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States Struggle to Meet Demand of Public Pensions

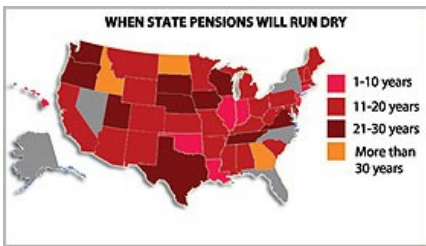
By [Kathy Kristof](#), [The Fiscal Times](#)



Many Americans are worried about funding retirement. Not Bernard Parks. The former Los Angeles police chief retired at age 59 with a pension that paid 90 percent of his final years' earnings – a tidy \$265,000 annually. And then, like millions of former public employees who retire young, he was able to pick up another job while still collecting that rich pension.

A year after his official retirement, Parks became a Los Angeles City Councilman, earning \$179,000 annually. Together, his pension and pay net him some \$444,000 – roughly \$44,000 more than the annual earnings of President Barack Obama – and considerably more than Parks' pre-retirement pay.

Rich retirement payments to government workers have long been a source of "pension envy," but payments for people like Parks are now a topic of heated national debate because public retirement funds are fast running out of cash. A recent analysis by [Joshua D. Rauh](#), professor of finance at Northwestern University's Kellogg School of Management, found that public pensions in four states – Illinois, Connecticut, Indiana and New Jersey – could run out of money this decade if nothing is done. Another 23 systems are slated to go belly up before 2029, according to Rauh. As taxpayers struggle with layoffs, stagnant wages and "frozen" benefits, they're becoming increasingly disenchanted with the seemingly sacrosanct employment and benefit prospects in the public sector, leading some to predict a coming war between public and private sector workers.



While Rauh's study has its detractors – the National Association of State Retirement Administrators disputes some of his assumptions – everyone agrees that pension funds operated by state and city governments are rapidly running short of the cash needed to fund their promises.

What happens then? If the systems aren't revamped, the pensions will eat up an increasing portion of state and municipal budgets, laying waste to parks, libraries, roads and other public services – as well as working cops, firefighters and other current employees. Need to fill potholes and keep cops on the beat? Taxpayers would have to shoulder the burden with higher annual levies.

"We are on the precipice of a disaster," said [Marcia Wagner](#), founder of the Wagner Law Group, a Boston-based employee benefits law firm. "We have massive underfunding that will take up more and more of state budgets, squeezing other things out."

In Ohio, where Rauh estimates the public retirement systems will run out of cash in 2030 and require 52 percent of state revenues to fund benefits, teachers commonly "retire and rehire." Just recently, for example, Kettering school district superintendent James Schoenlein said he wanted to retire – and return to his old position at a lower annual salary. On the surface, the deal would cut

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the Kettering school district's payroll, paying Schoenlein just \$130,000 instead of more than \$155,000. But add that to his retirement pay, which amounts to 90 percent of the average of his highest three-years' pay, and Schoenlein will take home more than \$250,000, according to the [Dayton Daily News](#).

A dozen state pensions have moved to stave off bankruptcy by boosting contributions required of existing workers and by cutting some future benefit accruals. But most state systems have done nothing—and even some of those that have acted may not have done enough.

Public pensions, unlike pensions provided in private industry, often allow payment of benefits after a set number of years of service, regardless of your age. As a result, an individual could go to work for a public entity when he was 20, “vest” in his pension benefits by age 40 and then “retire,” collecting payments for the next 40 or 50 years.

“Those are promises that are impossible to sustain unless the population and the economy are growing at a break-neck pace,” said [Peter Morici](#), former chief economist for the U.S. International Trade Commission. “You don’t have to have a PhD in finance to realize that you can’t give people 90 percent pensions at the age of fifty and not have the system go bust after a few years.”

Public workers commonly get a generous 1.8 percent of wages for each year they’ve worked, if they’re also covered by Social Security, said [Keith Brainard](#), research director for the National Association of State Retirement Administrators. Those who don’t participate in Social Security, such as many teachers and public safety workers, get considerably more – often 2% to 3% of pay for each year worked. Someone who started work fresh out of college could get 50 or 60 percent of their pay at age 42 and be able to collect that pension for life – regardless of whether or not they took another job and continued working. In New York, the hot tip is to work 20 years for one public agency; quit and get a job for another public agency for the next 20 years, said Morici. Then, after 40 years of work, you have two pensions that deliver 100 percent of your working wages.

In private industry, where only about one-fifth of workers get a defined benefit pension, payments dramatically less generous. Typically, employees get just 1.25 percent of wages for each year they worked, and they’re unable to claim any pension until after they hit the age of 65.

Other differences: Some public pensions give you a multiple of your “highest” year’s pay – even if that year was boosted by overtime – others only factor in “final” pay, and wink at those who “spike” it by allowing significant raises to be granted to people who are on the brink of retirement, said Wagner. In addition, public pensions are frequently adjusted each year to account for higher costs. Unlike Social Security, which is adjusted for inflation, public employee pensions are often adjusted by a set amount, say 3 percent per year. Pensioners receive that increase even when the economy is bad enough to create declining prices.

A recent [New York Times investigation](#) found that 100 retired police and fire fighters in Yonkers were making more retired than they did working. Why? They “spiked” their pensions by loading up on overtime in the years before retirement. Hugo Tassone, a 44-year old pensioner, told The New York Times that he merely took advantage of what the system allowed. The result: He took home \$74,000 annually when employed, but gets \$101, 333 retired.

A federal law called ERISA does not allow companies to pull pensions that have already been earned. As a result, many companies told workers that they would not be able to accrue new benefits and new workers coming in wouldn’t get a traditional pension – they’d have to save by personally contributing to 401(k) plans.

State and municipal governments are not regulated by federal law. Instead, their pension rules are set by state charters and constitutions that often say that new workers can’t be denied the pensions promised to existing workers, says Wagner. But these charters can be changed at will. The problem: There’s little will to do it since unions wield considerable political clout.

Adds Morici: “When you look at the grip of the unionized interests on state governments, it is just impossible for the pensions not to fail and the governments to fail with it. Yet, some progress has been made. Kansas, for example, made sweeping changes to its public employee plans, boosting employee contributions, changing benefit formulas and boosting age and service requirements to encourage people to wait until age 65 to retire. In California, where the state’s budget deficit exceeds \$19 billion, four public employee unions agreed to a raft of changes that hike employee contributions and raise the retirement age for newcomers. And revisions are in the offing in several additional states, which could help preserve the pensions without tapping taxpayers to do it.

That’s the kind of change that’s needed around the country, Wagner said.

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