



The Research Bureau

Massachusetts Pension Reform: What was accomplished? What remains to be done?

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After many months of public outcry over egregious pension abuses reported regularly in the *Boston Globe*, the Legislature passed and the Governor immediately signed “An Act Providing Responsible Reforms in the Pension System.” The Legislature’s vote was unanimous. The Governor had been impatiently lobbying the Legislature to pass pension reform, even threatening to veto any tax increases unless it (as well as ethics and transportation reform) was passed first. While the Legislature’s commitment to pension reform was not in doubt, the House and Senate were locked in a dispute over whether the reforms would apply to *current* employees or only to *future* employees. (The benefits of current retirees would not be affected in either case.) The Senate and Governor insisted that any reform apply to current employees. Speaker DeLeo and Representative Spellane, Chair of the Public Service Committee, raised the possibility that the state was setting itself up for lawsuits if it changed benefits for already-vested workers (and therefore violated their contracted rights). Past attempts to reform the public pension system had been stymied by similar legal issues. But in the end, the Senate, House and Governor agreed to apply the reforms to all current employees who retire after July 1, 2009.

The *Boston Globe* deserves a great deal of credit for publicizing pension abuses in need of reform and for making it such a high priority with the Legislature. While the newspaper was not the first to point out many of the abuses addressed in this reform,¹ it is important to note that almost every provision of the pension reform legislation corresponds with a front-page *Globe* article published within the last year.

What does this legislation accomplish?

- It eliminates the ability of elected officials to get a full year’s credit for as little as one day of service in that year. The *Globe* reported that since 1991, 52 retired legislators have gained a full year for only one day of service, an average annual increase of \$16,350 each. Since departing legislators’ terms do not officially end until their successor is sworn in at the beginning of the new legislative session in January, this loophole essentially provided an automatic pension boost for most legislators when leaving office.
- It eliminates the ability of elected officials with 20 years of public service to collect early, enhanced pensions if they lose an election or leave office voluntarily. This so-called “termination allowance” was originally intended, when it was enacted in 1945, to protect civil servants against politically-motivated firings. It was later expanded by the Legislature to apply also to elected officials who had been voted out of office. Since 1991, the state Retirement Board has also allowed elected officials who step down voluntarily to increase their pension and collect it early. According to the *Globe*, 14 legislators have taken advantage of this loophole, 10 of whom departed office voluntarily. Almost half of the current members would have been able to take advantage of this loophole had it not been closed.
- It eliminates “out-of-grade” accidental disability pensions. Normal, superannuation pensions are based on an employee’s highest three years’ average salary. Accidental disability pensions are calculated based on the most recent salary which the employee was receiving at the time of his permanently-disabling job-related injury. In January 2008, the *Globe* reported that 102 Boston

¹ See Kenneth Ardon, “Public Pensions: Unfair to State Employees, Unfair to Taxpayers,” Pioneer Institute, May 2006, http://www.pioneerinstitute.org/pdf/06_pension_paper1.pdf.

firefighters had claimed permanently-disabling job-related injuries while temporarily filling in for a superior at a higher pay grade, thereby managing to increase their pensions by an average of \$10,300 a year. This legislation ensures that in cases in which an employee suffers a job-related injury while elevated to a higher pay grade, his most recent compensation will be calculated based on the prior 12 months' salary he received, not just the salary he was receiving on the day of the injury.

- The definition of “regular compensation” upon which the pension is calculated will now be limited to wages and salary. No longer will employees be able to include housing, travel, and car allowances in their pension calculation. The most famous case of this abuse was that of the ex-Senate President William Bulger, who was able to boost his pension by \$17,000 a year by claiming credit for his housing allowance while he was Chancellor of the University of Massachusetts.
- No longer will employees be able to claim creditable years of service for unpaid positions, such as serving on a local library board or as a town moderator. An employee must be paid at least \$5,000 a year in order for the position to count as creditable service. This provision takes effect as of July 1, 2012, or when the employee's current term ends, whichever is sooner.
- No longer can someone “retire,” begin to collect his pension, and then be rehired by the government as an independent contractor.
- Part of “An Act Modernizing the Transportation Systems of the Commonwealth,” the comprehensive transportation reform recently signed into law by the Governor also includes pension reform. The legislation brings the unusually generous retirement and health benefits of MBTA employees into line with the rest of the state's pension system. This reform applies to future employees only.

What reforms remain?

According to legislative leaders and Governor Patrick, this legislation is not the end of pension reform. They promise that there will be a “phase two,” after the special commission currently studying the state's public pension system issues its report in September. This commission, whose members were appointed both by the Governor and Legislature, was created in the FY09 budget bill but had its scope slightly expanded by the pension reform legislation. It is now charged with conducting a comprehensive study of Massachusetts' public pension system, examining such features as employee and employer contribution rates, vesting periods, cost-of-living adjustments “with special attention paid to the cost of increasing the cost-of-living adjustments base,” group classification and pension caps.

Further reform is definitely needed. While it is difficult to put a precise price tag on the recently-passed reform (since it depends on estimating how many public employees would have taken advantage of the loopholes had they not been closed), even its supporters admit it will generate only minimal savings. None of the reforms that The Research Bureau recommended in our report “Public Employee Pensions: Is it Time to Retire the System?”² have been addressed in the current legislation. There are many, deeper, structural problems with the system:

The Legislature should address Massachusetts' high rates of accidental disability pensions. As The Research Bureau reports, at least 50% of municipal police and fire personnel in many Massachusetts systems regularly retire on accidental disability pensions. Nationally, including in other older industrial cities such as Baltimore and Chicago, only 20% or fewer public safety personnel retire on accidental disability pensions. In addition to the possibility of fraud that these high rates suggest, it should be noted that accidental disability pensions are much costlier than ordinary pensions (about 70% higher in the case of Worcester). In order to qualify for an ordinary pension of equivalent value, a public employee would have to have worked 29 years and be 55 in the case of public safety, or 65 in the case of all other employees, according to the *Quincy Patriot Ledger*.³

The Research Bureau recommended addressing these high rates through three methods. First, fitness standards should be instituted for all police and fire personnel. These should be made a requirement for *continued*

² Report No. 09-01, March 2009, <http://www.wrrb.org/documents/PublicEmployeePensionReport.pdf>

³ The *Patriot Ledger* recently published a series of articles on accidental disability abuse in the South Shore area. See “Disability Pensions: Abuse Costs us Millions,” <http://www.wickedlocalspecials.com/pensions/>.

employment, not just for initial employment as is the case now. Second, there should be a separate statewide pension system for all employees in hazardous occupations, such as exists in many other states. This would make the higher costs of providing pensions to them more apparent. Third, the state should reform Massachusetts' cancer presumption law. This law allows firefighters to retire on an accidental disability pension if they contract certain types of cancers during their service or within five years of retirement. According to a recent study published in the *Journal of Occupational and Environmental Medicine* which surveyed the existing medical literature on the link between various types of cancer and firefighting, most cancers presumed to be connected with firefighting by Massachusetts' law have no "probable" link to firefighting.⁴

The Legislature should bring more transparency to the way in which benefit increases are granted and funded.

In the same legislative session devoted to pension reform, the Legislature has considered and may approve other bills that would allow public employees to boost their pensions. The two most common are forms of "buyback" and "group jumping." "Buyback" refers to employees buying credit for years of service which they did not spend as a public employee in the Commonwealth. These include years spent in similar positions in the private sector (teaching or nursing), or in other forms of public service such as the Peace Corps. There are twenty buyback bills now before the Legislature.⁵

"Group-jumping" refers to seeking legislative approval to be placed in a different classification group with more generous benefits. In Massachusetts, there are four different groups of public employees:

Group One: The majority of state and local employees
Group Two: Hazardous occupations other than public safety
Group Three: State police
Group Four: Municipal police and fire

Employees classified in hazardous occupation groups have more generous benefits than those in non-hazardous occupations: they are allowed to retire and also collect full benefits ten years earlier than those in non-hazardous occupations. Thus, individuals stand to gain considerably if they can succeed in getting their occupation classified as hazardous. (This usually means group-one employees seeking to be transferred into group four. A good example would be public transit police or campus security personnel at a public university.) Group jumping was addressed by the Legislature's 2006 "Special Commission on Group Classification," but most of the recommendations contained in their report were never implemented. There are 85 group jumping bills currently before the Legislature.⁶ Group jumping and buyback exert considerable pressure on the retirement system's finances, by increasing the unfunded liability and thereby affecting the discretionary funding of a municipality.

The Legislature should end all "termination allowances." While "termination allowances" were ended for elected officials, they still exist for unelected ones under the current system. Public employees stand to gain considerably if they can manage to be fired instead of voluntarily leaving office.⁷

The Legislature should base pensions on average earnings over a longer span of service than three years. Even extending the base from the highest three years' compensation to five years would achieve substantial savings. To ensure equity with private sector employees, pensions should be based on an entire career's compensation, similar to the calculation for Social Security benefits. Such a reform would also solve the problem of the so-called "hockey-stick" or "soft-landing" pension. Well-connected public officials are often able to boost their pension by securing a highly-paid position for their last three years before retirement. For example, if a 62-year old legislator with 27 years of public service makes \$60,000 during each of his last three years and retires at 65, his pension will be

⁴ See Table 10 in The Research Bureau's "Public Employee Pensions: Is it time to Retire the System?," p. 28, <http://www.wrrb.org/documents/PublicEmployeePensionReport.pdf>.

⁵ John Monahan, "State pension benefits hikes championed," *Telegram and Gazette*, June 11, 2009.

⁶ Steve Pofatak, "No Pension Reform Laurels Just Yet," *Boston Globe*, June 25, 2009.

⁷ *Commonwealth* magazine has been raising this issue since 2002. See Michael Jonas' "Pension Liabilities," *Commonwealth*, Spring 2002, and "Cahill says he'll tackle early-pension reform challenge," *Commonwealth*, Winter 2004.

\$45,000 a year. But if he manages to secure a high-level executive job at a state agency or public university for those last three years in which his compensation is \$100,000, his pension will be \$75,000 annually. As noted in The Research Bureau's report, this sort of arrangement can do great harm to the finances of individual systems in the Commonwealth like Worcester's, which tend, on the whole, to be "sender" systems. Worcester sends more employees to higher-paying jobs in other systems than it receives. When a public employee leaves Worcester for a higher-paying job with the state, Worcester is still responsible for paying a portion of the pension calculated on the higher salary. Even if an employee never made more than \$60,000 in Worcester's system, Worcester must still pay for part of a pension calculated on an average salary of \$100,000 or more. Over the years, this has added \$16 million in liability costs to the Worcester Retirement System.

The Legislature should stop the practice of granting unfunded benefit increases, regardless of how small, including cost-of-living-adjustments, unless there is a funding source identified. (The Special Commission is currently studying this issue.)

Finally and most important, the Legislature should address the public retirement system's long-term sustainability and the inequity between retirement benefits in the public and private sectors. The most far-sighted pension reform the Legislature could enact would be to close the current defined-benefit retirement system and enroll all new employees in a defined-contribution plan. In addition to eliminating the possibility of abuse, a defined-contribution plan would eliminate the uncertainty associated with the long-term costs of the current system. In a defined-benefit plan, an employer is always making promises that it cannot know it can fulfill, at least without great expense. There would be no unfunded liability in a defined-contribution plan, since a defined-contribution plan is, by definition, always fully funded. While establishing a defined-contribution plan would do nothing to address the already massive liability owed to current employees and retirees, it would at least end the practice of burdening future generations of taxpayers with the cost of open-ended pension commitments. In fact, a defined-contribution plan would be fairer to private-sector taxpayers. Most workers in the private sector no longer have access to a defined-benefit plan because employers have found such plans unsustainable. According to the Center for Retirement Research at Boston College, between 1980 and 2006, the private sector experienced a drastic shift in the type of retirement benefits offered to its employees. In 1980, 60% of private sector employees' retirement benefits were in the form of an employer-sponsored defined-benefit plan, but by 2006, that figure had dwindled to 11%.⁸ After 2008's financial crisis, which prompted many more employers to freeze their defined-benefit pension plans, the figure is still lower, likely below 10%. Not only does a defined-benefit system for public employees provide a guarantee that most taxpaying citizens lack, it also asks those taxpaying citizens to compensate for the system's market losses. It seems manifestly unfair to require private-sector workers who bear the investment risk for their own retirement to also bear all the investment risk for public employees.

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⁸ These figures represent percentages of private sectors workers whose sole form of employer-sponsored retirement benefits are defined-benefit, just as is the case with public employees in Massachusetts. "Private Sector Workers with Pension Coverage, By Pension Type, 1980-2006," CRRBC, http://crr.bc.edu/frequently_requested_data/frequently_requested_data.html.