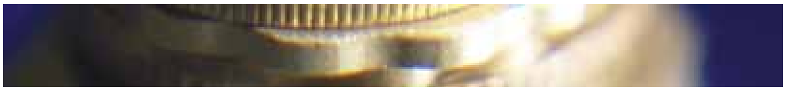

Systems in Stress

Public retirement systems are challenged by shrinking assets and growing liabilities

By Sujit M. CanagaRetna

As federal officials debate how much tinkering they need to do to keep Social Security solvent, policy-makers in the states are searching for solutions to shore up weaknesses in public retirement systems.

In many cases, these public retirement systems are underfunded at a time when the first wave of the nation's baby boomers is rapidly approaching retirement.

The problem is underscored in the results of a survey conducted by The Council of State Governments' Southern Office, the Southern Legislative Conference. Data from the nationwide survey showed that liabilities exceeded assets in 73 percent of the plans that responded.

Those survey results are among the findings in a comprehensive report, *America's Public Retirement Systems: Stresses in the System*, released by CSG's Southern office in Atlanta.

Federal data on all 2,670 state and local retirement systems plus survey results from 105 state retirement plans in 46 states are used in the report to provide analysis for policy-makers on the status and trends in the nation's public retirement systems.

Other findings in the report show that:

- Nationally, public retirement systems' payments to retirees are climbing while assets are dropping. Between 1993 and 2002, annual receipts for public retirement systems plunged from $125.9 billion annually to an aggregate deficit of $6.1 billion because of earnings losses on investments. Meanwhile during the same period, payments to retirees more than doubled from $52.6 billion annually to $122 billion.
- Liabilities are rising at a faster rate than assets. Between the fiscal years 2001 and 2002, the assets of public retirement systems increased by 3 percent while liabilities increased at a more rapid rate of 8.1 percent.
- States are responding to the challenge by refinancing funds through bond sales, calling for changes in qualifications to earn full retirement benefits, and monitoring more closely the performance and management of the nation's 219 state retirement funds.

Retirement Infrastructure Fragile

The report highlights that in addition to weaknesses in these public retirement systems, other elements of the nation's retirement architecture, vital to financing the retirement of millions of Americans in the future, remain extremely tenuous as well.

Specifically, the report notes the precarious financial position of corporate pension plans and the federal Pension Benefit Guaranty Corporation (PBGC); the looming shortfalls expected in the Social Security and Medicare programs in coming decades; and the low personal savings rates of most Americans, coupled with the high rates of consumer and household debt.

A variety of interest groups and concerned citizens have emphasized that policy-makers at all levels of government need to initiate concrete steps to prepare for the "graying" of America and the expected huge increase in retirees. In fact, the number of people in the United States 65 years and older is forecast to grow from about 13 percent of the total population in 2000 to 20 percent in 2030, and to remain above 20 percent for at least several decades thereafter. In this context, there is growing concern that more attention needs to be directed toward retirement planning and developing a retirement infrastructure that has the capacity to absorb the retirement needs of all Americans.

In recent years, public retirement funds have attracted a great deal of attention, sometimes because of their shrinking asset base and sometimes for a variety of other reasons. Nationally, there are 2,670 state and local government pension plans. By the end of fiscal year 2002, those retirement systems contained $2.2 trillion in cash and investment holdings for more than 17.3 million total members. These pension funds made payments to more than 6.2 million beneficiaries during this period.

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Funding Levels Plunging

Various studies show, however, that funding levels for public pension funds are plunging. For instance, according to a study by the National Association of State Retirement Administrators, the assets of public retirement systems increased by 3 percent between fiscal years 2001 and 2002 while liabilities increased by 8.1 percent. Then, a study by Wilshire Associates shows that the ratio of state pension assets to liabilities declined from 106 percent in 2001 to 82 percent in 2003. Finally, the majority of plans that responded to the CSG Southern office's survey revealed that a majority of the plans that responded were underfunded with liabilities exceeding assets in 68 of the 93 plans.

There is a great deal of variation among public pension plans and replicating the performance of one state's success with a particular approach may not always be possible in another state given its unique circumstances. Nevertheless, the report documents specific strategies adopted by a number of public retirement plans to improve and bolster their financial positions.

- *Alabama*—The Retirement System of Alabama (RSA) has gained national attention due to its "unorthodox" investments from the recent acquisition of US Airways to investments in the Robert Trent Jones Golf Trail to financing the restoration of portions of downtown Mobile to real estate investments in New York City. RSA's assets ballooned from $500 million in 1973 to $26.2 billion in the space of three decades. (For more information on RSA, see accompanying article in this month's *State News* on page 21.)
- *California*—The nation's largest public pension plan, the California Public Employees' Retirement System (CalPERS), voted to oust 38 hospitals from its Blue Shield HMO network in 2004 because they were deemed too expensive, a move that will save the giant pension plan $50 million annually.
- *Kansas*—In 2004, the governor and legislative leaders agreed on a strategy to borrow $500 million to buttress the state's beleaguered Public Employees Retirement System

Number, Membership, and Monthly Benefit Payments of State-Administered Employee Retirement Systems: 1993-2003

Item	2003	1998	1993
Number of systems	218	214	190
Membership last month of fiscal year			
Total membership	21,209,882	18,792,096	15,206,551
Active members	12,538,604	11,358,499	10,224,417
Inactive members	3,250,341	3,009,997	1,430,369
Percent distribution	100.0	100.0	100.0
Active members	59.1	60.4	67.2
Other	40.9	39.6	32.8
Beneficiaries receiving periodic benefits			
Total number retired or survivors	5,420,937	4,423,600	3,551,765
Former active members, retired service	4,642,902	3,798,600	3,099,491
Former active members, retired disability	342,286	254,718	187,795
Survivors of former active members	435,749	370,282	264,479
Percent distribution	100.0	100.0	100.0
Percent former active members, retired service	85.6	85.9	87.3
Percent former active members, retired disability	6.3	5.8	5.3
Percent survivors of former active members	8.0	8.4	7.4
Recurrent benefit payments for last month of fiscal year			
Total amount of benefit for retired/survivors	$7,852,487,401	$4,638,426,325	$2,823,434,232
Amount former active members, retired service	$7,013,919,983	$4,167,810,596	$2,525,531,815
Amount former active members, retired disability	$462,604,657	$257,442,309	$161,872,085
Amount survivors of former active members	$375,962,761	$213,173,420	$136,030,332
Percent distribution	100.0	100.0	100.0
Percent former active members, retired service	89.3	89.9	89.4
Percent former active members, retired disability	5.9	5.6	5.7
Percent survivors of former active members	4.8	4.6	4.8
Average monthly payment for beneficiaries			
Average for all beneficiaries	$1,449	$1,049	$795
For former active members, retired service	$1,511	$1,097	$815
For former active members, retired disability	$1,352	$1,011	$862
For survivors of former active members	$863	$576	$514

Source: U.S. Department of Commerce, U.S. Census Bureau, December 2004
Detail may not add to totals due to rounding.

At the federal level, most of the debate about the financial underpinnings for future retirees has centered on Social Security and Medicare. It is time for the plight of the PBGC to be added to that debate.

(KPERS). Kansas' strategy was one adopted by a number of states as they sought to reinforce their enfeebled retirement systems.

- *Maine*—In a contrarian approach, hailed by *The New York Times* as the first pension fund in the United States to do so, Maine has adopted a strategy known as matching, i.e., deliberately aiming for low but guaranteed investment income to pay for the retirement benefits of its workers.

Options for Improvement

To bolster the shaky pillars of America's current retirement system, *America's Public Retirement Systems: Stresses in the System* offers options for policy-makers to consider.

To overcome financial problems associated with a low savings rate, policy-makers at all levels of government should begin an assortment of educational and incentive programs to instill the importance of savings. The United States has a household savings ratio of 2 percent compared with 15 percent in Europe and 6.5 percent in Japan.

At the federal level, most of the debate about the financial underpinnings for future retirees has centered on Social Security and Medicare. It is time for the plight of the PBGC to be added to that debate. The PBGC, mandated to protect the pensions of bankrupt and failing corporations, is severely underfunded. Cumulatively, the level of pension underfunding could possibly eclipse the magnitude of the federal government's bailout of the savings and loan industry in the 1980s.

Finally, state policy-makers should pay more attention to the management of pension fund assets, the investment choices made by fund managers, and the practice of deferring contributions to retirement funds to offset budget shortfalls.

Ensuring both the short-term and long-term financial viability of America's public and private retirement systems is a challenge and a responsibility for policy-makers at every level of government—federal, state and local. In fact, resuscitating and then sustaining the financial health of our different retirement income flows provides the underpinnings for the foundation of the United States as an economic, political and military powerhouse in the global context. Consequently, it is imperative that policy-makers and citizens alike initiate efforts now to bolster the shaky pillars of America's current retirement system to minimize the costs of making these fundamental reforms in the future.

—Sujit M. CanagaRetna is senior fiscal analyst with The Council of State Governments' Southern Office, the Southern Legislative Conference. CanagaRetna's entire report is available online at slcatlanta.org.