Under Pressure: Tackling Pension and Health Care Costs

By John Friery

Fueled by declining revenue from the housing crisis, skyrocketing energy costs, and an economy in general disarray, the public is pressuring school administrators to make broader and deeper cuts in their operating budgets.

Much of our current problem can be traced back to the housing crisis, which began with highly inflated housing prices brought on by the increased demand for homes that stemmed from government programs to increase homeownership. That situation resulted in risky lending practices that were eventually exposed in the collapse of home values—the same home values that have created revenue streams to school districts in the form of real estate taxes.

As the baby boomers retire, put their houses on the market, and downsize, we'll see more downward price pressure on home values. This decline in home values will affect the revenues that districts take into the system in the form of real estate taxes.

Pension and health care costs are creating revenue pressure for school districts as well. The Social Security Administration's own Website indicates that the average retirement age in 1955 was 65; the average age at death was 69.6 years. Today, the average retirement age for many baby boomers is 66. According to the Institute of Education Sciences (2005) of the U.S. Department of Education, the average age of retirement for teachers in many districts is 58. Since the average age at death today is 78—much older than the average age when the pension system was developed decades ago—pension plans must now provide guaranteed payments to beneficiaries for many years to come.

These pension obligations are bankrupting states and increasing the districts' challenge to keep pension plans solvent. Ten years ago, the Pennsylvania state pension funds were running surpluses. Today, Pennsylvania's unfunded pension liabilities are around $20 billion and projected to increase to $55 billion in the next few years. Other states, such as New Jersey, are facing similar pension pressure as retired civil service workers, including teachers, often earn more in annual pension payments than the typical worker earns in regular wages in a year (Froonjian 2009).

Health care obligations are also of increasing concern. In the Milwaukee Public School System, obligations to pay for retired teacher health plans increased a 1989 liability of $202 million to more than $2.6 billion today—a figure that exceeds the school system's annual budget by double.

This increased health care liability is another consequence of obligations made years ago, in an era of overgenerous promises. These promises obligate states and districts to unaffordable liabilities in the future. As Rick Dreyfuss, a senior fellow with the Commonwealth Foundation stated: "It's easy to give benefits now and defer paying them for 30 years. Pension plans are run for a political rate of return. That is to say that it's easy

for a politician or a policymaker to give benefits right now, even retroactively, and then defer that cost up to 30 years" (Keith 2010). Those "deferred" costs are hitting districts and states everywhere and significantly affecting their ability to remain solvent.

Strategies and Solutions

Solutions are limited by the seemingly overwhelming extent of the problem, unyielding stakeholders, and lack of political will. However, something must be done or local and state governments will face the issues with which Pennsylvania, New Jersey, and Milwaukee are wrestling.

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Large states like California are facing more than $500 billion in unfunded liabilities from the three largest pension funds (Kolivikas 2010). This problem will affect everyone, from the taxpayers who will foot the bill, to the teachers who will have to make concessions, to the administrators and boards who will have to implement policies mitigating the crisis. If we do nothing today, future generations will be forced to pay for the extravagance of their parents and grandparents.

A Stanford University study recommended that at the very least, the state needs to "contribute to pensions at a steadier rate and not shortchange the funds when markets are booming" (Kolivakis 2010). This strategy could translate into more taxes to ensure adequate inflow of funds to pension investments. However, increasing taxes rarely elicits voter support.

The same study recommends moving away from a defined benefit program to more defined contribution programs, such as a 401(k) system. Such systems put the risk of making up shortfalls caused by market fluctuations on the people who receive the benefits rather than on the state pension fund owners. This approach is not so good for the recipients, but much more manageable for state pension fund managers and the school districts that must make contributions to the pension system.

In addition, authors of the study recommend moving investments from more risky stock market ventures to fixed-income investments that are less susceptible to market fluctuations. This change in strategy will help facilitate returns that are more reliable for the beneficiary.

These two steps will help stabilize the security of investments and returns for both the pension fund managers and the beneficiaries.

We could also bring retirement policies into line with the changing demographics that are exacerbating the situation. As noted earlier, the obligation of pension funds to individual beneficiaries has increased dramatically with extended life spans and the comparatively early retirement of teachers.

As part of the efforts to reduce the unfunded liabilities coupled with falling revenues, public unions and their representatives should be educated about the scope of the rising problem. Then, negotiations must align the ages at which retirees can receive benefits with more sustainable numbers that reflect the current demographic conditions.

Retirement ages must be pegged to rising life expectancy and must be calculated by anticipating projected benefits that will be required during beneficiaries' retirement. Such changes will help reduce sustained unfunded liabilities brought on by the changing demographics that were not anticipated during decades of collective bargaining.

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Barring a reasonable expansion of the working life for teachers and other public-sector employees, benefits will have to be cut to both current and former employees in order to bring the benefits in line with projected available revenues.

Taking Responsibility

School districts are not supposed to be in the business of providing pensions and health care to retirees.

It is time for teachers unions and districts to support responsible and sustainable pension and benefit packages for teachers and public-sector employees. If some compromise cannot be worked out, our districts and states are condemned to bankruptcy and our children will be forced to pay for the largess of previous generations.

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