Accounting for the Cost of a Public Sector Worker in New Jersey

From Defined Benefit to Defined Contribution

Rhode Island's Local Pension Debts

Illinois's Fiscal Breaking Points

The Political Economy of Medicaid Reform, Evidence from Five Reforming States

Institutions and State Spending, An Overview

The Fiscal Health of the States

Public Sector Unionism: A Review

The Heartland Institute

The State Public Pension Crisis: A 50-State Report Card

Defined contribution vs Defined Benefit Pensions

The Heritage Foundation
Understanding Public Pension Costs: The Example of Wisconsin

The Real Cost of Public Pensions

The Pew Center on the States
The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs

Platte Institute
Public Sector Pensions in Nebraska

Cato Institute

State and Local Pension Plans: Funding Status, Asset Management, and a Look Ahead
Jagadeesh Gokhale
For the full report please visit:
http://www.cato.org/store/reports/state-local-pension-plans-funding-status-asset-management-look-ahead

Pension and health care benefits provided to state and local government employees are considerably broader in coverage and more generous compared with those for private sector employees. According to the Bureau of Labor Statistics' Employee Compensation Survey (March 2010), 84 percent of all state and local government employees had access to a defined benefit retirement plan, 29 percent to a defined contribution retirement plan, and 23 percent to both types of plans during 2009. The corresponding numbers for all private-sector workers are 20 percent with access to defined benefit plans, 59 with access to defined contribution plans, and 14 with access to both types of plans. Using employer costs per hour worked as an indicator of the relative generosity of defined benefit pension plans, state and local government costs are $3.32 per hour worked, of which $3.00 is accounted for by defined benefit plans. Private industry costs are $1.03 per hour worked, of which $0.46 is accounted for by defined benefit plans.[1]

Goldwater Institute

Defusing the Pension Bomb: Making Retirement Plans Solvent for All Public Workers
By Byron Schlomach, Ph.D., director of the Goldwater Institute's Center for Economic Prosperity
For the Full article please visit: http://goldwaterinstitute.org/article/5974

Arizona's current public pension systems are costly, present needless risk to taxpayers, and drain tax resources from other potential uses. If policies are not changed, taxpayers will be on the hook to pay for these bloated plans far into the future, and other government programs may have to go on the chopping block to pay for pension benefits. Young employees, part of whose salaries are funding current pensions, are also at risk of never receiving the benefits they've already paid for if pension funds collapse under the weight of poor policy.

These risks are already understood by the Arizona legislature, as evidenced by the passage of Senate Bill 1609. This bill limits abuses such as "double-dipping" when retirees go back to their same jobs while receiving a pension. It also requires current employees to contribute more to their own retirements. However, the real risk is in the nature of pension systems themselves. Benefits guaranteed at future taxpayers' expense have to be funded even when economic times are bad. Benefits that are granted to retirees when economic times are good and pension funds' portfolios are flush cannot be rolled back when portfolios collapse with the pop of an economic bubble.

One way to see how Arizona's pension systems stack up is to compare them to a private employer's 401(k) contributions to employees. The average private employer's contribution to an employee's 401(k) is 3 percent of salary.1 Taxpayers are currently contributing about 9.8 percent of state government employees' salaries to their pensions, amounting to $173.6 million per year.2 If the public contribution fell to 3 percent of government employees' salaries, the annual contribution would be $53.1 million, saving $120.5 million, or more than 10 percent of Arizona's projected $1.1 billion budget shortfall for 2012. But the current level of public funding of

[1] Estimates, including the pension cost component, are as reported by the Bureau of Labor Statistics for the second quarter of 2011. The same pattern is observed in total compensation, with employer costs being $40.40 per hour worked in the state and local government sector versus $28.13 in private industry.

pension plans is likely to remain the same into the foreseeable future as pension fund portfolios are rebuilt to make the systems financially sound.

Arizona's pension systems are "defined benefit" systems, meaning a retiree receives a set pension each year after retirement determined by multiplying the retiree's salary level near the time of retirement by years of government employment and a multiplier of about 2 percent. Pensions are paid from funds accumulated through mandatory contributions by employees and taxpayers. Contributions are a percentage of current salary levels, and can vary from year to year according to the financial needs of the funds from which pensions are paid.

In 1998, the Arizona State Constitution was amended to include Article 29, Section 1(C), which states, "Membership in a public retirement system is a contractual relationship that is subject to article II, section 25, and *public retirement system benefits shall not be diminished or impaired*" (emphasis added). Before 1971, Arizona's retirement benefit was a defined contribution plan wherein the only guarantee was how much taxpayers were obligated to contribute; not how much they are required to pay out. The state managed employees' retirement investments and lifetime annuities were not guaranteed.3 This is more like the business-sector 401(k) plans.

Today, Arizona's public retirement systems have first priority in state funding since the funds come from general revenue sources but are not appropriated. The boards of the respective pension plans determine the level of contributions and state and local taxpayers are obligated to pay for them through their respective governments. This is in contrast to the defined contribution systems adopted in Alaska and Michigan, which are basically 401(k) retirement plans. There, taxpayer liability is limited to a contribution to a retirement account that the employee owns and controls. The Alaska and Michigan systems provide useful models for Arizona to follow as it works to stabilize its employee retirement benefit obligations.

Mercatus

The Crisis in the Public Sector Pension Plans, A Blueprint for Reform in New Jersey
Eileen Norcross, Andrew Biggs
For the full working paper please visit:
http://mercatus.org/sites/default/files/publication/WP1031-%20NJ%20Pensions.pdf

Pension plans operated by state governments on behalf of their employees are underfunded by an estimated $452 billion according to official reports,1 with total liabilities of $2.8 trillion and total assets of $2.3 trillion in 2008. However, many economists argue that even these daunting liabilities are understated. Current public sector accounting methods allow plans to assume they can earn high investment returns without any risk. Using methods that are required for private sector pensions, which value pension liabilities according to likelihood of payment rather than the return expected on pension assets, total liabilities amount to $5.2 trillion and the unfunded liability rises to $3 trillion.2 The ability of governments to pay for the retirement benefits promised to public sector workers runs up against the reality of limited resources.

Accounting for the Cost of a Public Sector Worker in New Jersey
Eileen Norcross, Roman Hardgrave
For the full working paper please visit:
http://mercatus.org/publication/accounting-cost-public-sector-worker-new-jersey

Much of the debate over the growing size of pensions relative to budgets has focused on whether public sector compensation costs are fair either in comparison to other municipalities or to the private sector. But this fairness debate, while important, obscures a more technical and far more fundamental question: why does the bill for public employee benefits appear to be a surprise to governments, beneficiaries, and taxpayers? This paper finds two primary reasons. First, the costs are not fully reported, but instead reflect accounting and actuarial assumptions that systematically underestimate the size of benefit liabilities. Second, the data are not always made easily available to the public. This information is important as the cost of long-term liabilities for pension and health benefits are matters that inform negotiations between public sector unions and state and local government officials. If the full costs are obscured by accounting conventions and actuarial techniques then policy makers, taxpayers and public employees are agreeing to policies without sufficient information about costs.

From Defined Benefit to Defined Contribution
Scott Beaulier

For the full working paper please visit:
http://mercatus.org/publication/defined-benefit-defined-contribution

State pension liabilities across the United States have surged to unprecedented levels in recent years. Historically, periods with higher levels of unfunded state pension liabilities have been associated with slower economic growth and restructuring of pension programs. Program restructuring takes many forms, and it ranges from benefit cuts to changes in eligibility requirements, to contribution rate increases—a more subtle form of restructuring involves adjusting the discount rate and actuarial assumptions built into defined pension benefit programs.

Many different state pension reform proposals have been proposed in the academic literature, and some states have engaged in radical reforms that shift public pensions from defined benefit to hybrid or defined contribution plans. The common rationale for reform is that defined benefit plans are proving costly to taxpayers, and the costs cannot be carried forward during stagnant economic times. In addition to their high total costs—as evidenced by total contribution rates that exceed 20 percent per dollar in most public programs—defined benefit programs are less predictable when it comes to future funding costs and outlays.

Despite the need for state-level reform, defenders of defined benefit programs assert that the programs simply need tweaks to be sustained; proponents resist radical reform because they are concerned about capital flight and the transition costs associated with shifting from defined benefit plans.

This paper explores the current state of public pensions across the United States and addresses transition cost and capital flight concerns. Further, it examines defined benefit programs vis-à-vis defined contribution plans, using a number of case studies to illustrate the challenges many states face.

Rhode Island's Local Pension Debts
Eileen Norcross, Benjamin J. VanMetre

For the full working paper please visit:
http://mercatus.org/sites/default/files/publication/RhodeIsland_NorcrossVanMetre_WP1143.pdf

Rhode Island’s state and municipal pension systems face large and growing unfunded pension liabilities. The governor and state treasurer have identified pension reform as a key to stabilizing the state’s finances and also to ensuring a sustainable retirement fund for Rhode Island’s public employees. According to government estimates, the unfunded liability for municipal plans and state plans totals $9.3 billion. These figures are calculated under assumed discount rates based on the expected return on pension asset investments. However, according to economic theory, pension liabilities should be valued based on their relative risk and thus the return on Treasury Bonds is currently the appropriate discount rate to use when valuing liabilities. Under this valuation, the unfunded liability for municipal governments including MERS and locally administered plans (and excluding the local portion of the teachers' plan) swells from $2.4 billion to $6 billion. The unfunded liability for the state plans increases from $6.8 billion to $12 billion.

The result of this miscalculation is that many municipal governments are in far worse shape than is currently reported, which presents serious revenue challenges for a number of Rhode Island municipalities. Unfunded municipal pension liabilities currently exceed municipal revenues by $2.6 billion in Rhode Island. The revenue index created in this paper indicates that Johnston, Providence, Cranston, Newport, and Central Falls are all in particularly bad shape relative to other municipalities in the state.

Illinois's Fiscal Breaking Points
Eileen Norcross, Benjamin J. VanMetre

For the full working paper please visit:
http://mercatus.org/sites/default/files/publication/Illinois-Fiscal-Breaking-Points_0.pdf

After more than a decade of failing to balance the state's budget, the Illinois legislature and Governor Pat Quinn presented the FY 2012 budget, "designed to help Illinois return to fiscal stability." The strategy presented includes, Illinois Working, a plan to "provide streamlined, efficient state government, foster economic growth, and develop the jobs of today and tomorrow."

Pointing to decades of fiscal mismanagement, compounded by a deep recession, the governor also signed into law Budgeting for Results, a spending reform which mandates that budget decisions be based on performance and impact, not politics. In addition, the legislature instituted a new law which it is claimed, "for the first time in Illinois's history, places limits on state spending." These measures led to an improved bond rating from Fitch Ratings and Standard & Poor's ratings agencies.

While these strategies sound meaningful they are unlikely to work, as they fail to identify the underlying causes for the rapid growth in spending in the state's budget. The legislature and governor continue to focus on revenue enhancements through increased taxation and borrowing, instead of institutional spending reforms, thus making it unlikely that the state will avoid serious fiscal repercussions in the near future, some of which will be triggered by the run-out in pension fund assets projected for 2018.

The Political Economy of Medicaid Reform, Evidence from Five Reforming States
Scott Beaulier, Brandon Pizzola

For the full report please visit:
http://grad.mercatus.org/sites/default/files/The-Political-Economy-of-Medicaid-Reform.pdf

In this paper, we look at the recent growth in Medicaid spending and attempt to explain Medicaid reform successes and failures by focusing on five reform experiences. Careful case study analysis will advance our understanding of best practices in Medicaid reform. Even though many states have introduced reforms over the last 10 years, combined federal and state Medicaid expenditures have grown from 2.0 percent of gross domestic product (GDP) in 2000 to 2.7 percent of GDP in 2007.

When we look past the rhetoric of cost savings and the so-called introduction of market principles into state Medicaid plans, the reality is that few reforms have succeeded at simultaneously (1) reducing costs, (2) maintaining or increasing access to health care, and (3) surviving the politics of reform. Some reforms that promise to reduce costs are dead ideas politically; others that are politically popular simply drive up costs.

Successful reforms that provide a combination of cost reduction and maintained or increased access are hard to find, and as a result, the easier path has been to increase Medicaid expenditures over time.

Institutions and State Spending, *An Overview*
Matthew Mitchell, Nick Tuszynski
For the full working paper please visit:
http://mercatus.org/sites/default/files/publication/Institutions_and_state_spending_Mitchell.10.3.11.pdf
U.S. fiscal policy at the federal, state, and local level is on an unsustainable path. While reformers should look for ways to reduce spending on particular budget items, tomorrow's legislatures may easily reverse these cuts. In contrast, a change in the rules that govern the political process—the "institutions" that shape a budget—can have a lasting effect on spending for years to come. Codified in statutes and in constitutions, these institutions include the rules of budgeting, electioneering, and legislating. They influence the decisions of legislators, governors, presidents, bureaucrats, voters, and even lobbyists. As such, institutional reform can be a more effective and sustainable path to fiscal probity than a one-time budget cut. This paper summarizes the empirical investigations of sixteen state-level institutions. The lesson for both state and federal policy makers is that there are a number of institutional reforms that seem likely to put spending on a more sustainable path

The Fiscal Health of the States
Jeffrey Miron, Robert Sarvis
For the full report please visit: http://mercatus.org/sites/default/files/publication/F111533064.pdf
States have large, understated implicit debts for unfunded pension liabilities, making their current net debt positions substantially worse than officially reported. And driven by increasing health care costs, state and local expenditures are growing faster than output. If spending trends continue and tax revenues remain near their historical levels relative to output, all 50 states will reach dangerous ratios of debt-to-GDP, and most will do so within 20 to 30 years.

While it will be politically difficult, states need to slow the growth of health care expenditures in order to avoid fiscal crisis. Also, the federal government will need to help states by changing some of its programs. It should consider converting Medicaid into block grants to states and then giving states substantial leeway to limit the rate of increase in program costs.

Public Sector Unionism: A Review
Eileen Norcross
For the full working paper please visit:
http://mercatus.org/sites/default/files/publication/WP1126-Public-Sector-Unionism.pdf
In 2009, membership in public sector unions surpassed membership in private sector unions for the first time in U.S. history. The growth in public sector unionism is part of a 60-year trend fueled by a decline in private sector union membership and the legalization of public sector unionization. The shift in American labor unionism from a private to a public sector movement has been described as a "structural break" in American labor unionism with implications not for the profitability of firms but for the solvency of governments.[2]

Public sector unions are able to affect governments' fiscal and budgetary policy by exerting influence through the collective bargaining process and through political activity by backing candidates likely to support the union's agenda. The effectiveness of these approaches in raising wages, employment, and spending depends on the interaction of collective bargaining laws and the political activity of unions.

In the larger policy debate over the role of public sector unions, there is a tendency to blur the lines between the history and goals of the private sector union movement and those of the public sector union movement, and thereby misunderstand their unique effects. The public sector union movement shares a link to the history and institutional structure of private sector unionism, yet they are also distinct movements, differing in origins, goals, approaches to bargaining, philosophies, and effects.[3] These two unionisms operate in different spheres. Private unionism operates as a labor cartel within the market economy and thus affects the profitability of firms, economic growth, the supply of labor, and consumer prices. Public sector unions function as a monopoly provider of labor within a bureaucratic-political realm. Public sector unionism introduces an unelected body into policy-making, thereby undermining the sovereignty of the state.[4] Public sector employees are able to influence through political lobbying of their "employer-sponsors" or politicians, who may seek to enhance union employment as a means of expanding their constituency.

This study reviews the origins, goals, and fiscal effects of public sector unionism.

The Heartland Institute

The State Public Pension Crisis: A 50-State Report Card
Policy Brief No. 126 the State Public Pension Crisis: A 50-State Report Card
By Eli Lehrer and Steve Stanek[2]

For the full report please visit:
http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/27578.pdf

Taxpayers in almost every U.S. state owe large and possibly unpayable retirement pensions to the men and women who work for the government. The deep recession of 2008-2009n has moved up the day of reckoning, requiring immediate action by many states to avoid financial catastrophe.

While no one doubts that the people, who police the streets, teach school, fight fires, plan roads, and administer government benefits deserve fair compensation for their labors, current public policy almost everywhere grants many public employees overly generous pensions that pose a large and growing burden on taxpayers. Even as many private employers have reduced or eliminated traditional pensions, they remain the norm for state government workers.

If large government pensions were part of a package that also included lower wages, they might be justified. But, on balance, government employees make more money than those in the private sector. According to the Bureau of Labor Statistics, average total compensation (wages and benefits) for government employees stands at $39.83 an hour, while private-sector workers receive an average of $29.40 an hour.[3] The average government employee, in other words, receives compensation worth almost $83,000 a year, while the typical private-sector worker’s compensation comes out to about $61,000.

The largest single cause of this disparity is not wages (although they are higher in the government sector) or even health insurance but, rather, the size of public-sector pensions. Only about a fifth of private-sector workers qualify for any sort of pension, while nearly 80 percent of government workers do. And governments spend nearly five times more on pensions than their private-sector counterparts.[4]

[2] Eli Lehrer is national director of the Center on Finance, Insurance, and Real Estate at The Heartland Institute. Steve Stanek is a Heartland research fellow and managing editor of *Budget & Tax News*. Longer bios appear on the back cover. They thank the following persons who assisted in research and peer review: Joseph Bast, Jesse Buggs, William Peirce, William Shughhart, and James Young. Any remaining errors are the authors’ responsibility.

[3] Bureau of Labor Statistics, “Employer Costs for Employee Compensation,” March 2010, http://www.bls.gov/news.release/ecec.nr0.htm.

[4] Ibid. Private-sector companies spend 1.5 percent of payroll, on average, on defined benefit pensions, while governments spend an average of 7.3 percent.

Public employee pensions are expensive. One analysis puts the unfunded collective burden of these pensions at between $750 billion and $1.75 trillion.[5] Unfunded liability is a measure of the shortfall between promised pension benefits and the ability of the pension fund to pay those benefits. For example, if the accrued liability is $5 billion and the value of assets is $4 billion, the unfunded liability is $1 billion. Dealing with these pension obligations represents a major challenge for the nation, its states, and its future. With all this in mind, the present report has three goals:

1. To draw attention to the enormous burdens public employee pensions pose in some locations;
2. To create an objective way to measure and rank states according to the operation and relative disposition of the pension plans in the 50 states; and
3. To suggest ways that states facing problems with their pension systems might go about solving these problems.

Part Two reviews the nature of the public-sector obligations and gives some evidence as to their size and fiscal risk. Part Three reviews and justifies the criteria we use to compare state pension plans. Part Four ranks all 50 states and every major public employee pension plan in the U.S. Part Five describes some reforms states could adopt to avoid the looming crisis. Part Six is a brief summary and conclusion. An Appendix contains tables showing enrollment of individual pension plans and how each plan scores on the six variables in the report card.

Defined contribution vs. Defined Benefit Pensions
John Nothdurft

For the full article please visit:
http://heartland.org/policy-documents/defined-contribution-vs-defined-benefit-pensions

According to the Pew Center on the States, state government employee pension plans nationwide have racked up nearly $360 billion in unfunded pension liabilities. There is also an additional $370 billion in unfunded liabilities for other retirement benefits, including health care. While those numbers represent a huge problem, they don't take into account the billions of dollars in underfunded county and city-level government pensions.

The underlying cause of the problem is "defined-benefit" pension plans, which guarantee employees a pre-set benefit amount upon retirement. At all levels of government, politicians and administrators have "guaranteed" overly generous benefits while pushing the costs onto future generations of taxpayers by failing to fully fund the pensions.

Some states are using stop-gap measures, such as increasing retirement ages or limiting benefits, but these don't fix the fundamental problems created by defined-benefit pensions. Only by following the private sector's lead and switching workers from a defined-benefit pension system to a defined-contribution system can states and localities eliminate the burden of future pension liabilities, avert the pension crisis, and make budgeting more predictable.

Consider this comparison of defined-benefit pension and defined-contribution retirement plans.

Defined-benefit pension plans ...

Create huge unfunded liabilities

Defined-benefit pension plans will continue to face an increasing strain as millions of baby-boomer employees retire over the next two decades. Due to budget deficits and other factors, states are increasingly lagging behind

[5] Robert Novy-Marx and Joshua D. Rauh, "The Intergenerational Transfer of Public Pension Promises," National Bureau of Economic Research, September 2008, http://www.nber.org/papers/w14343.

the 80 percent funding threshold widely accepted as being adequate. A 2008 Government Accountability Office study on the funding status of state and local pensions found, "58 percent of 65 large public pension plans were funded to that level in 2006, a decrease since 2000 when about 90 percent of plans were so funded."

Threaten future taxpayers

Peter Orszag, head of the Congressional Budget Office, estimates that in the past 15 months, and most notably in the past few weeks, employee retirement accounts have lost $2 trillion in value. By law, the trillions lost in public pension obligations must be paid out ... and taxpayers will be forced to foot the bill.

Restrict worker freedom

Defined-benefit pension plans prevent workers from having job flexibility and control over their own retirement. With vesting periods often 10 years or longer, many government workers are being boxed into a corner, staying with jobs they don't like or passing up better opportunities just to lock in pension benefits.

Defined-contribution retirement plans ...

Contain runaway costs

Defined-contribution retirement plans are fully funded up front, preventing pension obligations from sneaking up on future generations of taxpayers and allowing for more stability in budgeting. These plans are more transparent and sustainable for governments and taxpayers, because they are funded up front.

Create worker freedom and retirement fund portability

Defined-contribution retirement plans are particularly appealing to younger workers, as they allow workers to take their retirement funds from job to job. It is common today for workers to switch jobs numerous times over their lifetimes; with defined-contribution retirement plans, these workers can save towards their retirement earlier and with more job flexibility. The Reason Foundation study cited below found, "70 percent of [California] state and local government employees lose all employer contributions because they leave their jobs before satisfying the 10-year vesting requirement."

Create investment choice

Employees have ownership of defined-contribution retirement plans and choice over their retirement investments. If employees do not want to risk their retirement funds on the stock market, they can invest in savings deposits, money markets, or government bonds. Defined-contribution retirement plans allows workers to tailor their investments according to their own risk-tolerance and investment strategies.

The Heritage Foundation

Understanding Public Pension Costs: The Example of Wisconsin

Jason Richine, Ph.D

For the full issue brief please visit: http://thf_media.s3.amazonaws.com/2012/pdf/ib3617.pdf

The generosity of pensions provided to public-sector workers has come under increased scrutiny as states and local governments search for ways to close their budget deficits. The intense and ongoing battle over public-sector collective bargaining in Wisconsin, for example, is in part a conflict over the generosity of public-pension benefits. Whether reducing pension benefits is a wise policy choice depends crucially on understanding the full costs to taxpayers. Unfortunately, the complexity of estimating pension costs has led to significant confusion among both policymakers and taxpayers.

The problem, however, is that assigning a cost to public-pension compensation is difficult. It requires reading actuarial reports for individual pensions, adjusting the cost estimates to reflect market interest rates, and converting those estimates to comparable private-sector investments. The complexity of the issue can be confusing for policymakers and voters. Adding to that confusion are public-pension advocates who have offered misleading data points that make pension compensation seem modest. Citing the average pension benefit or the amount that states contribute to their pension funds as indicative of the true cost of pension compensation are two of the most common examples.

The Real Cost of Public Pensions

Jason Richine, Ph.D

For the full report please visit:
http://www.heritage.org/research/reports/2012/05/the-real-cost-of-public-pensions

Properly estimating the cost of public-sector pensions may at first seem like something that only number-crunching bureaucrats need to worry about. On the contrary, pension-cost analysis informs some of the nation's most highly charged political debates occurring at all levels of government. Specifically, whether reducing public-employee benefits to help balance budgets is a wise policy choice depends critically on whether current compensation for public workers is at appropriate market levels. If current compensation is too high, benefit reduction could be an excellent way to reduce budget deficits. If, on the other hand, current compensation is already too low, further cuts would be inadvisable.

Unfortunately, the existence of traditional DB pensions in the public sector makes proper comparisons difficult. The cost to the employer of a 401(k)-style DC plan is simply the amount of money contributed to the plan, but estimating the cost of DB plans requires a host of complicated actuarial calculations inaccessible to the average voter trying to make informed choices. Taking advantage of the inevitable confusion, some public-sector advocates have used misleading data points in debates over the cost and generosity of pension benefits. In reality, the average public pension is several times more generous than 401(k)-style plans in the private sector. A proper understanding of the real cost of public pensions, especially in comparison to private-sector DC plans, is the first step toward reform.

The Pew Center on the States

The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs

For the full report please visit:
http://leg.mt.gov/content/Publications/fiscal/Pensions/Pew-Report-Widening-Gap.pdf

In the midst of the Great Recession and severe investment declines, the gap between the promises states made for employees' retirement benefits and the money they set aside to pay for them grew to at least $1.26 trillion in fiscal year 2009, resulting in a 26 percent increase in one year.

State pension plans represented slightly more than half of this shortfall, with $2.28 trillion stowed away to cover $2.94 trillion in long-term liabilities – leaving about a $660 billion gap, according to an analysis by the Pew Center on the States. Pension funding shortfalls surpassed funding gaps for retiree health care and other benefits for the first time since states began reporting liabilities for the latter in fiscal year 2006.[6]

In all, state pensions were slightly less than 78 percent funded – declining six percentage points from the 2008 level of 84 percent. New York led the way with a funding level of 101 percent – the only state to enjoy a

[6] Some organizations, such as the Center on Budget and Policy Priorities, the National Association of State Retirement Administrators, the National Conference of State Legislatures and the National Association of State Budget Officers, among others, have suggested that it is not appropriate to combine the unfunded liabilities of state pensions and retiree health care benefits. They contend that because retiree health care benefits do not enjoy the same level of constitutional and statutory protections as pensions, the unfunded liabilities for those benefits should be considered separately.

surplus – while Illinois and West Virginia were at the back of the pack, with just slightly more than half of their liabilities accounted for. Overall, this is a worrisome trend, because most experts including the Government Accountability Office advise states to have at least an 80 percent funding level. Thirty-one states were below this threshold in fiscal year 2009, a dramatic one-year increase from fiscal year 2008, when 22 states were less than 80 percent funded.

Potential Consequences and Recent Reforms

Just as failing to meet a monthly payment on a personal loan can result in higher payments down the road, a state's failure to pay the annual bill for retirement benefits can mean it will have to pay more in the future. A comparison of New York and New Jersey provides a good example. Both states had fully funded pension plans in 2002. In subsequent years, the Garden State failed to make more than 60 percent of its annual contribution in each year and its funding gap grew to $46 billion.

Platte Institute for Economic Research

Public Sector Pensions in Nebraska
Andrew G. Biggs – American Enterprise Institute

For the full policy study please visit:
http://www.platteinstitute.org/docLib/20111212_Public_Sector_Pensions_in_Nebraska.pdf

Nebraska presents what could be a model for public sector pension reform, the so-called "cash balance" plan that offers some of the better aspects of both traditional defined benefit pensions and the defined contribution, 401(k)-type plans that dominate in the private sector. In this study we examine the factors that make cash balance plans attractive as well as examining some of their potential shortfalls.

Nebraska NPERS Cash Balance Plan

Pensions for Nebraska state government workers are managed by the Nebraska Public Employees Retirement Systems (NPERS), which administers several different retirement plans. Nebraska state employees hired since 2003 join a cash balance retirement plan, which includes features of both a traditional defined benefit pension and a 401(k)-style system. Nebraska employees hired prior to 2003 were enrolled in a DC pension plan, which is very unusual for a public sector pension. Other states, including Kansas, Maryland, Montana and Pennsylvania, have at least analyzed the idea of shifting to a cash balance approach.

Employees contribute 4.8 percent of their salaries to the Nebraska plan on a pre-tax basis. Employers contribute an additional 7.5 percent of pay, for total contributions of 12.3 percent. The government invests those contributions and manages them similarly to ordinary state and local DB pension assets. Roughly two-thirds of these assets are held in U.S. or foreign stocks, with most of the remainder in fixed income investments. Nebraska projects a future average return on these assets of 7.75 percent.

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