# 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

# Munnell, Hou, and Sanzenbacher

- 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

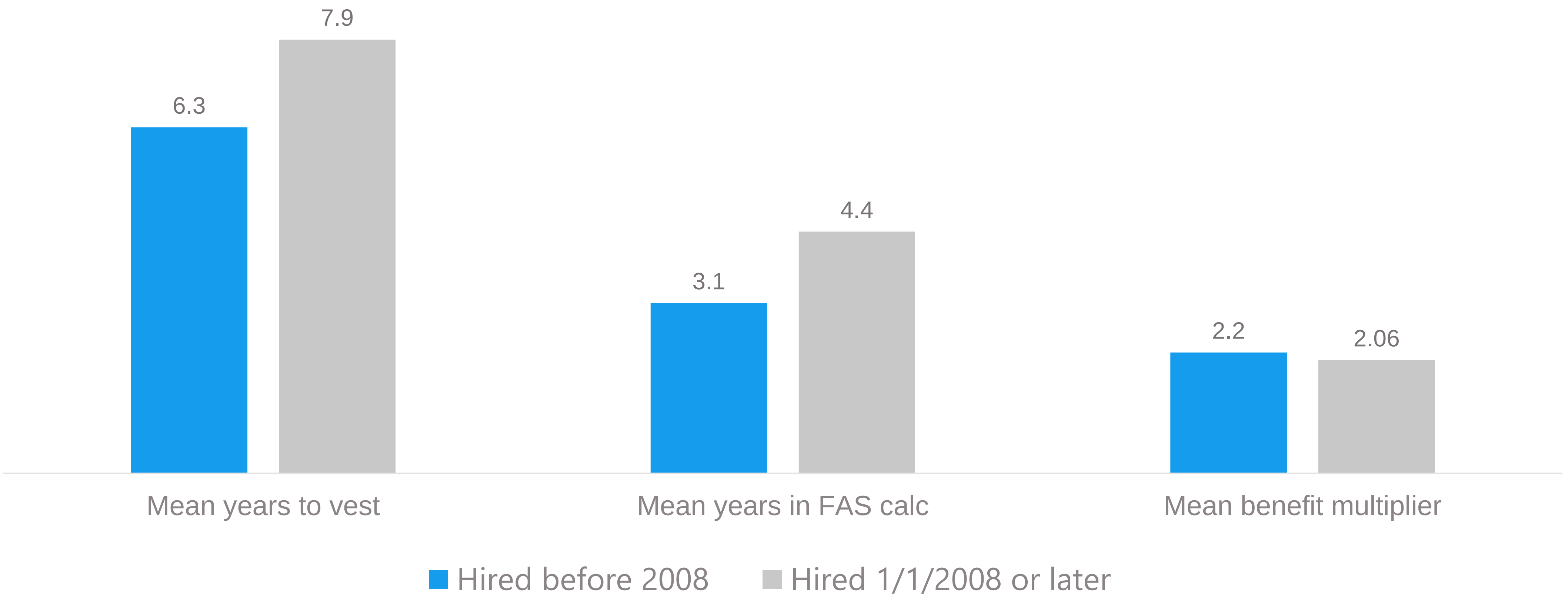
- How do we measure required payments?
  - Amortize unfunded liabilities over 30 years, level-dollar payments
  - Assume 6% rate of return

- 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




*Source:* Author's calculations from Urban Institute's State and Local Employee Pension Plan Database

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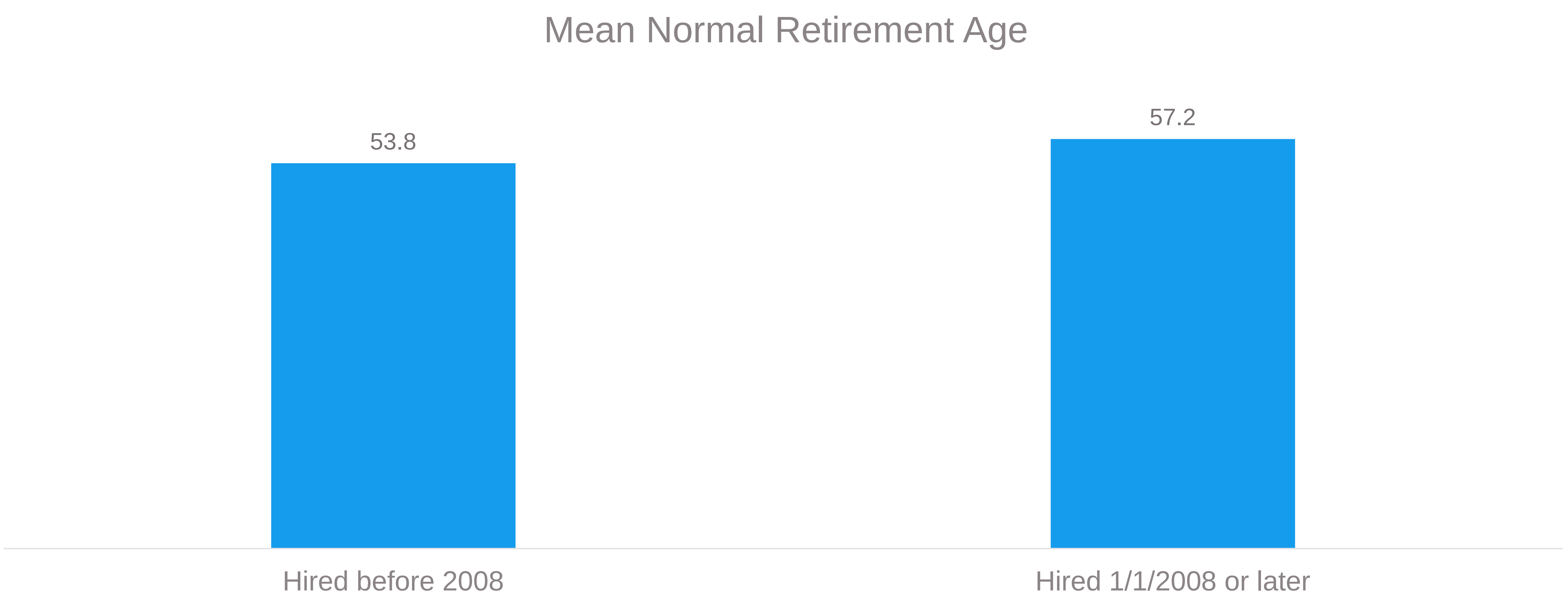


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# Conclusions

- 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?