



The Impact of Public Pensions on State and Local Finances: Areas for Reform

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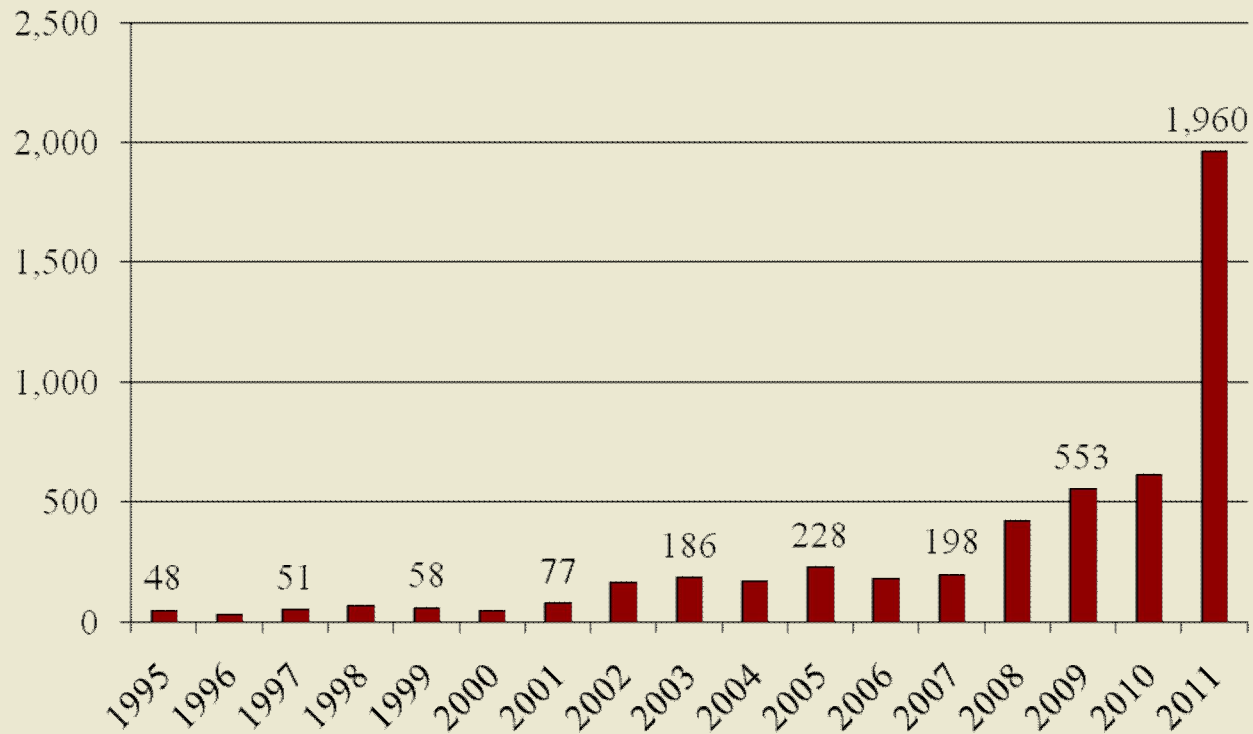
Rappaport Institute for Greater Boston
Worcester Regional Research Bureau
Worcester, MA
May 11, 2011

Topics for today's discussion:

- How did we get here?
- Impact of pensions on state and local budgets.
- Impact of pensions on state borrowing costs.
- Areas for reform.

Before the financial meltdown, state and local plans were not viewed as in “crisis.”

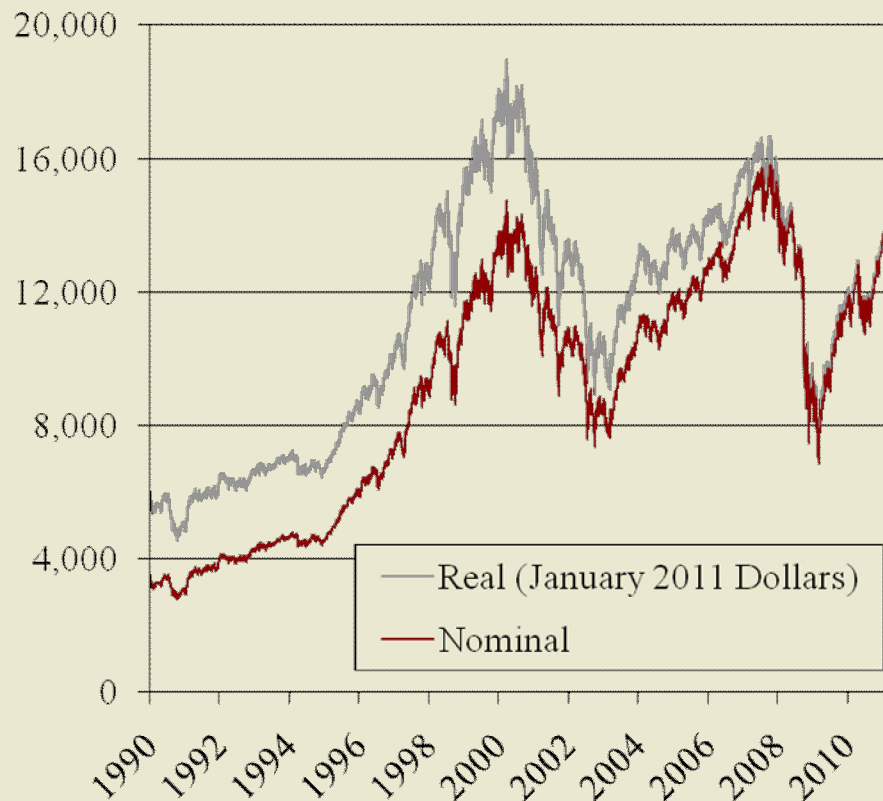
Average Monthly Google News Citations Using Terms “State,” “Local,” “Crisis,” and “Pension Fund”



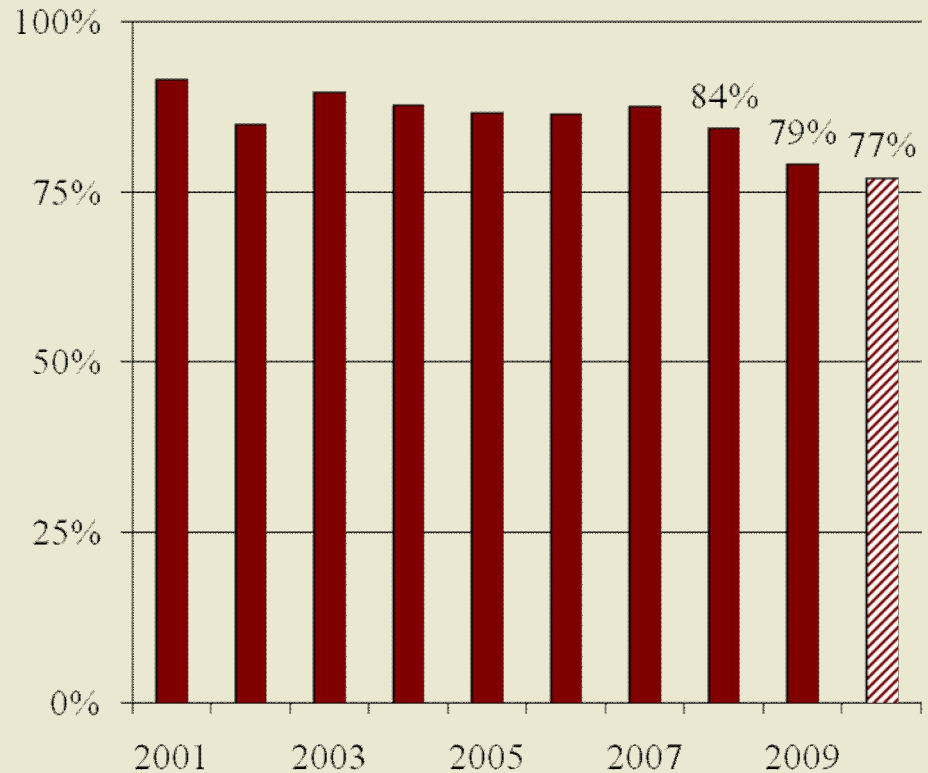
Source: Google News.

The financial meltdown caused a significant drop in funding.

Dow Jones Wilshire 5000 Index, 1990-Present,
Real and Nominal Values



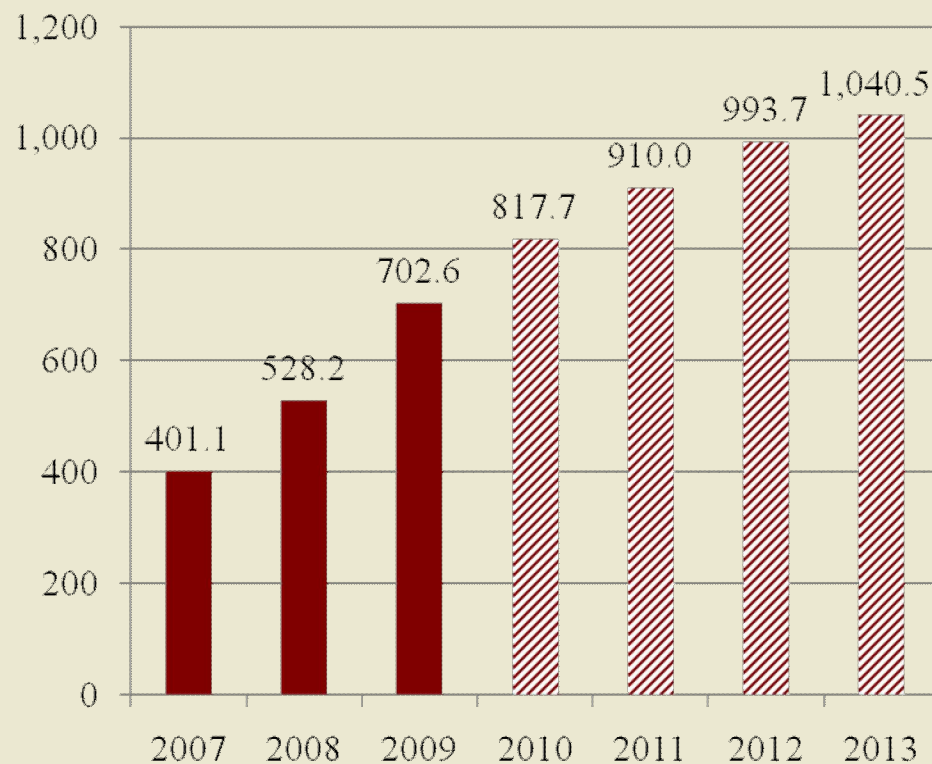
State and Local Funded Ratio, 2001-2010



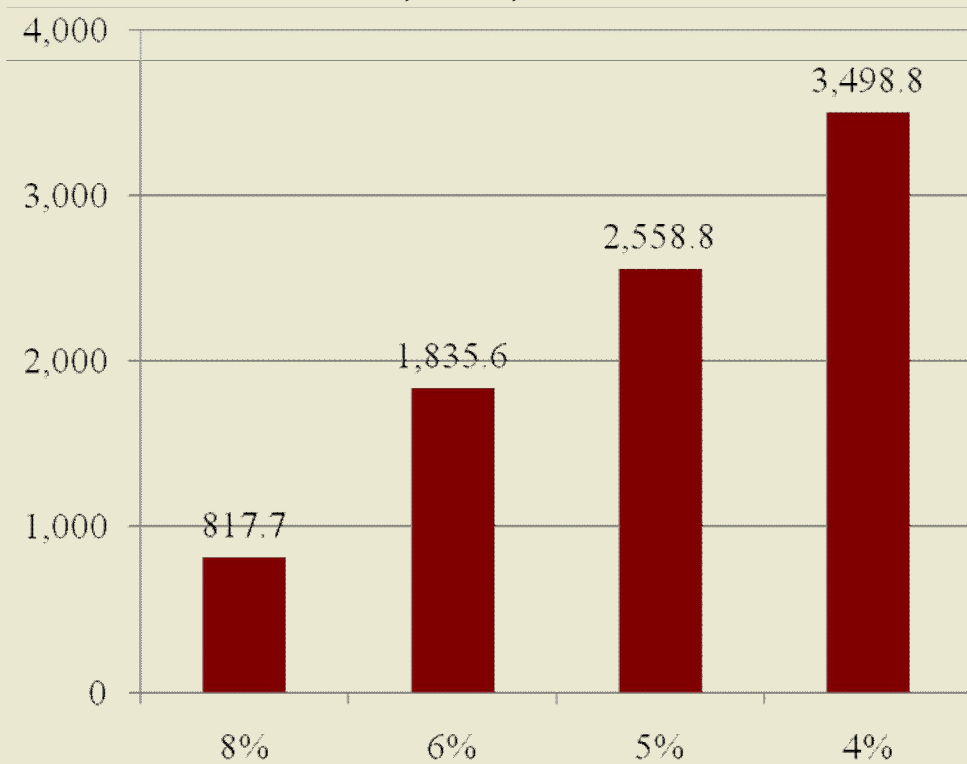
Source: Public Plans Database (2001-2010) and authors' estimates.

Unfunded liabilities are now \$800 billion and could be \$1 trillion by 2013.

Unfunded Actuarial Accrued Liability, 2007-2013,
2010 Billions of Dollars



Unfunded Liabilities under Alternative Discount
Rates, 2010, in Billions



Source: Public Plans Database (2007-2009) and authors' estimates (2010-2013).

Recent media has linked our pension finances to budget woes.

In Budget Crisis, States Take Aim at Pension Costs

By MARY WILLIAMS WALSH
Published: June 19, 2010

Many states are acknowledging this year that they have promised pensions they cannot afford and are cutting once-sacrosanct benefits, to appease taxpayers and attack budget deficits.



Seth Perlman/Associated Press

Illinois raised its retirement age to 67, the highest of any state, and capped the salary on which public pensions are figured at \$106,800 a year, indexed for inflation. Arizona, [New York](#), Missouri and Mississippi will make people work more years to earn pensions. Virginia is requiring employees to pay into the state pension fund for the first time. New Jersey will not give anyone pension credit unless they work at least 32 hours a week.

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In budget message, mayor scolds council over pension deadlock

Tuesday, November 09, 2010

By Joe Smydo, Pittsburgh Post-Gazette

Hours after Pittsburgh Mayor Luke Ravenstahl used his annual budget address to skewer City Council's rejection of his proposed pension bailout, at least two council members said they're holding out hope for a compromise that would stabilize the pension fund and safeguard the city's financial future.

Mr. Ravenstahl on Monday unveiled a five-year spending plan for the city's "short-term survival" and warned that council members who rejected his pension bailout will be to blame if the city falls into financial ruin in 2016.

In a budget message intended to reach beyond council chambers to the city's neighborhoods, Mr. Ravenstahl said his stewardship since 2006 rescued the city "from the brink of bankruptcy." But he said council is imperiling those hard-won gains by rejecting his plan to parlay parking lease assets into a pension bailout.

Pension reform snarls Calif. budget talks

Friday, October 01, 2010



Nannette Miranda

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SACRAMENTO (KABC) -- Gov. Arnold Schwarzenegger stepped up the pressure this year calling on lawmakers to reform what he calls California's over-generous pension system, which he says is bleeding the state's budget dry year after year.

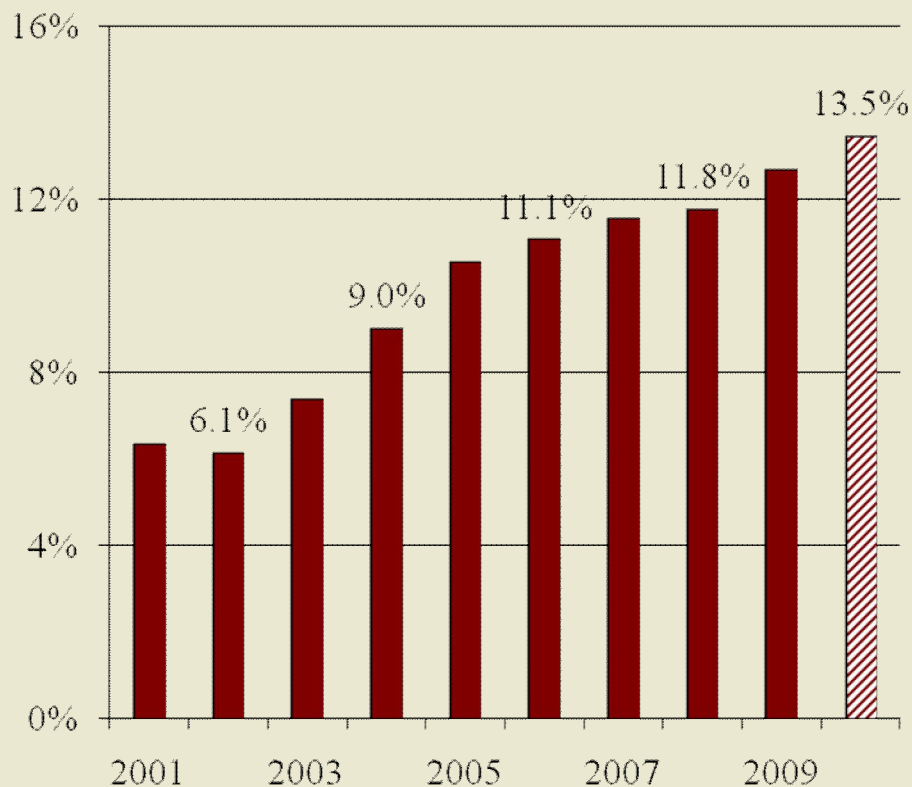
Two bills came as a result of the pay and pension scandal in the city of Bell.

A third addressed pension spiking.

But the governor vetoed all three.

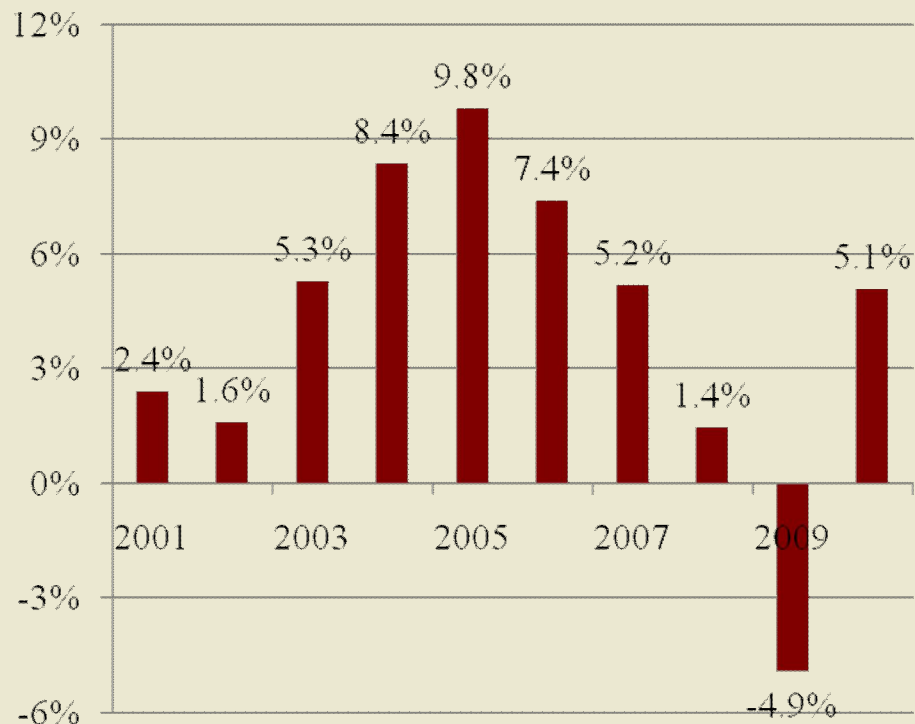
The ARC has increased, and state and local tax revenues have dropped due the great recession.

ARC as a Percent of Payroll, 2001-2010



Source: Public Plans Database (2001-2010).

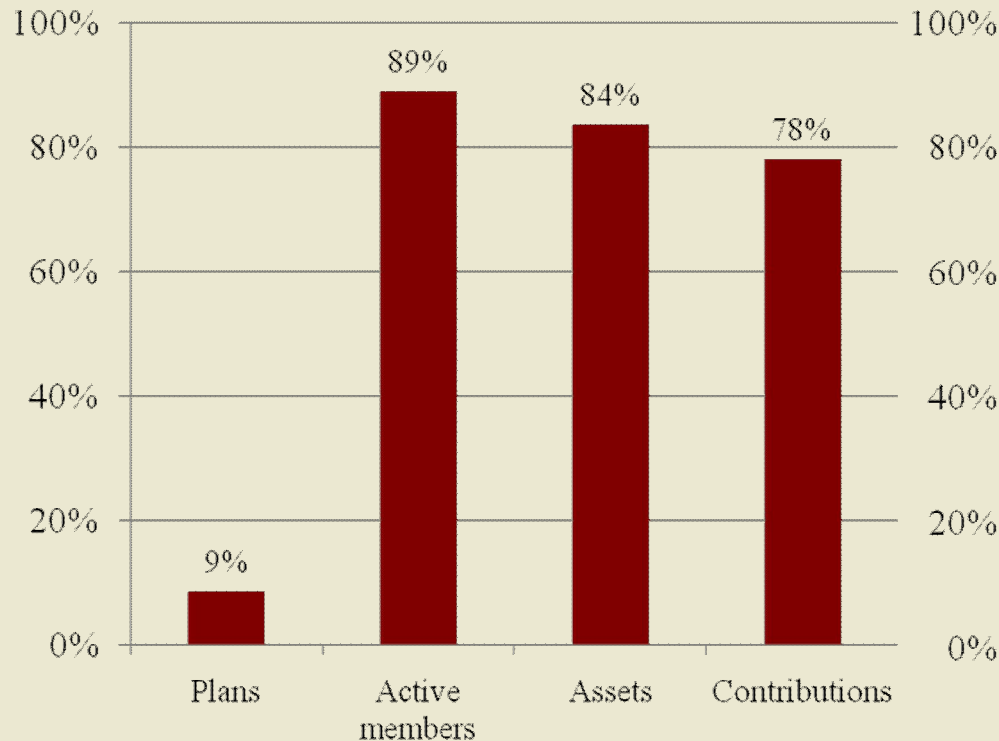
Annual Percent Change in State and Local Current Tax Receipts, 2001-2010



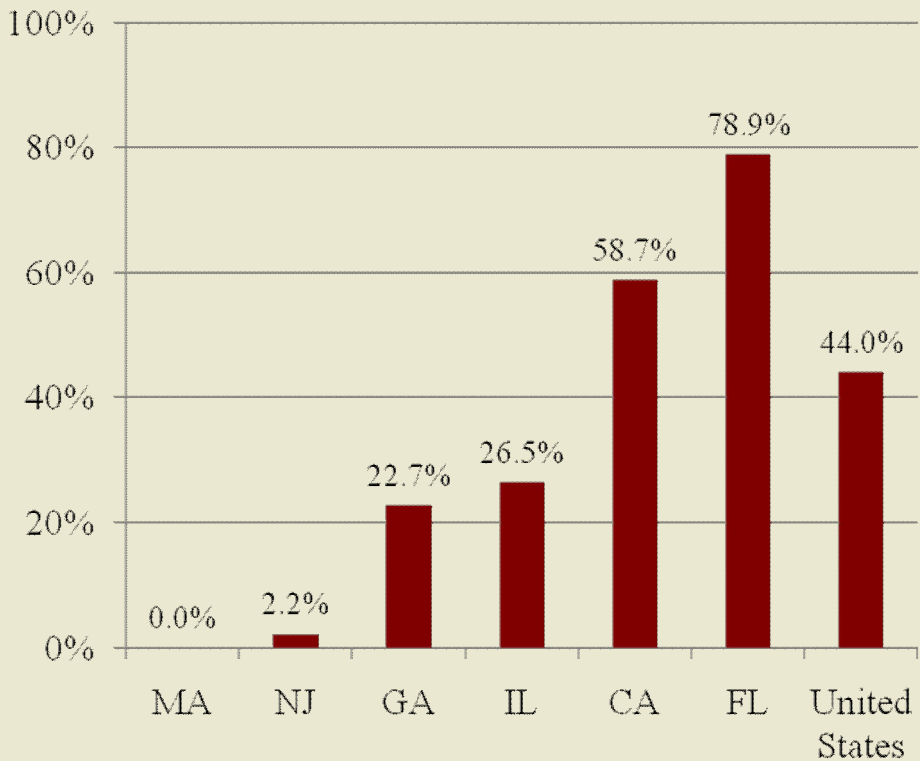
Source: Bureau of Economic Analysis, U.S. Department of Commerce. 2001-2010. *National Income and Product Accounts*. Washington, DC.

These costs are attributable mostly to state plans, but they also burden local governments

State Plans as a Percent of Total State and Local Plans, 2008



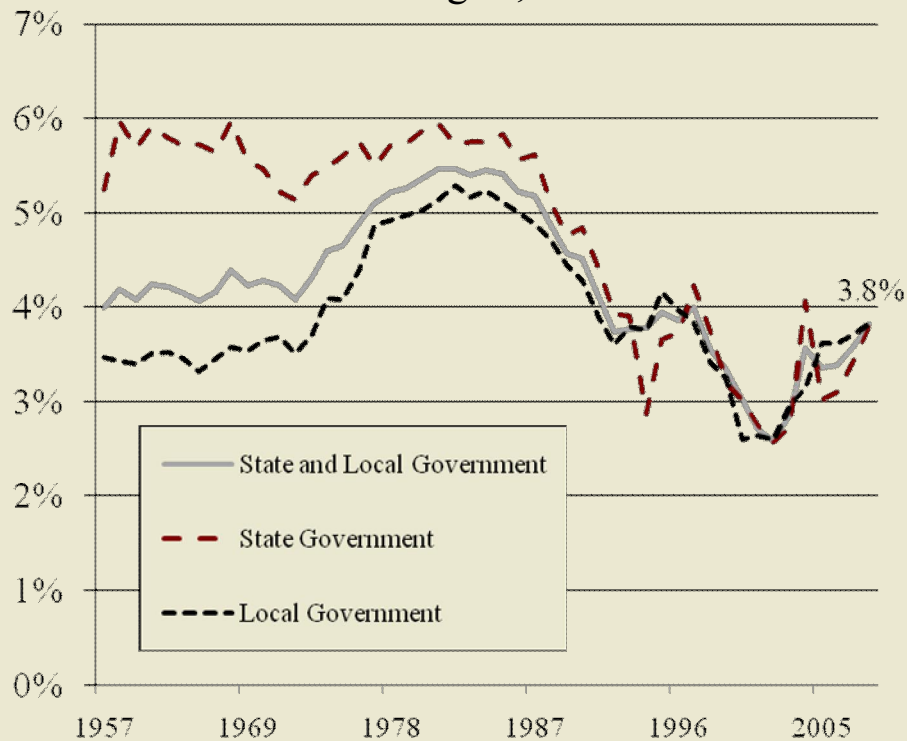
Percent of Contributions to State Plans Coming from Local Governments, Selected States, 2008



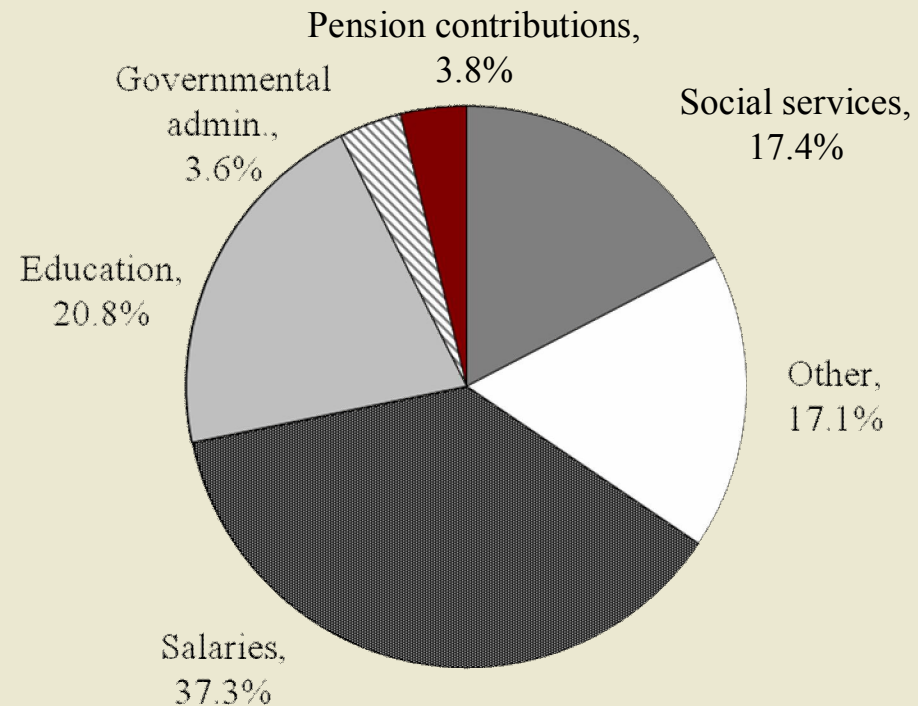
Sources: Authors' calculations from the U.S. Census Bureau. 2008. Employee-Retirement Systems of State and Local Governments. Washington, DC;

But, on the whole, pensions currently make up a small portion of state and local budgets.

Government Pension Contributions as a Percent of State and Local Budgets, 1957-2008



State and Local Government Direct Expenditure by Type of Expenditure, 2008

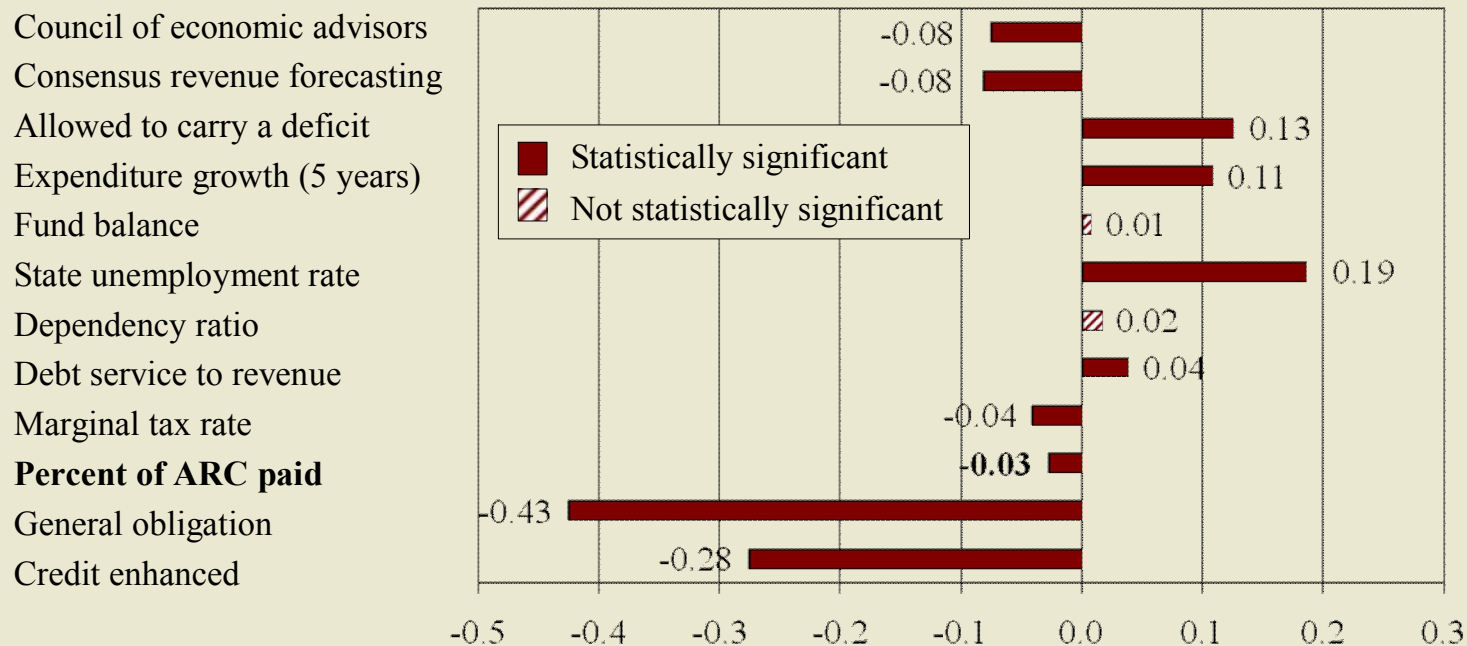


Note: Total budget equals direct expenditures from the general fund, excluding capital outlays.

Sources: Authors' calculations from the U.S. Census Bureau. 2008. Employee-Retirement Systems of State and Local Governments. Washington, DC; and U.S. Census Bureau. 2008. State and Local Government Finances. Washington, DC.

On the bond front, like the budget front, pensions have played a small role.

Impact of Selected Characteristics on Municipal Yields, 2005-2009

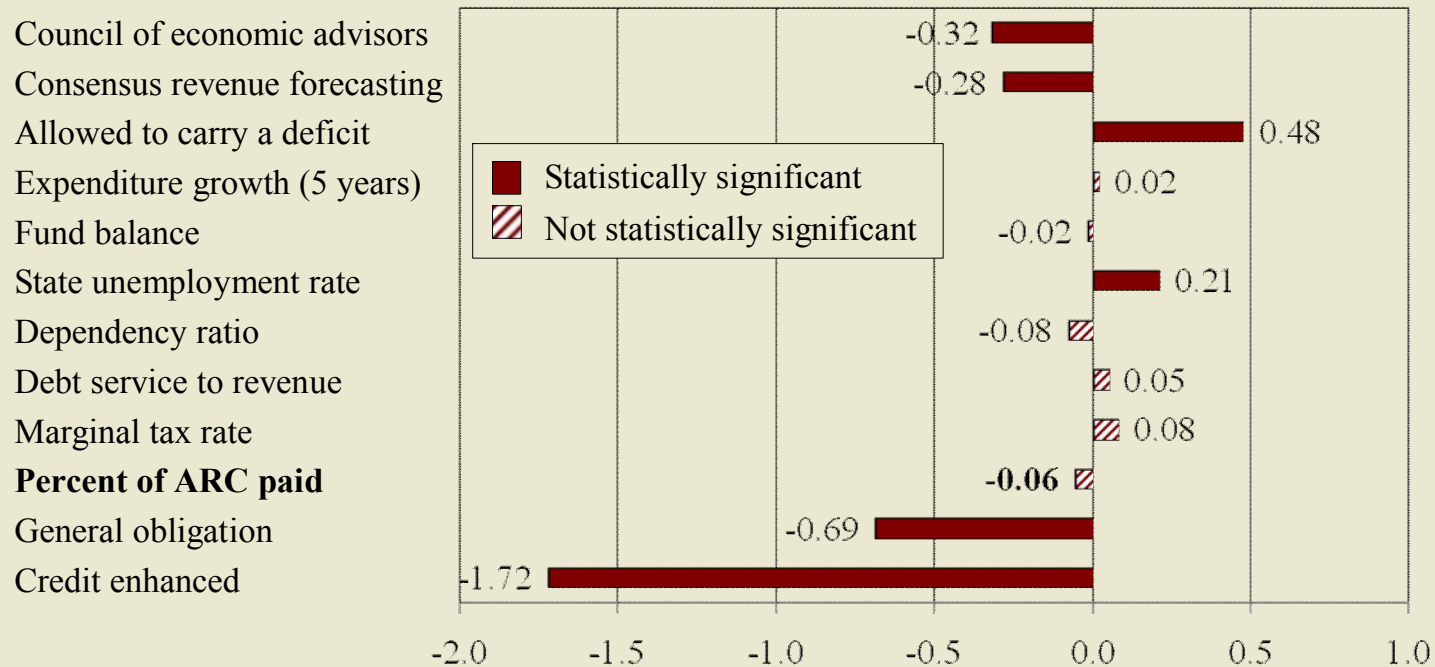


Note: Yield is the spread between municipal rate and rate on Treasury security of the same duration issued in the same week.

Source: Alicia H. Munnell, Jean-Pierre Aubry, and Laura Quinby. 2011. "The Impact of Pensions on State Borrowing Costs." *State and Local Pension Plans Brief* 14. Chestnut Hill, MA: Center for Retirement Research at Boston College.

And historically they have had no impact on municipal bond ratings.

Impact of Selected Characteristics on Moody's Municipal Bond Ratings, 2005-2009



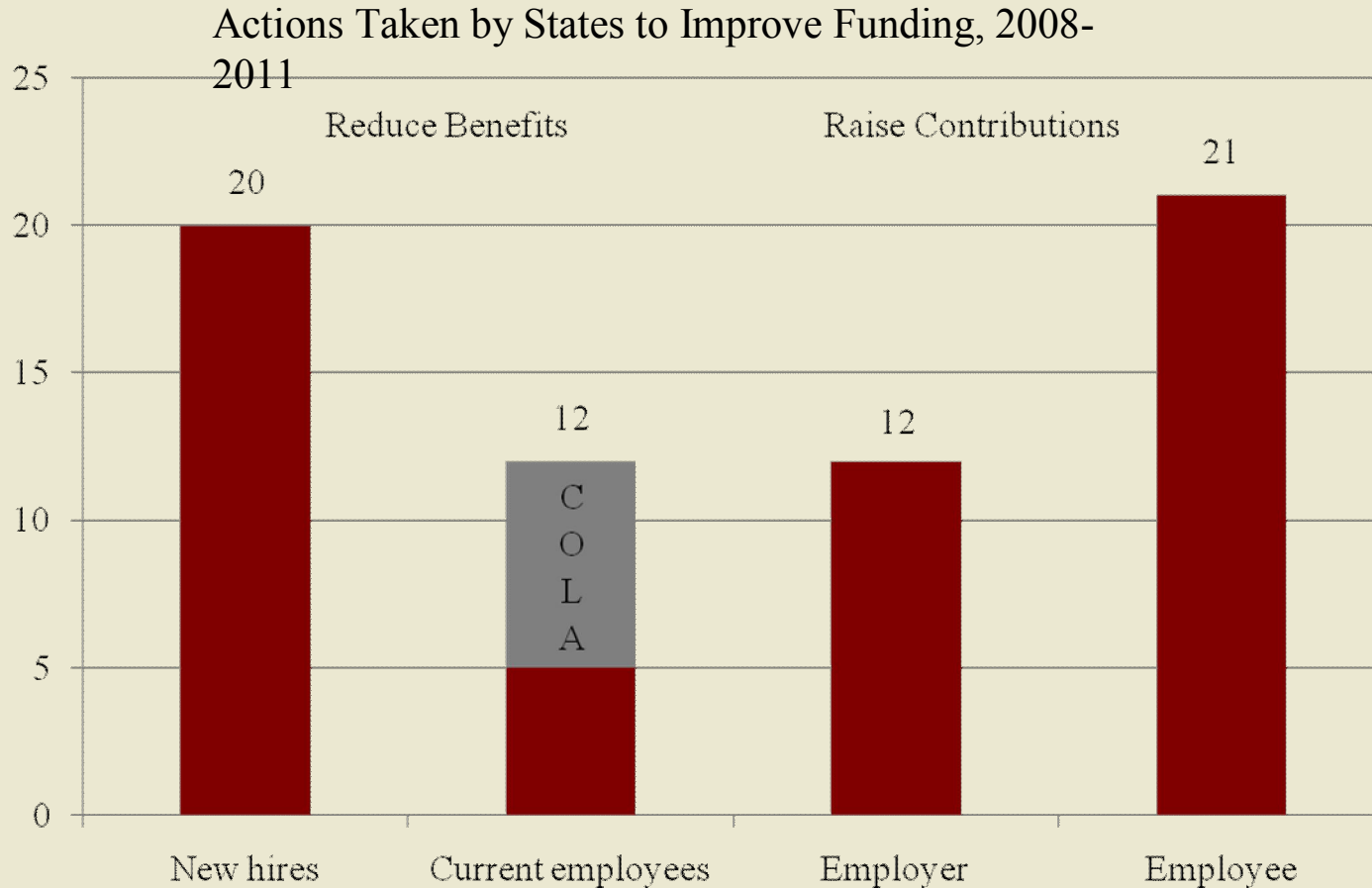
Note: Standard errors have been adjusted for state-level clustering.

Source: Alicia H. Munnell, Jean-Pierre Aubry, and Laura Quinby. 2011. "The Impact of Pensions on State Borrowing Costs." *State and Local Pension Plans Brief* 14. Chestnut Hill, MA: Center for Retirement Research at Boston College.

But this picture may be changing.

- Jan 27, 2011: Moody's combines unfunded pension liabilities with outstanding bonds.
- Feb 9, 2011: Standard and Poor's downgrades NJ from AA to
AA- due to pensions.

And many states have responded...



Source: National Conference of State Legislatures (2008-2011).

Areas for reform

Oldies but Goodies

- Make the full ARC.
- Increase the normal retirement age.

Innovative solutions

- Move away from final earnings.
- Consider a DC stacked on top of a DB for more equitable risk sharing.

Conclusions

- To date, pensions have had a small impact on budgets and borrowing costs.
- But they could become more important in the future.
- To keep the impact small, state and local plans should start making reforms.

The Center for Retirement Research at Boston College

<http://crr.bc.edu>

State and Local Pension Research

http://crr.bc.edu/special_projects/state_and_local_pension_plans.html

The Public Plans Database (PPD)

<http://pubplans.bc.edu>

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