New Book in a Nutshell

State and Local Pensions: What Now?

Recently, an unlikely topic has emerged as a staple of daily news coverage: state and local government pensions. A Google search on the words "state," "pension," and "crisis" found more than a twenty-fold increase between 2000 and 2011. Several small cities have filed for bankruptcy, with commentators citing pensions as a major cause. Many states have substantially reduced benefits for new employees and increased contributions across the board while a handful have cut the cost-of-living adjustments on benefits for retirees. The search for a culprit has stirred up both politicians, who often point the finger at public employee unions, and economists, who cite the rates of return used for discounting future benefits. Yet, at the same time, despite two financial crashes in the past decade and the tepid recovery from the Great Recession, the majority of plans face a manageable challenge, not a crisis. What is going on here?

This book tells the big and complicated story of state and local pensions over the past three decades. It is a story that reflects the diversity of the country – of plan sponsors with unique histories, resources, and political cultures that have shaped their plans' financial circumstances. By adopting a broad perspective, *State and Local Pensions* captures the core issues that should drive the policy debate, rather than more narrow concerns that produce much heat, but little light. It demonstrates that the solution for today's challenges cannot be reduced to a single mantra, such as limiting union power or discounting obligations by the riskless rate of return.

The book systematically explores the big questions, including:

- How did states and localities get into their current situation?
- Why are some plans in serious trouble while others are not?
- Would changing discount rates help in any way?
- Are state and local pensions too generous?
- Will pensions bust the budget?
- Are defined contribution plans part of the solution?

The concluding chapter looks to the future, highlighting three challenges facing all plans:

- investing less in equities to avoid excessive portfolio risk;
- ensuring that total compensation is sufficient to attract talented new workers; and
- gaining flexibility to alter *future* benefits for current workers to share the burden of cuts.

Finally, it offers principles for reforming plans with severe underfunding, drawing on a case study of Rhode Island's 2011 reform process. Such efforts should fairly distribute the pain among employers, current and future employees, retirees, and taxpayers.

Alicia H. Munnell. 2012. *State and Local Pensions: What Now?* Brookings Institution Press.