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Pensions In Crisis

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California State Teachers' Retirement System

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Pensions In Crisis

With the number of adversaries arrayed against public employees and the resources available to them, it is pointless to deny the seriousness of the assaults against public pension systems, even if the charges being brought against the systems are trivial, misleading or even patently false. Among the charges most often heard are the four listed in the first slide and they need to be countered,

• **Poorly Run** – If you measure systems by the return on investment they are quite well run and have done very well; except where in a few cases systems have plunged into equities to cover unfunded liabilities. In Illinois they have exceeded the actuarial predictions consistently and have helped a badly under-funded system from being worse.

• **Highly in Debt** – Nationally we are told that the funded ratio stands near 85% which is considered not too bad. In Illinois, with the unfunded liability in excess of 40% this cannot be said but debt is in most cases due to failure of employers to make the actuarially required contribution for normal costs or pay the debt interest that accrues from that unfunded position. Debt compounding debt is the monster that can destroy the viability of a pension system and at 85% funded, the interest on the 15% unfunded exceeds the normal cost of the system.

• **Expensive** – Captains of industry who have shed their corporations of any responsibility for the welfare of retired workers find defined benefit pensions to be expensive because the alternatives they offer do not bring protection, benefits or security i.e., “no pension is cheaper than any pension” therefore relatively public pensions are expensive.

• **Overly Generous Benefits** – The argument that is used to support the idea that public pensions are overly generous goes like this. Public employees used to be poorly paid compared to private sector employees. Decent pensions were necessary to attract and hold employees. Now private salaries are lower, so pensions are no longer needed to attract and hold employees and are therefore overly generous by definition – i.e., more than we need to provide. You can make up your own response to this.

The loss of relative wealth among the vast majority of American workers since 1970 is well documented. Adjusted for the cost of living, per capita wealth is up 30% or more during that period but wages for the vast majority have been stagnant. A smaller and smaller fraction have benefited handsomely while the majority have more or less stood still.
Poor labor laws, the move to the political right, the loss of bargaining power brought on by deregulation, efficient transportation of goods, globalization of trade to countries with no labor standards and an economic policy that sees unemployment and large soft labor pools as the cure for inflation have helped to diminish the power of workers to demand good wages and benefits.

So the last twenty years have brought the end to most private sector defined benefit pensions. Current government debt and pension system debt press down on government units and prevent addressing problems that need to be faced, but the debt frustrates. A future debt of almost unbelievable size awaits as Social Security and Medicare problems mature.

What we see in response is systems moving to DC’s and inadequate COLA’s and where resisted tiers among workers who are not willing or capable of defending the whole system. Public support is weak and growing weaker. “Why should you have a decent pension when I have none”? I will take up POGO in another slide, but what it means is that we often are our own worst enemies.

• **Pensions Are Expensive** – Whether DC or DB, proper funding takes 16 to 19% of payroll for 30 to 40 years to get a reasonable (70 – 80%) benefit. You can lower this somewhat by encouraging worker turnover and making vesting harder.

DC – PROBLEMS – The AFT doesn’t like Defined Contribution Plans – yet that’s not what they offer their employees – not hypocrisy but the reality of risk management. That and the fact that most employees begin work there in mid career – not really enough time left to grow a decent pension.

What’s at the heart of the objection is really the fact that DC’s – at least as they are promoted by business types - really are cheaper. They are cheaper because they are not funded properly. Three percent or that plus up to another three through matching present huge savings compared to a real 16-19% pension. And you get what you pay for. And the risk is shifted from the employer to the worker.

• **Incompetent Investor** – When will I sell a stock or mutual fund? When it goes down – too late!! When do I buy and what? Something that has gone up or done well recently – too late!! If I could read all that is available and would be constantly attentive, I would do better. But I don’t want to live that way. My self-description fits 95% of the people. Those with relatively large amounts to invest hire professionals to manage their investments and thrive; those who can’t don’t and suffer.

• **Cost** – In Illinois with more than 300,000 public employees, if each had all their pension funds in individual accounts with thousands of products to invest in and thousands of brokers, advisors, etc. taking a share by its very nature this would be more costly than 5 plans with 5 supervisory boards.
• **Economy of Scale** – Only large scale investors can take advantage of certain opportunities and systems get chances that individuals never see.

DC – **BENEFITS** – United Airlines goes into bankruptcy – last in line to be compensated – the individual pension member. American Airlines threatens to go bankrupt and demands pension concessions. Some companies take advantage of friendly laws and close down their pension systems paying off members at cents on the dollar. DC’s are not subject to such tampering and they are potentially portable which means little to K-12 employees but professors are more mobile. People like DC’s for good and bad reasons but mostly because they are being manipulated by P.R. generated by interests groups that have a stake.

• **Defending Public Pensions** – Imperative that we succeed because failure of one system gives power to those who attack all the systems yet the defense of each system will be different because although they share the common name, each public pension system is somewhat unique and thus its problems are likely to be unique also.

Union’s can make the problems worse or can push for changes that strengthen the systems- hopefully we will do less of the former and more of the latter.

Enemies of Public Pensions blame the problems on the systems themselves and the changes members have sought. To the extent that these arguments have merit the citizens are absolved of responsibility to solve pension problems.

If the state is not making its required payments is it wise to legislatively work for further improvements that also won’t be funded?

• **Problems In Illinois** – Largest pension debt in the nation 40-50 billion unfunded liability – 50 to 60% funded, second only to West Virginia per capita. You get there by not paying the normal cost nor the interest due on debt accumulated from previous under-funding; a problem somewhat like credit card debt totaling 200% of family income. With 42 billion in debt the yearly cost is 5 billion, nearly 4 billion just for interest on the debt. Even with benefits guaranteed by the constitution – can it be sustained?

While 90% funded is considered pretty good – in fact the 10% debt will require interest payments that will nearly double the pension cost – a really unreasonable place to be. How would it be if you had to pay double for everything? That’s what 85-90% funded costs – don’t pay and next year you are only 88% funded and your yearly costs are up even more. Thus the state of Illinois achieved 53% funding.

The list of proposed solutions is a wish list of public employee unions. It is proper that education unions, especially K-12 take the lead in bringing stability to Illinois pension systems by political action that incorporates some or all of the first seven proposed
solutions. The representatives of the government of Illinois have been angered and frightened at the size and seriousness of the response generated when government officials proposed the last two bullets as the path to take.