



# TESTIMONY

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## THE NEED FOR REAL PENSION REFORM

*By Patrick Ishmael*

Testimony Before the Missouri Senate MODOT and Patrol Employees' Retirement System Study Committee

### TO THE HONORABLE MEMBERS OF THIS COMMITTEE:

My name is Patrick Ishmael and I am the director of government accountability at the Show-Me Institute, a nonprofit, nonpartisan Missouri-based think tank that supports free-market solutions for state policy. The ideas presented here are my own. This testimony is intended to share long-standing Show-Me Institute research on pension-related topics.

One of the most pressing concerns in public policy nationwide is the looming cost of public pensions—especially the unfunded liabilities that seem to be coming down the pike. As Andrew Biggs wrote for the Show-Me Institute last year,<sup>1</sup>

On paper, public sector pensions acknowledge being underfunded by more than \$1 trillion;

economists estimate a nationwide funding shortfall exceeding \$4 trillion. Missouri's public employee plans are no exception: the main state government plan, the Missouri State Employees Retirement System (MOSERS), has seen its funding health decline while required government contributions have increased.

Built into this shortfall is an important debate about the guarantees made by government officials on behalf of taxpayers and the assumed rates of investment growth by pension managers. Pensions offered by the government are typically, though not always, structured as "defined-benefit" plans, meaning states assume liability that is ascertainable long before an employee's retirement. In the interim, the state sets aside money to be saved for this eventuality, but that amount can vary depending on the expected rate of return on the investment. The greater the assumed rate of return, the less the state has to set aside for pension liabilities.

<sup>1</sup> Biggs, Andrew G. "Policy Solutions for Missouri's Government Employee Pensions" <https://showmeinstitute.org/publication/public-pensions/policy-solutions-missouris-government-employee-pensions>. April 9, 2018.

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The problem is that over time the effect of consistently overestimating those rates of return can be devastating to taxpayers when employees retire and draw on their pensions. Indeed, near-term funding decisions based on overly optimistic rates of return can lead to serious, negative consequences, because those presumed future returns justify substantively underfunding these pensions today—requiring greater pension deposits from future state budgets to “catch up” and fulfill the state’s benefit obligations to pensioners.

As with investment funds generally, administrative costs are an important consideration when determining whether an investment strategy should be altered. Consolidation of pension plan administration as a means to reducing plan overhead may have merit on those grounds. However, the core concern for the long-term viability of Missouri’s pension funds is tied up tightly with the expected returns foreseen by the fund manager, whoever that manager may be. In 2013, Biggs evaluated both the Missouri State Employee Retirement System (MOSERS) and the MoDOT & Patrol Employees’ Retirement System (MPERS) and found that both funds were not only underfunded, but potentially dramatically so.<sup>2</sup> Using a risk-adjusted discount rate of 4 percent, Biggs found that MOSERS was only 41.5 percent funded for the liabilities it was set to pay out, and startlingly, MPERS was only 23.7 percent funded. Put a different way, future generations may end up having to cover what could be an enormous pension deficit with future dollars because today’s state officials appear to be severely short-changing the funds.

<sup>2</sup> Biggs, Andrew G. “Public Employee Pensions in Missouri: A Looming Crisis” <https://showmeinstitute.org/publication/taxes-income-earnings/public-employee-pensions-missouri-looming-crisis>. March 11, 2013.

Certainly, there are tradeoffs to providing greater funding to pensions today. For instance, spending more on pensions means the state isn’t spending that same money on other state services. However, the state is bound by the promises made to its employees. Using overly optimistic rates of return to justify lower contemporaneous payments to these pensions is misleading both to the public and the pensioners. Built into the privilege of governance is the obligation of stewardship, and under present budgetary circumstances, that stewardship includes a reassessment not only of how the state’s pensions are administered, but also the manner in which they’re structured.

Administrative consolidation may have some cost benefits and should be investigated, but the nature of defined-benefit pension plans, the questionable establishment of these funds’ expected rates of return, and the likely underpayment by the state in accordance with those dubious rate assumptions should spur legislators to do more than tinker with who exactly is presiding over these funds. Defined-contribution pension plans—at least for those employees now entering the state workforce—would relieve the state of these long-term liability concerns and empower employees to better control their retirement futures. I hope legislators will consider that shift as they consider ways of protecting taxpayers.

Administrative improvements are important and should be pursued, but make no mistake: The state can’t just rearrange the deck chairs of the state’s pension programs indefinitely. And at some point, changes will come. The question is whether those changes will be imposed on future taxpayers, or whether forward-looking officials will, as responsible stewards, change course on these pension issues today. I certainly hope it will be the latter.



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