"BUT THE PENSION FUND WAS JUST *SITTING* THERE…" THE POLITICS OF TEACHER RETIREMENT PLANS

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Foreword

For those who believe it is morally incumbent upon each generation to confront its challenges and not palm them off on the next generation, this has been a tough year and a tougher decade. From the Medicare drug benefit to the stimulus package, from bailing out Freddie and Fannie to auto industry "relief," elected officials have ladled out sweeteners and stopgap measures funded by trillions of borrowed dollars. The tendency to dress these measures up as "investments" is even more disheartening, as we burden our children with staggering liabilities and avoid the consequences of our own lax discipline.

There may be no place where this tension is as stark as when it comes to teacher benefits and pensions in K-12 schools. There, public officials make expensive promises to influential adult constituencies, saddling our kids with enormous new obligations that will do little to improve teaching and learning. Before the market meltdown last fall, state pension systems were already more than $730 billion in the red. Moreover, teacher pensions—with their industrial-era inflexibility, emphasis on time served, and lack of portability—are ill-designed for attracting and retaining talented teachers in today's labor market. The result is a system that increasingly funnels K-12 dollars toward generous benefits while impeding efforts to boost teacher quality. Typically, when discussed at all, pension reform is understood as a fiscal challenge.

In this paper, my colleague Juliet Squire and I argue that the two central challenges of pension reform are political. Underfunding is a product of an organized, influential constituency (teachers and public employees) demanding benefits from state policymakers who can grant future benefits without making offsetting cuts or raising taxes. Though this dynamic can alter when fiscal distress becomes stark enough, even this thin silver lining doesn't offer much hope for pushing policymakers to revisit the anachronistic structure of the benefits. We suggest some institutional reforms that might help tame irresponsible behavior, but we are not optimistic.

It is easy to wrap these choices in the garb of "investment." It is always pleasant for state officials to please influential constituencies, and even better when doing so can be labeled virtuous. Ultimately, however, we have an obligation to steward our youth—and that means educating them and doing so in a fiscally responsible manner. The past decade would suggest that we're faring miserably on both counts, but it is hard to think of a better place to start than the way we pay teachers.

I hope that this analysis furthers the understanding of these issues and helps policymakers and education leaders rethink teacher retirement plans.

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Executive Summary

The tension at the heart of pension politics is the incentive to satisfy today's claimants in the here-and-now at the expense of long-term concerns. Rules and auditing standards are intended to tame this kind of short-sighted behavior in the private sector. In the public sector, the primary safeguard is the hope that public officials will not be unduly tempted by short-term considerations or influential constituencies.

Teacher pensions, in particular, pose two challenges. The first challenge is that political incentives invite *irresponsible fiscal stewardship*, as public officials make outsized commitments to employees. The second is that incentives *hinder modernization*, as policymakers avoid the politically perilous task of altering plans ill-suited to attracting talent in the contemporary labor market. The alignment of the political stars has helped states and localities to address the first challenge, but there is little evidence of a willingness to tackle the second.

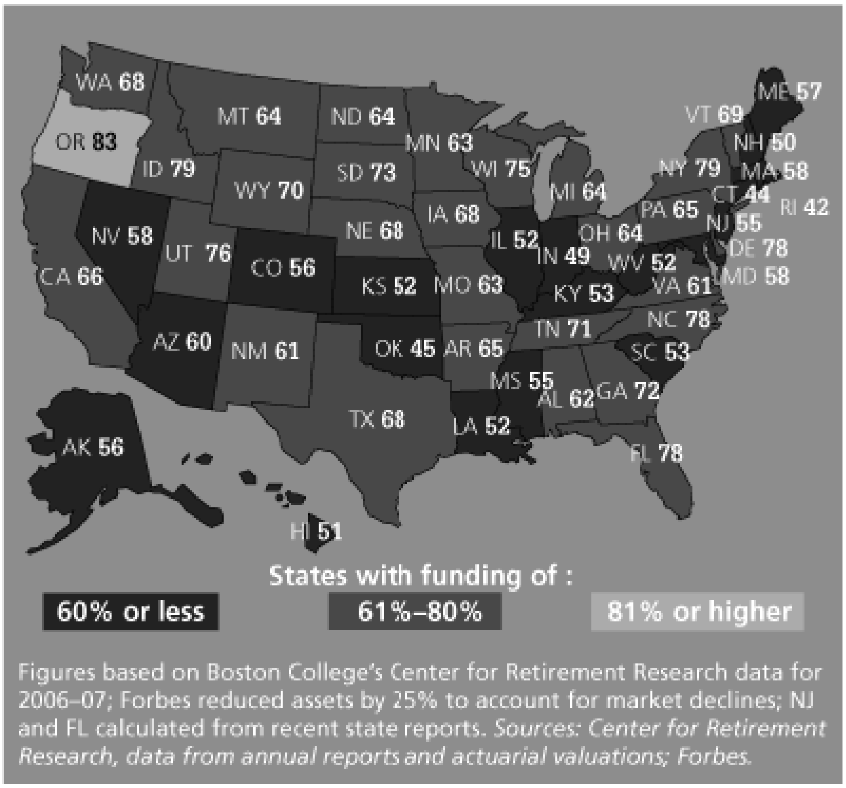
We illustrate those dynamics through discussions of fiscal crises in New Jersey, Oregon, and San Diego and the way in which those crises created opportunities for addressing funding shortfalls. We close by suggesting several political strategies that could make pension challenges more tractable and encourage public officials and especially state legislators to be more responsible fiscal stewards or to revisit anachronistic retirement systems in pursuit of improved teacher quality.

In a memorable "Doonesbury" comic strip from the late 1970s, Garry Trudeau's Raoul Duke—serving as general manager of the Washington Redskins—waved off the need to draft more linemen because he had managed to improbably sign star lineman "Lava Lava" Lenny from the Detroit Lions. When asked how he had pulled off this remarkable feat, Duke insisted he had not spent "a penny more than he's worth! I swear it! Besides, the pension fund was just *sitting* there!"[1]

In this punch line, Trudeau captured the tension at the heart of pension politics—the incentive to address today's claimants and focus on the here-and-now at the expense of long-term concerns and more dispersed constituencies. Those temptations are omnipresent in the private and public sectors alike. In the private sector, rules and regulations seek to tame corner-cutting and short-sighted behavior—with varying degrees of success. In the public sector, including public education, the primary safeguard is the self-discipline of public officials and the hope that they will not be unduly tempted by short-term electoral considerations and influential constituencies.

Given the state of public pension funds, these safeguards hardly seem adequate. In 2008, the Pew Research Center projected that state pension plans, with a $2.7 trillion obligation in coming decades, are $731 billion short of the funds needed to meet that obligation.[2] Figure 1 displays the systematic underfunding of state pension plans as of 2006-07. Boston College Center for Retirement Research has reported that, as of 2007, nearly every state had funded less than 80 percent of its obligation and that many had funded less than 60 percent.[3] The 2008 and 2009 economic downturn substantially aggravated that situation. Meanwhile, Joseph O'Keefe of Fitch Ratings has noted that actuarial studies suggest contribution rates for public employees are lagging benefit costs, meaning that the problem is due to get worse.[4]

Figure 1: Underfunding of State Pension Plans, 2006-07[5]



Teacher pensions, in particular, pose two challenges for K-12 schooling. The first challenge is the political incentives that lead to *irresponsible fiscal stewardship*, as public officials make commitments to employees that outstrip the available funds. The second is that of electoral considerations which *hinder modernization*, as policymakers dance around existing structures built to serve an industrial-era workforce and ill-suited to attracting talent in the contemporary labor market. As we shall discuss, the alignment of the political stars has helped some states and localities to address the first challenge, but there has been little evidence of a willingness to tackle the second.

Discussion of teacher pensions has focused on economic and technical questions such as whether pensions are adequately funded, how they impact state and district budgets, and how benefit formulas affect efforts to attract and retain talented teachers. What has garnered less attention is the degree to which unaffordable promises and anachronistic program designs are due to political incentives. Public pension systems inextricably intertwine political considerations with actuarial and technical ones, making it foolhardy to discuss reforms without contemplating how they may be affected by legislative preferences, constituent politics, and institutional arrangements. The Employee Benefit Research Institute has observed, "Because public employee benefit plans are legislative products, political forces impose a greater effect on their design than economic forces…The interest group activities can usually extend far beyond the public administrators and employees (and their unions and associations) that are directly affected."[6]

Treating public pension reform primarily as a technical, fiscal, or actuarial exercise is self-defeating because the key decision-makers are motivated by political incentives, not economic ones. While officials in the private sector are driven, for better or worse, by investors who keep a fierce watch on profitability, public officials are judged by more ambiguous criteria. Public officials depend on public support; they must marshal votes and win elections, or at least be appointed and supported by elected officials, and cultivate influential, organized, and attentive constituencies. And few potent constituencies are focused on fiscal health or rationalizing benefit systems.

Unlike institutional shareholders, voters have little cause to focus upon balance sheets or on whether public agencies are maximizing productivity.[7] Voters are most concerned with ensuring that taxes are not raised and that state programs that directly benefit them are maintained. Revising existing arrangements to promote amorphous ends like fiscal responsibility or teacher quality, however, imposes costs on a distinct and organized constituency of veteran teachers.

The costs of reform are concentrated upon today's career educators while benefits are spread widely among the state's citizens, prospective teachers, and teachers early in their careers or those uncertain of how long they will continue teaching. Long-time public employees have a great deal invested in existing pension systems. They have contributed to the plans over a period of years, understood their promised pension as a key element of their compensation, and traded the opportunities they might have pursued in the private sector for the security and assurances implied by public employment. The politics are predictable. Those who stand to lose are typically far more energized, organized, and vocal than any of those who would benefit, making it unpopular and politically perilous for public officials to address funding shortfalls or change retirement rules. This dynamic is not unique to pension politics; it is visible in policies from sugar subsidies to highway funding. Public officials will be loath to challenge the interest of an organized, attentive, and vocal constituency if they have more subtle alternatives or can acquiesce discreetly.

These political dynamics can flip when a fiscal crisis makes pension costs salient to the broader public by highlighting how the public's interests are being compromised or the public purse emptied in order to cater to public employees. Even amidst crises, however, while reforms have yielded more sustainable benefit levels, they have done little to rationalize these systems for a changing labor market. Addressing the pension challenge, then, is not merely a matter of technical patches; it requires understanding both the complexity of the problem and the politics and incentives that shape pension reform.

What's the Problem?

Public pension systems are subject to three key political tensions. The first is that pensions are in the business of delayed gratification. They allow public officials to make promises today while leaving the costs for others to deal with later. As Olivia Mitchell and Kent Smetters of Wharton Business School note, pensions “systematically transfer risk away from early generations and toward later generations…favor[ing] current taxpayers, plan participants, and politicians, at the expense of future taxpayers.”[8] This is an inducement to short-sighted behavior on the part of politicians, who face reelection every few years and have incentives to deliver benefits today while pushing off costs until later. Lance Weiss, a senior manager at Deloitte Consulting in Chicago, has similarly explained, “Public pension policy often suffers from an ‘It won’t be my problem after I am out of office’ mentality… Policy leaders reap political rewards for creating new benefits for public employees or underfunding retirement systems and using the money for other short-term goals.”[9]

Even better, from a politician’s perspective, the costs and the full benefits of pension systems can be opaque to the larger public, masking the cost of generous promises. The result is a tendency towards expansive commitments. Marguerite Roza, of the University of Washington, has observed, “Teachers’ retirement benefits, like their health benefits, are, on average, unusually generous when compared to the benefits received by employees in the private sector.”[10] Renowned Harvard economist Edward Glaeser has opined, “Our local governments have pensions that are too high and salaries that are too low, because everyone screams at the prospect of a public servant getting paid a decent wage, but no one who isn’t a CPA can figure out how much a benefits package is worth.”[11] Glaeser has observed the “strong tendency to load compensation towards non-transparent forms of payment.”[12]

The second challenge is that today’s defined-benefit plans reflect an expectation that personnel will teach in the same state or district for the length of their career. In 2007, an employee had to work approximately six years to become fully vested in the typical public pension fund, with seven of the nation's largest teacher pension funds requiring ten years of service or more.[13] Pension systems reflect a strict careerist tilt, in which educators are penalized for departing before serving twenty-five or thirty years and in which they are penalized for remaining longer. Economists Robert Costrell and Michael Podgursky have observed how pension rules influence teachers contemplating retirement and how they affect teacher quality, noting, "Teachers typically earn relatively little in the way of pension benefits until they reach their early fifties, when much larger benefits start to accrue. The system therefore pulls teachers to 'put in their time' until then, whether or not they are well-suited to the profession. Beyond that point, the pension system quickly begins to punish teachers for staying on the job too long, pushing them out the door at a relatively young age, often in their mid-fifties, even if they are still effective."[14] Today's pension systems are an irksome legacy adopted decades ago and designed for a very different labor market.

Existing pension policies reduce worker flexibility and penalize teachers for moving across state lines or into and out of schooling. Not incidentally, this discourages potential entrants—including talented midcareer applicants—who might not be inclined to commit to a decades-long career in a single job or locale. A more flexible and portable model would ease exit from and reentry into the profession, and enable the teaching profession to more effectively compete for college-educated talent. Two more flexible models have become increasingly common in recent years: cash-balance plans and defined-contribution plans. Cash-balance plans have a guaranteed level of benefits, which accrue steadily rather than at the end of an employee's career and can be rolled over into an IRA or another employer's retirement plan, should the employee change jobs. Defined-contribution plans are also portable and flexible, but the burden for investing the funds is on the employee, rather than the employer.

Shifting away from today's defined-benefit plans to plans that embrace flexibility and portability would reflect broader trends in the American economy. In 1979, 62 percent of private-sector workers were enrolled in defined-benefit plans, compared to 16 percent in defined-contribution plans. By 2005, those numbers had reversed, with 63 percent of private-sector workers participating in defined-contribution plans and just 10 percent participating in defined-benefit plans. In other words, most employers are responding to a more mobile workforce by making it easier for workers to enter or exit jobs without putting retirement benefits at risk.[15] Cash-balance plans have also become increasingly popular, today including 23 percent of private sector employees, but a negligible percentage of public employees.[16] More flexible plans have not gained popularity in K-12 schooling, preventing education from adapting to the changing labor force. Matthew Lathrop of the American Legislative Exchange Council has noted, "The guaranteed benefit is only good for those who spend a substantial part of their career with one employer. That's an enormous drawback in today's economy."[17]

Finally, a third and related challenge is that many stakeholders—including legislators, board members, employee unions, fund management firms, and actuaries—may have investment preferences that are not necessarily aligned to the long-term interest of the fund. This is an issue particularly when officials push to hire management firms or to make investment decisions based on political, rather than fiduciary, considerations. As pension expert David Hess has noted, "In addition to personal political motivations, outside political pressure, such as from the local mayor or governor, may be placed on politically-affiliated trustees."[18] Political officials and pension boards may also have incentives to take undue risks, since they stand to reap the benefits of successful but risky investments in the short term (e.g. by providing larger payouts or collecting smaller contributions) while pushing the consequences of shortfalls off until later.

Such practices are familiar, popular short-term patches for public officials. Perhaps most notable in Illinois was the 2005 scandal involving infamous former governor Rod Blagojevich and pension board member Stuart Levine. An ongoing investigation has unearthed an alleged kick-back scheme, in which pension board members were rewarded for directing pension funds toward investment and consulting firms. The investigation revealed links to supporters of Blagojevich's gubernatorial campaign, including convicted felon Antoin Rezko.[19] Less dramatically, a pension board may divest from companies whose politics or employment practices it finds unappealing or seek to keep business in-state by hiring a local fund management firm. Such decisions, while legal, frequently do not serve the broader public interest in the efficient delivery of benefits.

Public Pensions and State Government

Pension funds are hard-wired to the state political process by constitutional provisions, statutes, and collective bargaining agreements. The American Association of Retired People (AARP) reported in 2000 that thirty-one states have ninety-three constitutional provisions that establish governing structures and secure the rights of beneficiaries.[20] All other states either have protections for pensions written into statute or recognized under common law.[21] The Government Accountability Office's Director of Education, Workforce, and Income Security Barbara Bovbjerg has explained, "These constitutional pension provisions prescribe some combination of how pension trusts are to be funded, protected, managed, or governed."[22]

State benefit formulas (including eligibility, contributions, and types of payments) are set by the legislature. Locally administered plans are typically governed by local laws. Boards of trustees establish the overall policies for the operation and management of individual funds. Boards of trustees typically have leeway to operate within the framework of state statutes governing actuarial assumptions, procedures for financial control and reporting, and investment policy. As creatures of the state, the behavior of pension boards is influenced by how rules are written, how personnel are appointed, and how their mission is defined. Some plans are overseen by elected officials and others by self-perpetuating boards; some have precise policies governing investment and performance evaluation while others have few formal policies; some favor patient investment while others trade more actively.[23]

Pension boards vary substantially in size and composition. The National Association of State Retirement Administrators reports that boards range in size from nineteen members (in the Tennessee Consolidated Retirement System) to five (in several states). Some boards are composed entirely of elected officials, others entirely of appointed members, and some entirely by ex officio members, but most include some combination of these. The Public Pension Coordinating Council reports that the national aggregate shows that boards are composed of 36 percent elected trustees, 15 percent ex officio trustees, and 44 percent appointed trustees.[24] Most governing boards do not handle investment decisions themselves but use outside firms to gauge requisite funds and manage investments. While some intriguing research has sought to identify correlations between board characteristics and pension outcomes, that work has delivered mixed findings that are far from dispositive.[25]

Crucially, when it comes to the policy implications, pension benefits are considered the property of beneficiaries. This makes them very different from, for example, Social Security benefits. State legislatures can change the terms of benefits for new hires but have little ability to adjust benefits already promised.[26] The National Conference of State Legislature's Ron Snell has explained, "It is very difficult or impossible to reduce pension benefit packages because of various constitutional and statutory guarantees and judicial decisions. Once granted, a pension is a contractual obligation of the employer, so that in most cases in most states it is impossible to cut the promise of a future benefit, or even to increase the employee contribution to the pension fund."[27] This means that if investments perform poorly, the employer (i.e. taxpayers) must usually make up any shortfall.

In some cases, pension benefits are not laid out in state or local statute but are negotiated between employers and unions. However, the U.S. Department of Labor reports that the vast majority are determined by state legislatures rather than through collective bargaining agreements.[28] Moreover, the Employee Benefit Research Institute has noted, "Even where collective bargaining over benefit issues is allowed, the legislatures generally retain some measure of control."[29]

Most teachers' pensions are included in plans that cover other public employees. In thirty-three states, teacher contributions go into a state fund; in the other seventeen they contribute to a separate teacher retirement fund.[30] Many other school districts have their own, localized pension plans for teachers. There are currently over 2,500 public pension plans across the country. Ninety percent of state and local workers are enrolled in state-administered plans, with the remainder participating in local plans.[31]

Legislators naturally prefer to see pension funds capturing high returns, thus allowing them to minimize taxes or divert state contribution dollars to other budget items. If pension investments do not perform well enough to compensate for additional costs, the government must make up the difference. As David Hess has explained, "Since these additional contributions typically come from the government's general fund, they compete for funding with other government projects."[32] Given such alternatives, underfunding a pension plan can be an appealing option for policymakers—especially because the complexity of determining future liabilities and adequate funding levels provides public officials with substantial wriggle room.

Actuaries are charged with projecting the future costs of pension benefits and estimating the rate of return that the fund can expect. However, these estimates are widely recognized as malleable and board members have incentives to prefer actuaries and firms deemed to be team players. By manipulating actuarial assumptions, such as an expected rate of return, a fund can appear better funded than it would be if it used more conservative assumptions. Scholars Tim Eaton and John Nofsinger have also suggested that pension funds are systematically more likely to use assumptions requiring smaller government contributions during fiscal downturns in order to mask shortfalls.[33] Indeed, many economists fear that actuaries routinely underestimate the cost of public pensions by as much as a third.[34] Intended safeguards like independent actuaries too often provide a flimsy bulwark against chicanery or political irresponsibility.

Pensions and Public Employee Unions

Two dynamics of teacher union politics dominate public pensions. The first, and most obvious, is that those who are in line for pensions are intensely interested in the contributions they are asked to make, the age at which they become eligible for benefits, and the size of the benefit they will receive. Those who do not stand to benefit—meaning everyone in the state or community who is not a public employee—have little at stake in such questions. For disinterested parties, public employee benefits are one government outlay among many, one that exists outside of routine budget processes and is rarely scrutinized by the media. Even substantial changes to pension systems are unlikely to have more than a glancing impact on any individual taxpayer. Meanwhile, public employees are intensely interested, organized, and aware that modest tweaks to formulas or retirement eligibility could be worth tens or hundreds of thousands of dollars to them personally. Consequently, public officials are presented with an active, organized, and influential constituency demanding generous benefits and minimal costs and opposition that is typically nonexistent or restricted to anti-tax activists or budget watchdogs that lack the votes, network, and resources of the public employee unions.

The second dynamic is the inevitable tension between younger public employees and their veteran peers. Veteran employees are deeply invested in promised benefits and regard any effort to alter those benefits as an attempt to renege on a promise. Newer employees have much less at stake. They are much further from collecting benefits, have contributed little into the system, and consequently face much smaller opportunity costs should they change employers. Moreover, newer teachers are by and large younger and generationally much more familiar with a highly mobile job market than are teachers who entered the workforce two decades ago. Existing pension systems are a legacy of the industrial era, a time when employees routinely stayed with one employer for decades or their entire career—and where benefits premised on long service were the norm. Today, decades in the service of a single employer is no longer the expectation for talented college graduates.

The split between newer teachers and their veteran colleagues shows up clearly, to take one example, in a 2008 Education Sector national survey of teachers. Twenty-six percent of recent hires think that the unions "lean more toward taking care of the needs of veteran teachers" and just 4 percent think that they favor newer teachers.[35] New teachers are more likely to favor reforming traditional pay systems than are veteran teachers. They are 10 to 20 percentage points more likely than veteran teachers to favor giving financial incentives to teachers whose classes routinely outperform on standardized tests, who hold certification from the National Board for Professional Teaching Standards, or who receive outstanding evaluations from their principals.[36]

Veteran teachers entered the profession and have labored under the implicit understanding that they would not be monetarily rewarded for excellence but would be provided with job security, consistent pay raises, and a lucrative benefits package. Such teachers are naturally less receptive to measures that would upend those arrangements than are teachers who have not made those same trade-offs and who have not spent decades in lunchrooms and faculty meetings with like-minded colleagues.

Veteran interests typically predominate in negotiations and public debates. While it is theoretically possible for rapid staff turnover or aggressive organizing efforts by a cohort of Teach For America entrants to give newer employees the upper hand in one or another locale, such an outcome is rare. The ranks of union leaders are dominated by long-time educators, as the process of establishing rank-and-file credibility typically takes years and requires extended service in a variety of lesser posts. Given the day-to-day demands on new teachers and the fact that approximately half of new teachers exit the profession within five years, it is no surprise that most teachers actively involved in union affairs are several years into their tenure. As Ed McMahon of the Manhattan Institute has summarized, "The most senior employees…tend to wield the most clout within the unions."[37]

Union leaders in education, as in any sector, also place a premium on maintaining solidarity and unity—prompting them to prefer uniform, collective benefit systems and disinclined to accept measures which differentiate employees or create individualized accounts. Given these dynamics, union demands are unsurprising. Union leaders want their members to receive comfortable benefits, want large taxpayer subsidies for those benefits, and want to be confident that the rules won't be changed on employees in the midst of their careers. Given their confidence that schools will not shutter due to international competition or pick up and relocate south of the border, teacher unions have little cause to fear the destructive impact of benefits on jobs. Indeed, efforts to reduce class size have led to a 51 percent increase in the teacher workforce since 1980, creating more than a million new teaching jobs even as teacher benefits have expanded.[38]

Except in the most extraordinary crises, the steadfast opposition of National Education Association (NEA) and American Federation of Teachers (AFT) affiliates and fellow employee unions to measures that would scale back benefits, increase employee contributions, or render the existing system more attractive to younger employees has typically been enough to stifle serious proposals to alter pension rules. Indeed, while some observers have been trumpeting the need to overhaul teacher pensions since the 1970s, just eleven states and the District of Columbia have adopted any kind of defined-contribution alternatives; only four of these have defined-contribution plans as their primary plans.[39] A recent scholarly analysis found only two "hybrid" cash-balance public pension plans, which have become increasingly popular in the private sector.[40]

The source of teacher union influence on pensions also lies in their numbers, resources, and organization. While union membership in the U.S. has steadily declined in recent decades, from 24 percent of all public and private employees in 1973 to 12 percent in 2006, public sector unions have gained in strength.[41] Union membership among public sector employees grew from 23 percent in 1973 to 36 percent in 2006. While public and private sector employees were unionized at similar rates in 1973, by 2006 the public sector rate of 36 percent dwarfed the private sector rate of 7.5 percent.[42] This shift strengthened public employee unions and gave them an increasingly significant role in the ranks of organized labor. Public education's teacher unions, given the sector's 3.3 million full-time teachers, more than 5 million total employees, and millions of retirees, today rank among the nation's most influential unions. Indeed, with more than 80 percent of the nation's teachers in a union, teaching is the most highly unionized sector in America.[43] Nearly all belong to either the National Education Association or the American Federation of Teachers.

Including teachers and other employees in allied "education, training, and library occupations," the NEA represents a total of 3.2 million members[44] and the AFT 1.4 million (most, but not all of AFT's members, are teachers).[45] Surveying political contributions from 1989 to 2008, the nonpartisan Center for Responsive Politics named the NEA and AFT as two of the nation's twenty "most influential organizations in federal politics," with the NEA ranked seventh and the AFT fifteenth.[46] In the past eight years, the NEA and AFT have ranked among the top contributors to twenty-four of the twenty-seven Democrats on the U.S. House of Representatives Education and Workforce Committee.[47] *Fortune Magazine* named teachers unions one of the twenty-five most influential interest groups in 2008.[48] In 2007, the NEA spent nearly $30 million on political activities and lobbying[49] and the smaller AFT spent over $18 million.[50]

It would be a mistake, however, to think the strength of the NEA or the AFT primarily lies in Washington. Most observers regard the unions as strongest at the state and local level where 90 percent of education spending takes place. Stanford political scientist Terry Moe has written that in state legislatures, "The teacher unions are aggressive, omnipresent participants. This is often true even in right-to-work states. They monitor all relevant legislation, propose bills, carry out background research on issues, attend committee hearings, keep scorecards on legislators, and bring their formidable power to bear…On education, teacher unions are the 500-pound gorillas of legislative politics."[51]

Helping to explain union influence, economist Richard Freeman has reported that union members are about 12 percentage points more likely to vote in national elections than other citizens.[52] That finding echoes decades of research showing union members are more likely to vote than are nonmembers.[53] Stanford's Terry Moe has documented how teacher union influence is exercised at the state level, reporting that, in California's largest school districts, unions "support candidates for office in 92 percent of these districts. They make phone calls in 97 percent, they campaign door-to-door in 68 percent, and they provide mailings and publicity in 94 percent."[54]

Union clout was famously displayed in California in January 2005, when Governor Arnold Schwarzenegger proposed converting public pensions in California from defined-benefit plans to 401(k)-style defined-contribution plans. He explained that California had promised "state workers more than it should and more than it could," noting that pension obligations had grown from $160 million in 2000 to $2.6 billion in 2005.[55] Schwarzenegger proposed that pensions for new state workers reflect those for workers without government jobs. He said that if the Democratic-controlled state legislature did not support his proposal, he would put forward a referendum on the issue the following November.[56]

The proposed reforms drew immediate criticism from California's public employee unions.[57] The *San Francisco Chronicle* predicted, "Labor unions and education groups… will put up whatever it takes to challenge the governor."[58] Within weeks of Schwarzenegger's announcement, the California School Employees Association boasted that twenty unions representing 2.5 million members had already formed a "pension protection coalition."[59]

The union message was carried forth by sympathetic figures like teachers, nurses, firefighters, widows, and orphans who portrayed Schwarzenegger as cruel and out of touch. By spring, Mark Barabak and Robert Salladay observed in the *Los Angeles Times*, "In just a few months, Schwarzenegger has gone from seeming invincibility to a politically precarious state, his approval ratings sagging and his staff plagued by internal scuffles."[60]

In April, Schwarzenegger abandoned the proposal. Though he vowed to address the issue later, he ultimately settled for a commission to study the California pension system. Schwarzenegger's Post-Employment Benefits Commission submitted its report in July 2007 and issued thirty-four recommendations. Former Assemblyman Keith Richman dismissed the recommendations as failing to "address any of the substantive issues."[61] Ultimately, the bold effort led to a modest concession from California's State Teachers Retirement System (CalSTRS) that would allow the state to modestly reduce its contribution under certain circumstances.[62]

<u>Few Safeguards on Public Pensions</u>

There are few meaningful guardrails to prevent public officials from steering state pension systems into the ditch or to remind them of the need to stay on the straight and narrow. As Deloitte Research has pointed out, "There are generally no requirements forcing public retirement plans to fund their pension liabilities. As a result these plans are funded to varying degrees, including some that are completely unfunded and operate on a 'pay-as-you-go' basis."[63]

Pension expert David Hess has explained, "Whereas federal law requires private pension plans to meet certain funding levels and insurance requirements, public pension plans do not face such requirements."[64] Private pensions, as Hess notes, are required to comply with the Employee Retirement Income Security Act of 1974 (ERISA), which established minimum funding standards for company sponsored plans. ERISA, which covers approximately 150 million Americans with more than 679,000 private retirement plans, is beset by its own shortcomings, of course, but that is a subject for another time.[65]

Public plans are governed by accounting standards set up by the Governmental Accounting Standards Board (GASB). These standards provide the framework for the annual audits that most governments contract to independent accounting firms, and those audit reports are a key factor in how credit risk agencies evaluate government credit quality. While GASB sets guidelines, however, it has little or no enforcement power and limited incentive to confront the states and localities that contribute to its budget. As a result, pension analysts fret that many states have adopted accounting methods determined more by politics than sound fiscal standards.[66]

Not infrequently, watchdog organizations and whistle-blowers have played crucial roles in creating enough visibility to prompt public officials to address pension issues. One such case unfolded in Massachusetts in early 2008, where the Massachusetts Taxpayers Foundation warned that a proposed boost in pension benefits "could cost the state more than $3 billion over the next 20 years."[67] The MTF president Michael Widmer said, "There is no money to pay for this enhanced benefit, regardless of the merits…It's another example of the administration and the Legislature passing a benefit and simply passing the buck to the future taxpayer."[68]

Governor Deval Patrick had supported the pension boosts, but requested an amendment limiting cost-of-living increases to those whose pensions were below $40,000. The legislature ignored the request, betting that Patrick would not use his veto. "We rolled the dice and we came up empty," said Ralph White, president of the Retired State, County, and Municipal Employees Association of Massachusetts.[69] Widmer, of the Massachusetts Taxpayer Foundation, said "The easy decision would have been to sign it and give an added benefit to

100,000 employees. But the state didn't have any money to pay for it."[70] Patrick's veto illustrates that exposure and pressure from watchdog groups can awaken public concerns about unaffordable promises and change the politics of pension promises.

A Familiar Story: Crisis…and Then Reform

It is useful to see how these pressures play out in practice, encouraging gradually expanding promises and spurring public officials to hope that market gains or financial sleight-of-hand can spare them from making unpleasant choices. As the following brief tales from Oregon, New Jersey, and San Diego illustrate, it is only when the gloom of crisis finally descends that public officials muster the will to address the mismatch between promises and resources.

Oregon: "We've run out of excuses, folks"

In November 2002, the Oregon Public Employees Retirement System (PERS) triggered a panic when it reported a $15 billion shortfall, after raising eyebrows the previous year when it noted a shortfall of nearly $10 billion. "We've had a sudden and sharp downturn in the markets that's been a big departure from our expectations," said PERS Executive Director Jim Voytko.[71] The immediate problem was the decline in the equity markets, but the deeper problem was a decade's worth of dubious decisions by the PERS board. During the 1990s, when the PERS fund consistently blew past the 8 percent expected return mark—returning as much as 20 percent a year—the PERS board did not use the additional revenue to bolster its reserve funds. Instead, it boosted benefits at record rates and without regard to repeated warnings that the system was being exposed to calamity.[72]

Oregon's pension system had been regarded as lavish for nearly two decades. A 1990 study by Portland's city auditor found that many workers retired with more take-home income than they earned while working, partly because they could roll in half of their unused sick leave. The official goal of PERS was to provide career public employees with the same net income in retirement, factoring in Social Security, as they had while working.[73] In 1994, *The Oregonian* reported that some financial advisors were telling clients not to bother saving for retirement at all. The paper noted advisors saying, "PERS benefits are so generous that it's not necessarily wise for public employees to sock away today's income for tomorrow's retirement. They just won't need the money." Ken Sutherland, an insurance company representative who worked with PERS members, said, "They don't realize how good they have it."[74]

In November 2002, *The Oregonian*'s Steve Duin railed, "We've run out of excuses, folks. At $15.7 billion, the unfunded liability for the Public Employees Retirement System works out to a $4,589 debt for every man, woman and hungry child in Oregon, including those who still have their heads in the sand. Not your problem, you say? Think again. YOUR Oregon Legislature greased the skids of this disaster, screwing up the compensation formulas, guaranteeing 8 percent annual returns, and stocking the PERS board with the government managers and union reps who pushed boom-time profits into retirement accounts instead of rainy-day funds."[75]

PERS officials issued preliminary estimates of the necessary increases in employer contributions the following month, forcing city managers, county officials and school leaders to confront the budgetary impact.[76] The *Oregonian* reported, "The growing pension costs will further drain the budgets of state and local governments—including those of school districts, cities and counties—that can't easily raise taxes and are already squeezed by a weak economy."[77] When it was reported that Oregon school districts would have to shell out an additional $123 million per year for pensions, an Oregon School Boards Association lobbyist declared, "That's outrageous," and announced the need for dramatic change—pointing to a new study showing

Oregon schools are paying more for employee benefits than any state except Rhode Island.[78] In 2003, newly elected Democratic Governor Ted Kulongoski and the legislature did push to reform the system.

Republicans, who controlled the state House, pushed to recast the retirement system into a defined-contribution 401(k)-like pension, while Democrats, who controlled the state Senate, objected. A hybrid compromise emerged. Retirees would receive a pension benefit intended to approximate 45 percent of their working salary and would also be required to contribute 6 percent of their salary to a 401(k)-type investment account. Employers could agree to make this contribution in the employees' stead. The plan would cost employers about 8.6 percent of payroll for retirement benefits, compared to the 12.5 percent figure that prevailed.[79] The legislature also remade the PERS board, demanded up-to-date mortality tables, and eliminated the 8 percent guaranteed annual growth in accounts.[80]

Because Oregon's plan actually reduced the pension benefits promised to current employees, it came under the inevitable legal challenge from public employee unions. Ultimately, the last hurdle was cleared when, in 2006, the 9th U.S. Circuit Court of Appeals ruled in favor of the state.[81] The result was a deficit that had reached $17 billion in 2003 had become a modest surplus by 2008. "It took a lot of political courage because you were really impacting—hurting is the right word—members and retirees," says Paul Cleary, executive director of the Oregon Public Employees Retirement System.[82]

New Jersey: "If the pension system is healthy…I say give it to them"

In the 1990s, New Jersey Governors Jim Florio and Christie Whitman took to balancing the state budget by redirecting dollars that would have otherwise funded the pension system.[83] In an attempt to improve the system's books, Whitman issued $3.4 billion in pension obligation bonds in 1997—essentially borrowing dollars to inject immediately into the pension fund by taking on new long-term obligations. By overfunding the pension fund through the bond initiative, Whitman was able to forego the state's annual contribution to the pension fund and instead use those dollars to avoid spending cuts or tax increases in an election year.[84] The nuts and bolts of Whitman's deal showed what a bad deal it was for New Jersey taxpayers: the state promised an annual 8 percent payment to bondholders, a calculation that made sense only because the state projected it would generate a 12 percent annual return on its investments.[85]

In 1990, a majority of the state's retirement plan assets were in safe, low-yielding, fixed-income accounts. By 2000, about 70 percent were invested in equities.[86] The booming 1990s stock market led to a surplus, prompting state and local government employees to push for a benefit boost in 2000—the last year of the dot-com boom. The acting governor, Republican Donald T. DiFrancesco, said, "The way I look at it, if the pension system is healthy, if we can give them some benefit resulting from the good economy, I say give it to them." In 2001, in the midst of a heated election season, the legislature voted to enhance pension benefits by 9 percent. In doing so, it committed $4 billion of the surplus accumulated during the boom years, despite an $8 billion dip the previous year.[87]

The Pension and Health Benefits Review Commission, made up of Treasury Department representatives and private citizens, voted 7-0 to recommend the Legislature adopt the pension boost."[88] The plan proceeded to sail through a legislative review panel, "generating less than 10 minutes of discussion."[89] Even though the state's pension funds lost $12.5 billion between June 2000 and March 2001—the entire surplus on which the legislature and pension board were counting—DiFrancesco signed the increased benefits into law in June 2001.[90]

In 2002, newly elected governor James McGreevy proposed an early retirement plan in order to reduce budget outlays. Similar efforts by Governor Florio in 1992 and 1994 led to short-term budget savings but significantly increased long-term pension costs.[91] The bill was nonetheless signed into law on May 31, with Treasury officials conceding the program would cost the state $220 million over the next five years.[92] Lawmakers also enacted dramatic changes at the Division of Investments, the Treasury Department branch that oversees the state's investment portfolio, replacing its director, changing the membership on the State Investment Council, and hiring an outside auditor.[93] By 2003, the state's once flush pension system was among the worst performing in the nation.[94]

Under New Jersey state regulations, pension fund managers were allowed to assume an 8.75 percent return on investments and required to make up the difference when returns fell short. In 2004, local municipalities had to raise taxes to make their contributions to the state pension funds. The East Brunswick Finance Director said, "Everyone knew this holiday was coming to an end" and termed the suspension of state payments in 1997 "a classic example of sacrificing the future on the altar of the immediate."[95] Meanwhile, the McGreevey administration failed to inject the $400 million in 2003 that it was required by law to provide, with the state treasurer explaining the state couldn't "afford to make the contribution."[96]

Teachers unions blamed the state for failing to make required contributions. Lawmakers blamed the investment board for underperformance and called for investments in high-yield bonds and real estate (the investments that were doing well in the aftermath of the dot-com crash).[97] Meanwhile, Governor McGreevey did not direct any money into the pension fund in 2004, despite the actuary's recommendation that a $1 billion infusion was needed.

After McGreevey resigned amidst an unrelated 2004 scandal, acting governor Richard Codey announced that he would not seek election and pledged to veto any legislation that would enhance retirement benefits without paying for them.[98] Codey put aside $337 million in his budget for replenishing the pension system. It was no surprise when the pension crisis emerged as a key issue of the 2005 gubernatorial race.[99] Four union political action committees, including the New Jersey State Laborers PAC and the New Jersey Education Association (NJEA) PAC, were among the top ten givers in that year's campaign.[100] Democratic nominee Jon Corzine, a former Goldman Sachs executive and U.S. Senator, won the gubernatorial election.

After his January 2006 inauguration, Governor Corzine set to work on rehabilitating the state's pension funds. "'Make no mistake—our unfunded pension obligation is a real bill,' Corzine told lawmakers … Corzine's proposed $1.5 billion contribution would exceed the total payments governors made to the retirement funds over the preceding nine years," but amounted to just 70 percent of the amount actuaries deemed necessary.[101]

Corzine convened a special session to examine public worker benefits and cut property taxes, urging legislators to find ways to reduce pension costs. Proposals included raising the retirement age to sixty-two, adding co-payments for health coverage, and rolling back pension benefits by about 9 percent for new employees. Employee unions launched a fierce counterattack, saying that they supported proposals to curtail pension abuses but, in the words of the NJEA, regarded "any reduction in rank-and-file pensions…to be a non-starter."[102] This opposition was important because, noted Senator Gerald Cardinale, a Republican from Bergen County, "Some legislators are so afraid of the NJEA they quake."[103] Corzine responded by agreeing to negotiate with the unions at the collective bargaining table.

Those Democrats who had backed a reform bill in the face of union opposition felt undercut by Corzine's move to the collective bargaining table. "I think there is a fair amount of frustration on the part of members that they extended themselves, demonstrated courage, and it has not led to where it should, in the short term," Assembly Speaker Joseph Roberts said.[104] The bill that was subsequently passed by the legislature left most major changes to collective bargaining.

Corzine claimed some modest concessions from public workers' unions in the collective bargaining agreement, exchanging 3 to 3.5 percent raises over the following four years in exchange for a 1.5 percent contribution to health care costs, an increase in the retirement age for new workers from fifty-five to sixty, and a cap on pension payments for some highly paid employees.[105] Corzine had made little direct headway on the pension shortfall, but was able to insist on four years of modest raises, returns worth close to $1 billion. The various unions approved the contract a few months later by safe margins. Scott Porter, an actuary for Milliman Consultants observed that the changes would not be visible in the short term. "Twenty years from now, then you'd start to see some of this," he said.[106] "This is a guy [Corzine] who stood up for organizing rights at Rutgers University; who spoke at our rally last summer; who made contributions to our pension for the first time in ten years," said Bob Master, lead negotiator for the Communication Workers of America (CWA). In light of the fact that lawmakers had boosted pensions seventeen times since 1999, Master acknowledged that unions were fortunate to receive 13 percent in salary increases spread over four years and retain fringe benefits "essentially intact."[107]

In June 2008, still faced with a projected unfunded liability of $25 billion, the legislature sought to further trim the cost of the pension program by eliminating Lincoln's Birthday as a state holiday, raising the retirement age from sixty to sixty-two, and barring public employees from using time worked in other states to reach the twenty-five years of employment needed to qualify for the generous lifetime health benefits.[108] All these adjustments combined were still only expected to save $150 million by 2022.[109] The modest legislation dropped the more ambitious reforms that had been proposed, including measures that would base retirement benefits on the average of an employee's last five years' pay (rather than their last three years') and that would require part-time employees to work at least thirty hours per week to be eligible for a pension. The watered down legislation eventually passed, but Corzine postponed signing the legislation into law until late September to ensure that thousands of new teachers would be grandfathered under the old rules. If he had signed the legislation in June, it would have affected teachers hired after August 1.[110]

San Diego: "Enron-by-the-Sea"

It is useful to recognize that the issues faced by teachers are reflective of problems endemic to other public pension funds. San Diego is perhaps the poster child of a pension fund run amok, earning the moniker "Enron-by-the-Sea" for its disastrous experience earlier this decade. The system fell from a 100 percent to 67 percent funding ratio in just ten years, due to substantial benefits boosts for city employees, intentional underfunding, and conflicts of interest and corruption.[111] During this time, the San Diego pension fund was managed by the thirteen-member San Diego City Employees' Retirement System Trustees ("the Retirement Board"), which hired an outside actuary and investment firm.

While the market boom of the 1990s allowed San Diego in 1996 to increase employee benefits while reducing the city's contribution to the fund, the downturn in the early 2000s left benefits unfunded. In response to that downturn, however, the City Council refused to reduce benefits or offset the losses with increased payments to the pension fund in order to avoid having to trim city services. Instead, the city steadily increased pension obligations, often against the advice of financial advisors and actuaries. In 1997, a trial program aimed to retain experienced employees was put in place; the program became permanent in 2000. The Deferred Retirement Option Program (DROP) allowed senior city employees to continue to collect their regular salaries and to simultaneously draw retirement pay deposited into special accounts, if they agreed to work an additional five years. Also in 1997, San Diego added a program that allowed employees to boost their retirement pay by purchasing service credits, allowing them to add up to five years more than they actually worked. Objections from the pension system's actuary were ignored.[112]

In 2000, at the height of the dot-com boom, City Council members granted themselves a larger pension, lowering the age when members could collect pensions from sixty to fifty-five and boosting the formula used to determine their benefits.[113] In 2001, they reduced the retirement age and determined that benefits would henceforth be based on the highest salary earned during an employee's career instead of on the average of their three highest annual salaries.[114] In 2002, the pension fund lost millions, but Larry Grissom, the city's Retirement Administrator, said there was no reason to worry and that, "If we never make another dime in income, we would be able to pay retirement benefits for the next 26 years."[115]

Seven months later, the *San Diego Union-Tribune* reported the existence of a $721 million shortfall, up from $68 million two years before. Benefit increases approved by the council had driven up the city's payroll costs by 18.5 percent over two years.[116] "Nobody wants to deal with it," said Diann Shipione, a retirement board trustee and critic of the city retirement policy. "It's financially and politically inconvenient."[117] Shipione had warned the Mayor and the City Council in 2002 of the problem. In 2003, she again wrote to city officials and wrote an op-ed calling attention to the underfunding and the board's refusal to acknowledge it.

The underfunding eventually led the U.S. Securities and Exchange Commission (SEC) to rule that the city had defrauded investors in 2002 and 2003 by not disclosing the massive pension deficit. The SEC found that the city had filed "materially misleading" documents and committed securities fraud. An investigation was launched by City Attorney Michael Aguirre, a criminal case was pursued against six members of San Diego's pension board, and Mayor Michael Richard Murphy resigned. These court cases were still pending in the spring of 2009, with the verdicts likely to affect whether the city can rescind promises made by those under investigation.[118]

In the meantime, the city adopted a series of short-term solutions. In 2004, it approved Proposition H, which added seven independent financial professionals to the board of trustees.[119] The city has implemented financial reporting requirements similar to those used in the private sector.[120] In 2006, San Diego adopted Proposition B, which required voters to approve employee pension-benefit increases for the next fifteen years, and the new mayor and the city council agreed to redirect $100 million expected from a new stream of tobacco settlement money to bolster the pension fund.[121] Standard & Poor's suspended the city's credit-rating, barring San Diego from pursuing the popular option of issuing pension obligation bonds. The new mayor, Michael Sanders, also developed a payment schedule for the pension plan, which was adopted by the pension board in 2007 to pay off the liability over the next fifteen years.[122] However, those promised contributions are now in jeopardy, as the pension deficit climbed to $2.55 billion during the market turmoil of late 2008 and early 2009.[123]

With legal battles still pending, Sanders is pursuing a hybrid pension system for future city employees that incorporates defined-contribution plans.[124] Nevertheless, the various reform measures pursued in the political aftermath of this crisis have not so far addressed the structural problems in the pension system.

Conclusions

Reforming public pensions is as much a political exercise as a fiscal or technical one. Measures intended to rationalize existing practices must be designed accordingly. For one thing, existing safeguards, such as incorporating independent pension boards and actuarial expertise, too often prove a frail bulwark against irresponsibility. For another, even when public officials have been roused to confront pension problems and have enjoyed some success, as in Oregon, the victories have focused exclusively on correcting budgetary shortfalls. They have not reworked retirement benefits in a manner that makes teaching more competitive with other professions in the contemporary labor market or that helps school systems find ways to push out ineffective veterans and retain effective educators after they have maximized their pensions. In fact, many cost-cutting measures exacerbate the faults in the existing structure by raising the retirement age and the number of years needed to become vested in the plan and increasing the contribution levels of new employees to compensate for the fixed contribution rates of veterans.

Active, organized, and vocal minorities routinely outweigh much larger but inattentive majorities in legislative processes. This is the case with issues ranging from tobacco to textiles. When it comes to public pensions, beneficiaries inevitably enjoy massive advantages in communications, awareness, and interest relative to taxpayers and would-be reformers. Consequently, addressing persistent underfunding or concerns about structural incentives requires far more than thorough technical analysis—it requires proponents to change the political climate, foster awareness, build support for change, alter political incentives, or design politically workable solutions.

The preceding analysis suggests that public pension politics are inevitably characterized by four simple truths. First, underfunding is a persistent concern because elected officials will always have cause to emphasize the short term; this dictates a need to create institutions and rules that ameliorate that temptation or reward attention to the long term. Second, meaningful reform is only possible when the broad public is stirred and its electoral might is arrayed to neutralize the familiar advantages of the employee unions. Third, legislators and governors rarely accept responsibility for poor stewardship or extravagant promises, especially since they are able to blame pension managers and investments for funding shortfalls. The case of New Jersey illustrates the natural inclination for public officials to shift blame onto investment decisions as a way to divert attention from their own fiscal decisions. Finally, modifying pension systems requires addressing concerns of veterans who will feel cheated out of what they've been promised, organizing and selling advantages to younger educators and to recruiters, and designing systems that are clearly more responsive to public concerns and to the challenges of staffing schools—so as to provide plausible cover to reform advocates. Successful reform on this count begins by clearly and concretely making the argument that the system of teacher training, hiring, staffing, and compensation that worked passably well in the 1950s is no longer well-suited to the needs or labor market realities of 2009. Proffering workable solutions alone, however, is only a start.

Given the political landscape, there are at least four tacks that pension reformers might pursue to reshape the political context or alter the balance of power. The first is to embrace a "starve-the-beast" strategy. Since there are temptations for legislators to spend and unions to demand any available dollars, there is a perverse discipline implicit in funding shortfalls that dampens the urge to ratchet up benefits. In other words, the fiscally responsible course of maintaining healthy reserves can be regarded as an invitation to political irresponsibility. *Newark Star-Ledger* reporter Dunstan McNichol observed of New Jersey’s staggering shortfall, “But something else may be at work here. It may be that the state has stumbled on the last, best defense against union demands for more. It's harder to tap into undernourished pension funds than healthy ones.”[125]

Two provisos deserve notice here. For one, it is not clear how sustainable this strategy is over the long haul. For another, even when public officials finally bite the bullet on the mismatch between promises and resources, as in San Diego or Oregon, there is little evidence that they have the stomach to address anachronistic pension rules that push out capable veterans at age fifty-five or keep worn-out teachers in the classroom for years past their “sell-by date.” Why? Because while there may be bondholders or voters willing to punish public officials for untenable shortfalls, there are no credit markets, editorial boards, or budget watchdogs similarly attentive to the state’s response to labor market dynamics. This leaves the preferences of union veterans largely unchallenged. The stories of “successful” pension reform are merely tales of fiscal responsibility, and do not address the substantive barriers that pension systems pose to competing for twenty-first century talent.

Second, there is a persistent need to buy off, or in more decorous language, to “grandfather,” current teachers and retirees when promoting change. This is due not only to legal limitations but because unions will fight bitterly to protect the benefits of current members while, whatever they say, less passionately protecting those of future members. Just as New Jersey’s Governor Corzine was able to boost the retirement age from fifty-five to sixty, but only for new hires, viable reforms typically must placate current teachers as the price for change. This limits the fiscal benefits of new rules and ensures that workforce transformation will be a decades-long process, but promises to change long-term expectations by altering the understood terms under which new entrants join the profession.

Third, reform requires that proponents change the context of the political debate by agitating, mobilizing, and publicly explaining the costs of current arrangements—and framing debates over policy and practice in terms of the actual costs imposed. This is extraordinarily difficult to do, and the reality is that it typically only happens when fiscal crisis throws existing policy choices into stark relief. When those moments emerge, reform-minded legislators and advocates have the opportunity to harness public opinion and frame benefit increases as irresponsible, craven, and kowtowing to "special interests." Of course, the effort to manufacture such a moment can fall flat—as happened with Schwarzenegger's effort in California—which is why reformers must use fiscal crises as opportunities for promoting measures to modernize benefits and deliver responsible fiscal stewardship, and not simply settle for makeshift patches that soon allow states and localities to carry on business as usual.

Simple exhortation is unlikely to spur the necessary efforts or to render them effective. Today, the rewards for public officials who step up and take on pension reform are almost nonexistent; as actuary Scott Porter noted of Corzine's efforts in New Jersey, "Twenty years from now, then you'd start to see some [of the fruits] of this."[126] Given that the rewards for pension reform are so out of step with political incentives, it is essential to devise institutions and arrangements that don't depend on self-abnegating public officials to produce sensible reforms or responsible public stewardship. A useful example of this is how H. Ross Perot's 1992 bid for the U.S. presidency led to extraordinary attention to the federal budget deficit, which influenced policy choices by the Clinton administration and, most significantly, helped lead to the adoption of new budget rules in Congress that produced budget surpluses in the closing years of that decade.

Finally, and perhaps most significantly, there are tools and institutional innovations that can better enable public officials to make the kinds of difficult choices needed to rationalize existing pension plans or ensure responsible fiscal stewardship. Given the temptation for officials to cater to the demands of active, organized, and influential constituencies, even when they may run counter to the public interest, the challenge is to find ways to modify those incentives. One approach, particularly relevant to efforts to promote sound fiscal stewardship, is to craft rules that temper short-term political incentives. This might include increasing the autonomy and independence of auditors to provide greater insulation from pension boards and legislators. Another might be the creation of a federal or multi-state body with the authority to police public pensions and to establish guidelines regarding matters like fund balances and anticipated rates of return. Adopting such measures would be enormously difficult, since they run contrary to the normal incentives for elected officials, but the important thing is that they are measures that would need only to be adopted once. Afterwards, legislators would operate with more barriers against irresponsible behaviors (making it easier to explain "no" votes to interested constituencies) while forcing future officials who wish to make unaffordable promises to visibly and actively challenge these protections. Reformers who use windows of opportunity to enact such measures are not merely solving the current problem but are altering the political calculus going forward.

A similar tack, but one perhaps better suited to pension modernization, is to devise reform packages that insulate the reform-minded from the wrath of veteran public employees while appealing to the sensibilities of civic leaders, journalists, and the broader public. One model deserving attention is the manner in which Georgia draws attention to the fiscal impact of new promises and seeks to change the political incentives at play. In 1983, Georgia enacted the "Retirement Systems Standards Law" requiring any legislation with a fiscal impact on the state pension plan be subject to additional independent and legislative scrutiny.[127] In order to even be considered by the legislature, a measure must first be sent to the Office of Legislative Counsel. If the Legislative Counsel finds that the law has a fiscal impact on the retirement system, it can be passed but cannot be enacted unless it is concurrently funded. If a bill is passed but is deemed by the state auditor to be unfunded, the law is "null and void and shall stand repealed on the first day of July immediately following its enactment."[128] Of course, because Georgia's state auditor is appointed by the Governor, the safeguard is far from ironclad.[129] Nonetheless, this kind of insulation and analysis creates a "cooling off" period and can provide an opportunity to ensure that the costs and implications are fully aired.

Another model is represented by the highly successful U.S. Congress's Defense Base Realignment and Closure Commission (BRAC), which succeeded in closing more than 350 military installations through a process designed to counter the tendency for legislators to advocate realignment and modernization in theory, but to bitterly resist any effort to shutter a hometown base. The historic problem was that legislators might embrace the theoretical notion of new efficiencies and cost savings, but face enormous pressures to protect hometown jobs—even when those might entail wasteful or duplicative spending. The key innovation of the BRAC process was that it established criteria for base closures on the front end and then required legislators to vote the entire proposed package up or down. The process meant that officials could no longer lobby to protect particular bases, providing substantial insulation against irate constituents, even as it framed a vote to reject closures as a vote for inefficiency and waste.

Legislators find it enormously difficult to resist the pressure of public employee groups that are unwilling to contemplate even gradual changes to the familiar benefit structure and that are fearful that even changes which “grandfather” current employees may sow future splits within union ranks. Framing akin to the BRAC process, in which legislators are voting for a package of provisions to fundamentally modernize and rationalize teacher hiring (perhaps accompanied by heightened pay), could allow reformers to make a “no” vote look like a capitulation to narrow interests while offering a simple up or down vote that legislators could readily explain to the broader electorate as a vote in the public interest. None of this should be taken to suggest that such a path is easy or likely, only that approaches like this offer a more fruitful course than those tried thus far.

The temptation for politicians to see pension funds as just “sitting there” is profound, and Raoul Duke’s jaunty solution—to “charge a little more for hot dogs this year”—will rarely suffice. Moreover, while schools are competing for talent in the twenty-first century labor market, public officials find the pains of retooling industrial era benefit systems politically unappealing. Indeed, even the four courses of action we have just discussed to help promote more responsible fiscal stewardship offer little to spur states or districts to shift from defined-benefit to more flexible plans or to revisit the industrial-era pension model. The evidence seems to suggest that the stars are more likely to align for more responsible fiscal stewardship than for labor policy modernization—and the case for optimism on the first count itself is far from rosy. Only time will ultimately tell whether looming fiscal crises, unaffordable promises, and heightened attention to the costs of public pensions will yield a new era in which the electoral rewards for fiscal responsibility and workforce modernization rival those of placating impassioned claimants.

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