



Massachusetts Pensions in Crisis

By Charlie Curnow

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We [wrote](#) in the past about the perilous situation of public pension systems nationwide, and the Massachusetts state pension system is no exception. The severe problems Massachusetts faces - created by years of generous worker benefits and declining asset values - mirror challenges faced by many other states.

Rising costs and shrinking revenues are finally catching up with the Massachusetts pension system. State pension programs faced \$22.1 billion in total unfunded actuarial liabilities in 2009, for a total funded ratio of just 62.7 percent, according to the Public Employee Retirement Administration Commission's 2009 actuarial report. That's not as bad as Illinois, whose "basket case" system is the benchmark of mismanagement with a 40 percent funding ratio in 2008, but it's worse than the national average funded ratio of 85 percent, according to a 2009 Pew study.

These large unfunded liabilities could soon affect the state's normal operating budgets, according to Steve Poftak, head of research at the Boston-based Pioneer Institute, a state policy think tank that published a series of reports on the Massachusetts pension system in 2006.

"The challenge is: How do you fund these things going forward and how do you fund them in a responsible way?" Poftak said in an interview with Advisor Perspectives.

Digging the hole

Teachers' pension benefits are a big part of the problem; they alone account for \$13.6 billion in unfunded actuarial liabilities.

The average Massachusetts teacher's salary was \$60,029 in 2009, according to the PERAC report. Teachers hired after July 1, 2001 pay 11 percent of their earnings into the pension system, which means that these teachers may end up paying an average of about \$6,600 into the retirement system per year.

Retired Massachusetts teachers, meanwhile, earned an average annual benefit of \$35,750 last year. An immediate annual annuity of \$35,750 from the national average teacher retirement age of 58 costs approximately \$502,841 for Massachusetts men and women, according to [Annuity Quick Quote](#). With a total



of 89,788 teachers active in the workforce and 52,107 retired teachers receiving benefits in 2009, the gap between teacher pensions and contributions represents a major financial headache for the state.

The economic downturn also shares blame for the state pension system's current actuarial shortfalls. The state's 106 local retirement boards assume annual investment returns of 7.75 to 8.5 percent when planning benefits schedules. Many pension funds lost as much as 25 to 30 percent of their value, however, following the financial collapse of 2008, PERAC investment director Robert A. Dennis noted in a newsletter last December. To make matters worse, the full impact of the 2008 downturn may not have even shown up yet in actuarial valuations because state officials use an actuarial practice called "smoothing" to average market values over five years in order to avoid high sensitivity to gains and losses.

In addition, decades of political maneuvering by state officials have led to ballooning benefits and mounting costs among other groups of state workers. Last March, the Boston Globe reported that 106 former state employees or their survivors earned annual pension benefits of \$100,000 or more from the state, a group that tripled in size over the previous five years. Some of these big-benefit retirees took advantage of the state's benefit calculation formula, which calculates benefits from the average of an employee's highest three years of earnings. Most of the highest earners were retired doctors, state police officers, or university professors and administrators. Topping the list was University of Massachusetts Medical School doctor Arthur M. Pappas, who had earned a pension of \$230,000 since retiring a decade before. His colleague Aldo Rossini and former University of Massachusetts president and onetime state senate president William Bulger were close behind at about \$200,000 apiece.

There are also instances of kickbacks and "double dipping" by Beacon Hill legislators and other officials, detailed by the Globe in a special series of articles in 2008 and early 2009. Among the alleged abusers were 10 former state senators and representatives who earned early retirement benefits immediately after losing elections or failing to qualify for ballots and several former legislators who collected pensions while continuing to work for the state in other positions. These abuses were the main focus of a reform bill passed in 2009.

Retiring the issue

Because the Massachusetts state pension system depends so heavily on invested assets to make up the difference between employee contributions and annual costs, its financial situation largely tracks the market. The system's \$22.1 billion in total unfunded actuarial liabilities last year in the wake of the market collapse were the largest of the decade. Its \$4.8 billion in total unfunded actuarial



liabilities during the pre-9/11 market highs of 2000, on the other hand, were the smallest in 20 years.

The good news is that state pension funds are doing better as markets recover. Managers of the Pension Reform Investment Trust (PRIT), the statewide investment fund that serves state employees and teachers as well as many local retirement boards, announced in December that its assets increased 18 percent in 2009, to \$42.3 billion. The fund could gain even more if markets continue their resurgence this year.

Barring some market miracle, however, investments alone are unlikely to close the gap between assets and liabilities. The state must take some combination of three actions to restore its pension system to solvency: cut benefits, raise contributions or increase system efficiency.

Most of the reforms passed in 2009 and, as well as changes proposed by Patrick in January, focus on cutting benefits. Patrick's proposals include an increase in the minimum retirement age from 55 to 60 for most state workers, a new benefits formula that would base retirement earnings on a worker's highest five years of wages rather than his highest three and a new cap on benefits that would limit payments this year to \$85,000. The \$5 billion in savings over 30 years estimated by Patrick from these reforms, however, represents just a fraction of the system's unfunded liabilities. Lawmakers will likely need to make deeper cuts in the years ahead to get the system back on track. But they could face stiff opposition from the Massachusetts Teachers Association and other powerful groups representing the state's highly unionized and politically active labor force, as could any attempts to significantly raise employee contribution rates.

The state pension system could also save money by increasing its efficiency and lowering administration costs. Officials could, for instance, consolidate the state's 106 local, county and regional retirement boards into one centralized retirement agency. A centralized statewide agency could offer lower administrative costs than local pension boards by, for instance, eliminating staff redundancies and by decreasing the potential for "sweetheart deals" between local officials and retirement boards, as the Globe has argued. A centralized system might also yield higher investment returns. A 2006 study by the Pioneer Institute found that only six of 104 local pension systems earned returns that were as good as or better than the PRIT with their independent investment funds. The study estimated the cumulative loss to local pension systems from lower investment returns at \$1.6 billion over 10 years.

This year's governor's election may actually help the political prospects of pension reform. Fiscal responsibility was one of the main themes of Republican Scott Brown's victorious campaign for the U.S. Senate in January, and voter



skepticism toward government spending may carry into November. Governor Patrick, Republican candidate for governor Charlie Baker and independent Tim Cahill have all made pension reform part of their campaign platforms. Cahill focuses on his efforts to close pension loopholes as state treasurer. Baker's proposals largely mirror the cost-cutting plan put forward by Patrick in January.

In the long run, however, the state pension system's financial problems may persist as long as Massachusetts allows policymakers to defer the costs of new benefits to future generations of taxpayers. If legislators vote to increase pension benefits in 2010, the costs of those new benefits will not show up as line items on the 2010 or 2011 budget. Indeed, the state may not realize their full costs until 2040 or 2050. Until Massachusetts and other states can find a way to hold elected officials directly accountable for any new entitlement benefits they grant to state workers, perhaps by adopting pay-as-you-go financing, policymakers will always have an incentive to promise now and pay later.

"It's very easy to burden future taxpayers," Poftak said. "No one comes back from the future to vote in past elections."

Charlie Curnow is an Assistant Editor at Advisor Perspectives.

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