PUBLIC PENSION REFORM

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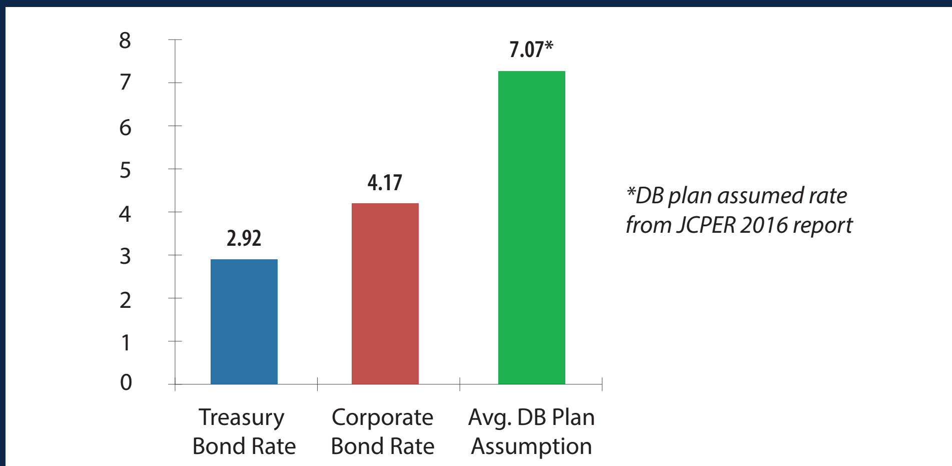
THE PROBLEM: Defined benefit (DB) pension plans promise employees annual payments for life upon retirement, but if a public plan does not have enough money to make these payments, taxpayers are legally bound to fund the difference. Pension plans can come up short if they fail to make sufficient contributions or overestimate their investment returns. Nationwide, state-run public pension funds are underfunded by nearly $1 trillion dollars.

RATES OF RETURN: TREASURY AND CORPORATE BONDS VS. DEFINED-BENEFIT PLAN ASSUMPTIONS

Defined-benefit plans assume higher return rates than either Treasury bonds or corporate bonds.



Sources: Joint Committee on Public Employee Retirement 2016 annual report; IRS data.

THE SOLUTION: *Defined contribution plans.*

Defined contribution (DC) plans consist of employer/employee contributions into individual accounts—think 401(k)—which employees can manage as they see fit. Upon retirement, the funds are available to employees. DC plans fundamentally differ from DB plans in that they cannot incur unfunded liability (so taxpayers are not on the hook), they put investment decisions into the employee's hands, and they are transferable from one job to another.

WHO ELSE DOES IT? Of Missouri's 128 public retirement plans, 78 are DB, 38 are DC, and 12 are a combination of the two plans. Public DC plans exist across the nation; states such as Michigan and Alaska offer DC plans for new state employees, while others such as Florida offer both DC and DB plans.

THE OPPORTUNITY: Missouri's DB plans value their unfunded liabilities at approximately $15.6 billion.[1] In 2015 an independent expert, using a corporate bond rate of 4.35%, valued the funding gap at closer to $57 billion. Pension reform offers a chance to stop the bleeding. DB plans can hold taxpayers accountable if investment returns are lackluster, whereas DC plans cannot incur unfunded liabilities by definition.

KEY POINTS

- DC plans can protect Missouri from devastating budget shortfalls.
- When a DB plan's investment returns are below (sometimes unrealistic) assumptions, taxpayers can be forced to pay the cost.
- DC plans put investment decisions in the employee's hands and can be transferred from one job to another.
- Shifting to DC plans reduces the political incentive to overpromise when impacts won't be felt for years.

[1]Joint Committee on Public Employee Retirement 2016 annual report.

SHOW-ME INSTITUTE RESOURCES

Policy study: “Public Employee Pensions In Missouri: A Looming Crisis”

Essay: “The Funding Status of State and Local Government Pensions in Missouri”

Policy study: “Missouri Transition Costs and Public Pension Reform”

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