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Your Tax Dollars at Work – and in Retirement

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In the coming months, BGR will release reports addressing the issue of public pension costs, with a particular focus on the retirement systems in the New Orleans area. We will examine public pension plans in Jefferson, Orleans and St. Tammany parishes, compare the terms of government pension plans with those in the private sector, and examine trends in the U.S. for managing retirement costs.

WHEN CITIZENS THINK about their state and local tax dollars, they tend to think mainly about schools, roads, public safety and the like. But across the country, retirement costs have been consuming an increasing share of local and state budgets. That means yesterday's employees and tomorrow's retirees are consuming an increasing share of a citizen's local property and state income tax bills. It means less money left over for the services and infrastructure that citizens expect government to provide.

Take New York. During the past 10 years, pension payments from local governments increased more than 650%, prompting reforms earlier this month. New York's reforms are part of a wider trend in recent years, in which the vast majority of states have enacted reforms to reduce pension obligations.

Louisiana is among them. Last year, for example, voters passed a constitutional amendment to dedicate revenue to paying down unfunded pension liabilities, and the Legislature passed a bill to keep the costs of certain pension systems from spiking. More changes may be coming in the immediate future. This session, the Louisiana Legislature is considering nearly 30 bills geared toward improving the health of, and reducing the costs associated with, various public pension systems.

The state's two largest retirement systems, the Teachers' Retirement System of Louisiana and the Louisiana State Employees' Retirement System, face daunting challenges. Each is less than 60% funded. As of June 30, 2011, the teachers' system reported unfunded accrued liabilities of $10.81 billion, while the state employees' system reported $6.46 billion. The actuarially required employer contribution to the teachers' system totaled $1.09 billion in fiscal year 2011, nearly double the level five years before. The required employer contribution to the state employees' system totaled $678.1 million for fiscal year 2011, up 56% from five years earlier.

Nationwide, a number of factors have contributed to the rising cost of public employee pensions. Among them:

- *Investment losses*. Turmoil in the financial markets in 2008 and 2009 led to significant investment losses for public pension plans.
- *Promises made during good times*. When the stock market enjoyed better years during the 1980s and 1990s, many pension plans became more generous with their benefits and cost-of-living adjustments.
- *Longevity of retirees*. Retirees are living longer and receiving more years of pension benefits.
- *Historic underfunding*. Some plans continue to deal with the costly legacy of inadequate funding contributions. These plans have accrued large unfunded liabilities that must unfortunately be shouldered by current and future taxpayers.

The reforms enacted nationwide over the past few years have taken a variety of forms. The most common approaches are to increase required employee contributions or to lower the level of pension benefits. The latter approach may be accomplished by raising the threshold for retirement eligibility or changing the way a retiree's benefits are calculated.

Some states, however, have taken more drastic steps to restructure their pension systems. They have begun to move away from the defined benefit model, in which retired workers receive a guaranteed benefit throughout their lifetime, toward defined contribution plans. Defined contribution plans provide retirement benefits through contributions to individual retirement savings accounts. The funds in each account are invested, and a retiree receives only the value of his account – contributions made over the course of his participation, plus or minus investment gains or losses. This is the form most private sector retirement plans take.

Other reform efforts favor a combination of defined benefit and defined contribution plans, called a "hybrid" plan. But the underlying motivation is the same: More of the risk associated with funding retirement benefits shifts from the public onto the employee.

In the current session, the Louisiana Legislature is considering an array of reforms to reduce public obligations to retirement plans. Among them are proposals aimed at certain systems to:

- Increase the retirement age.
- Increase employee contributions.
- Lengthen the period of time over which earnings are averaged for the purpose of calculating retirement benefit levels.
- Reduce benefit multipliers (the percentage by which compensation and years of service factors are multiplied to calculate a retiree's annual benefit).
- Impose new restrictions on cost-of-living adjustments for retiree benefits.
- Place new employees in defined contribution plans.

The issues surrounding public pensions can be complex, but the implications are significant for citizens and public officials. Stay with us as BGR explores pensions in depth during the months ahead.

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