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BGR MEDIA RELEASE

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BGR Report Reveals Costs, Generosity of Local Government Pensions

Today BGR releases *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*. The report examines 18 defined benefit pension plans available to local government workers in Jefferson, Orleans and St. Tammany parishes (the Plans). The report tallies the costs the Plans impose on local government entities in the three parishes, and compares the pension benefits they offer to those available to private sector workers and other state and local government workers across the U.S.

The Rising Cost of Yesterday is the second of a series on public pension plans. The first report, *Understanding Pensions: A Primer on Public Employee Pension Plans*, provided an introduction to the subject. It is available on BGR's website, www.bgr.org. The next report in the series will explore reform options.

BGR's research led to the following major findings:

- The costs associated with the Plans are large and rising.
- The Plans provide greater security and larger benefits than do the retirement savings vehicles available to most private sector employees.
- With one exception, the Plans are initially more generous than the median public sector retirement plan.
- Nearly all of the Plans initially provide larger benefits than are necessary to maintain one's quality of life in retirement.

A Growing Burden

The Plans are imposing significant financial burdens on local government bodies and the public that supports them. In 2010, pensions cost residents and businesses in Orleans Parish \$122 million, which equates to \$861 per household. They cost \$88 million in Jefferson Parish (\$519 per household). In St. Tammany Parish, they cost \$58 million (\$660 per household). On an inflation-adjusted basis, pension costs increased in all three parishes over a

10-year period: 9% higher in Orleans, 33% higher in Jefferson and 94% higher in St. Tammany.

The City of New Orleans had the highest pension bill of any government entity in the three parishes. In 2010, it spent \$78 million to support pensions, 11.3% of its operating costs. Most of that cost, almost \$54 million, came from one pension system, for city firefighters. Because of the disastrous state of that system, the employer contribution rate as a percentage of payroll has grown tenfold since 2000.

Far More Generous than the Private Sector

The Plans provide their participants with greater security than the retirement savings vehicles available to private sector employees. They entitle participants to a specified annual benefit level for life and place the financial responsibility for investment losses on the government employer.

Nationwide, more than a third of private sector workers do not have access to *any* employer-supported retirement plan. They depend solely on Social Security. Where private sector employees do have access to a retirement plan, it is usually a defined contribution plan. With that type of plan, employees receive only the value of their accounts at retirement. Unlike their public sector counterparts, they bear the risk of investment loss and of outliving their savings.

Not only are the Plans' benefits more secure; they are more generous. For a worker who is hired today at a salary of \$40,000 and retires after 30 years of service (Hypothetical Employee), the Plans (and Social Security, where applicable) would yield annual retirement benefits \$4,000 to \$20,000 higher than what that same worker could expect to receive in the private sector from Social Security and an employer-supported defined contribution plan.

More Generous than Other Public Sector Plans

Not only are the benefits offered by the Plans superior to those available to private sector employees, they are generous by public sector standards. BGR found that, for the Hypothetical Employee, the benefits paid by all of the Plans in the initial years of retirement would exceed the national median. Nearly three quarters of the Plans would provide him with an annual benefit that is at least \$5,800 larger than that median. Under some Plans, the benefit would exceed the median by \$8,000 to \$10,000.

Benefit amounts alone, however, do not determine the generosity of a plan. In most cases, public employees contribute to their pension plans. To assess the overall generosity of a Plan, BGR considered both the size of employee contributions and the benefits employees can expect in retirement. It measured the Hypothetical Employee's annual pension benefit as a percentage of his total pension contributions. Under that test, 17 of the 18 Plans are initially more generous than the national median plan. For some of the Plans, the difference is significant. The Plan for firefighters in New Orleans, for example, would provide the Hypothetical Employee with an annual retirement benefit that, as a percentage of his total contributions, is three times more generous than the national median.

In most cases, the relative generosity of the Plans will decline over time due to relatively stringent policies governing cost of living adjustments (COLAs). But if history is a guide, the retirees in most of the Plans will be beyond age 90 or 100 before their cumulative benefits fall below the median U.S. plan.

More Generous than Needed to Maintain Quality of Life

In an ideal world, a worker's retirement plan would produce sufficient income for him to maintain his quality of life in retirement. According to one estimate, an employee making \$40,000 at retirement needs 85% of his pre-retirement income to maintain his quality of life.

All but two of the 18 Plans would initially provide the \$40,000 employee with benefits that exceed this benchmark level. Indeed, 10 of the Plans, together with Social Security where applicable, would provide the retiree with an annual benefit that approaches his pre-retirement compensation. Members of two other Plans – those for city workers in New Orleans and employees of the Sewerage & Water Board – would actually earn more in retirement than they did while working.

If the Plans continue to grant COLAs at the same level and frequency as in the past, the benefits payable by eight of them would be below the target replacement rate within 10 years of retirement. However, nearly all of the other Plans would remain above the target rate well into retirement.

Now What?

Unfortunately for local governments, there is no way to make the obligations that they have incurred in the past magically disappear. The Plans must pay down their unfunded liabilities and make promised benefit payments to retirees. However, lawmakers at the state and local levels can craft careful reforms that over time provide benefits that are fair to both public sector retirees and the residents and businesses that help to support them.

Doing so will require lawmakers to perform a balancing act. On the one hand, it is unfair to ask workers in the private sector help pay for public retirement benefits that are far more generous and secure than their own. On the other hand, the private sector at large is failing to provide for a secure retirement, and lawmakers should be wary of embracing private sector models too enthusiastically.

“The growing costs and excesses evident in some of the Plans tell you it's time to seriously explore reform,” BGR Chairman Sterling Scott Willis said. “BGR will be doing exactly that in the next report in its pension series.”

The Rising Cost of Yesterday is available on BGR's website, www.bgr.org.

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BGR is a private, nonprofit, independent research organization. Since its founding in 1932, it has been dedicated to informed public policy-making and the effective use of public resources in the Greater New Orleans area. For more information call 525-4152 or visit BGR's website, www.bgr.org.