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Montana must face up to its pension problems

By Tom Barnett Guest columnist Feb 14, 2018

Montana's pensions for our government employees are in trouble. We need to have a candid discussion of the costs the state faces to make pensions solvent.

Montana has nine public-pension systems, one each for judges, highway patrol officers, sheriffs, game wardens, city police officers, firefighters, volunteer firefighters, teachers, and public employees. The teachers' plan, TRS, and the public-employees' plan (for employees not covered by other plans), PERS, are by far the biggest. Combined, they cover about 90 percent of employees owed state pensions.

All of them are defined benefit (DB) plans, meaning the system pays a specified monthly benefit to retirees, the level of benefit for each employee depending upon salary and length of service. DB plans are precarious because the Legislature (or, more precisely, taxpayers) and employees have not put enough money into reserve to sustain the promised payouts over the long term. For example, the highway patrol plan was only 63.9 percent funded in June of 2014.

Most private-sector employers have moved away from DB plans and into defined contribution (DC) plans, commonly 401ks (and 403bs for nonprofits); only 18 percent of employees in the private sector are covered by DB plans. On the other hand, 88 percent of public employees are covered by DB plans.

Public pensions are a splendid deal for Montana state retirees, who receive on average $34,308 per year. If combined with an average Social Security benefit of $14,800 per year their benefits would total about $49,000 yearly. Is that generous or stingy? Well, one obvious comparison is with the median annual wage in Montana: $29,580.

But Montana's public pensions aren't sustainable, as too little money is being put aside to fund, over the long haul, the pensions contractually due to the employees. I believe many public employees understandably worry that the pension benefits they've been promised will be hard to collect; some have privately told me so.

A critical factor in projecting the sustainability of a pension program is the annual rate of return on the program's investments. (The return consists of interest payments, dividend payments, and possible capital gains from buying and selling assets, so the rate of return is a blend of their rates.)

One way our pensions have masked their weakness is by assuming a highly optimistic annual rate of return, 7.75 percent on their invested assets. The governing board for one of Montana's pension programs recently reduced that number by a microscopic amount, to 7.69 percent. Most economists who study pension programs recommend using drastically lower rates of return, between 4.5 percent to 5 percent. Some even recommend a "risk-free" rate of return assumption of 2.344 percent. At that rate, Montana pensions are only 34 percent funded.

One of our legislative fiscal analysts ran a computer model of the teacher's retirement system assuming a 4.65 percent rate of return, which still may be overly optimistic. His result? An additional $350 million per year would have to be paid into the fund to make it solvent. Since PERS is roughly the same size as TRS, a similar infusion may be needed for it. The two total $700 million per year, a staggering figure.

How should we think about that $700 million per year? One way is to compare it to other items in the state's budget. For example, the university system gets $189 million per year from the budget. The Army National Guard gets $18 million, K-12 schools get $731 million in aid, and the highway patrol gets $37 million.

Another way to think about the $700 million is via its average burden on taxpaying Montana households. That would be $1,687 per household per year.

Clearly, something needs to change. And the longer we delay changes, the more onerous the necessary adjustments will be.

Money to cover unfunded pension obligations will have to come from somewhere. Employees can be asked to put in more during their working years, but taxpayers will still bear the brunt of the burden, through higher taxes and/or reduced services. For taxpayers, the prospect of getting fewer educational or public-safety services in order to support pensioners is distressing.

Government budgets are increasingly distributed to pension costs rather than core services. In Illinois, for example, 89 cents of every new dollar for education goes to educators' pensions[vii]. Rahm Emmanuel, the mayor of Chicago, has said that without pension reform, taxpayers will be forced to "choose between pensions and police officers, pensions or paved streets or pensions and public health."

Dan Liljenquist, former Utah state senator, writes, "Pension reform is not a partisan issue, but a math problem."

Things that can be done to steady the pension ship include moving new hires to DC plans; assuming realistic rates of returns; resisting benefit increases; trimming the guaranteed annual benefit adjustment; persuading employees of the necessity of increasing the retirement age, length-of-service requirement, and contribution requirements; and making significant payments on the unfunded liability.

Public-pension finance is an expensive, hence discouraging, topic. It's also unavoidable, so we need serious attention paid to the stark choices that loom.

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