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This newsletter highlights articles, research, opinion, and other information related to public pension problems and reform efforts across the nation. To find previous editions, please visit http://reason.org/newsletters/pensionreform/.

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Articles, Research & Spotlights

Articles, Research & Spotlights

GAO Report on Pension Discount Rates: A Comprehensive Picture
By Truong Bui, Reason Foundation

The Government Accountability Office (GAO) released a comprehensive report on defined benefit plan (DB) discount rates to inform the debate surrounding the appropriate interest rates used to value public plans. While the report does not provide definitive answers or give specific recommendations, its findings reveal an overall picture of the use of pension discount rates in the US.

The report identifies two primary approaches to determining a pension plan's discount rate: the assumed-return approach and the bond-based approach. The former is based on the long-term average rate of return on the plan's assets, while the latter is based on marker prices for fixed-income securities that are similar to the plan's benefit promises. In the United States, public sector plans and private sector multiemployer plans use the assumed-return approach, while private sector single-employer plans use the bond-based approach. As a result, the two groups have potentially large differences in funded ratios and reported liabilities.

To read the rest of the blog, go here. To read the GAO's full report, go here.

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Myth and Muddle Blocking Pension Reform
By Lance Christensen on Anthony Randazzo, Reason Foundation

When it comes to public pension debates, few myths are as enduring as the "transition costs" myth. Reason Foundation economist and pension expert, Anthony Randazzo, devoted a major article debunking the myth here , and the fallacy has briefly discussed here. In a recent interview with Michigan Capitol Confidential, Randazzo outlined the key points regarding the misconception:

Randazzo: The myth is based on two mistaken assumptions that certain steps need to be taken when switching from a defined-benefit system to a defined-contribution system. They are:
(1) That government must start making bigger debt payments to the defined-benefit system after it is closed.
(2) That a defined-benefit system needs new members in order to keep it solvent.
Neither of these assumptions are true. Regarding the first mistaken assumption, it might be recommended that a government increase the size of its debt payments after the system has been closed in order to pay off the debt sooner, but there is no legal requirement that it do so.
Regarding the second mistaken assumption, defined-benefit systems are supposed to be fully funded on a yearly basis by employer and employee contributions plus investment earnings. These systems are not based on new workers subsidizing older workers.

Randazzo then rightly argued that a defined contribution (DC) system is "100 percent more transparent than a defined benefit system" since the DC system does not require any actuarial assumptions about the future, and annual costs are straightforward, without any contingent obligations on future taxpayers.

To read the whole interview, go here.

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Stockton and Detroit Exit Bankruptcy Leaving Pension Systems As-Is
By Lance Christensen & Victor Nava, Reason Foundation

The landscape for public employee pensions shifted in 2014 as federal judges gave credence to the idea that pension benefits may be cut in bankruptcy. This challenges the long held idea that pension benefits are impervious to cuts and most observers are wondering just how significant this shift will be going forward.

This fall, city leaders watched as federal judges approved debt-cutting bankruptcy plans in Stockton and Detroit, ending two of the largest municipal bankruptcy cases in U.S. history. Many speculated both cities could do more to ease their fiscal problems by making significant cuts and structural changes to public pensions. However, both judges demurred and moved forward with plans that eased a portion of the cities' financial obligations, but largely protected pensions. The failure to significantly address public pension debt and make structural changes to the pension systems in both Stockton and Detroit does not bode well for the economic future of either city post-bankruptcy. It also presents an interesting conundrum for other cities in dire fiscal distress that bear significant pension costs and unfunded liabilities. Are more cities to follow the path to pension cuts in bankruptcy?

To read the rest of the column, go here.

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Judge Strikes Down Reform of Illinois' Extremely Screwed Up Public Pensions
By Scott Shackford, via Reason.com

The public employee pension system in Illinois is an absolute disaster. It's objectively in the worst state in the whole country. According to a recent analysis by non-profit State Budget Solutions, it's at or near the top of several different lists for underfunding. Its liabilities are worth more than $300 billion, and the pensions are only 22 percent funded, leaving each resident of the state on the hook for $25,000 in potential debt if the funds miss their targets. Employees barely contribute to their own pensions and the state has also frequently skipped its own payments.

The state managed to push through some extremely modest pension reforms last year after a lot of wrangling and hand-wringing. It froze cost-of-living increases, raised the retirement age, and capped the maximum salary used to determine pensions. But employee unions have fought it, and today they were handed a victory. A judge ruled the reforms violate the state's constitution.

To read the whole blog, go here.

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Pension Debt: Omaha's Billion Dollar Problem
By Anthony Randazzo, Truong Bui and Leonard Gilroy, Reason Foundation

A recently study jointly released by Reason Foundation and the Platte Institute discusses how poor actuarial assumptions and irresponsible public policy decisions have caused several problematic trends. Omaha is using an unrealistic assumed rate of return on its investments, and is inappropriately depending on savings from the recently adopted deferred retirement option plan for current employees.

The only real way to reform Omaha's public employee pension plans is to adopt a new system that is not wholly reliant on the speculative forecasts of financial risk professionals.

To read the full study, go here.

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Demographic Changes Threaten Pensions
By Steven Greenhut, via Reason.com

In a 2011 profile about California's ongoing fiscal mess, Vanity Fair interviewed San Jose's then-Mayor Chuck Reed, a progressive Democrat who has for years been warning about coming cuts in public services if the state's pension systems don't get benefit levels under control. Reed did the math and the picture wasn't pretty.

"By 2014, Reed had calculated, a city of a million people, the 10th-largest city in the United States, would be serviced by 1,600 public workers," according to the piece. "The problem was going to grow worse until, as he put it, 'you get to one.' A single employee to service the entire city, presumably with a focus on paying pensions."

Pension activists still refer to Reed's "joke," but it wasn't really a joke and it's certainly not funny. Defenders of the current pension system accused Reed and the state's pension reformers of overstating the problem. But while San Jose and other cities will never literally reach a single employee who sits in the room mailing out pension checks, the trajectory is headed in that troubling direction. One city manager even quipped to a newspaper a few years ago that cities are becoming pension providers that offer a few public services on the side.

To read the rest of the column, go here.

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Truth in Accounting: The 2013 Financial State of States
By Truong Bui, Reason Foundation

Truth in Accounting's most recent comprehensive review of state finances reveals $1.2 trillion in total state debt that is not backed by available assets, and $1.1 trillion in total unfunded pension liabilities. It should be noted that of the $1.1 trillion in unfunded liabilities, more than $993 billion are off-balance sheet due to outdated accounting standards.

Among the 50 states reviewed, 41 have financial holes imposing "Taxpayer Burden" on current and future taxpayers, despite balanced budget requirements in 49 states. The state with the highest Taxpayer Burden is Connecticut with $48,100 in the burden, followed by Illinois - $43,400, New Jersey - $36,000, Massachusetts - $28,000, and Hawaii - $27,000. "Taxpayer Burden" here means the amount of money each taxpayer would have to send to their state to eliminate its current financial hole. On the bright side, the top five states for "Taxpayer Surplus" are Alaska, North Dakota, Wyoming, Utah, and South Dakota. These states have assets available to pay their bills.

To read the blog online, go here. To read the Truth in Accounting's review, go here.

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Pension Reform Handbook: A Starter Guide for Reformers
By Lance Christensen and Adrian Moore, Reason Foundation

Reason Foundation has just released a pension reform handbook as a comprehensive starter guide for state and local reformers. This handbook aims to capture the experience of policymakers in those jurisdictions that have paved the way for substantive reform, and bring together the best practices that have emerged from their reform efforts, as well as the important lessons learned. By presenting these alongside the general principles and approaches that work to reform public policy, this handbook represents a "what you need to know" starter guide for anyone planning to reform his or her jurisdiction's pension system.

The handbook begins by outlining the causes of pension problems, before taking the reader through seven pension reform case studies. It offers guidance to policymakers seeking to research their jurisdiction's pension problem, lays out the general principles of reform, and then examines in detail what it takes to build a successful reform effort from the ground up.

To access the handbook, go here.

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Quotable Quotes on Pension Reform

"San Bernardino's choice to leave its accrued pension liabilities unimpaired means that its contribution requirements to CalPERS will likely increase to the point where they weaken the city's financial profile, even after the relief provided by the bankruptcy adjustments,"
- *Gregory Lipitz and Thomas Aaron, Moody's*

"It is working its way back to financial health and will become healthy if all assumptions hold and we are comfortable with asking people who have not been born yet to help pay for work that was performed last year,"
- *Gretchen Tegeler, president of the Taxpayers Association of Central Iowa*

"While I understand the need to re-balance the budget in light of unexpected shortfalls, the decision to delay state contributions to our underfunded pension system is disappointing,"
- *Ron Estes, Kansas State Treasurer*

"Service purchases are a rip-off of epic scale. And no one - no one - should be able to collect a public pension at age 43."
- *Glenn Cook, senior editor writer, Las Vegas Review-Journal*

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Contact the Pension Reform Help Desk

Reason Foundation set up a Pension Reform Help Desk to provide information on Reason's work on pension reform and resources for those wishing to pursue pension reform in their states, counties, and cities. Feel free to contact the Reason Pension Reform Help Desk by e-mail at pensionhelpdesk@reason.org.

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