Massachusetts: The Worst for Public Pensions?

May 10, 2014

MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

Too stingy is a new complaint.

My friends at the Urban Institute just released a report grading America's public pension plans on how well they serve government employees and taxpayers. This report found Massachusetts to have the single worst state-administered plans in the country in terms of the benefits provided to employees and the funding of the plans by taxpayers. While critics often rail against excessive benefits for employees and excessive burdens for taxpayers, this report penalizes Massachusetts for the opposite — providing meager benefits. Massachusetts is clearly a more nuanced story. Let me talk first about current benefits and then about funding.

Massachusetts has two state-administered plans, the State Employees' Retirement System (SERS) and the Teachers' Retirement System, which are combined for the state rankings. Massachusetts does stand out in one dimension among state-administered plans. It ties with Colorado for having the cheapest retirement system in the country. Three factors explain why it is so cheap. First, public employees in Massachusetts are not covered by Social Security, which means the state does not pay the 6.2 percent of payrolls that other employers pay for Old Age, Survivors, and Disability Insurance. Second, despite having no Social Security protection, the normal cost – the cost of benefits earned each year by current workers – of the Massachusetts plans is below the national average for state-administered plans. And third, Massachusetts public employees pay a much higher percent (SERS – 70 percent, Teachers – 82 percent) of normal costs than most other public employees.

The bottom line is that, while taxpayers in other states are paying an average of 14.2 percent of payroll (6.2 percent for Social Security and 8 percent public pension costs), taxpayers in Massachusetts are paying less than 3 percent of payroll for public employee retirement benefits. Thus, in terms of benefits, the Massachusetts plans serve the taxpayer very well.

The flip side of that, of course, is that Massachusetts plans do not serve public employees as well as plans in other states. Given that Massachusetts plans cost the state only one fifth the cost of the average state-administered plan, it falls short on four out of five of the Urban Institute's benefit criteria. Massachusetts received low marks on benefits for young and short-term workers because of 10-year vesting and high employee contributions. Regarding older or long-term workers, Massachusetts fared better, but still received an "F" for encouraging older workers to work longer because benefits are capped at 80 percent of earnings and a "C" for providing retirement security because benefits are only partially inflation-protected. Social Security coverage would counter many of these benefit shortfalls, improving Massachusetts' low grades. Such coverage, however, would cost the state 6.2 percent of payrolls.

Turning from benefits to funding, Massachusetts received a "D" in terms of its funded ratio and an "F" in terms of making required contributions. In

Massachusetts' defense, the state only started funding in the early 1980s, so the state has been promising benefits for eight decades and funding for three. Not surprisingly, it entered the century with a substantial unfunded liability.

But since 2000 the unfunded liability of the Massachusetts SERS and Teachers' plan has increased 6-fold and 12-fold, respectively. Roughly half of the increase can be attributed to two financial crises, but the other half reflects the fact that the state has simply not been contributing enough money. To prevent the unfunded liability from growing – never mind paying it down – the state must contribute enough to cover the normal cost and the interest on the unfunded liability. The state has failed to make this minimal contribution to either plan for the last ten years. Moreover, the state shows no inclination to mend its ways. This behavior helps current taxpayers, but hurts: 1) future taxpayers who will have to pick up the bill; and 2) current and future employees who are unlikely to see the benefit improvements they need. Massachusetts has indeed done a miserable job in terms of funding.

Ranking anything always makes headlines, but it is not always helpful. Massachusetts is a good example. It has been prudent, if not downright stingy, on the benefit side during a period when the major concern has been profligacy. Cheap benefits should be easy to fund, but the state has blown it, failing to make even the minimal contributions to stop the unfunded liability from exploding. The story is clearly more complicated than simply giving the state a failing grade.