

**Testimony before U.S. House Committee on Education and the Workforce
Subcommittee on Employer-Employee Relations
Field hearing on
“Examining the Retirement Security of State and Local Government Employees”**

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submitted on behalf of NASRA and the National Council on Teacher Retirement**

Mr. Chairman, members of the Subcommittee, I want to thank you for the opportunity to speak to you today. The membership of the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR) administer State, territorial, local, university and statewide public pension systems that collectively hold over \$2.1 trillion in trust for over 18 million public employees, retirees and their beneficiaries.

Broadly speaking, I believe the retirement security of the nation’s state and local government employees and retirees, particularly when compared with other groups, is strong. This strength is the result of a system that features:

- a) pre-funded defined benefit plans;
- b) reasonable costs that are shared by public employees, employers, and investment earnings;
- c) flexible plan designs that accommodate the objectives of relevant stakeholders, including public employers, taxpayers, those who rely on public services, and public employees;
- d) voluntary defined contribution plans that supplement defined benefit plans;
- e) exemption from most federal regulation, allowing cities and states to design, administer, and finance retirement benefits in concert with the unique needs of each pension plan sponsor and within each state’s constitutions, statutes, case law, and political culture.
- f) state protections of pension benefits, many of which pre-date and exceed federal regulations of pension benefits among private employers.

Sixteen million Americans—more than 10 percent of the nation’s workforce—are employed by a state or local government. These are public school teachers, administrators, and support personnel; firefighters; public health officials; correctional officers; judges; police officers; transportation workers; child protective service agents; and myriad other professionals responsible for performing a broad array of essential public services.

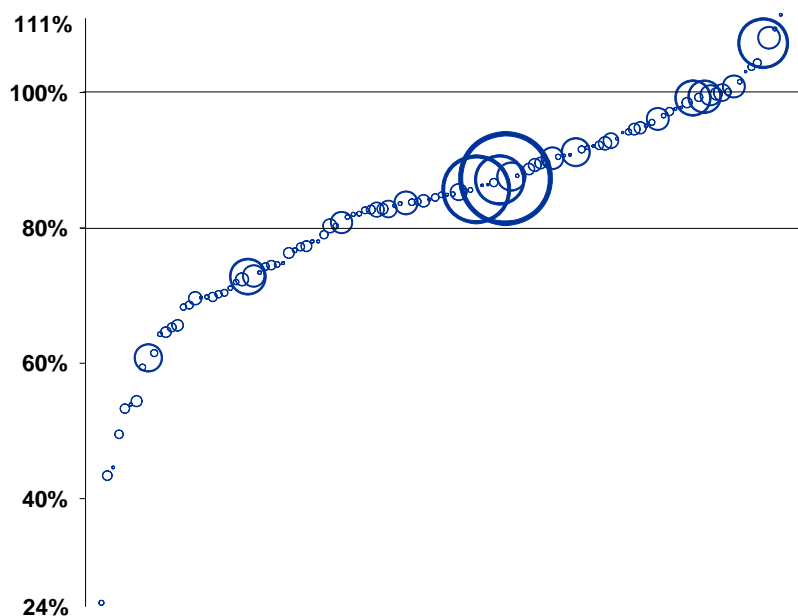
Ninety percent of these workers have a defined benefit plan, or traditional pension, as their primary retirement benefit, a figure that stands in increasing contrast to the diminishing portion of the nation’s private sector workforce with access to a traditional pension. This pension coverage makes a significant

and cost-effective contribution to the retirement security of not only these public employees, but also to the nation as a whole.

Pension plans for the vast majority of state and local government employees are in reasonably good condition. Based on the latest available data, public pensions have approximately \$2.8 trillion in assets to fund more than 86 percent of the next 30 years on pension liabilities they have incurred to-date. Based on my projections, this figure will begin rising again in FY 2006 and for the foreseeable future. Absent an extreme downturn in investment markets, 86 percent is likely to be the low point for the aggregate public pension funding level.

Figure 1. plots the current funding level of 117 public pension plans around the country. Combined, the plans depicted in this chart provide pension benefits for approximately 85 percent of all state and local government employees in the U.S. The size of the bubbles in the chart is roughly proportionate to the size of each plan. Larger bubbles indicate larger plans, and smaller plans are indicated by smaller bubbles. As the chart shows, most plans are funded above 80 percent, especially most of the larger plans.

Figure 1. Current funding level of 117 state and local pension plans



There is nothing inherently flawed about defined benefit plans for public employees that makes them risky or expensive to taxpayers, and cities and states that have properly funded their pension plans and managed their liabilities are generally in good actuarial condition.

I want to take a moment to explain the meaning of underfunding in the context of a public pension plan. Most pension benefits for public employees are pre-funded, meaning that all or most of the assets needed to fund pension liabilities are accumulated during an employee's working life, then paid out in the form of retirement benefits. Pre-funding is one way of financing a pension benefit, enabling a large portion of the benefit to be paid with investment earnings rather than contributions from employees and employers. All else held equal, a fully funded pension plan is better than one that is poorly funded, but a plan's funded status is simply a snapshot of what is happening at a particular point in time in an ongoing pre-funding process. It is a single frame, if you will, of a movie that spans decades. There is nothing magic about a pension plan being fully funded, and even with no changes to funding policies or plan design, most underfunded public pension plans will be able to pay promised benefits for decades. Pension liabilities typically extend years into the future, and it is during this time that a pension fund can accumulate the assets it needs to fund its future liabilities. *The critical factor in assessing the current and future health of a pension plan is not so much the plan's actuarial funding level, as whether or not funding the plan's liabilities creates fiscal stress for the pension plan sponsor.*

Underfunding is a matter of degree, not of kind. Many pension plans remain underfunded for decades with no deleterious consequences. The status of a plan whose funding level declines from 101 percent in year one to 99 percent in year two, has changed from overfunded to underfunded. Although the nomenclature describing the plan's funding condition has changed diametrically, the financial reality of its funding condition has changed little. Fully funded and underfunded plans both continue to require contributions and investment earnings.

As mentioned previously, public pensions as a group have accumulated assets equal to approximately 86 percent of their liabilities, a figure I project will begin rising in the coming months as more of the investment earnings generated since March 2003 are incorporated into public funds' actuarial calculations. In my view, the fact that public pension funds have accumulated as much of their liabilities as they have deserves praise, not condemnation. Whether one refers to the public pension funding glass as 86 percent full or 14 percent empty, the glass undeniably is mostly full.

This is not to suggest that there are not funding problems among some public pension plans. There are, and they need to be addressed. But there is no national crisis, and suggesting that a plan is in crisis simply because it is underfunded is to misunderstand the meaning of that term.

On a national basis, the cost to taxpayers of public pensions, both as a percentage of public employee payroll and of all state and local government spending, is lower today than during most of the last decade. As shown in Figure 2., on a national basis, employer (taxpayer) pension costs for state and local government pensions, are lower today than they were during the mid-1990's. In most cases where

employer costs have risen sharply, a major factor contributing to the rise is that the employer allowed its contribution rates to decline to very low levels.

Figure 2. Employer (taxpayer) contributions to state and local government pension plans as a percentage of payroll and of total state and local government spending, 1995 to 2004

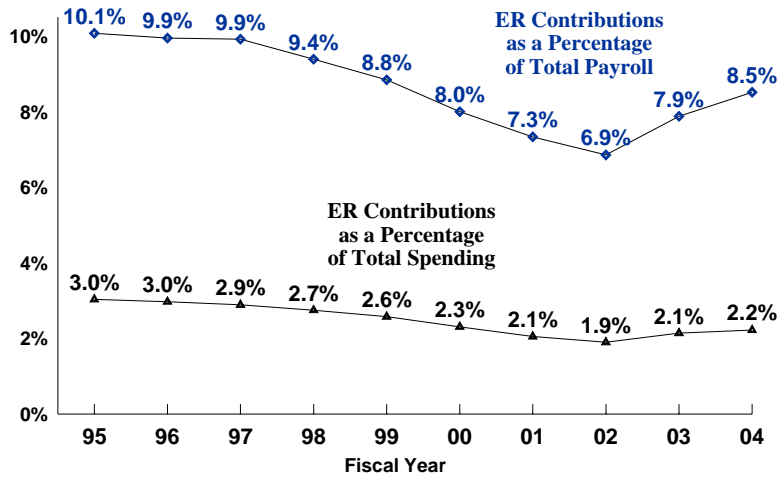
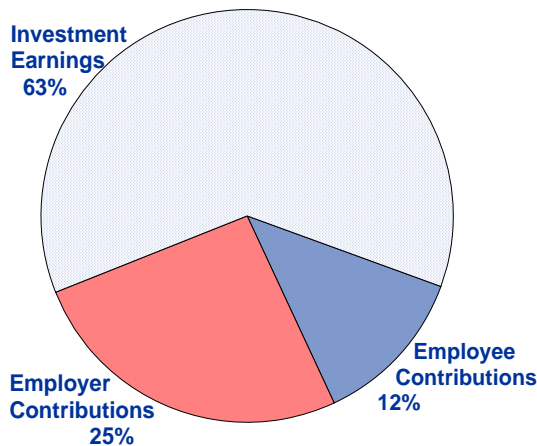


Figure 3. shows the three sources of public pension revenue for the 22-year period from 1983 to 2004 (these are the only years of this data available from the U.S. Census Bureau.) As the figure shows, three-fourths of all public pension revenue came from sources other than taxpayers. Unlike most corporate pension plans, most employees are required to contribute to their pension plan; five percent of pay is the median and most popular employee contribution rate.

Figure 3. Sources of state and local government pension revenue, 1983-2004



In addition to promoting retirement security for public employees and the nation as a whole, traditional pensions for state and local government employees offer other advantages that benefit all Americans relative to defined contribution, or 401k, plans. For example, traditional pensions strengthen the ability of public employers to attract and retain the personnel needed to perform essential public services.

Taxpayers benefit from these plans because they promote worker retention and longevity, encouraging experienced and qualified workers to return the investment in training and experience that has been made in them by their public employers. Those who rely on public services—which includes all of us—enjoy myriad benefits that emanate, directly or indirectly, from the provision of these services.

Americans also enjoy the economic benefits generated by traditional pension plans for public employees. The \$2.8 trillion held by public pension funds is a key source of liquidity and stability for the nation's financial markets. Pension assets are real, invested in stocks, bonds, real estate, venture capital, and other asset classes. Public pensions hold in trust more than 10 percent of the nation's corporate equities, and, as institutional investors, public pension funds are an important source of long-term, patient capital for the nation's publicly-traded companies. Recent studies have found that public pension funds are significant sources of economic support and stimulus that reaches every city and town in the nation. Public pension funds are also a key source of financing for venture capital, which represents the seeds of the nation's future economic growth and productivity gains.

State and local governments take seriously their legal and civic responsibilities for paying promised benefits to their employees and retirees. Comprehensive state and local laws and significant public accountability and scrutiny, provide rigorous and transparent regulation of public plans and have resulted in strong funding rules and levels. These safeguards often pre-date and exceed federal laws for private sector pensions.

Additionally, public plans are backed by the full faith and credit of their sponsoring state and local governments, and public plan participants' accrued level of benefits and future accruals typically are protected by state constitutions, statutes, or case law, which prohibit the elimination or diminution of retirement benefits. These constitutional and statutory protections provide far greater security than are provided to private sector pension plans under the Employee Retirement Income Security Act (ERISA) and the Pension Benefit Guaranty Corporation.

Although any group as large as the public pension community could benefit from some common sense reforms, on the whole, a fair review will lead a reasonable person to conclude that: a) the model for providing retirement benefits for employees of state and local governments is working for all stakeholders: public employers, taxpayers, recipients of public services, and public employees; b) pension benefits of working and retired public employees are safe and assured; and c) the model used by state and local governments to provide employee retirement benefits contains elements worthy of imitation by other employer groups and segments of the economy.

I am happy to respond to any questions you may have about public pension issues. Thank you.