Unfunded Retirement Liabilities

Discussant Comments

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Unfunded Liabilities Beset Many Programs Serving Older Americans

- Social Security Retirement (OASI)
- State and local retirement benefits
- Other programs with dedicated funding
  - Social Security Disability Insurance
  - Private pensions (PBGC)
  - Medicare Hospital Insurance
  - Retirement benefits for federal workers
- Programs without dedicated funding
  - Medicare Parts B and D
  - Medicaid
How Serious Is the Problem?

- **Social Security Retirement (OASI)**
  - Social Security trustees project that the trust fund will run out in 2035, after which about three-quarters of scheduled benefits can be paid
  - 75-year actuarial deficit is 2.67% of taxable payroll
  - These are the intermediate assumptions; outcomes are worse under high-cost scenario

- **State and Local Pensions**
  - Difficult to estimate, because there are thousands of plans
  - Using each plan’s discount rate, Pew estimates $1.4 trillion funding shortfall
  - Rauh (2017), using a lower discount rate, estimates $3.8 trillion shortfall
How Did Unfunded Liabilities Arise?

- Promised benefits cost more than anticipated
  - Life expectancy increased
  - Health care costs rose

- Revenues did not grow as fast as anticipated
  - Birth rates fell, reducing worker to retiree ratio in Social Security
  - Poor investment returns

- Bad choices
  - Some S&L plans didn’t make scheduled contributions
  - Some plans increased benefits when they were flush
  - Little incentive to make hard choices

- Early generations got really good deals: Legacy debt
How Should We Finance Unfunded Liabilities?

- Cut benefits
  - Current retirees
  - Current workers
  - New generation of workers

- Raise revenues
  - From workers
  - From taxpayers
    - Invest in higher return/riskier assets

- Roll over the debt indefinitely
Who should pay for the legacy debt?

In absence of legacy debt, fully funding requires contributions of 10.6% of payroll

- PAYGO requires 14.3% contributions
- PAYGO depends on population growth and economic growth

Broad-based income tax may be a better way of paying off the legacy debt
Aubry

- How much will future retirement benefits for S&L government workers cost taxpayers?
- How should we measure cost burdens?
  - Share of own-source revenue
  - Could consider as share of income, but difficult to measure
- How do we measure required payments?
  - Amortize unfunded liabilities over 30 years, level-dollar payments
  - Assume 6% rate of return
- Cost burdens vary widely
  - Some are staggering
  - Might treat legacy costs differently
Lenney, Lutz, and Sheiner

- How sustainable are state and local pensions?

- Consider PAYGO approach to financing, and assess sustainability of debt
  - Is pre-funding necessarily desirable?
  - Especially in low-interest rate environment

- Reverse engineer cash flows
  - Dig into plan’s actuarial reports
  - Enormous undertaking

- Result: Plans can stabilize pension debt with moderate fiscal adjustments
  - Not in every case
  - Benefits payments seem to have peaked
State and Local Plans Have Become Less Generous over the Past 10 Years

Mean years to vest

Hired before 2008: 6.3
Hired 1/1/2008 or later: 7.9

Mean years in FAS calc

Hired before 2008: 3.1
Hired 1/1/2008 or later: 4.4

Mean benefit multiplier

Hired before 2008: 2.2
Hired 1/1/2008 or later: 2.06

Source: Author’s calculations from Urban Institute’s State and Local Employee Pension Plan Database
State and Local Plans Have Become Less Generous over the Past 10 Years

Mean Normal Retirement Age

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<th>Hired before 2008</th>
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<tr>
<td>Mean Normal Retirement Age</td>
<td>53.8</td>
<td>57.2</td>
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Source: Author’s calculations from Urban Institute’s State and Local Employee Pension Plan Database
Conclusions

- Currently accruing costs should be funded

- Legacy costs might be treated differently
  - Should only current workers have to pay for past mistakes?
  - Creates enormous intergenerational inequities

- Handling legacy costs outside the system makes funding problems more tractable

- Lots of variation across state and local plans

- How do we prevent future bad choices that undermine S&L plan finances?