The Center for State and Local Government Excellence

2008 Research Highlights

Center for State & Local Government Excellence

With fiscal pressures increasing on an aging workforce in state and local governments, anxiety has grown about pensions and retiree health benefits. What are the facts?

In 2008, the Center for State and Local Government Excellence initiated major research projects on these topics and conducted public opinion research on Americans' attitudes toward public service jobs. Below we digest some of our key findings, which we hope will help bring much-needed clarity to these issues.

Looking forward to 2009, we are planning new and updated studies to:

- Evaluate the impact of the financial crisis on state and local pensions and retiree health care;
- Examine the merits of different actuarial methods for valuing pension liabilities;
- Take a close look at health insurance plans for active and retired workers to assess the most promising approaches to managing costs, and how benefit plans affect career choices;
- Explore the role of bonds in funding pension and health care liabilities; and
- Analyze efforts to expand private pension coverage through public plans.

We invite you to learn more about the Center and its work at www.slge.org.

Elizabeth K Kellar

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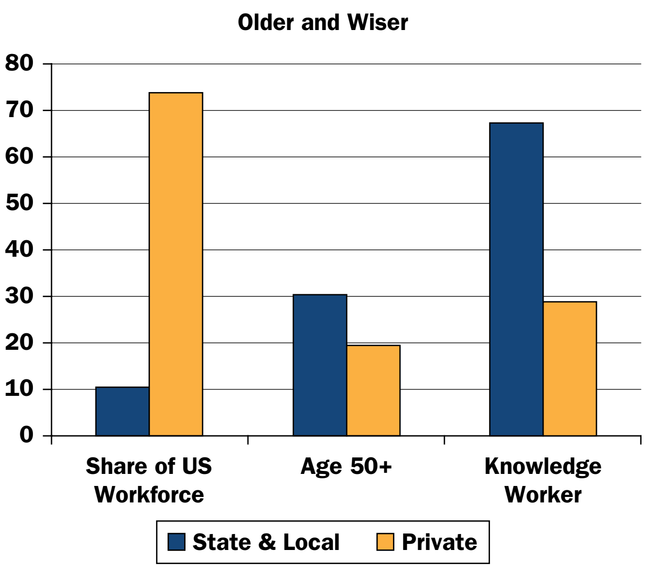
Baby Boom Retirements to Hit State and Local Government Workforce Harder than Private Sector



Source: Public Sector Employment, the Current Situation, (August 2007)

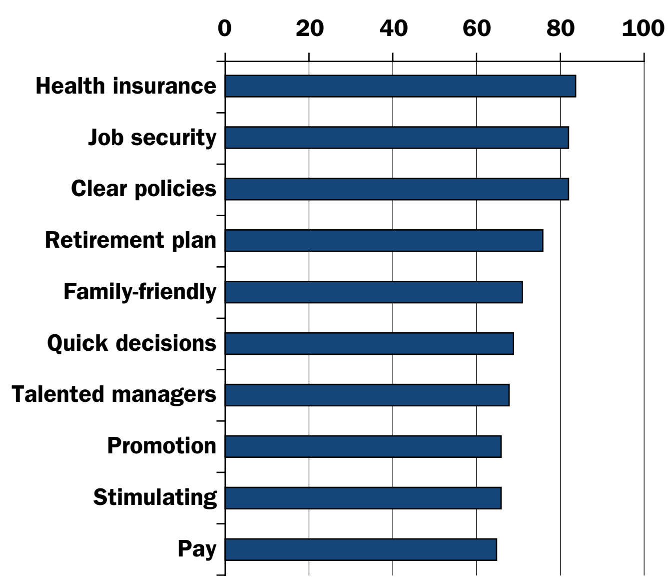
With the graying of the American workforce, interest in retirement security issues like pensions and healthcare is naturally on the rise. But it's not widely known that the baby boomer retirement "tsunami" will hit the state and local government sector harder than the private sector. Even with current hiring freezes, furloughs and layoffs, many states and localities are bracing for a massive recruitment challenge as they must replace many of their most skilled workers.

Key factors driving the challenge:

- More than a third of public sector employees are over 50, versus less than a quarter in the private sector.
- Public workers are much more likely to be "knowledge workers," often with specialized or hard-to-replace skills.
- Competition for talent is expected to be most intense for experts in science, engineering, management, finance, information technology, public health, and public safety.

Survey: What Do Americans Want from a Job?

Economic uncertainty was already increasing when the Center commissioned a survey of what workers want in a job. In the poll the Center released in January 2008, respondents put health insurance and job security atop their wish list, along with clear policies and a retirement plan. Pay came in a distant tenth.



Source: Survey of 1,200 adults 18+, by Princeton Survey Research Associates for the Center for State and Local Government Excellence. Released January 3, 2008.

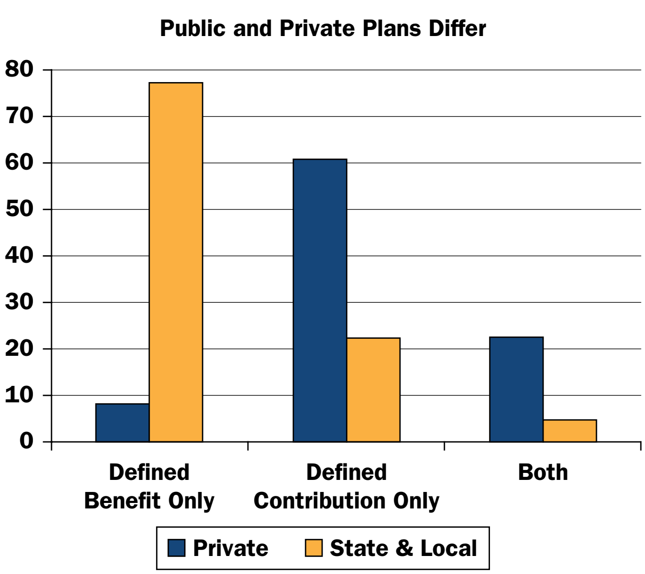
Pressures Increase On State and Local Pensions

Most state and local pension funds entered the economic downturn on sound footing, with assets covering nearly 90 percent of liabilities. That's remarkable given that public pensions were not well funded in the 1970s. Governments increased assets per worker markedly in the 1990s in response to new rules issued by the Government Accounting Standards Board (GASB), a move that has already helped in previous downturns. In addition, most governments use more stringent actuarial standards than does the private sector to determine how much to contribute to pensions each year.

The landscape of retirement savings in state and local government differs significantly from the private sector:

- 80 percent of state and local workers participate in a defined benefit pension plan only, compared with 10 percent in the private sector.
- 14 percent participate in a defined contribution plan only, compared with 64 percent in the private sector.
- 6 percent participate in both a defined benefit and defined contribution plan, compared with 26 percent in the private sector.
- State and local defined benefit pension plans rely heavily on employee contributions, which is unheard of in the private sector.

One reason that state and local workers are much more likely to participate in defined benefit pension plans



Source: State and Local Pensions Are Different From Private Plans, Nov. 2007

is that only 72 percent of them are covered by Social Security, while virtually all private sector workers have Social Security coverage.

Since state and local pension funds have long investment horizons, their investment behavior is shaped accordingly. They reallocate assets in the light of price changes and avoid herd mentality by following the best practices of other funds.

Governments generally have resisted pressure to increase risk in down-markets as a strategy to recapture lost gains. In short, they generally act as prudent investors, protecting the interests of retirees and taxpayers alike.

State and local government defined benefit pensions are protected by law, often written into state constitutions. At the same time, a few governments have opted to shift new hires to defined contribution plans or may offer a defined contribution plan as an additional way to help workers save for retirement.

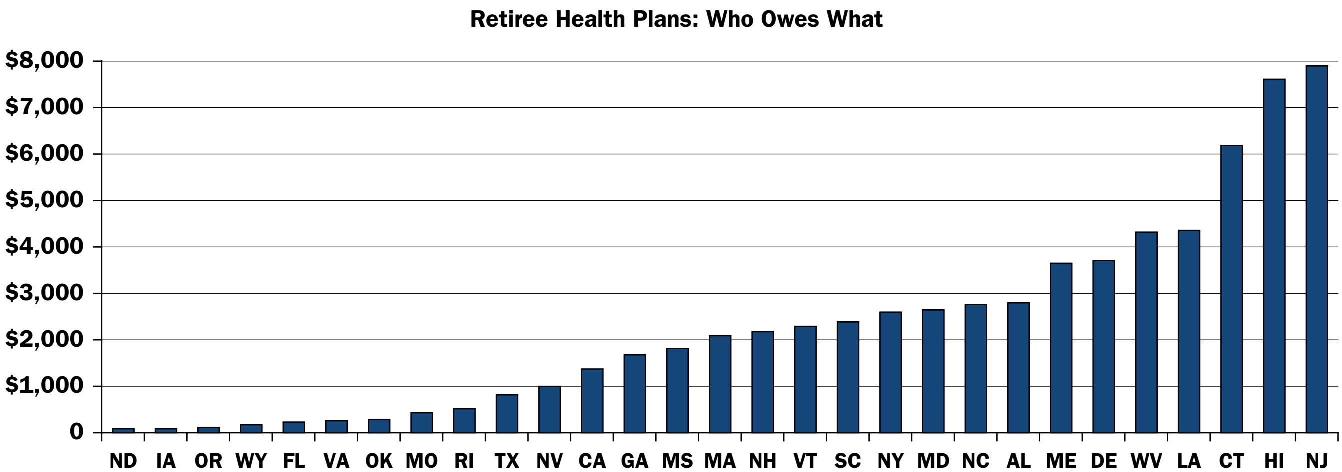
There is significant variation in the funding of state and local pension plans. Fiscal strains will make it especially difficult for governments to improve the funding status of poorly funded pension plans. Addressing these issues will affect employees and taxpayers alike.

Retiree Health Plans

While pension plans were relatively well funded before the economic downturn, retiree health care is another story. Although states and localities face substantial unfunded liabilities for retiree health care, they also have more latitude to address the issues. And, like pensions, there is substantial variation in those unfunded liabilities, depending on the size of the work force, how generous the health plan is, and how much of the cost is paid by employees, rather than the government.

Most states report they intend to continue financing retiree health care on a pay-as-you-go basis. Most have also begun cost-cutting measures through disease management programs, precertification requirements, and tighter auditing procedures.

Looking ahead, 16 states plan to limit or terminate subsidies for current retirees, while 17 states expect to introduce a plan to limit the subsidy for future retirees. Three states say it is likely they will terminate subsidies for current retirees.



Estimates of Per Capita Unfunded Liability for State Retiree Health plans.
Source: The Crisis in State and Local Retiree Health Benefit Plans: Myths and Realities

The Next Five Years

Looking to the next five years, most states intend to keep financing retiree health care on a pay-as-you-go basis, with 30 percent planning partial funding to offset costs. Five states report that they have established a trust and 15 others say they are likely to adopt a trust.

On the cost side, 17 states expect to introduce a plan to limit the subsidy for future retirees; three states say it is likely they will terminate subsidies for current retirees. A large majority of states have introduced disease management programs, have precertification procedures in place for inpatient hospitalizations, and conduct claims payer audits. Sixteen states say they are likely to increase the years of service required for vesting in retiree health care.

Future Cost Sharing Changes

In the next five years does your state intend to increase:	Very Likely	Somewhat Likely	Somewhat Unlikely	Very Unlikely
Retiree contribution premiums	34% (17)	42% (21)	8% (4)	8% (4)
Dependent contribution premiums	26% (13)	46% (23)	12% (6)	8% (4)
Retiree deductible amounts	16% (8)	48% (24)	22% (11)	6% (3)
Family deductible amounts	18% (9)	44% (22)	22% (11)	8% (4)
Coinsurance rates	6% (3)	44% (22)	34% (17)	8% (4)
Co-payment amounts	18% (9)	50% (25)	16% (8)	6% (3)
Co-payments for prescription drugs	18% (9)	52% (26)	14% (7)	6% (3)
Cap on employee out-of-pocket expenses	8% (4)	30% (15)	42% (21)	12% (6)

Note: Figures are percentage (number) of states responding in each category. Remaining percentages (states) are missing values: rows may not sum to 100 percent.
Source: Retiree Health Care in the American States

Helping state and local governments become knowledgeable and competitive employers

About the Center for State and Local Government Excellence

The Center for State and Local Government Excellence helps state and local governments become knowledgeable and competitive employers so they can attract and retain a talented and committed workforce. The Center identifies best practices and conducts research on competitive employment practices, workforce development, pensions, retiree health security, and financial planning. The Center also brings state and local leaders together with respected researchers and features the latest demographic data on the aging work force, research studies, and news on health care, recruitment, and succession planning on its web site, www.slge.org.

The Center's five research priorities are:

- Retirement plans and savings
- Retiree health care
- Financial education for employees
- Talent strategies and innovative employment practices
- Workforce development

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