Public Pension Q & A

What is a pension?
A pension is the strongest and most stable retirement option. Workers earn their pension by contributing a portion of every paycheck toward their retirement. Their contributions are combined with their employer’s contributions and then that money is invested. After they retire, the worker receives their pension through a monthly benefit that will last for the rest of their life.

What is the difference between a pension and a 401(k)?
A defined benefit pension offers a guaranteed payment in retirement for the rest of someone’s life. A defined contribution plan, like a 401(k), does not guarantee a certain amount each month in retirement. Instead, workers are only guaranteed a certain contribution from their employer during their working years. The worker then receives these contributions as a lump sum when they retire. The worker must decide how to invest this money, unlike in a pension, where the money is collectively pooled and professionally managed.

Who gets a public pension?
Many firefighters, public school teachers, nurses, librarians, sanitation workers, and other public employees earn a defined benefit pension as part of their compensation during their working years. Many of these workers accept lower pay during their careers in exchange for the promise of a pension in retirement and they contribute a portion of every paycheck toward their pension. In some states, public employees do not receive Social Security, so their pension is their only source of retirement savings.

How are pension benefits calculated?
Pensions use an employee’s years of service and average salary to calculate the monthly pension benefit in retirement. The longer an employee has worked and the higher their salary was, the larger their pension benefit will be because they paid into the system for longer. When the state or city creates the pension plan, they decide how much income they want to replace in retirement for their employees and set up the pension benefit formula accordingly.
How are public pensions funded?
Funding for public pensions comes from three sources: employee contributions, employer contributions, and investment earnings. Of the three, investment earnings typically make up the majority: more than 70 percent. Historically, state and local government employers have contributed 19.4 percent of pension plan revenues. The remaining 10.6 percent is contributed by public employees, who pay for their pension with every paycheck.

Aren’t public pensions in a crisis?
No. Most public pension plans are well-funded and their funding levels are improving. One study found that the average funding ratio across all public pension plans improved by 10 points from 2009 to 2013. Another study estimates that most plans will reach sustainable funding levels by 2018. According to the Wall Street Journal, the top five public pensions are all over 100 percent funded.

What about Illinois, New Jersey, and other states like them?
There are a few states with severely underfunded public pensions, but these states are the exception, not the norm. It’s also important to remember why these pensions are underfunded: in these states, irresponsible politicians deliberately skipped making contributions to the pensions, often for decades. Pension opponents use scare tactics and fear-mongering to make it seem like all public pensions are in the same bad situation as these few are.

Why are pensions the best way for working people to prepare for retirement?
A defined benefit pension is a secure and reliable way to prepare for retirement. Earning a defined benefit pension guarantees a monthly payment in retirement for the rest of your life. Pensions are professionally managed and pool risk collectively among all the participants in the plan. Pensions can also balance risk and reward in their investments because they do not depend on any one person’s lifespan.

Do recipients of public pensions also get Social Security?
In fifteen states, public employees do not contribute to Social Security and, therefore, do not earn Social Security benefits. For these employees, their pension is their only source of retirement income. In other states, public employees earn both their pension benefits and Social Security benefits through their contributions to both systems.

Source: National Public Pension Coalition, protectpensions.org

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