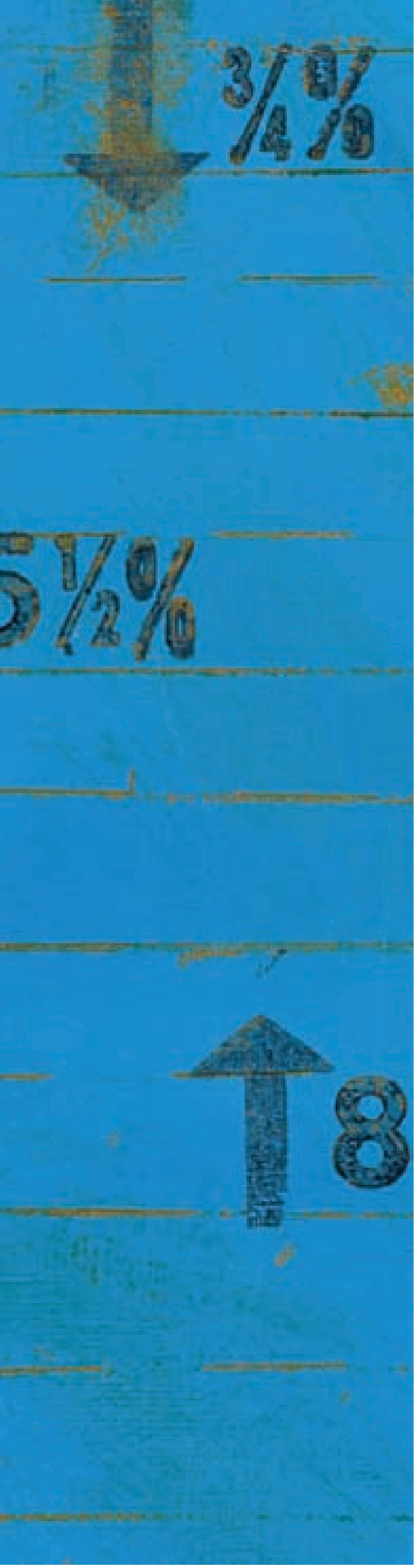

Poor performance

Losses in pension funds, long-term trends have states looking at system

BY TIM ANDERSON

For all of the public dollars dedicated to government pension plans, the attention paid to state retirement systems has often been scant or nonexistent. Those days, though, may be over – at least for the foreseeable future.

"The public retirement system community has experienced a confluence of events that is probably unprecedented," said Keith Brainard, director of research for the National Association of State Retirement Administrators.

For the past few years, losses in the stock market have hit state pension funds hard. The declines came after the huge market gains of the late 1990s, causing sharp, eye-catching drops in portfolio values. Between 2001 and 2002, for example, assets in the nation's 123 public retirement systems fell by 6 percent while liabilities grew by 10 percent. Pension funds went from a "$112 billion overfunded condition in 2001 to a $180 billion shortfall in 2002," a 2003 report from investment adviser Wilshire Associates concluded.

These numbers alone would be enough to grab the attention of the public and state legislatures, which ultimately have authority over the pension plans. Brainard added that the state workforce has become much more aware of retirement issues over the past 20 years.

"Retirement systems have gone from being obscure to fairly well-known state agencies," he believes.

In addition, trends in the retiree population are pressuring states to act sooner rather than later.

"The economy and our [lack of] return on investments have only been part of the problem," Iowa Sen. John Kibbie said about conditions in his state. "We've also got more people retiring and at higher wages."

Kibbie added that the benefits package offered to retirees is more generous than it has been in the past. Iowa is not alone. According to Brainard, many states in the late 1990s responded to a run-up in portfolio values by enhancing benefits – such as increases in the retirement multiplier, cost-of-living adjustments, better health insurance, etc.

"There has not been much ratcheting backward since," he said. "That tends to go only in one direction [toward benefit enhancements]."

With the pending retirement of the baby boom generation, pressures on state public pension funds will only increase in the future.

"That is the real issue for us," said Kansas Sen. Jim Barone. "We are confident that the pension for everybody collecting one today is secure. The question is, what will be there 30 years from now for the people currently working? There is a lot of concern about that."

Courts have ruled in the past that states must find a way to pay the benefits guaranteed to workers. Understanding this, and accepting demographic projections for the retiree population, some states are seeking changes now to their public pension fund systems. This task is not an easy one, especially when tight budget conditions make it difficult to compensate for declining assets or increasing liabilities with additional state dollars.

"It's going to take a comprehensive plan to address the issue in Kansas," Barone said.

In December, the Kansas Legislature's Joint Committee on Pensions, Investments and Benefits approved a plan to issue $500 million in pension obligation bonds.

The proposal was given the initial OK during the 2003 legislative session and still needed final approval from the governor and legislative leaders at the time this article was written.

Supporters of the pension obligation plan believe it will help the long-term health of the state's retirement fund, which has been experiencing a growing shortfall between assets and liabilities. The proposal calls for the state to back the bond payments with general tax revenues. The idea is for the state to borrow the money at a low rate and hope to make more on the investments made with the $500 million.

Kibbie says Iowa officials also have discussed similar kinds of proposals.

"If you can borrow money and get a greater return on it, most private-enterprise people would tell you that's good business," he added. Some, though, believe these plans are too risky and could put future generations into debt.

During its 2003 session, the Illinois General Assembly passed legislation authorizing a $10 billion pension financing plan in order to shore up state retirement funds and help balance the budget.

While he has supported the $500 million pension obligation plan in Kansas, Barone also says more should be done. First, he believes the state needs to kick in more money to the system.

"We haven't taken care of our end in the past," he said. Barone added that state and local governments will need to tighten up their retirement benefit systems, making sure workers aren't able to "jump out" and still collect pensions.

Other ideas include changing the amortization period of unfunded liabilities or increasing the contributions made by employers and workers. This last idea appears to have significant support in Iowa. "That's the easiest thing to do, but it's something that needs to be phased in over time because of what it would do to local and state budgets," Kibbie said.

Currently, local and state governments set aside 5.75 percent of their payrolls for pensions, while workers contribute 3.70 percent of their salaries. This year, Iowa lawmakers are expected to consider a proposal to gradually increase the current 9.45 percent total to more than 13 percent.

States ranked by funding ratio (assets/liabilities) ($ in millions)

State	Ratio of assets to liabilities*	Rank	Assets minus liabilities	Rank
Wisconsin	1.26	1	$13,586	1
North Carolina	1.16	2	$7,675	2
Georgia	1.11	3	$5,544	4
Arizona	1.09	4	$1,786	7
Florida	1.04	5	$3,059	6
New York	1.02	6	$4,415	5
California	1.02	7	$5,552	3
Pennsylvania	1.02	8	$1,227	8
South Dakota	1.01	9	$48	9
Virginia	0.99	10	-$218	12
Alaska	0.99	11	-$81	10
Tennessee	0.97	12	-$632	16
New Jersey	0.97	13	-$2,159	26
Delaware	0.96	14	-$202	11
Wyoming	0.94	15	-$310	13
Utah	0.93	16	-$994	17
Arkansas	0.90	17	-$1,389	21
Michigan	0.89	18	-$5,819	36
South Carolina	0.89	19	-$2,651	28
Colorado	0.88	20	-$3,883	31
Iowa	0.88	21	-$2,113	25
Vermont	0.85	22	-$370	14
Texas	0.85	23	-$19,402	48
Minnesota	0.84	24	-$6,397	39
Idaho	0.83	25	-$1,247	20
Hawaii	0.83	26	-$1,746	23
Ohio	0.83	27	-$21,980	49
Washington	0.83	28	-$7,808	43
North Dakota	0.83	29	-$471	15
Missouri	0.81	30	-$6,305	38
Kentucky	0.81	31	-$5,248	35
Alabama	0.81	32	-$5,045	33
Nebraska	0.81	33	-$1,037	18
New Mexico	0.80	34	-$3,428	30
Maryland	0.78	35	-$7,544	41
Oregon	0.76	36	-$10,753	47
Massachusetts	0.76	37	-$8,765	44
Kansas	0.76	38	-$2,841	29
Montana	0.75	39	-$1,685	22
New Hampshire	0.74	40	-$1,096	19
Connecticut	0.73	41	-$6,782	40
Nevada	0.72	42	-$5,050	34
Maine	0.72	43	-$2,091	24
Rhode Island	0.70	44	-$2,541	27
Mississippi	0.70	45	-$6,232	37
Indiana	0.67	46	-$7,677	42
Louisiana	0.65	47	-$9,287	45
Oklahoma	0.56	48	-$9,662	46
Illinois	0.54	49	-$34,946	50
West Virginia	0.45	50	-$4,595	32

**Ratio is based on market value of assets.*
Source: 2003 Wilshire Report on State Retirement Systems, Wilshire Associates

Employers and workers would share the increased burden.

"The sooner we start to solve the problem, the better off we'll be," said Kibbie, adding that higher contribution rates will be needed even if the state begins to earn greater returns on investments in the stock market.

A recent Ohio Retirement Study Council report found that contribution increases or benefit cuts were needed to keep three state public pension funds from falling short of future obligations. Meanwhile, the Ohio Legislature has been considering other reforms to the state's retirement system in the wake of news reports detailing the questionable travel and spending practices of pension fund trustees.

"In the past few months, we've seen one news story after another about abuse of authority, mismanagement of funds and broken trust with respect to the state retirement systems," wrote Ohio Sen. Lynn Wachtmann in a recent online column. "What happened at these organizations is outrageous."

Separate legislative bills would increase

oversight powers of the state treasurer and attorney general while also requiring the state's pension boards to implement new ethics policies and carry out reviews of management and investment practices.

Looking to the future

Despite the recent concerns and controversies, Brainard said the nation's public retirement system is "generally healthy."

"Funding a retirement plan is a long-term process, not unlike a mortgage for individuals," he explained. "It's not something you fund overnight; it takes place over many years."

As a result, even a three-year fall in stock market prices can be made up over time. Some states, though, do have more troubling pension fund situations, due largely to the fact that they haven't fully funded contributions in the past. Every state, too, must prepare for the influx of new beneficiaries with the retirement of baby boomers.

"A lot of people approach the phenomenon from the mindset of Social Security, but that has traditionally been a mostly pay-as-you go system, whereas public retirement systems are mostly pre-funded," Brainard said.

"If you combine the pending large number of retirees with less-than-full funding for a retirement system, then you have a problem. Otherwise, though, these retirement systems will have anticipated these folks' retirement and funded for it."

— Tim Anderson is publications manager for the Midwestern Office of The Council of State Governments. This article originally appeared in Stateline Midwest, *a publication of CSG Midwest.*

Budget balancing tactics Continued from page 13

- Texas drafted rules to recover money from the estates of some deceased Medicaid patients.
- In Connecticut, hundreds of low-income elderly and disabled people opted out of the state's prescription drug programs because of the move to recoup expenses from program recipient's estates.

Inventive measures to maximize federal matching funds under Medicaid

States continue efforts to maximize their Federal Medical Assistance Percentage and produce additional revenue. In the area of nursing facilities, one of the more common strategies has been the use of upper payment limits in which local government providers are paid more money than they would otherwise receive, thus generating a greater FMAP. The local providers then return the excess money to the state.

Streamlining government services

- North Carolina disposed of state-owned surplus real property more efficiently generating $10 million in revenue; consolidated employee death and disability benefit reserve funds saving $55 million; implemented "prior approval" and use of generics in Medicaid prescription drugs for a savings of $97 million; and accelerated the state's debt collection practices for $50 million in additional revenue.
- A commission appointed by South Carolina's Gov. Mark Sanford to improve the delivery of state services and generate revenue recently issued its final report. Recommendations contained an estimated savings of $225 million in the first year and more than $300 million annually thereafter.

Prescription drugs

- Lawmakers in Illinois created a statewide, centralized buying club to negotiate the best rates on prescription drugs for seniors and disabled persons. Illinois saves $150 million annually by purchasing these prescription drugs centrally at a volume discount.
- Illinois, New Hampshire, Minnesota, Wisconsin, Iowa, Michigan, Vermont and West Virginia continue to press the federal government to permit the importation of lower-priced prescription drugs from Canada. Illinois estimates $91 million in annual savings here.

Although the financial picture in many states remains murky and job growth continues to be tepid, there is room for cautious optimism. In addition to the positive trends noted, after the two quarters that ended in September 2003, state revenues had increased by more than 9 percent, even though half this increase came from the federal aid to states and the other half from higher tax collections.

State and local spending, in contrast, increased at an annual rate of 1 percent during the same period. States have also increasingly looked to greater borrowing to bridge shortfalls, increasing from a total of $48 billion in 1992 to over $127 billion in 2002. Along with the improved state revenue picture, the boost to the economy from record low interest rates, enhanced productivity levels, and growing business and consumer confidence certainly creates buoyancy.

— Sujit M. CanagaRetna is senior fiscal analyst at CSG's Southern office, the Southern Legislative Conference in Atlanta. This article is based on a presentation he made before the Governor of Alabama's Commission on Efficiency, Consolidation and Funding, November 21, 2003 at the Alabama Statehouse in Montgomery.