National Conference on Public Employee Retirement Systems

NCPERS Research Series

August 2017

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Public Pensions Are a Good Deal for Taxpayers

Public pensions are beneficial to taxpayers in a variety of ways that are both under-reported and poorly understood by many observers. In the quest for simple answers to complex questions about public pensions, facile observers routinely overlook salient facts. For example, taxpayers get public services from dedicated nurses, firefighters, teachers, and police officers and pay only 20 cents on the dollar for their retirement benefits. The rest of the money comes from investment earnings and employee contributions. Taxpayers benefit from $3.7 trillion of pension fund assets invested in our economy, providing capital for established businesses and start-ups. Additionally, taxpayers benefit because retirees typically spend their pension checks locally, creating new jobs. Above all, tax revenues created through retiree spending and pension investments may exceed what taxpayers pay into public pensions.

In the following sections, we expand on these observations using empirical data. We also focus on the resilience of public pension funds through economic ups and downs. This Research Series article is organized as follows:

- Pension funds are resilient.
- Pension funds pose little burden, if any, on taxpayers.
- Taxpayers' contributions are fully or partially offset by the tax revenues generated by public pension investments in the community and by the local spending of retirees who receive pension checks.

Dismantling pensions, which is often advocated on the grounds of ideology or misleading information, harms taxpayers economically. Our earlier analysis of empirical data for the last 30 years shows that dismantling pensions contributes to income inequality, a sluggish economy, and economic volatility. We found that if governments continue to dismantle public pensions they will inflict $3 trillion in economic damage by 2025.[1] In other words, the prevailing practice of dismantling pensions is a bad deal for taxpayers..

Contents

[1] NCPERS, Economic Loss: The Hidden Cost of Prevailing Pension Reforms. Washington DC: NCPERS, 2017. http://www.ncpers.org/files/NCPERS_2017%20Economic%20Loss.pdf

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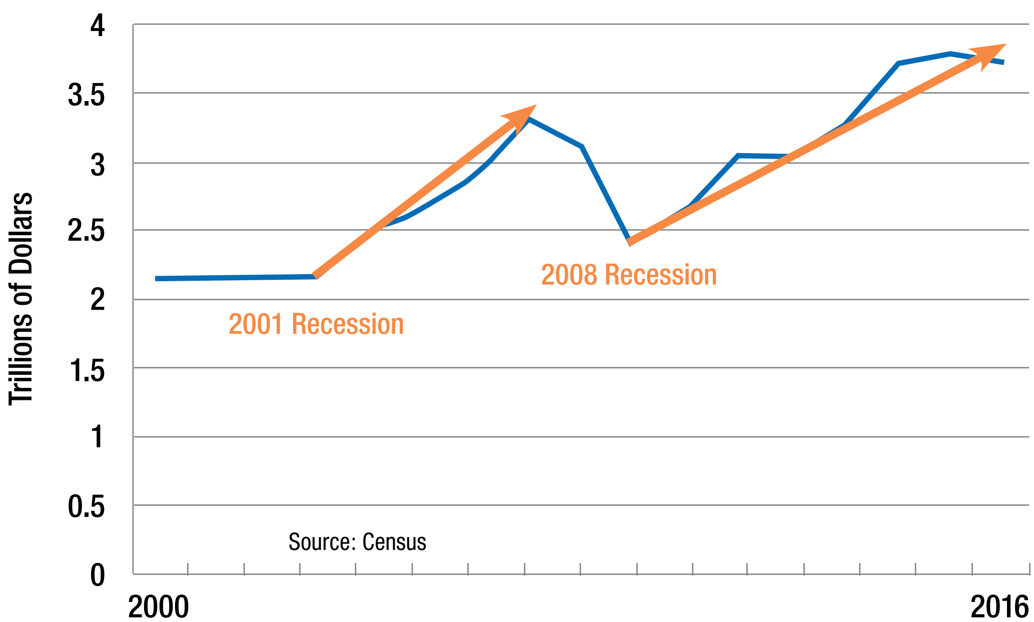
Pension Funds Are Resilient

Pension funds are resilient and well managed. They have stood the test of time for more than 100 years through economic ups and downs. If state and local legislators had kept their side of the bargain over the years by making scheduled payments on time, most critics of public pensions would have to find another hobby. Under the careful oversight and direction of trustees and managers of pension funds, these funds consistently recover despite economic ups and downs and state and local governments that renege on their obligations.

Figure 1 bears testimony to the resilience of pension funds. Using data from the U.S. Census, it depicts the growth of pension fund assets, including the impact of 2001 and 2008 recessions. It shows that after each recession, pension fund assets bounced back and kept growing. The slope of the recovery from the 2008 recession is slightly less than the slope of the recovery from the 2001 recession (as shown by the two arrows). This is due to the depth and duration of the 2008 recession. Yet, both arrows point to the resilience of state and local pension funds.

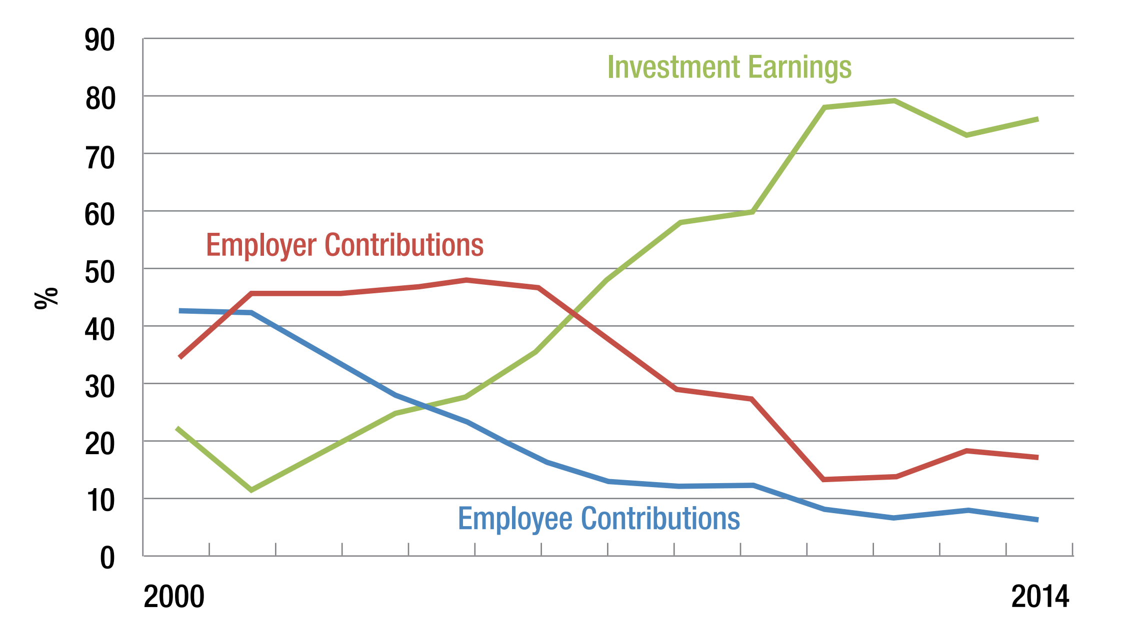
Figure 1. State and Local Pension Fund Assets 2000-2016



Pension Funds Pose Little Burden, If Any, On Taxpayers

Opponents of public pension often argue that taxpayers cannot bear the heavy burden of funding public pensions. The fact is quite the opposite. When public programs are funded on a pay-as-you-go basis, taxpayers put up every dollar for the services they receive. But public pensions are funded in advance, over the course of many years, with investment earnings and employee contributions powering asset growth. Consequently, taxpayers pay only about 20 cents on the dollar for pension benefits, which are an integral element of compensation for

Figure 2. Composition of Income of Public Pension Funds, 1940-2014



public-sector workers. The remaining 80 cents per dollar of benefit, as shown in Figure 2, comes from investment earnings and employee contributions.[2]

This is a good deal for taxpayers. They get quality public service from dedicated nurses, firefighter, teachers, and police officers by paying only about 20 cents on the dollar for the retirement portion of earnings. Because government workers earn lower wages on average than their private-sector counterparts, pensions are an important tool to attract and retain qualified professionals in public service.

If we take into account tax revenue generated as a result of pension spending and investment, the 20-cents-on-the-dollar tax burden is wiped out. Thus, pension funds pose little, if any, burden on taxpayers because of the advantages of advance funding.

Public pension opponents often focus on unfunded liability when they make a case that taxpayers cannot afford to pay for public pensions. They fail to recognize that when you advance-fund a program, you have an unfunded liability. Suppose you want to prefund your child's college education and establish a college fund at birth. The college savings program would have an unfunded liability from day one until the child enters college. At that point, depending on a variety of factors, it could have a surplus, a deficit, or be exactly on the mark. The same is true of pensions. Hitting the mark is of course important; historically, pension funds have actually exceeded it. The unfunded liability is a bogeyman conjured up by critics who are either ignorant of or willfully ignoring how advance-funding mechanisms like pensions actually work.

[2] The Source of data for Figure 2 - NCPERS, Economic Loss: The Hidden Cost of Prevailing Pension Reforms. Washington DC: NCPERS, 2017. http://www.ncpers.org/files/NCPERS_2017%20Economic%20Loss.pdf

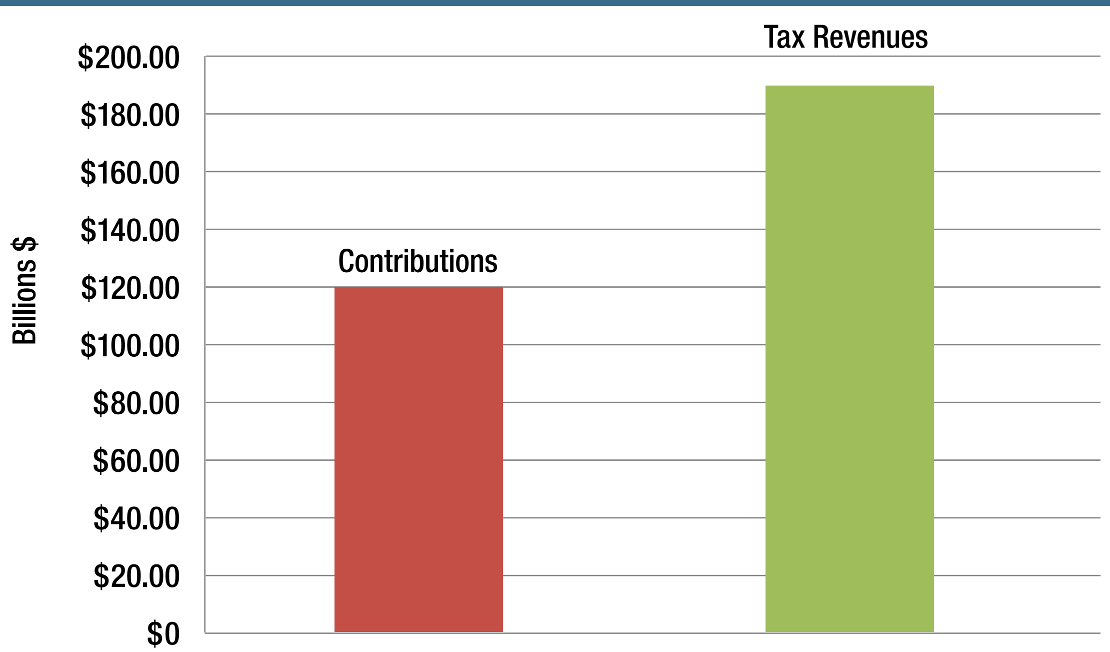
Regardless of the fluctuations in the level of unfunded liability, prefunding beats the pay-as-you-go approach any day. This is because of the investment income component. Shouldn't more public programs be funded as pensions are? After all, the pension funding model has stood the test of times. And, remember pension assets provide a great source of capital for established businesses and start ups.

Taxpayer Contributions Are Offset by Revenues Generated by Pension Investments and Local Spending by Retirees

Pension funds help to fuel our economy. Spending by retirees stimulates local economies, and pension assets are an important source of capital for businesses and start-ups. A recent study by the National Institute on Retirement Security (NIRS) shows that every dollar paid in pension benefits creates $2.21 in economic output.[3]

There is little or no research focused narrowly on whether tax revenues generated through pension fund investments and spending of retiree pension checks in local economies is enough to pay the taxpayer portion of pension contributions. However, one can get a rough idea from data presented in the NIRS study despite its limitations. The study focuses on the economic impact of spending of retiree pension checks only and includes public and private pensions.

Figure 3. State and Local Government Pension Contributions vs. Tax Revenues Generated by Economic Impact of Spending by Retirees, 2014



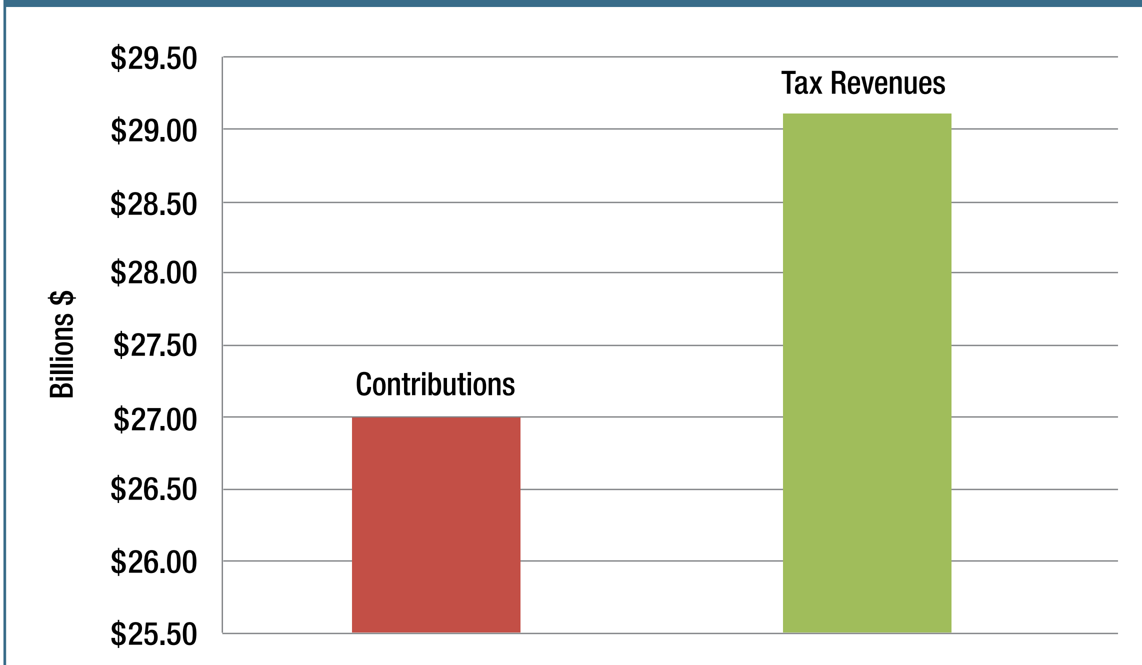
[3] Jennifer Erin Brown, Pensionomics 2016. Washington, DC: National Institute on Retirement Security, 2016 - http://www.nirsonline.org/storage/nirs/documents/Pensionomics%202016/pensionomics2016_final.pdf

It shows that economic activity generated by just the spending of retiree pension checks in 2014 resulted in $189.7 billion in tax revenues. Compare this with $120.5 billion in taxpayer contributions to state and local pension funds in 2014 (see Figure 3).

The $189.7 billion figure includes federal as well as state and local taxes and is based on public and private sector pensions: it does not include the revenue that might be generated by economic impact of pension fund investments. If economic impact of investments were taken into account, it seems that state and local revenues might have been enough to pay the taxpayer portion of pension contributions.

Fortunately, California Public Employees Retirement System (CalPERS)[4] and California Teachers Retirement System (CalSTRS)[5] have recently studied the economic impact of their investments in California. We use this data to calculate approximately how much state and local revenues will be generated by CalPERS and CalSTRS in-state investments. CalPERS and CalSTRS studies show that their investments support 1.45 million jobs. If the 2016 average salary in California is about $90,000[6] and 2016 average tax rate is about 17 percent (Income+Sales+Property+Excise),[7] CalPERS and CalSTRS investments in California will generate $22.2 billion in state and local revenues. Combine this with NIRS estimate showing that spending by public sector retirees in California resulted in $6.9 billion in state and local revenues. In other words, spending by retirees and pension fund investments in California

Figure 4. State and Local Government Pension Contributions vs. Tax Revenues Generated by Economic Impact of Spending by Retirees in California, 2016



[4] https://www.calpers.ca.gov/docs/forms-publications/calpers-for-ca-2016.pdf

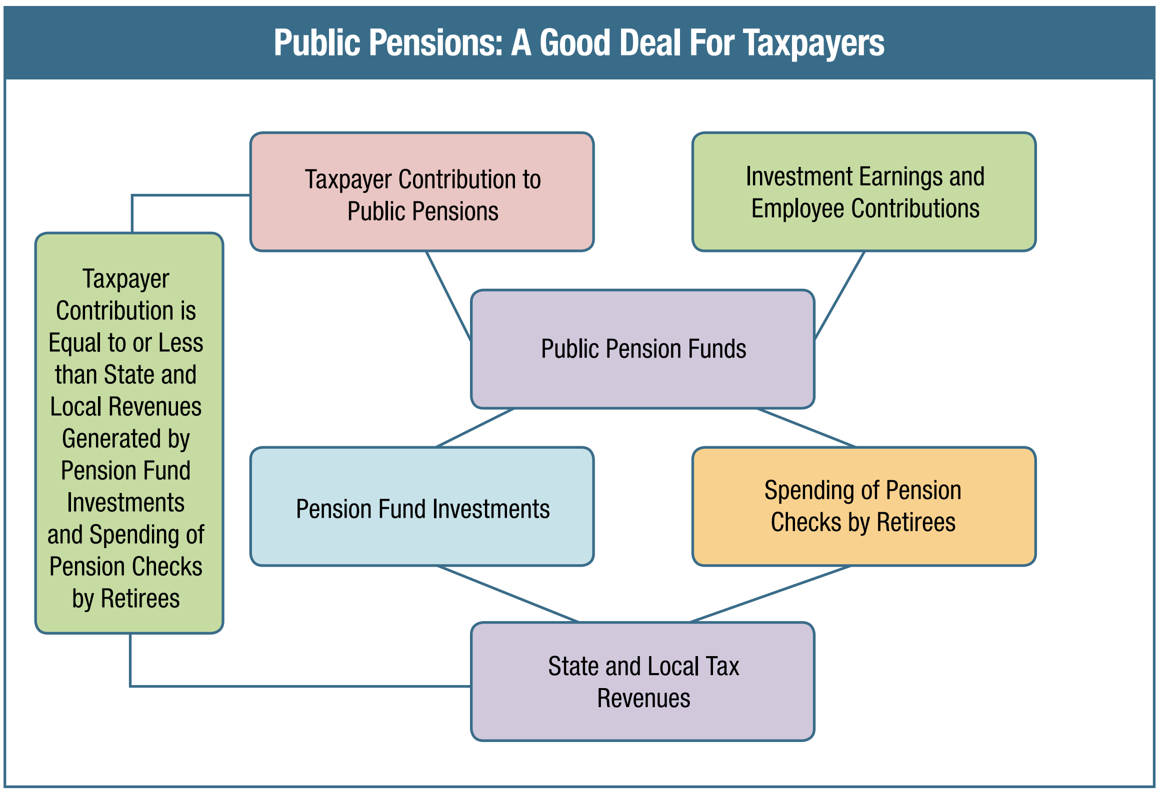
[5] Bardhan, Ashok, Impact of CalSTRS' Investments on California's Economy, Paper presented at CalSTRS Board Meeting, Nov 6, 2014.

[6] http://www.averagesalarysurvey.com/search/states

[7] https://itep.org/tag/california/

resulted in $29.1 billion in state and local revenues ($22.2+$6.9 = $29.1). Remember this analysis is based only on CalPERS and CalSTRS investments in California. The revenue amount would have been exceeded $29.1 billion if we took into account investment by all state and local pension funds in California.

How much did taxpayers contribute to California state and local pension funds in 2016? According to U.S. Census data,[8] it was about $27 billion. As shown in Figure 4, tax payer contribution to state and local pension funds was $2.1 billion less than state and local revenue generated by CalPERS and CalSTRS investments and spending by public sector retirees in California. In other words, taxpayers got a $2.1 billion bonus ($29.1-$27.0=$2.1) just because the state maintains state and local pension funds.



In short, our preliminary analysis shows that the argument that taxpayers cannot afford public pensions is bogus. As shown in the flow chart, it seems that taxpayers, contribution is equal to or less than tax revenues generated by investments by pension funds and spending of pension checks by retirees.

In case of California, taxpayers get a bonus just because of the existence of state and local pension plans.

[8] https://www.census.gov/govs/retire/

Conclusion

Public pensions are a good deal for taxpayers. Taxpayers get public services from dedicated nurses, firefighters, teachers, and police officers for the long haul by paying only 20 cents on a dollar for their retirement benefits. Taxpayers benefit from $3.7 trillion of pension fund assets invested in our economy by public pension funds. On top of that, taxpayers benefit when retirees spend their pension checks in the community. Although more research is needed, our preliminary analysis of pension spending and investments in California shows that pensions are not just a good deal but a great deal for taxpayers. Taxpayers get $2 billion more in state and local revenues than they pay into pensions.

On the contrary, dismantling of pensions as a reaction to misleading information or ideological argument presented by opponents of public pensions is a bad deal for taxpayers. Our earlier analyses of empirical data for the last 30 years from all 50 states show that dismantling of pensions contributes to rising income inequality, a sluggish economy, and greater economic volatility. We found that if governments continue to dismantle public pensions, they will inflict $3 trillion in damage on our economy by 2025.[9] In short, while public pensions are cost-effective and beneficial, dismantling pensions is costly and short-sighted for taxpayers.

[9] NCPERS, Economic Loss: The Hidden Cost of Prevailing Pension Reforms. Washington DC: NCPERS, 2017. http://www.ncpers.org/files/NCPERS_2017%20Economic%20Loss.pdf

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