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BHI Study: MA public sector pension system puts taxpayers at risk

(BOSTON) Under current assumptions made by the Commonwealth, fully funding the three largest public employee pension funds would require the state to make the equivalent of mortgage payments of $1.3 billion a year for the next 30 years. Moreover, the taxes that would be required to meet this annual obligation would destroy jobs, investment and disposable income. This is the finding of a new study from the Beacon Hill Institute at Suffolk University (BHI).

Macroeconomic conditions call into question the ability of the state to realize 8.25 percent returns for the funds that it manages. Viewing these unfunded liabilities as mortgage payments over the next 30 years offers a clearer perspective of the true costs to the taxpayer.

The vast change in the ratio of expected liabilities to expected assets, or unfunded liability, for these pension funds over the course of a period of underperforming years shows how the underlying assets and assumptions applied to these assets can create distinctly different predictions of the pension's viability.

The current funding ratios may even be more optimistic than reality.
In its study, BHI used two alternative methods of calculation unfunded liabilities, Accrued Benefit Obligation (ABO) and Projected Benefit Obligation (PBO).

Using the Commonwealth's assumed discount rate, combined unfunded liabilities for its three largest pensions are $3.1 billion in an ABO analysis and $12.6 billion under PBO. Using a more applicable discount rate for state general obligation bonds of 4 percent would increase the unfunded liabilities to $22.1 billion and $47.7 billion for ABO and PBO, respectively.

Current assumptions would require $179 million or $731 million annual payments, respectively using ABO and PBO measures of liabilities. More realistic assumptions would require $1.3 billion or $2.8 billion in annual payments, 4 percent and 8.5 percent of the proposed 2013 budget for ABO and PBO methodologies, respectively.

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While recent reforms slowed the growth of unfunded liabilities, this solution alone will not fix the problem. Other solutions, such as tax increases, will damage the Commonwealth economy.

Using its trademark STAMP model, which simulates tax law changes in the Massachusetts economy, BHI examined the effect of fully funding pensions according to ABO or PBO methodologies. The new revenue flowing from the private sector to the public sector would cause negative economic effects.

- Total state employment would fall by 8,640 or 18,665 jobs compared to a baseline.
- Investment would decrease by $185 million or $400 million.
- Disposable income per capita would fall by either $105 or $225 per person.

"When there is another decline in assets, private employees will feel the effects thorough losses of their own retirement savings, as well as the loss of having to make up the loss of assets in the pension fund," said Paul Bachman, Director of Research and one of the study's authors.

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