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DEFUSING NEW YORK'S PUBLIC PENSION BOMB

A Fair Approach for Workers and Taxpayers

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EMPIRE  CENTER
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EXECUTIVE SUMMARY

New York State and its local governments, including New York City, provide their employees with constitutionally guaranteed pensions based on workers' peak salaries and career longevity. This defined benefit (DB) system requires government employers to contribute annually to retirement funds to cover future pension payments. But their contributions vary depending on actuarial assumptions and market fluctuations. Earnings during bull markets reduce employer contributions, while losses during bear markets can force governments to drastically increase contributions. Since bear markets usually coincide with recessions, DB pension plans force governments to spend more when they are least able to afford it. The financial complexity of the DB system has made it all too easy for elected officials to ignore or misrepresent the true costs of pension benefit increases for government workers.

This study shows how greater fairness for New York taxpayers and competitive retirement benefits for government employees can be achieved by switching from the current defined benefit (DB) pension plan to the savings-based defined contribution (DC) model used by the vast majority of private companies. A DC plan guarantees that a set amount of money will be put aside for retirement out of every employee's paycheck, while making the ultimate retirement income dependent on how much is saved and on returns from investment over the employee's working life.

Under the plan proposed here, government employers in New York would deposit a minimum of 5 percent of each worker's salary into a retirement account, to be matched by a minimum 3 percent employee contribution, bringing the total minimum retirement savings to 8 percent of salary per year. Employers would match up to 2 percent of additional employee contributions, raising the employer-matched minimum savings to 12 percent of salary. The recommended DC plan would effectively cap employee retirement costs at 7 percent of pay, which is less than the rate at which employers are now billed for members of the New York State and Local Retirement System.

In a DC retirement system, taxpayers would no longer bear all the financial risks associated with providing guaranteed pension benefits. Public pension costs for the first time would become both predictable and easily understandable, and the real costs of proposed benefit increases would be completely transparent.

DEFUSING NEW YORK'S PUBLIC PENSION BOMB

A Fair Approach for Workers and Taxpayers

INTRODUCTION

Skyrocketing pension expenses have been a major factor in the fiscal stresses afflicting every level of government in New York State. From 2000 to 2005, state-wide public pension contributions soared by more than \$5.6 billion—and they are still climbing. In New York City alone, higher annual pension costs have consumed three-quarters of the new revenue generated by a record property tax rate increase and rising property assessments since Mayor Michael Bloomberg took office in 2002.

Today's resurgent pension obligations represent a return to historical norms after an unprecedented period of declining costs during the 1990s. Significant recurring infusions of tax money will be needed to make good on New York State's generous retirement promises to its public employees for many years to come.

The pension problem is not simply a function of the 2000-03 stock-market slump or of Albany's 2000 increases in pension benefits, although both helped precipitate the latest crisis. The real cause is the fundamental design of the pension system itself, which obscures costs and wreaks havoc on long-term financial planning.

In the past three years, officials of the state and city retirement systems have sought to minimize the impact of pension cost increases by adjusting contribution schedules, "smoothing" investment return assumptions over longer periods, and allowing government units to "amortize" their increased contributions over a number of years.

This kind of tinkering merely pushes costs into the future and will not prevent future gyrations in pension contributions for government employers. Because the New York State Constitution does not allow pension benefits to be "diminished or impaired" for current public employees, nothing can be done to reverse the recent run-up in pension costs. But this system, which contributed to a previous budgetary meltdown in the Empire State,¹ will remain a ticking fiscal time bomb if it remains unchanged.

Only by bringing its outmoded, early 20th century pension structure into the 21st century can New York make pension costs more transparent, predictable and controllable. This modernization can be accomplished by shifting from the state's current *defined-benefit* pension entitlement to a *defined-contribution* retirement savings plan for government employees.

This change would save money in the long run. At the same time, a personalized, savings-based pension would provide employees with benefits that are flexible, portable—and comparable to those offered by most private-sector retirement plans.

By acting now to reform government pensions in a way that protects the interests of both employers and employees, farsighted public officials can make real progress in bringing these costs permanently under control—before another generation of New Yorkers must wrestle with the consequences.

PENSION INSTABILITY

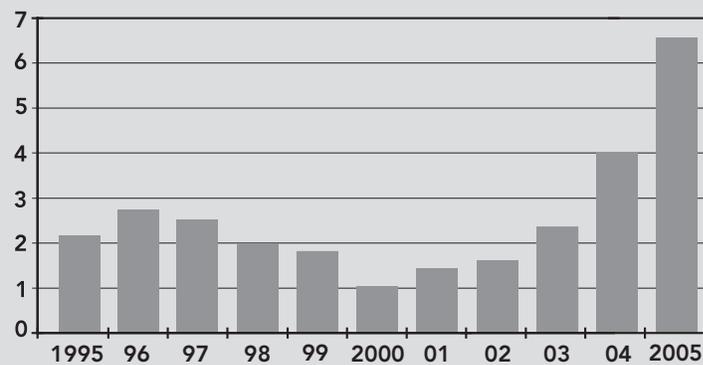
The last few years have seen a dramatic surge in public pension costs in New York State. As shown in Figure 1, tax-funded contributions to public pensions in New York State rose from \$1 billion in 2000 to \$6.7 billion as of 2005. Preliminary budget data for the state and local governments indicate the total will approach \$7.5 billion for 2006 fiscal years.

The increase in pension costs reflects an increase in contribution rates—calculated as a percentage of salaries and wages for current employees—necessary to make good on present and future public sector pension promises. As illustrated in Figure 2, the contribution rate charged to the state and all local government employers (other than school districts) outside New York City has varied widely over the past 20 years. After plunging from nearly 15 percent into low single digits for much of the 1990s², the rate had risen back to 12 percent of employee payroll by 2005. (For 2007, the rate is projected as 9.4 percent.) Pension contributions in New York City’s separate retirement system currently range from 11 percent for most civilian employees to 21 percent for teachers. These rates also represent significant increases over the levels in effect during the late 1990s.

The problem with public pension plans

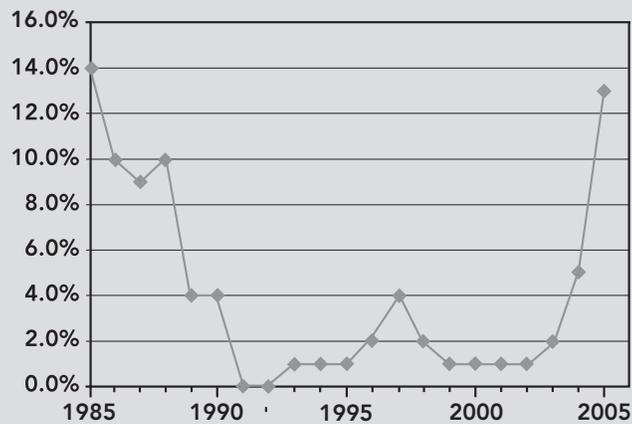
In New York, as in nearly every other state, public employees belong to defined-benefit (DB) pension plans. Under such plans, all workers are promised a stream of post-retirement income based on their peak salaries and career longevity. These payments are financed out of common pension trust funds, invested mainly in

**Figure 1. Tax-Funded Pension Costs in New York State
Public Employer Obligations, 1995-2005
(Billions of Dollars)**



Source: New York State and Local Retirement System, 2005 Comprehensive Annual Financial Report; New York State Teachers Retirement System, 2005 Annual Report; City of New York, Comprehensive Annual Financial Report

Figure 2. The Pension Roller-Coaster
Contribution Rate as Percentage of Salary,
NYSLRS*, 1995-2005



*New York State & Local Retirement System

Source: New York State & Local Retirement System

stocks and bonds. The funds are administered by government and supported primarily by employer contributions.

The percentage of employee salaries that employers must contribute to the pension fund is based on actuarial assumptions concerning the number of active and retired workers; the projected salaries, pensions and life expectancies of retirement system members and their beneficiaries; and, last but not least, the current and projected rate of return on pension fund investments. Retirement systems are considered fully funded when they keep enough money on hand to meet all current and future pension obligations.

When a DB pension fund's investments earn a larger-than-projected return, the required employer contribution to the fund decreases. Conversely, when the rate of return falls short of projections, employer contributions must increase to make up the difference. Since stock markets often decline during recessions, DB plans require governments to spend more money on pensions when unemployment is up and revenues are down—exactly when they can least afford it. This pattern has particularly dire implications for New York, which is much more dependent on revenues from the securities industry than most other states. It makes it even harder for New York to weather economic downturns without raising its already high taxes, which in turn depresses the state's economy and harms its business climate.

The right solution

How can the cost of New York's public employee retirement plans be made more predictable and affordable without depriving workers of the benefits they need?

The answer lies in switching from the defined-benefit pension plan to a defined-contribution (DC) model. Instead of a single common retirement fund, a defined-contribution plan consists of individual accounts supported by employer contributions, usually matched at least in part by the employees' own savings. These contributions are not subject to federal, state or local income taxes. Funds in the accounts are managed by private firms and invested in a combination of stocks and bonds.

A key difference between the two types of plans has to do with timing: Under a DB system, the employer promises to finance a *future* retirement benefit for a large group of current and former workers. Under a DC system, the employer promises to make *current* contributions to the retirement accounts of each employee. The size of the ultimate retirement benefit generated by a DC plan depends on the amount of savings and investment returns the worker is able to accumulate over the course of his or her working life. The downside risk of unanticipated investment losses and the upside potential for unanticipated investment gains are both shifted from the employer to the employee.

The most common example of a defined-contribution plan is the 401(k), which has become the backbone of the retirement planning for many private sector workers. Such a plan is not unheard of in the public sector—it is now being phased in as the sole pension for state government employees in one major state (Michigan) and as an option in another (Florida). A defined-contribution plan also has been the retirement vehicle of choice for most employees of public higher education systems throughout the country, including the State University of New York (SUNY) and the City University of New York (CUNY).

The financial plus for taxpayers

Over the long term, shifting all civilian public employees to a DC plan in New York State would steadily reduce taxpayers' pension funding obligations to just over one-half the "normal pension cost" projected by the state comptroller.³

The DC plan recommended by this report could deliver competitive retirement benefits within a fixed and predictable cost envelope of 5 to 7 percent of total salaries for non-uniformed employees.⁴ Applied to the current workforce and compared to 2006 pension contribution rates, that would represent an annual savings of more than \$1.3 billion for New York City alone—and roughly \$1 billion for the state and other local governments.⁵

Such savings would not be realized quickly. However, at normal turnover rates, one-third to one-half the state and local civilian workforce would be covered by the new plan within 10 years.⁶ A sizeable majority would be in the DC plan within 25 years.⁷ This transition would make a significant dent in public pension obligations during inevitable future downturns in the stock market and tax revenues. It would also greatly simplify financial planning for governments.

Such a plan will also result in equivalent or improved retirement benefits for many if not most government employees, even assuming they chose to immediately convert their retirement savings accounts into annuities. As shown on pages 7–10, employees who spend only part of their careers with government receive much higher retirement income with a DC plan, while career, senior-level employees can do just as well if they contribute slightly more than required to their plans.

Like so many other issues, the urgent need to deal with the rising cost of public pensions in New York boils down to a question of equity. Does the current system strike the right balance between the interests of taxpayers and of public employees? To arrive at an answer, it's necessary to review the structure of the current system and to compare its cost and benefits to those of other public and private retirement plans.

PUBLIC PENSIONS IN NEW YORK

There are eight different retirement systems for government employees in New York State, organized along jurisdictional and occupational lines as shown in Appendix A.

Taken together, New York's public pension pools hold over \$250 billion in stocks, bonds and other financial assets in support of retirement benefits for current and past government workers.⁸ In 2002, pension payments to roughly 600,000 New York state and local government retirees and their beneficiaries totaled over \$12 billion—an amount that exceeded the entire state government payroll.

Details vary, but all state and local public pensions in New York share certain basic characteristics:

- Employees are promised fixed retirement payments based on their number of years worked and an average of their highest salaries.⁹
- The benefit structure is designed to favor long-term career employees.
- Employee contributions to the common pension funds, for those still required to make them, are comparatively small. Most employees do not have to make any pension contribution.
- Employees receive a right to pension benefits (“vesting”) only after five years on the job. People who leave before that receive nothing, beyond the right to withdraw their own pension contributions.
- An employee's pension benefits at the time of hiring are guaranteed by the state Constitution¹⁰ and, when paid out, are exempt from New York State and New York City income tax, and from federal payroll taxes.

Trail of “tiers”

New York's public pension plans are organized into benefit “tiers” based on hiring dates, as follows.

- **Tier I** benefits are available to all employees who landed on a participating government payroll before June 30, 1973;
- **Tier II** covers all employees hired between June 30, 1973 and before July 27, 1976;
- **Tier III** covers employees hired between July 27, 1976 and before Sept. 1, 1983; and
- **Tier IV** includes all employees hired since Sept. 1, 1983.

The cutoff dates for each tier reflect the recent history of legislative attempts to control runaway government pension costs in New York.

The most generous pension plan is Tier I, which requires no employee contribution and allows unrestricted retirement with full pension as early as age 55. Significantly, Tier I does not cap the final average salary (FAS) used as a basis for computing the pension.¹¹ Thus, compared to employees hired after 1973, Tier I members have more ability to significantly pad their pensions by working additional overtime in the year or two before retiring.

Tier II, enacted as fiscal storm clouds were gathering around New York in the early 1970s, raised the basic retirement age to 62. Retirement at age 55 with the maximum pension is still allowed for Tier II employees, but is restricted to those with at least 30 years of service. Pensions are reduced for those with fewer than 30 years in the system who retire between the ages of 55 and 62. In addition, the definition of salary used to compute pensions is subject to a cap. Like Tier I, Tier II requires no employee pension contribution.

The creation of Tier III, during the darkest days of the New York City fiscal crisis, marked the first time most state and local employees in New York were required to kick in some of their own money—3 percent of salaries—towards their future retirement benefits. The retirement ages are basically the same as in Tier II, but the cap on final average salary is slightly lowered.

For the first 16 years after its enactment, Tier IV also required a 3 percent employee contribution. This tier also initially featured more restrictions on early retirement. However, pension benefits and eligibility rules are now virtually identical under Tiers III and IV.

Under pension enhancements passed in 2000, Tier III and IV workers outside New York City, and most civilians in city pension plans as well, are no longer required to make pension contributions after 10 years of government employment.

Carving out special benefits

Over the years, various public employee unions have successfully lobbied the state Legislature to create special plans for specific employee groups within the tier structure, such as sheriffs, corrections officers and teachers. As a result, Tier IV alone also encompasses 11 separate retirement plans.

Putting aside the often bewildering array of retirement options available under these different plans, virtually all Tier III and Tier IV employees who have attained the five-year “vesting” point can retire from government service and start drawing at least a partial pension as early as age 55, with full benefits at 62. Civilian retirees with fewer than 20 years in the system receive 1/60 of their salary (1.67 percent) for each year of service. Those with 20 to 30 years receive 1/50 of

salary (or 2 percent) for each year. For each year of service over 30 years, the pension includes an addition 3/200 (1.5 percent) of final average salary.

In practice, these rules mean the basic pension for a 30-year employee of the state system is at least 60 percent of final average salary, rising to 75 percent for a 40-year employee. When federal Social Security benefits are added to the mix,¹² many career New York State and local government employees can retire at more than 100 percent of their final salaries.¹³

Police and fire

Police officers and firefighters throughout New York are grouped into two pension levels—Tiers I and II—both of which offer more generous benefits, in some respects, than those available to civilian employees. Members of the police and fire pension systems can retire at half pay after just 20 years on the job, with no age restriction.¹⁴ As a result, most New York cops and firefighters who are not promoted to a supervisory ranking choose to begin second careers in their early 40s, backed up by pensions often swollen by overtime in their pre-retirement, peak earning years.¹⁵ (In 1992, retirement at half pay after 20 years was also extended to New York City sanitation workers; however, Tier IV sanitation workers must make an added 5.35 percent contribution per year to qualify for this benefit.)

Members of the New York State Police and Fire Retirement System, which covers agencies outside New York City, are not required to make any contribution towards their own pensions. In New York City, employee contributions to the police and fire pension funds are determined by age and experience. However, these pension contributions are partially to fully covered by special added pay allowances from the city.

Pensions as a security blanket

Public sector pensions in New York are structured to provide most career government employees with the ultimate in financial security—the *guaranteed* prospect of retiring at a relatively early age with little or no net decrease in income. For police and firefighters (and, most recently, New York City sanitation workers), the pension system provides a financial platform for embarking on a second career in middle age.

Such generous provisions are not uncommon in other states and the federal government—but they are unheard-of for the vast majority of private sector workers who pay government's bills.

Reaching for more

The cost of generous retirement plans for public employees was driven home for many New Yorkers when transit workers staged a week-long strike over pension

issues in December 2005.

Although they are employed by a state agency, the Metropolitan Transportation Authority (MTA), members of Local 100 of the Transit Workers Union (TWU) are members of New York City Employee Retirement System. In addition to the other city pension benefits described above, the transit workers have the right to retire at half pay at age 55 after just 25 years on the job (known as 25/55). Union negotiators in the 2005 contract talks wanted management's cooperation in seeking an even better retirement deal: the possibility of retiring at age 50 after just 20 years on the job (20/50). A 20/50 retirement bill had been approved unanimously by the state Legislature in 2003, only to be vetoed by Governor Pataki. But the governor had not rejected the idea in principle, and the Pataki-controlled MTA management apparently stunned the union by countering with a proposal to increase the retirement age to 62 and to slightly increase (from 2 to 3 percent) the employee contribution to the pension fund for newly hired workers.

The TWU ultimately returned to work without a contract—and without the pension sweetener it had sought. But unions continue to press demands in Albany for more expensive retirement benefits. Indeed, even in the face of rapidly rising tax-funded pension costs, proposed pension sweeteners for public workers have continued to receive a warm reception at the Capitol. In the 2006 session alone, both houses of the Legislature passed at least 36 bills increasing pension benefits for entire groups of employees, with \$84 million in onetime costs and over \$105 million in recurring expenses to taxpayers. In the 2006 session alone, both houses of the Legislature passed at least 36 bills increasing pension benefits for entire groups of employees, with \$84 million in onetime costs and over \$100 million in recurring expenses to taxpayers.¹⁶

New York City's largest municipal union, the United Federation of Teachers (UFT) identified a 25/55 pension for teachers as its "number one legislative issue" for 2006.¹⁷ The UFT's push for an even earlier retirement age was encouraged when Mayor Bloomberg agreed, as part of the union contract signed in 2005, to form a labor-management committee to "study" the proposal.

PUBLIC AND PRIVATE PENSION TRENDS

Half of all private-sector workers were active participants in any employee-sponsored retirement income plan as of 1999, according to data compiled by the Employee Benefits Research Institute. Among those private workers who did participate in such a plan, the majority were in defined-contribution accounts, such as 401(k)s, to which employers usually contribute. Roughly one-quarter of private sector workers had any stake in a defined-benefit pension plan. DB pension plans are typically found in large, old-line industrial companies—most of which are struggling to limit backbreaking pension obligations.

Prompted initially by changes in federal tax and employee benefit laws starting in the late 1970s, the shift to DC plans picked up more momentum as a long bull market commenced on Wall Street in the 1980s. Steven A. Kandarian, executive director of the Pension Benefit Guaranty Corp., which insures private pension plans, summarized the factors driving employers towards DC plans in recent congressional testimony:

“[I]ncreased competitive pressures. . . have led companies to reexamine their entire cost structure. In the 1990s, companies noticed that many workers did not place a high value on their defined-benefit plans, compared to the value they placed on their 401(k) plans. Furthermore, companies became concerned that their financial obligations to defined-benefit plans were highly volatile, in part because of fluctuations in interest rates and a dependence on equity investment gains. This volatility can make business planning difficult. As a result, many companies have been increasingly unable to afford, or unwilling to maintain, defined-benefit plans. In addition, companies found that demographic trends have made defined-benefit plans more expensive. With workers retiring earlier and living longer, plans must pay annuities for far longer. Today, an average male worker spends 18.1 years in retirement compared 11.5 years in 1950, an additional seven years of retirement that must be funded.”¹⁸

Each of the corporate concerns cited in Kandarian’s testimony could apply with equal force to New York State, New York City and other large government employers.

In recent years, three states have joined the DC trend on a broad scale, while the one state with a DC plan has moved towards a hybrid DB option.

Michigan leads the way

Under the leadership of then-Governor John Engler, Michigan became the first large state to shift from a DB plan to a comprehensive DC plan in 1997. In the DC plan, the state contributes a minimum of 4 percent of each worker’s salary to an individual investment account and matches voluntary employee contributions up to an additional 3 percent of salary, making a total contribution of 10 percent. Additional employee contributions up to 13 percent of salary are allowed, but are not matched by the employer.

The employer’s contributions are considered partially vested after two years and fully vested after four years. The “unvested” portion of the state’s contribution is not included in the permanent account a worker can transfer to another employer’s retirement plan before the four years is up

Michigan’s DC plan was mandatory, replacing the previous DB plan, for all employees hired after the March 1997 effective date. Those already in the system at that time were given a four-month window to shift past employee contributions

and the discounted “present value” of their accumulated retirement benefits to a DC account. In the limited time available, with unions running a campaign opposed to the change, only 3,600 out of 58,000 workers, according to the Michigan Office of Retirement Services, opted to join the DC plan.¹⁹

Counting new workers, however, the DC plan has grown over the past few years to 18,500 members, 30 percent of the total workforce of 61,500 as of 2002. At this turnover rate, most Michigan state employees should be in the DC plan by 2017.²⁰

Other Statewide Retirement Reforms Since 1999

Florida — In 2000, the Florida Legislature voted to create a defined-contribution plan as an optional alternative to the existing DB state plan. Government employers contribute to personal accounts at a rate of 9 percent of each worker’s wages. The plan was unveiled in 2002—a time of financial uncertainty heightened by sharp stock market downturn and the corporate accounting scandals.²¹ Only 5 percent of existing employees opted to shift out of the DB program. However, since the plan’s inception, 17 percent of new employees have opted for DC accounts, according to the National Association of State Retirement Administrators.

Oregon — Employees hired after Aug. 29, 2003, participate in a hybrid DB-DC plan, with employee contributions going to retirement savings accounts and employer contributions going to support guaranteed pensions. (Some aspects of the new plan were altered or invalidated by a state court decision in 2005.)

Nebraska – Until Michigan’s reform, Nebraska was the only state to exclusively offer a DC plan to a broad segment of its public employees. But the Nebraska plan, which has covered state workers since 1964, recently has been augmented by an optional “cash balance” plan that is a hybrid of DC and DB models.²² Although the change was made on the grounds that the new plan would provide more secure returns, more than two-thirds of the employees in the DC plan have opted not to shift.

Colorado — Effective in 2006, all new Colorado state government employees have a choice of three retirement plans: the traditional DB plan and two alternative DC plans, one administered by the existing public retirement system.

Alaska — In July 2005, Governor Frank Murkowski signed a bill making Alaska the first state to shift all public employees to a defined contribution pension plan. For all employees hired after July 1, 2006, Alaska’s DB plan has been replaced with a 401(k)-type retirement account.²³

Both the Alaska and Colorado plans feature relatively high mandatory employee and employer contribution rates because they are among the few states whose public employees are not covered by the federal Social Security system, and thus do not pay Social Security taxes on their wages.

Interest in defined-contribution plans also is growing elsewhere in the country. The most visible recent effort at pension reform was launched in California by Governor Arnold Schwarzenegger, who proposed shifting newly hired public employees to a DC plan as part of his reform platform in 2005. Opponents claimed that the Schwarzenegger proposal failed to preserve death and disability benefits—a point contested by the governor, who nonetheless withdrew the proposal and has yet to revisit it.

In California, as in many other states, efforts to restructure public retirement benefits are complicated by the problem of large unfunded pension fund liabilities, which must be paid regardless of whether new employees are shifted to a different system. This is less of an issue in New York, where the major state and local retirement systems are at, or close to, fully funded status.

Federal pension reform

For all employees hired after 1984, the federal government's defined-benefit pension for civilian workers was replaced by a system that combines a small DB pension²⁴ with a DC pension known as the Thrift Savings Plan (TSP). In TSP, federal agencies will match up to 5 percent in employee contributions, measured as a percentage of pay. On top of that 10 percent, employees can contribute an extra 5 percent a year without a government match.

Higher education precedent

New York and many other states allow their public college and university employees to opt into defined-contribution plans.

The choice has been available to SUNY employees for nearly 40 years. Over 85 percent choose a DC plan, such as the one offered by New York-based Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF). Employees contribute 3 percent of salary; the employer contribution in the SUNY system is 8 percent a year during an employee's first 10 years, and 10 percent thereafter.

CUNY also offers its employees a DC option, managed exclusively by TIAA-CREF.

COMPARING THE PENSION ALTERNATIVES

As explained on pages 1–3, moving to a defined-contribution plan clearly would represent a better deal for state and local government—and the taxpayers who ultimately foot the bill—while having no effect on current employees, who are constitutionally locked into the DB system. But what would it mean for employees who would be covered by such a plan in the future?

To illustrate the comparative benefits of DB and DC plans, consider two sets of hypothetical state workers and the benefits they could expect under both plans.

The first set of examples consists of workers who leave the state pension system 10 to 20 years into their working lives. Such “early-career” state employees have the most to gain from a DC system. This is because such workers never reach the peak earning years that are the basis for the traditional DB pension, and employer pension contributions made in their behalf don’t grow in individual accounts after they leave the government.

The second set of examples features two career government employees, one assumed to retire after 30 years of service and the other after 40 years, and projects their actual DB and potential DC benefits upon retirement from state service. The analysis shows that the 30-year employee can equal or exceed the current pension benefit under a DC plan that sets aside 10 to 12 percent of annual salary, while the 40-year employee will need to have set aside more than 12 percent of salary annually to earn benefits fully equivalent to a DB pension.

In estimating the returns from defined-contribution pension funds for both sets of examples, we combined *actual* market returns from 1983 through 2002 with an assumed 4.6 percent real rate of return for the next 10 to 20 years. This figure is based on the cautious mid-range assumptions used by President Bush’s Commission to Strengthen Social Security, chaired by the late former Senator Daniel P. Moynihan of New York, to assess proposed private savings accounts.

It’s important to note that this estimate is *below* long-term historical results and *lower* than projected in the actuarial assumptions built into the current New York State and New York City systems.

Early-career workers

All three employees in this series of examples are assumed to have begun working for the state at age 22 in 1983, at which point they would have become members of Tier IV of the New York State & Local Retirement System.

- **Employee A** spent 10 years working for the state in a low-level institutional job.²⁵
- **Employee B** worked for 15 years in the professional, scientific and technical services unit.²⁶
- **Employee C** was a managerial employee for 20 years before moving to a private sector job in September 2003.²⁷

To begin with, we calculated the maximum state pension²⁸ that would be due to each worker upon retirement at age 62 in 2023, using the current Tier IV formula combining years of service and final average salary.

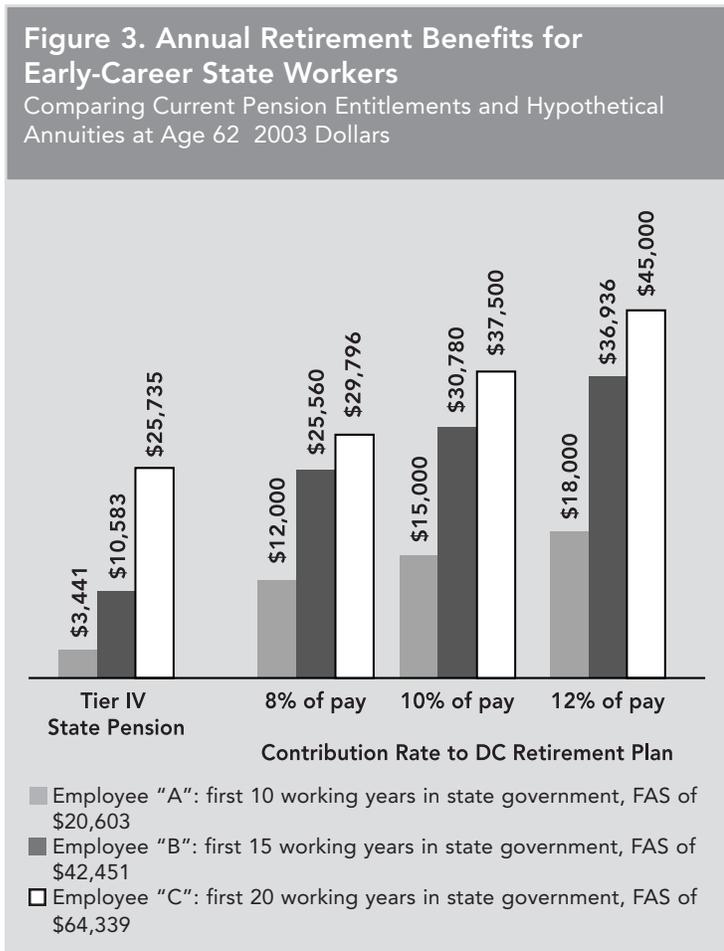
We also estimated the pension savings each worker would have accumulated in a 401(k)-style fund if, during their years of state employment, they had instead belonged to a defined-contribution pension plan. Savings were calculated for each

worker under three different annual contribution levels—8 percent, 10 percent and 12 percent of salary. In each case, these figures are based on pay grades, contractual salary increases and incremental longevity “steps” that were effective during the time of state employment.

Investment and Return Assumptions

It is assumed in these examples that the hypothetical DC employee pension funds

Figure 3. Annual Retirement Benefits for Early-Career State Workers
Comparing Current Pension Entitlements and Hypothetical Annuities at Age 62 2003 Dollars



were not cashed in or rolled over to a new employer's plan after each worker left the state payroll. Instead, after state employment and contributions ceased, each fund continued to passively accumulate investment gains until the date of the worker's retirement.

Each worker is assumed to have invested in the same fund mix of 60 percent stocks and 40 percent corporate bonds between 1983 and 2002, shifting to a ratio of 50 percent stocks, 30 percent corporate bonds and 20 percent government bonds in future years.²⁹ Performance of the funds between 1983 through 2002 was based on actual returns from stocks and bonds during that period.³⁰

To provide a direct comparison of state pensions and potential DC retirement benefits, each hypothetical pension fund was

converted at age 62 into a “single lifetime” annuity.³¹

Dramatic differences

The results of the hypothetical exercise are displayed in Figure 3. As shown, under all scenarios, the DC retirement benefit stemming from the period of state employment would dwarf the conventional DB pension.

Combining actual investment results with conservative future projections, these examples illustrate the benefits of a DC pension for younger workers who don't spend their careers in government. Another advantage, unstated in these examples,

is the flexibility and discretion these plans offer. Depending on circumstances, a worker might decide not to convert the pension fund into an annuity but make periodic lump sum withdrawals from an active investment account. Under this scenario, of course, the fund would continue to grow until it is converted into a larger future annuity, used to pre-pay an assisted living facility or nursing home, or passed on to the retiree’s heirs.

Long-term workers

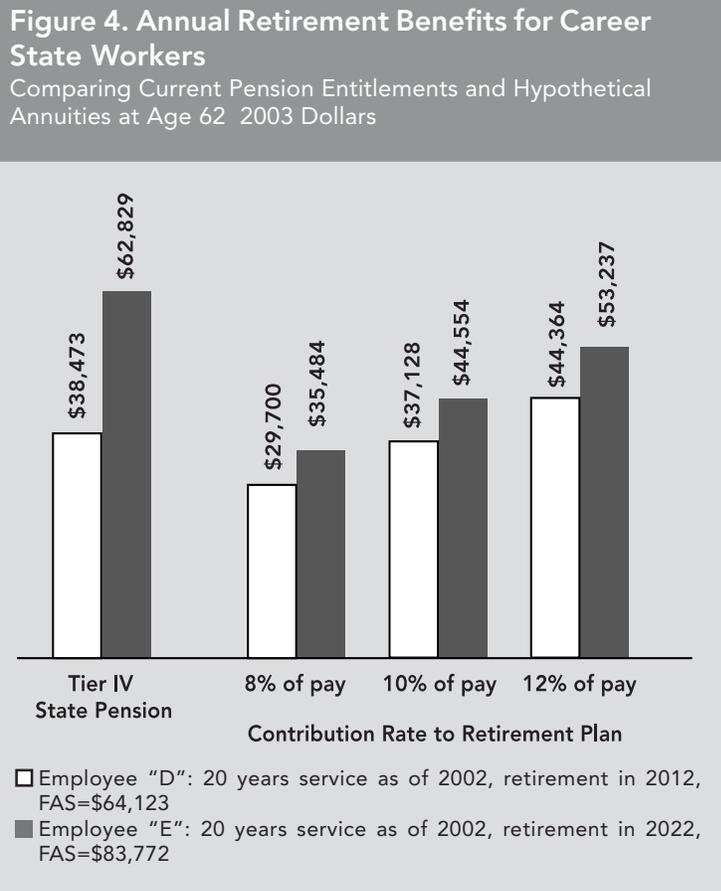
The next comparison features examples of two career state employees, both assumed to be earning \$50,000 as of the end of 2002, and both assumed to have started working for the state in 1983. Employee D plans to retire in 2012, after 30 years of service, at age 55. Employee E doesn’t plan to retire until 2022, after 40 years of service.

State workers’ salaries typically grow faster than the cost of living, both as a result of promotions and of above-inflation settlements in their union contracts. Therefore, we did not simply assume level, inflation-adjusted salaries of \$50,000 per employee. Instead, we constructed a salary progression to \$50,000 over a 20-year period (1983-2002) that reflects average step increases and promotions consistent with the actuary’s assumptions.³² On the same basis, we continued to project future salaries until the projected retirement ages for Employees D and E.

The results of this analysis are presented in 2003 dollars in Figure 4.

As shown, Employee D could come close to equaling the current Tier IV defined-benefit pension if at least 10 percent of his pay was put aside in a DC account every year. He would exceed the current pension at a contribution rate of 12 percent.

Employee E is the most senior, long-term hypothetical worker in any of these examples. Not surprisingly, given the system’s pronounced bias in favor of longevity, this employee’s guaranteed pension under the current system would be larger than his annuity under a hypothetical 401(k)-style pension savings plan. But it does not necessarily follow that the DC pension is inadequate for this type of worker.



Combined with Social Security, a retirement annuity purchased with the DC savings at a 12 percent contribution rate would provide Employee E with an effective income equivalent to at least 90 percent of final average salary—a “coverage ratio” in line with what is recommended by retirement planning experts. Moreover, as an alternative to a straight single-life annuity, his pension fund can be managed in a way that does more to keep up with inflation than the partial cost-of-living adjustment that applies to the current DB pension.

Even under the very conservative future rate-of-return scenario used here, Employee E could afford to buy an annuity equaling what would be provided under the DB pension formula merely by depositing 2 percent more in his DC account (boosting the total contribution to 14 percent).

These hypothetical examples do not include late-career entrants to the public retirement system—employees who land a government job for the last 10 to 20 years of their working lives. In any investment scenario, such workers have the greatest advantage under the current pension system. They could not replicate the DB pension under a DC system unless they save much more toward their retirement.

Pension bias

As noted in this report, New York's DB public pension plan reserves its biggest payoff for employees who spend their entire careers in government. Moreover, just as the current system discriminates against those who are on a government payroll for brief periods early in their careers, it is tilted in favor of older, late-career workers who pursue government jobs specifically to take advantage of the high pension.

Because pension benefits are financed out of a common pool, the lifetime employee's generous pension ultimately comes at the expense of those who *don't* put in 40 years on the state payroll. By the same token, the late-career worker's windfall ultimately comes at the expense of younger, more mobile employees.

REAL PENSION REFORM FOR NEW YORK

A defined-contribution plan could be designed for New York to replace the traditional defined-benefit plans for civilian government employees.

Ideally, as in Michigan and Alaska, the plan would require all new workers to enter the DC system and give all existing DB pensioners an option to switch into the system, bringing their accumulated pension assets and credits with them.

Under the New York plan proposed here, state and local government employees would be required to contribute at least 3 percent of their salaries to a retirement account. The government employer would match this threshold amount with a

contribution of 5 percent, bringing the total minimum retirement savings to 8 percent of salary per year.

Employers would match up to 2 percent of additional employee contributions, so that total retirement savings of 12 percent of salary would consist of up to 7 percent from the employer and 5 percent from the employee. Workers could voluntarily contribute even more pre-tax income to their pension investment funds, subject to federal Internal Revenue Service limit³³ but without an employer match for that extra amount.

These contribution levels would be equivalent to what is provided under the federal DC plan and the Michigan plan, and significantly larger than those provided under some major corporate plans.³⁴

As in SUNY's optional retirement program, workers would choose among several private investment fund managers, which in this case would be approved and regulated by the state comptroller. Workers could switch among investment funds during an open season in the first three months of each year. Administrative expenses would be borne by the plan's sponsoring government agencies.

The funds in the new retirement accounts would become the immediate personal property of the worker, with the employer-financed portion vesting after one year, as in the SUNY and CUNY systems.³⁵ However, withdrawals or loans from the account before retirement would be tightly restricted. Workers who left New York state employment would be permitted to roll over their retirement accounts into a subsequent employer's DC fund, such as a 401(k), or into an Individual Retirement Account. The funds and investment returns would continue to accumulate in the accounts on a tax-free basis until withdrawn at retirement.

Workers could choose to withdraw funds from their accounts without penalty at any time after they reach 59 1/2,³⁶ regardless of how many years they have worked for state or local government. Retirement benefits would be higher the longer the worker waited to withdraw funds.

Such a reform plan would provide major advantages for both workers and taxpayers.

Advantages for Workers

- Benefits would be portable. When a worker changes jobs, her retirement account can be transferred to the new employer or converted into an IRA.
- Employer contributions, as well as any and all investment gains on those contributions, become the worker's property after just one year's employment.³⁷
- Workers gain a greater degree of control and discretion over their own retirement planning than is available under the DB plan.

- All employees accumulate benefits on the same basis, regardless of how long they plan to work for government.

Advantages for Employers and Taxpayers

- The recommended DC plan would effectively cap costs at 7 percent of pay, more than two percentage points below the projected 2007 employer contribution for the New York State & Local Retirement System.
- Taxpayers would no longer bear the risks associated with market downturns.
- Public pension costs for the first time would become both predictable and easily understandable. The real costs of proposed benefit increases would be completely transparent, rather than obscured by complex actuarial calculations.

Under a DC system, it would no longer be possible for elected officials to significantly enhance pension benefits under the pretense that they were serving up a fiscal free lunch. This is what happened in 2000, when Governor George Pataki, then-Comptroller Carl McCall and near-unanimous majorities in both houses of the Legislature agreed to add an automatic annual COLA for all retirees and to eliminate the employee share of pension contributions for all Tier IV workers with 10 or more years of experience. At the time, proponents claimed these changes would not require an increase in pension contributions, as long as the rate of return on investments remained at 8 percent. But the retirement systems proceeded to *lose* money over the next two years—a risk that no one involved in the 2000 changes was willing to acknowledge.

Although the stock market was invariably blamed for the subsequent increase in required employer pension contributions, Albany's pension enhancements clearly made a bad situation much worse—accounting for fully one-half of the increase in contributions billed by the statewide system for 2003-04 fiscal years.

In New York City, fully \$771 million of the \$1.8 billion increase in tax-funded pension contributions between 2000 and 2004 could be attributed to benefit enhancements enacted at the state level or negotiated by the city with its public employee unions, according to an analysis by the Independent Budget Office.³⁸

Criticisms of DC Plans

Probably the most frequent objection to DC plans is that they shift investment risk from the employer to the worker. In a DB plan, the worker receives the specified benefits regardless of investment performance, so the worker apparently bears no investment risk. In a DC plan, the worker's benefits depend entirely on the investment performance of his retirement account, so the worker bears full investment risk. Poor investment performance leads to lower benefits.

Concerns about investment risk understandably resonated with retirees during the stock market downturn of 2000-2003. Over the long term, however, such risks can be overstated.

As explained by a leading expert in the debate over savings-based alternatives to Social Security: “Stock market investment is indeed risky over the *short* term. But over the *long* term, stocks and bonds clearly can form the basis of stable and adequate retirement wealth accumulation for all workers [emphasis added].”³⁹ Even workers retiring during the Great Depression would have received a 4 percent annual return after inflation during their years on the job.⁴⁰

The Employee Benefit Research Institute (EBRI) has developed a model that projects the proportion of an individual’s pre-retirement income that might be replaced by 401(k) plan accumulations, under several different projected scenarios. Based on equity returns from 1926 to 2001, the model finds that a combination of 401(k) benefits and Social Security payments will produce benefits ranging from 103 percent of pre-retirement earnings for workers in the lowest income quartile to 85 percent in the highest quartile.

Significantly, the EBRI reported, “[e]ven if equity returns in the future are projected to replicate the worst 50-year segment in the Standard & Poor’s (S&P) 500 history (1929 to 1978), 401(k) accumulations are still projected to replace significant proportions of projected pre-retirement income.”⁴¹ Moreover, proponents of traditional plans tend to downplay the potentially devastating effects of high inflation on a defined-benefit pension. Adjusting benefits for inflation—even on a partial, limited basis, as was just done in New York—is enough to make an already costly DB plan prohibitively expensive for taxpayers.

Under a DC plan, asset value tends to rise along with inflation over the long run, providing something closer to a real market rate of return. This would tend to keep prospective long-run benefits rising with inflation.⁴²

Over a long-term horizon, workers can weather many ups and downs in investment performance. Those nearing retirement, when savings become more vulnerable to market downturns, can minimize risk by changing the mix of their investments to include more bonds than stocks, and by avoiding too big an equity stake in any one industry or company.

Special Issues

As noted, New York police and firefighters are eligible for retirement at half pay after just 20 years on the job. All state correction officers, along with many local jail guards and sheriff’s deputies, can retire at half pay after 25 years. Thus, while the pension for most workers is designed to reward longevity, public safety employees have an incentive to retire as early as possible.

There's a lot to be said for the argument that chasing bank robbers, fighting fires and guarding hardened criminals is a young person's job. But so is heavy construction and road-building work—yet even unionized workers in these fields generally lack the kind of early retirement pension benefit available to police and firefighters.

Nonetheless, early retirement at half pay has come to be viewed as an integral part of the overall police and fire compensation package. In reshaping the pension system to make it more affordable, careful cost benefit analysis needs to be devoted to the relationship of retirement benefits to salaries and work rules, and to the question of whether the minimum service period can reasonably be extended—to, say, the same 25 years as state and local corrections officers. Any DC plan designed to preserve an early retirement preference for such workers would require higher employer and employee payroll contributions than the range described above for other employees. Withdrawals from conventional retirement savings plans are subject to a federal tax penalty before age 59 1/2, further boosting the savings requirement for workers who retire earlier.

Fairness

New York's public pension system is a vestige of the last century, when ultra-secure retirement benefits and civil service job protections were seen as compensation for the low wages paid to a non-unionized government workforce.

Nowadays, public employee unions are the most powerful interest groups in New York State. As more than one labor leader has been known to observe, union members effectively elect their own bosses in the State Capitol and City Hall. Elected officials have rewarded unions' campaign support by preserving the traditional pension system and other benefit perks—all the while agreeing to contracts that raise employee wages faster than inflation without regard for performance or productivity (which, in most cases, is not even measured).

Career government workers have an obvious interest in preserving a pension guarantee specifically to reward longevity while shielding them from any investment risk. Since the most senior employees also tend to wield the most clout within the unions, this explains why union leaders can be expected to continue supporting a system that actually shortchanges at least a sizeable minority of their members.⁴³

But while this provides the political explanation for the persistence of DB pensions in the public sector, it hardly serves as a justification for continuing the system, especially when the fiscal hazards of maintaining it have been so vividly highlighted by the latest funding crunch.

Costly return to the "norm"

"The boom of the 1990s was an exceptional time that allowed (employer pension) contributions to drop to zero in some years," State Comptroller Alan Hevesi has

pointed out. “But it is unrealistic to expect to provide a pension without any cost.”⁴⁴

Government employers in New York, Hevesi said in 2003, “must plan to again make contributions of at least 12 to 16 percent of payroll as a normal pension cost.”⁴⁵

In the face of this trend, individual retirement savings accounts represent a fair, sensible alternative to outmoded public employee pension plans whose “normal” costs would place an intolerable burden on taxpayers for decades to come.

APPENDIX A:

NEW YORK’S PUBLIC PENSION SYSTEMS

Here is a list of the public pension systems in New York State and a description of their primary membership:

New York State & Local Employees Retirement System

All employees—in occupations other than police officers, firefighters and educators—on the payrolls of the state and of local governments outside New York City

New York State & Local Police and Fire Retirement System

Police officers and firefighters employed by the state and by local governments outside New York City

New York State Teachers Retirement System (TRS)

Teachers and other education professionals employed by school districts outside New York City

New York City Employees Retirement System

City employees other than those employed by the police, fire and education departments

New York City Teachers’ Retirement System

Education professionals employed in the city’s public schools

New York City Board of Education Retirement System

Civil service workers and other non-education professionals in the city education department

New York City Police Department Pension Fund

City police officers

New York City Police Department Pension Fund

City firefighters

APPENDIX B: HOW GENEROUS ARE NEW YORK'S PUBLIC PENSIONS?

New York's benefit levels and eligibility guidelines are not atypical for the public sector. Some states offer earlier retirement ages or larger benefits than New York for some occupations—but such largess is often accompanied by the requirement that employers and employees contribute much more to their retirement systems.

Two recent nationwide reviews of public retirement systems showed that New York's employee share of pension contributions is relatively low compared to requirements in most jurisdictions:

- Of the 85 state and local government retirement systems included in a nationwide survey conducted for the Wisconsin Legislature in 2000⁴⁶, only 18 had mandatory employee contribution rates lower than the maximum 3 percent required of most New York public employees during their first 10 years on the job. Only 11 pension plans required no contribution from some or all employees, as is now the case in New York.
- Only four of the 34 states with pension systems most comparable to that of New York required no pension contribution from employees as of 1999, according to the U.S. General Accounting Office⁴⁷. Among states in this group requiring a member contribution, only five were below the current New York maximum of 3 percent.

Private counterparts

As noted on pages 5–6 of the main report, few private employers offer any guaranteed pension. In fact, even among the shrinking number of companies offering defined-benefit pensions, few rival the package available to career public employees in New York.

- General Electric, for example, offers workers a DB pension roughly half the size of the New York government plan, combined with a defined-contribution savings account. IBM also offers a package of DB and DC retirement benefits, although it is in the process of converting its traditional DB plan into a cash balance plan.
- Members of the United Auto Workers are famous for their high hourly earnings and big pensions—but after age 62, their retirement benefits are reduced by the amount of Social Security they receive. New York government retirees, by contrast, are entitled to full Social Security benefits

in addition to their full pensions.

- Microsoft, the quintessential high-tech growth company, offers no DB pension at all—just a 401(k) plan, plus the option to purchase company stock at 85 percent of market value.⁴⁸

Other comparisons

Because there are literally tens of thousands of different privately administered pension plans offering seemingly endless permutations of benefits and eligibility standards, it is difficult to conjure an “average” private plan for comparison with public pensions. In the absence of such data, one measure of how New York’s DB pension compares to private plans is a 1999 Congressional Budget Office (CBO) report focusing on the federal government’s pension plans for civilian employees.

Even among a select group of larger employers offering more generous retirement benefits, including guaranteed pensions, the CBO said only 15 percent allowed retirement with a full pension at age 55 after 30 years of service, which is permitted in Tier III and IV of the New York system.⁴⁹ In this same group, less than one private employer in ten provided for any kind of regular post-retirement inflation increase, such as the one extended to New York public employees in 2000.

Consistent with the CBO analysis, Census Bureau data indicate the average state and local government retirement payment in New York as of 2002 was \$20,057 per person, compared to an average company or union pension of \$11,949.⁵⁰

ENDNOTES

¹High public pension costs also contributed to the New York fiscal crisis of the mid-1970s, prompting legislative efforts to rein in pension benefits in 1976 and 1983, as reviewed on pages 45.

²The sharp drop in contribution rates beginning in 1989 came after then-Governor Mario Cuomo and the Legislature agreed to a law changing the funding method for New York State Retirement Systems from an Aggregate Cost (AC) method to a Projected Unit Credit (PUC) method, which reduced contribution requirements in the short term while creating a risk of larger rate increases and more volatility in the longer term. In December 1993, the state Court of Appeals ruled in favor of labor unions that had challenged the PUC move as an unconstitutional impairment of pension rights. The cost of transitioning back to the AC method over the balance of the 1990s ended up being more than offset by the historic growth in equity values during this period.

³“Local governments must plan again to make contributions of at least 12 to 16 percent of payroll as a normal pension cost,” Comptroller Alan G. Hevesi said on Sept. 8, 2003.

⁴The precise costs would depend on the level employees choose to contribute, since the employer contribution would be made on a matching basis. In light of their traditionally younger retirement ages, restructured DC retirement plans for police and firefighters would require separate consideration. See pages 10–11 for details.

⁵The projected employer pension contribution for New York City and New York State and local government workers other than police and firefighters is at least 12 percent of salary for fiscal

years beginning in 2004. For teachers outside New York City, the rate is 8.9 percent as of 2006. For New York City teachers it is 21 percent, and for other non-uniformed city employees the average rate is 11 percent.

⁶ This is based on the state actuary's expectation that approximately 50 percent of newly hired retirement system members terminate employment within 10 years.

⁷ The average length of service for members of the New York State and Local Employee Retirement System is 24 years, according to the state actuary.

⁸ The \$126 billion, 982,000-participant New York State and Local Retirement System alone is the second largest in the country, after California's massive "CalPERS" system.

⁹ Most New York State government employees also qualify for subsidized post-retirement health insurance. However, retiree health benefits are treated as a current expense; they are not financed out of the pension fund but out of the "general state charges" line in the budget's general fund. They are not part of the pension system or subject to the constitutional pension guarantee.

¹⁰ Article 5, Section 7 of the Constitution mandates that "membership in a retirement system shall be in the nature of a contract, the benefits of which shall not be diminished or impaired." New York is one of only five states to provide this maximum level of security for government pensions.

¹¹ For most current government workers, final average salary (FAS) is the average of wages earned during any 36 consecutive months when earnings were the highest, subject to certain limitations. For members of Tiers II, III and IV, the wages in any year used in the FAS calculation cannot exceed the average wage of the previous two years by more than 10 percent.

¹² On average, Social Security benefits are 40 percent of average annual earnings over a worker's entire career.

¹³ For example, a 40-year state employee retiring at 62 with an FAS of \$50,000 (roughly the average for all state workers as of 2002) immediately qualifies for a state pension of \$37,500 and Social Security benefits of \$12,948, yielding a total of \$50,448. Since the pension payment is not subject to federal payroll tax or to state and local income taxes, which can approach 10 percent, the effective difference between retirement and working incomes is even larger than it appears in this example.

¹⁴ The average age at retirement in the New York Police Department in recent years has been 43. New York City police pensions date back to the 1850s and were the first of their kind in the United States. Retirement at half pay first became an option in 1878.

¹⁵ In 2002, newly retired members of the state's police and fire system received an average pension of \$48,456 a year, according to the system's annual report.

¹⁶ See the July 13, 2006, Manhattan Institute FiscalWatch Memo, "Pension Watch '06: The Sweetening Continues," at http://www.nyfiscalwatch.com/html/fwm_2006-07.html.

¹⁷ *New York Teacher*, April 27, 2006, article posted at http://www.uft.org/news/teacher/pension/55_25_nbrone_issue/.

¹⁸ Statement of Steven A. Kandarian before the Subcommittee on Select Revenue Measures, Committee on Ways and Means of the U.S. House of Representatives, April 30, 2003.

¹⁹ Unions campaigned against the switch, and the time window was limited. With a wider window and a marketing campaign that did a better job of informing workers, more might have switched.

²⁰ In addition to the state, four large Michigan counties and the capital city, Lansing, have moved from DB to DC pensions plans.

²¹ "The New Choice in Retirement Planning in Florida," state guide posted at <http://www.fsba.state.fl.us/pdf/news/8-11-03.pdf>.

²² In making the move, state retirement officials expressed concern that 90 percent of investments were directed to only three of 11 available funds, principally a conservative “default” option. These statistics did, indeed, highlight a known weakness in the DC system. Left entirely to their own devices, many participants in such plans tend to overly cautious in their investment decisions, as reflected in sub-market rates of return for 401(k) accounts in recent years. However, rather than reforming the manner in which funds are invested under the existing DC plan, Nebraska officials appear to have been distracted by goals of “competitiveness” with public DB systems and by a consultant’s recommendation to the effect that only a pension duplicating the worker’s pre-retirement standard of living could be called “adequate.” Under the new plan, the employer will guarantee employee account balances and annuities at retirement. Responsibility for investment decisions (and all the downside risk) is shifted under the cash balance plan to a state-run Investment Council.

²³ Further information on the new plan can be found at the website of the Alaska Department of Administration, Division of retirement and Benefits, <http://www.state.ak.us/admin/drb/home.htm>.

²⁴ Guaranteed pension benefits for post-1984 Federal Employee Retirement System members accrue at the rate of 1 percent of salary per year—only half the level available to New York State employees.

²⁵ Pay Grade 6.

²⁶ It’s assumed the employee’s first 10 years were in Pay Grade 14 and the last five were in Pay Grade 18.

²⁷ It’s assumed this employee progressed from Grade 14 to Grade 18 after 10 years, and then to Grade 23 after 15 years.

²⁸ This would be “Option 0,” the single life allowance, which does not provide for payments to a beneficiary after the retiree’s death.

²⁹ This is consistent with the recommendation by most financial planners that workers adopt a more conservative investment mix, with fewer stocks and more bonds, as they approach retirement.

³⁰ The return on each worker’s corporate bond portfolio was equal to the average return on all corporate bonds rated in this period by Moody’s Investor Service. The return on each worker’s stock portfolio matched the composite returns on the S&P 500 as reported by Ibbotson Associates in its *2003 Stocks, Bonds, Bills and Inflation Yearbook*. This index reflects the returns on “large cap” corporate stock and this is a relatively conservative number; the historical composite returns on “small cap” tend to be higher.

³¹ Annuities were calculated by entering accumulated savings as “deposits” on the webannuities.com site, which generates an average annuity estimate from 16 companies.

³² The state actuary assumes underlying annual inflation and wage growth averaging 5.8 percent.

³³ The IRS limit on pre-tax employee contributions to 401(k) accounts is \$15,000 as of 2006. Contributions above that amount are taxable.

³⁴ For example, the Microsoft and IBM pension savings plans match only 3 percent of employee pay contributed to 401(k) savings plans, while General Electric matches up to 3.5 percent of pay.

³⁵ As in all DC plans, the employee’s portion of the account, including all investment gains, immediately is considered the employee’s property.

³⁶ This is the minimum age at which the IRS allows penalty-free withdrawals from qualified retirement savings plans.

³⁷ Under the current system, Tier IV workers with less than 10 years of service can withdraw only their own contributions, with interest of just 5 percent. After 10 years, there is no right of withdrawal.

³⁸ "What's Driving New York City's Growing Pension Burden?", Independent Budget Office, *Inside the Budget*, Number 119, Aug. 13, 2003.

³⁹ Andrew G. Biggs, "Personal Accounts in a Down Market: How Recent Stock Market declines Affect the Social Security debate," Cato Institute Briefing Paper No. 74, September 10, 2002, p. 2.

⁴⁰ See Gary Burtless, "Social Security Privatization and Financial Market Risk," Center on Social and Economic Dynamics, Working Paper no. 10, February 2000, Figure 4, p. 28.

⁴¹ Sarah Holden and Jack VanDerhei, "Can 401(k) Accumulations Generate Significant Income for Future Employee Benefits," Employment Benefit Research Institute *Issue Brief*, November 2002. The EBRI model is based on an average contribution of 9.3 percent of pay, which is less than the maximum recommended for New York. It also assumes levels of funding withdrawals that would be restricted or prohibited altogether for participants in the proposed New York plan.

⁴² EBRI's 401(k) model (Ibid.) found that a three-year bear market immediately before retirement could depress the level of pre-retirement income replacement by 13 to 17 percent. By comparison, inflation between 1978 and 1981 eroded the value of a dollar by 25 percent.

⁴³ The distribution of worker longevity on state government payrolls can be viewed as a pyramid, with most workers clustered near the base, in bands with least experience. In 2001-02, from 40 to 44 percent of the general employees (excluding police and firefighters) in New York City and in others towns, cities and counties had spent less than 10 years in the public pension system; more than 80 percent had less than 20. The state government's workforce is older and more senior on average; at the state level, about 33 percent of employees had been in the pension system less than 10 years, and 68 percent had been in the system for less than 20 years.

⁴⁴ Statement quoted in Press Release from the Office of New York State Comptroller Alan G. Hevesi, Sept. 8, 2003.

⁴⁵ Ibid.

⁴⁶ State of Wisconsin, Retirement Research Committee, "2000 Comparative Study of Major Public Employee Retirement Systems," Staff report No. 83.

⁴⁷ U.S. General Accounting Office, Report to Congressional Committees, "State Pension Plans: Similarities and Differences between Federal and State Designs," March 1999, GAO/GGD-99-45.

⁴⁸ Other large companies including GE and IBM offer similar stock purchase options.

⁴⁹ Congressional Budget Office, CBO Memorandum, "Comparing Federal Employee Benefits with Those in the Private Sector," August 1998, p. 9.

⁵⁰ Weighted survey data from the March 2002 supplement to the Current Population Survey. These averages compared only public and private DB plans and did not include 401(k) accounts, Individual Retirement Accounts and other savings-based retirement plans commonly found in the private sector.

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