Why Public Pensions Are So Rich

Shifting government workers to 401(k)-style plans would offer greater transparency and keep benefits in line with the private economy.

By ANDREW G. BIGGS and JASON RICHWINE

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According to government union leaders, their employee retirement benefits are "not lavish by any means." So says Art Pulaski of the California Labor Federation. According to the American Federation of Teachers, public-employee pensions "typically are modest." And the Service Employees International Union asserts that "After decades of full-time work for the state, the sad truth is that far too many retired state employees receive yearly amounts that force them to live in poverty."

These claims are misleading, but reformers have a hard time conveying to taxpayers precisely how generous public-sector retirement benefits can be. That's because government employees typically have "defined benefit" pensions that pay a guaranteed benefit regardless of how the plan's investments may fare. Most private-sector workers hold "defined contribution" 401(k)-type savings accounts that guarantee no specific pension. Complex formulas obscure the fact that public pensions typically are much more generous than 401(k)s, making the situation ripe for misleading claims.

A case in point is the Illinois Teachers Retirement System (TRS), which insists that, because Illinois teachers don't participate in Social Security, the average teacher's pension of almost $43,000 "cannot qualify as 'too generous.'" One might assume from such a statement that the typical Illinois teacher who retires this year after a full career will collect $43,000 per year. Not so. That average figure reflects the pensions of employees who retired years or decades ago, as well as individuals who worked only part of their careers in public schools.

The 2010 annual report for the TRS actually shows that the average teacher who retires today after 30 to 34 years of service had final earnings of $84,466 and collects a pension of $60,756 a year, plus annual cost-of-living adjustments, providing an income higher than 95% of retirees in Illinois. That's a lifetime value of almost $1.6 million if collected at age 62, and more if the employee retires in his 50s, as many do. In addition, Illinois employees—like many public employees around the country—are eligible for retiree health care that can be worth thousands of dollars per year.

Compared to this, how would a private-sector worker's retirement plan stack up? Private-sector workers typically rely on a combination of Social Security and a 401(k). If the private employee had the same $84,466 final earnings as that veteran teacher, Social Security would pay around $17,750 per year. The remaining $43,000 has to come from elsewhere.

The private worker wouldn't get far to that goal through his employer's contribution to a 401(k). An employer contribution of 6% of pay every year—an amount that only one out of 10 employers exceeds—would generate a guaranteed income of around $3,850 per year in
retirement. Benefit levels are low in part because, to replicate the government-guaranteed benefits a public employee receives, a worker with a 401(k) would have to have invested in ultrasafe (but low-yielding) assets such as Treasury securities.

To make up the rest, a private worker would need to save an almost implausible 45% of his salary for retirement. Compare that to the 9.4% of salary that Illinois teachers must contribute toward their pension plan. Many Illinois teachers pay even less because their school districts "pick up" all or part of the 9.4%, a practice that reforms in Wisconsin and Ohio have targeted.

Public employees who don't work full careers fare less well under defined-benefit pension plans, and those with very short careers would do better with a 401(k). But for the average public employee, retirement benefits typically are several times more generous than what they would receive in the private economy.

This comparison illustrates the generosity of retirement benefits for Illinois teachers, but we could generate similar examples for public employees in California, Ohio, Wisconsin or practically any other state where public-sector pay has been a major issue.

As long as the public sector uses defined-benefit pension plans, fair comparisons of benefits will require the kind of detailed calculations presented here. But shifting public employees to 401(k)-style retirement plans would offer greater transparency for taxpayers.

The generosity of defined contribution pensions can't be obscured by complicated accounting rules and benefit formulas. The benefit is simply what the employer puts into the account each year, and that's it. Such pensions also allow for much greater portability, attracting mobile employees who fare poorly under defined-benefit plans and eliminating the "job lock" that keeps burned-out public employees who wish to quit from doing so.

There is no good reason why public employees should receive retirement benefits so much more generous than those of other Americans. If government workers were moved to defined-contribution pensions, it would be much easier to ensure fair market compensation in government.

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401(K)-STYLE RETIREMENT PLANS ARE THE NEW NORMAL; ILLINOIS SHOULD GET ON BOARD

Benjamin VanMetre

401(k)-style retirement plans have become America’s primary retirement vehicle.

In 1985, only one in 10 Fortune 100 companies offered 401(k)-style retirement plans to their employees. Today, seven in 10 Fortune 100 companies provide only defined-contribution, 401(k)-style retirement plans to new employees.
This trend is in line with the private sector overall, where nearly 85 percent of employees are enrolled in 401(k)-style retirement plans.

But public employees in Illinois, unlike their private-sector counterparts (and public employees in many other states), have not been given the opportunity to change with the times. They continue to be stuck in a broken pension system.

According to Bloomberg, the number of people participating in 401(k) retirement plans has increased by more than 53 million people since the 1980s:

“Created by federal legislation in 1978 as a supplement to traditional pensions, 401(k)s instead have supplanted them as corporate America’s primary retirement vehicle. Participants increased to 61 million in 2011 from 7.5 million in 1984, according to Labor Department data. Americans held $4.3 trillion in 401(k) plans as of March 31, according to the Investment Company Institute, a trade association for the fund industry.”

Bloomberg recently released a first-of-its kind ranking of 401(k)-style retirement plans at 250 of the nation’s largest companies. Although the structure of retirement plans differs between companies, the findings show that 401(k)s provide comfortable and secure retirements for workers today.

Workers at some companies are able to retire with nearly $4 million in their 401(k):

“ConocoPhillips estimates that an employee could retire at 60 after 35 years of service with savings of $3.8 million, adjusted for inflation, assuming a starting salary of $75,000 and increases of 4 percent a year. ‘Our goal is to help employees replace at least 80 percent of their incomes in retirement by providing two-thirds of what they need while they save one-third,’ said Lynn Tramel, a benefits manager at ConocoPhillips. ‘It’s a partnership.’”

There are, of course, a number of factors that can impact the amount an individual has at retirement.

But regardless of the differences between companies, the important point is that 401(k)s provide comfortable and secure retirements for private-sector workers. Unfortunately, these retirement plans aren’t an option for most government workers in Illinois – instead, these workers are forced to participate in pension systems that are controlled by some of the nation’s most corrupt politicians.

It’s time to take politicians out of the retirement business and give workers control and ownership over their own retirement futures with the same 401(k)-style retirement plans that provide comfortable and secure retirements for private-sector workers.
Pension disaster: Californians understand the looming crisis

By Mark Bucher

Concern about California's overspending on public pensions is no longer limited to policy wonks: Today, according to a new Public Policy Institute of California poll, fully 85 percent of likely voters say those state and local government expenditures are a problem. Seventy-three percent favor offering new government employees 401(k) plans similar to what most private sector employees get.

The state's voters are prescient: Unless they stop California's statewide spending spree, they'll soon face a full-blown public pension debacle.

As The New York Times recently reported, the plight of cities like Desert Hot Springs -- a small town nearing bankruptcy largely due to unsustainable pension costs -- is casting a national spotlight on the disastrous growth of California's pension liabilities.

For years, the state's coastal cities and inland municipalities have promised -- and delivered -- larger and larger retirement benefits to public sector workers. Now, California state and local governments face an estimated $655 billion in unfunded pension and health care liabilities.

A new database available at www.transparentcalifornia.com contains salary and pension data for most of California's government employees. It paints a startling picture of state profligacy. In 2012, over 99,000 California county employees received six-figure salary compensation packages, representing over 50 percent of the estimated full-time workforce, while over 12,000 county workers made in excess of $200,000.

The problem is acute in the Bay Area, where public employee compensation has reached unsustainable highs. Pensions in Alameda County provide 538 retirees with payouts of over $100,000 a year -- 25 of which enjoy packages exceeding $200,000 in annual income. Alameda's retired public defender clears over twice that sum -- $527,255 a year. One retired Palo Alto official clears $281,108; a Mountain View retiree, $262,365. From Sunnyvale to Berkeley to San Leandro and beyond, the list goes on and on.

The fiscal irresponsibility doesn't stop with pensions. The highest-paid public employees enjoy salaries that most taxpayers could only dream of. Hayward's Deputy Fire Chief pulled down $328,000 in total compensation. A Milpitas fire chief took home $494,000. And in Santa Clara, the acting police chief made out like a bandit with a grand yearly total of $639,000.

San Jose Mayor Chuck Reed has filed a statewide ballot initiative that could address the problem at its source. California is desperate for action that would provide state and local governments with the tools they need to fix California's public employee retirement plans. Without such changes, policymakers are likely to follow the dangerous lead of California cities like Vallejo and Stockton--which have been forced to impose heavy write-downs on municipal bondholders.

Reed is only one of the Democrats in the bipartisan coalition of mayors supporting and promoting efforts to solve the problem. Though labor unions are working overtime to pressure state Democrats to kill any initiative that calls for sincere change, the pensions and benefits crisis
isn't a partisan issue -- as current polls make clear. Everyone, especially young Californians, should be terrified at the prospect of this kind of spending continuing unabated.

Other states across the country such as Connecticut, Illinois, and Kentucky are confronting a similar crisis. California needs to set an example for the rest of America by confronting its unsustainable spending head-on. But to do this, California agencies need the legal authority to negotiate changes to pensions and benefits going forward. Playing politics is no longer an option. Without significant pension reform, the world's 12th largest economy is in for a rude awakening.