Five Main Parts

I. State Fiscal Trends

II. Different Elements in our Nation’s Retirement Infrastructure

III. Public Pension Plans – Current Status

IV. Key Emerging Trends – Public Pension Plans

V. Strategies Adopted by Different States
I. State Fiscal Trends

- Revenue inflows above forecast in 23 states in all major categories for FY 2005
- Although 33 states closed a cumulative budget gap of $36.3 billion in enacting their FY 2005 budgets, only 3 (MI, NE and NH) faced new gaps after year began
- This is a marked improvement from recent years; in FY 2004, 10 faced post fiscal year gaps and in FY 2003, 31 faced gaps during the year
Since FY 2001, states have bridged budget shortfalls that exceeded $235 billion

State tax revenue grew almost 8 percent between Oct. & Dec. 2004 compared to the same period in 2003; this was the strongest 4th quarter since 1991
I. State Fiscal Trends

- In prior years, states solved their budget gaps by
  - Slashing Spending
  - Tapping Rainy Day Funds
  - Deploying Tobacco Settlement Monies
  - Raising Taxes and User Fees
  - Hiking Cigarette Taxes
  - Cutting Funds to Local Governments
  - Racking Up Debt
  - Generating Funds via Gaming
I. State Fiscal Trends

- Even though state revenues have improved, state expenditures have exploded at a faster pace
- For FY 2005, 31 states report spending overruns
- Rising healthcare costs and utilization are causing Medicaid expenditure to soar; 23 states report spending overruns in healthcare
- States also face higher expenses in corrections (13 states over budget), education, pensions, transportation and infrastructure
- Consequently, 26 states are reporting shortfalls totaling $25 billion in enacting their FY 2006 budgets
II. Retirement Infrastructure: Demographics

- Elderly population in every state will grow faster than the total population (3.5 times faster)
- Seniors will outnumber school-age children in 10 states in the next 25 years
- 26 states will double their populations of people older than 65 by 2030
- FL, PA, VT, WY, ND, DE, NW, MT, ME and WV will all have fewer children than elderly
- Ratio of workers to retirees will decline in coming decades
II. Retirement Infrastructure: Three Legged Stool Concept

- Social Security
- Pension Income (Private or Public Sector)
- Personal Savings

Unfortunately, all these elements are currently on shaky ground
II. Retirement Infrastructure: Social Security

- At the end of 2004, 48 million people were receiving Social Security benefits.

- Costs will increase rapidly between about 2010 and 2030, due to the retirement of the large baby-boom generation.

- Annual cost will exceed tax income starting in 2017 at which time the annual gap will be covered with cash from redeeming special obligations of the Treasury, until these assets are exhausted in 2041.
II. Retirement Infrastructure: Private Pensions

- In January 2005, the Pension Benefit Guaranty Corporation (PBGC), the federal organization that protects the pensions of over 45 million corporate workers, ran a deficit of $23 billion.

- The PBGC has been coping with a number of large pension failures since 2002 and has warned about its ability to protect private pensions in the future.

- Last week, the PBGC took over all four of United Airlines' employee pension plans, with a shortfall of $9.8 billion, making it the biggest pension failure since the government began insuring pension benefits in 1974.

- The PBGC has warned that its deficit could balloon to $40 billion by the end of 2005 if it has to take over more airline pension plans.
## II. Retirement Infrastructure: Private Savings

<table>
<thead>
<tr>
<th>Year</th>
<th>Disposable Personal Income (Billions of $)</th>
<th>Personal Savings</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>$978.3</td>
<td>$102.7</td>
<td>10.5%</td>
</tr>
<tr>
<td>1983</td>
<td>$2,608.4</td>
<td>$233.6</td>
<td>9.0%</td>
</tr>
<tr>
<td>1993</td>
<td>$4,911.9</td>
<td>$284.0</td>
<td>5.8%</td>
</tr>
<tr>
<td>2003</td>
<td>$8,202.9</td>
<td>$165.6</td>
<td>2.0%</td>
</tr>
</tbody>
</table>
### III. Public Pension Plans – Cash & Investment Holdings (Thousand Dollars)

<table>
<thead>
<tr>
<th>Category</th>
<th>1993</th>
<th>2000</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Short - Term Investments</td>
<td>$66,192,708</td>
<td>$121,142,060</td>
<td>$117,392,023</td>
<td>$99,812,059</td>
</tr>
<tr>
<td>Government Securities</td>
<td>$203,452,928</td>
<td>$271,551,952</td>
<td>$246,787,978</td>
<td>$222,534,967</td>
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<tr>
<td>Non-Government Securities</td>
<td>$571,391,516</td>
<td>$1,602,291,271</td>
<td>$1,620,488,011</td>
<td>$1,669,422,866</td>
</tr>
<tr>
<td>Other Investments</td>
<td>$68,813,123</td>
<td>$173,657,750</td>
<td>$172,961,157</td>
<td>$180,231,896</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$920,571,814</strong></td>
<td><strong>$2,168,643,033</strong></td>
<td><strong>$2,157,629,168</strong></td>
<td><strong>$2,172,001,788</strong></td>
</tr>
</tbody>
</table>
### III. Public Pension Plans – Receipts (Thousand Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Contributions</td>
<td>$16,137,931</td>
<td>$24,994,468</td>
<td>$27,544,022</td>
<td>$28,843,747</td>
</tr>
<tr>
<td>State Government Contributions</td>
<td>$15,186,886</td>
<td>$17,546,723</td>
<td>$17,182,861</td>
<td>$19,567,749</td>
</tr>
<tr>
<td>Local Government Contributions</td>
<td>$19,804,798</td>
<td>$22,608,391</td>
<td>$21,609,170</td>
<td>$26,644,540</td>
</tr>
<tr>
<td>Earnings on Investments</td>
<td>$74,812,951</td>
<td>$231,900,075</td>
<td>($72,456,581)</td>
<td>$72,690,968</td>
</tr>
<tr>
<td>Total</td>
<td>$125,942,566</td>
<td>$297,049,657</td>
<td>($6,120,528)</td>
<td>$147,747,004</td>
</tr>
</tbody>
</table>
### III. Public Pension Plans – Payments

(Thousand Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Withdrawals</td>
<td>$2,477,142</td>
<td>$4,431,876</td>
<td>$4,079,492</td>
<td>4,891,041</td>
</tr>
<tr>
<td>Other Payments</td>
<td>$1,793,697</td>
<td>$4,751,715</td>
<td>$7,772,328</td>
<td>7,647,415</td>
</tr>
<tr>
<td>Total</td>
<td>$52,598,701</td>
<td>$100,457,883</td>
<td>$121,980,231</td>
<td>134,844,916</td>
</tr>
</tbody>
</table>
IV. Key Trends – Public Pension Plans

- Shift to Non-Governmental Securities (corporate stocks, corporate bonds, foreign stocks)
- In 1993, public pension plans had only 62 percent of their total cash and investment holdings in Non-Governmental Securities
- In 2003, this percentage had ballooned to 77 percent
## IV. Key Trends – Public Pension Plans

<table>
<thead>
<tr>
<th>Category</th>
<th>1993</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Short-term Investments</td>
<td>7%</td>
<td>5%</td>
</tr>
<tr>
<td>Government Securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ø Federal Government</td>
<td>22%</td>
<td>10%</td>
</tr>
<tr>
<td>Ø State and Local Governments</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Non-governmental Securities</td>
<td>62%</td>
<td>77%</td>
</tr>
<tr>
<td>Ø Corporate Bonds</td>
<td>19%</td>
<td>15%</td>
</tr>
<tr>
<td>Ø Corporate Stocks</td>
<td>33%</td>
<td>37%</td>
</tr>
<tr>
<td>Ø Mortgages</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Ø Funds Held in Trust</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Ø Foreign Investments</td>
<td>0%</td>
<td>12%</td>
</tr>
<tr>
<td>Ø Other Non-governmental</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Other Investments</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Ø Real Property</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Ø Miscellaneous Investments</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
IV. Key Trends – Public Pension Plans

- Payments have clearly surpassed receipts, led by healthcare expenditures.
- Given the flurry of corporate scandals and the steep drop in asset values, greater activism by boards, controlling authorities and legislatures.
- Vast majority of the plans are unfunded, i.e., assets less than their accrued liabilities.
IV. Key Trends – Public Pension Plans

- Majority of plans have unfunded liabilities

- According to Sept. 2004 NASRA report:
  - IL Teachers ($23.8 billion; 49.3%)
  - IL SERS ($10.1 billion; 42.6%)
  - OK Teachers ($5.5 billion; 54%)
  - WV Teachers ($5.1 billion; 19.2%)
  - IN Teachers ($8.5 billion; 42.1%)
V. Strategies Adopted: Pension Obligation Bonds

- Racking up debt to bridge budget shortfalls has been a popular strategy among states recently.
- According to an April 2004 Moody’s report, state net-tax supported debt rose at the fastest pace in the 24 years the company calculated this figure; currently at $305 billion and expected to rise.
- Recent bond issues have been very successful (CA, NJ, OR, IL).
V. Strategies Adopted: Pension Obligation Bonds

Pros:

- Interest rates currently at historic lows
- Funds raised via bonds relieves immediate pressures on budget
- Opportunity to reduce/eliminate state’s unfunded liability level

Cons:

- Possibility of investment earnings being lower than interest rate
- Locked into making debt payments
- Increases the state’s net tax-supported debt level
- Fiscally dangerous policy of borrowing to meet ongoing expenditures (possible credit rate lowering)
V. Strategies Adopted: Pension Obligation Bonds

- In 1997, New Jersey borrowed $2.8 billion to, among other goals, clear its unfunded liability.
- Investment earnings that exceeded 7.6 percent required to cover interest payments.
- In June 2000, pension plan was worth $83 billion; by June 2003, it had plummeted to $55 billion.
- City of Pittsburgh suffered similar fate too.
V. Strategies Adopted: Trimming Benefits

- Moving workers away from DB plans to 401(k)-style, DC plans (CA, SC, MA, AK)
- Linking annual increases to CPI (IL, RI, NH)
- Adjusting age at which retirees paid full benefits (IL, RI, TX, LA)
- Reducing percentage of pay retirees get each year (RI)
- Eliminating DROPs (LA)
- Ending practice of employees serving a short period in a position to boost overall pension (MO)
- Placing salary caps on rehired retirees (NM)
V. Strategies Adopted: Other

- Increasing the costs to workers, counties and cities (AK, MN, TX, KY)
- Consolidating retirement boards (WV, LA, AK)
- Matching, i.e., deliberately aiming for low, but guaranteed, investment income from conservative bonds (ME)
- Unorthodox investments (AL, MA)
Thank You

Stresses in the System:
Trends in Public Retirement Systems

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