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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

Mixed Results for Pension Reform Supporters in Midterms
By Scott Shackford, via Reason.com

Candidates who have taken on the unions fared well in the 2014 midterm elections. Initiatives related to reforming their pensions did not, however, do so well. Rick Snyder of Michigan and Scott Walker of Wisconsin, both Republican, fended off challengers to earn additional terms as governors. Both have earned the ire of unions; Snyder for supporting right-to-work laws and Walker for stripping public sector employees of some collective bargaining powers.

Possibly more important, though, is the victory by Democrat Gina Raimondo in Rhode Island. As treasurer, Raimondo hammered out significant public employee pension reforms, forcing them into solvency and shifting employees into hybrid plans to reduce the amount of potential debt obligations the state would take on. Polls then showed union workers rallying behind her Republican opponent, Allan Fung, 42 to 30 percent. She eked out a three-point victory, nevertheless.

On the flip side, a couple of public employee reforms on city ballots failed. In Phoenix, a ballot initiative to fight pension spiking and to force new city employees into 401(k)-style defined contribution plans failed, losing 43 to 57 percent. In a smaller loss, but a loss nevertheless, bankrupt San Bernardino, California, has failed to make changes to the charter so that the City Council can actually have some control over public employee salaries.

To read the full blog, go here.

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Why Were Ventura County Residents Blocked From Voting on Pension Reform in the Midterm Elections?

By Alexis Garcia, via Reason.com

Like so many retirement systems across the country, Ventura has seen its pension fund go from having a healthy surplus to being over a billion dollars in debt. To avoid having their county become the next Stockton or Detroit, the Ventura County Taxpayers Association (VCTA) crafted a reform measure that would move the county from a defined benefit to a defined contribution system.

But shortly after it was approved to appear on the ballot, a local judge preemptively ruled the measure illegal and ordered it stricken from the 2014 election-thus ending Ventura's hopes to change their costly pension system. According to the judge's ruling, even though voters elected to create a pension fund decades ago, the law provides them no way to exit the system through a vote. Reformers would have to either repeal or amend the law through state legislation to change their costly pension programs.

The decision was a setback for the VCTA who had hoped a midterm victory could expedite change to Ventura pension's growing mountain of debt. In 1999, pension payments accounted for just one percent of the total budget-today that number is 17 percent . Change in demographics and unrealistic investment targets are among the key factors contributing to the rise in pension costs. The reform measure was estimated to save the county $460 million over the next 15 years and would reduce pension liabilities by $1.8 billion.

To see the video, go here.

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Tulsa Pension System Is Underestimating Its Debt, Investment Risk by Millions

By Anthony Randazzo, Reason Foundation

The Tulsa Municipal Employees' Retirement Plan (MERP) released an annual report this year stating that it was $118.9 million in debt, or about $300 in debt for every citizen living in the city limits. This means the city only has 77.7% of the assets needed to pay out all of the pension benefits it has promised to city employees. This is in stark contrast to the city's situation a decade ago, when the system was fully funded.

Taken at face value, MERP's estimate of its unfunded liabilities is worrisome enough. Unfunded liabilities have soared since the end of 2003, and the funding ratio has steadily declined. This has been largely driven by a divergence in the growth rate of MERP's assets and liabilities.

However, Reason's recent analysis of the MERP system suggests that Tulsa is currently underestimating its debt by as much as $500 million, and is facing millions more in additional pension costs due to an unrealistic expectation on its investments over the next 30 years.

To read the actuarial analysis, go here.

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Wyoming's Pension System: Afloat in Troubled Waters

By Maureen Bader, Wyoming Liberty Group and Lance Christensen, Reason Foundation

The state of Wyoming may not have massive pension debts like other U.S. states, but earlier this year, the Pew Foundation reported that Wyoming has $1.7 billion in unfunded pension liabilities, which without reform to its flawed pension system, are a threat to its fiscal well- being now and in the future. The state's continued use of defined benefit (DB) pension plans exacerbates a dangerous financial risk for state and local government balance sheets, putting taxpayers at risk for a retirement system bailout and government retirees at risk for decreased pension payouts. Elected officials need to put government employees on a path to retirement security that is fiscally sound for both them and the taxpayer.

Lawmakers need to act now and implement substantial reform to ensure that unfunded liabilities are paid down in a reasonable timeframe and pension systems are honestly and adequately funded with responsible governance, management and transparency controls. With reform, Wyoming's state and local governments will do much to avoid inevitable financial shortfalls that will affect taxpayers and government workers alike.

In this report, Maureen Bader at the Wyoming Liberty Group and Lance Christensen at Reason Foundation assess the funding status and pension costs of the Wyoming's state pension system, as well as provide recommendations for reform. The authors also address the key objections to reforming the Wyoming system.

To read the report, go here.

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Update on State Unfunded Liabilities

By Truong Bui, Reason Foundation

Last year, State Budget Solutions produced widely read research revealing that state public pension plans were underfunded by $4.1 trillion, based on fair-market valuation. Reason Foundation commented on analysis here . State Budget Solutions has recently updated the study, finding that the unfunded figure has increased to $4.7 trillion, with the aggregate funded status having dropped to 36 percent from 39 percent in 2013. Part of the deterioration in funding is due to a decrease in the fair-market discount rate from 3.255 percent to 2.734 percent. Had the study applied last year's discount rate to this year's numbers, it would have still resulted in an increase of nearly $110 billion in unfunded liabilities.

Using the market-valued approach that relies on an almost risk-free discount rate, the study shows a more accurate picture of state pension debts. Most financial economists agree that the discount rate used to value pension liabilities should reflect the risk of these liabilities, not the expected returns of the invested assets. Because pension payments to state employees are guaranteed, the appropriate discount rate should be much lower than the 7 to 8 percent rate assumed by most state pension plans.

The study finds that California has the largest unfunded liability in total dollars at $754 billion, followed by Illinois at $331.6 billion and New York at $307.9 billion. In terms of funded ratio, the Illinois system is the most underfunded, with a funded ratio of 22 percent, followed by Connecticut at 23 percent and Kentucky at 24 percent. With regard to unfunded liability per capita, Alaska is the worst with $40,639 pension debt per capita, followed by Illinois and Ohio.

To read the research, go here.

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Poor Financial Estimates Plague Orange County, CA Retirement System

By Anthony Randazzo, Reason Foundation

Here's a piece of good news for Orange County taxpayers: Over the past decade, the county has acted fiscally responsible by paying 100 percent of the amount financial risk specialists suggested should be saved to pay for pension benefits that have been promised to employees.

But here's the bad news: The financial experts haven't been making good estimates, and the Orange County Employees Retirement System has $5.4 billion in debt. In 2000, OCERS had more assets on hand than it had promised to pay in retirement benefits. But today, the system has just 65 percent of the money needed to pay for pension promises made to employees.

Poor actuarial assumptions about the pension's investment returns and life expectancy of retirees are the main causes behind the situation. Consider that 10 years ago OCERS officially assumed that it would earn a 7.75 percent investment return on its assets over the following decade. Instead, the county earned 6.56 percent. Furthermore, the life expectancy projections the county was using 10 years ago were nearly 50 percent too low for most age groups.

To read more about the issue, go here.

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California Pension Fund Mystified That Folks Are Upset About Budget-Busting Bonuses

By Scott Shackford, via Reason.com

In August, Victor Nava of the Reason Foundation highlighted what is ultimately the destruction of a significant feature of California Gov. Jerry Brown's modest public employee pension reforms. He sought to stop one source of pension spiking-the pursuit of temporary bonuses and extras in pay that ultimately permanently boost an employee's pension payout-by requiring pensions to be calculated from base pay, not including these bonuses.

No problem, said the California Public Employees' Retirement System (CalPERS). They'll just declare all sorts of bonuses to be part of their base pay and force them right back into the pension calculations. CalPERS voted to have 99 bonuses sometimes given to certain public employees for various tasks that most of us would classify as expected job duties (like officers directing traffic) as part of their base pay. And so California's multi-billion-dollar pension crisis gets worse.

To read the full blog, go here.

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The "Transition Costs" Myth

By Anthony Randazzo, Reason Foundation

When a particular state or local government proposes switching its pension plan for new employees from the old style defined-benefit (DB) to a modern defined-contribution (DC) plan, it is often argued that the switch will cost money-that transition costs will outweigh the benefits of the change. However, those arguments fundamentally misunderstand how defined-benefit pension systems are funded.

So what are the major arguments that there are transition costs involved in switching to a DC plan? According to one argument, the Government Accounting Standards Board recommends that when a g overnment closes a DB plan that has unfunded liabilities, the payment schedule on that debt should be shortened, effectively increasing employer pension costs in the short run. Another prominent argument is that a DB plan needs new members-and their payments into the system-in order to keep it solvent. Closing the DB plan to new entrants will require higher payments from employees in the plan or from the government. In this brief, Reason's Anthony Randazzo explains the fundamentals of pension funding, and debunks these "transition costs" arguments in the clearest possible terms.

To read the brief, 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

"You can't be a progressive and be opposed to pension reform. You can't have well-funded and flourishing public schools and public buses and an underfunded pension system. It's just not possible. So by asking people to go without a cost-of-living increase in retirement, then you can have better bus service, good streets, safe parks, Head Start and universal pre-K."
- Gina Raimondo, Rhode Island Governor-elect

"In the months ahead, California and its local communities will continue to wrestle with how to responsibly manage the unfunded liabilities associated with providing retirement security to police, firefighters, teachers and other providers of critical public services. Those debates and the actions that flow from them must be informed by reliable data that is free of political spin or ideological bias. Toward this goal, my office is now providing a one-stop portal into

the financial underpinnings of each of California's 130 public pension systems. By pushing our state into the digital age of providing knowledge and information, I hope to empower greater citizen participation in how government handles a policy matter which is central to California's long-term prosperity."
- John Chiang, California State Controller

"We just got blindsided... They had a job to do and we trusted them. And it turned out the trustees, the advisers, the actuaries and the accountants misled us."
- Coletta Estes, Detroit pension plan member

"Bringing about a systematic change in our pension system is absolutely required, not just for Pittsburgh but for every other older city throughout the state of Pennsylvania."
- Bill Peduto, Mayor of Pittsburgh

"The SOA's updated tables and mortality improvement scale show that people are living longer. For example, the updated reports show that among males age 65, overall longevity rose 2.0 years from age 84.6 in 2000 to age 86.6 in 2014. For women age 65, overall longevity rose 2.4 years from age 86.4 in 2000 to age 88.8 in 2014. Based on the data, the SOA estimates there could be a four to eight percent increase in private pension plan liability. This average cost impact will vary greatly according to the design and demographic profile of each plan."
- Society of Actuaries

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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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Follow the discussion on pensions and other governmental reforms at Reason Foundation's website or on Twitter @ReasonReform. As we continually strive to improve the publication, please feel free to send your questions, comments and suggestions to lance.christensen@reason.org.

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