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Bulletin

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Crippling State and Local Retiree Liabilities

State and local governments in Massachusetts are currently responsible for $83 billion in unfunded pension and retiree health care obligations. With only $63 billion set aside, the state and municipalities have funded less than half—just 43 percent—of the $146 billion they need to pay for benefits already promised to current employees and retirees.

As Table 1 shows, Massachusetts taxpayers are saddled with nearly $37 billion in unfunded pension benefits and an additional $46 billion for unfunded retiree health care benefits. Pension liabilities are only 63 percent funded statewide, and there is virtually no funding set aside for retiree health care liabilities.

Table 1:
Unfunded Retiree Benefit Liabilities For Massachusetts State and Municipalities

	2012 Unfunded Liability ($ billions)	2012 Total Liability ($ billions)	Funded Ratio	Date of Full Funding
State Pension	$7.28	$27.78	74%	2040
Teachers Pension[1]	$14.34	$36.48	61%	2040
Municipal Pension	$14.76	$34.65	57%	Up to 2040[2]
Total, Pension	**$36.37**	**$98.91**	63%	--
State Retiree Health Care	$16.30	$16.66	2%	None
Municipal Retiree Health Care	$30.00	$30.00	<1%	None
Total, Retiree Health Care	**$46.30**	**$46.66**	<1%	None
Total, Retiree Benefits	**$82.67**	**$145.57**	43%	--

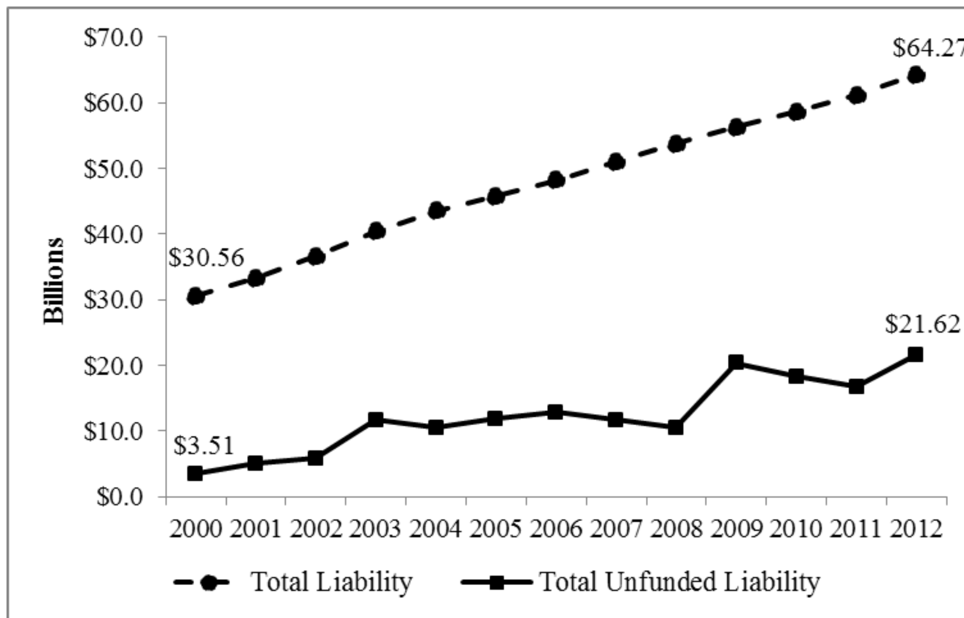
[1] The Teachers Pension category excludes the liability for Boston Teachers which is included in the Municipal Pension category.
[2] Local pension systems have a wide range of fully funded dates. One system—Minuteman Regional—is already fully funded while Leominster plans to achieve full funding in 2016. On the other hand, 75 systems do not plan to fund their pensions fully until 2030 or later, including six systems which will not be funded until 2040.

Pensions: Losing Ground
The troubling reality is that unfunded pension liabilities have grown over the past decade despite the enormous sums that state and municipal governments have contributed to their pension funds. A variety of factors account for this reality, including legislation to enhance benefits and provide early retirement incentives, as well as the failure of most systems to achieve the typical 8.0 percent or 8.25 percent target for annual earnings on pension assets. To compound these problems, nearly all systems have extended their funding schedules—from 2018 to 2040 in the state's case—to restrict short-term growth in contributions, but this move adds dramatically to long-term costs.

Between 2000 and 2012, the state's unfunded liability increased six-fold, growing from $3.5 billion to $21.6 billion despite the $15 billion that the state contributed to its pension fund over that period (Figure 1). In 2000, the state's pension was approximately 88 percent funded but by 2012 it had dropped to 66 percent.[3]

The effect of the state's November 2011 pension reform—intended to offset the added costs of extending the funding schedule—will not be seen for many years because it applies only to employees hired after April 2, 2012. In 2012, the impact was practically nonexistent: pension reform reduced the total liability for state employees (excluding teachers) by just $500,000, a reduction of 0.002 percent.

Figure 1:
Growth in Total and Unfunded State and Teachers Pension Liabilities Since 2000



[3] Effective in 2013, the state switched from an 8.25 percent to 8.0 percent assumed rate of return which will increase unfunded liabilities further.

Municipalities, like the state, are also dedicating more resources to pension systems while making little or no progress in reducing their unfunded liabilities. In 2000, the state's 99 local pension systems had approximately $13.5 billion in unfunded liabilities, compared to the $14.7 billion total unfunded liability in 2012.

Although the unfunded liability for municipalities has grown more slowly than the state's, the same factors have resulted in municipal pensions being just 57 percent funded in 2012, compared to approximately 59 percent in 2000, despite making billions in contributions during that period. Asset growth has fallen far short of their assumed rates of return.[4] Like the state, municipalities have extended their funding schedules to limit short-term growth in contributions: in 2000, all systems were on track to have their pensions fully funded by 2028 but by 2012 nearly three-quarters of local systems had extended their funding schedules to 2030 or later.

Retiree Health Care: Overwhelming Liabilities

Even more staggering than pensions, the state and municipalities face enormous unfunded liabilities for retiree health care benefits. Without changes to benefits, the state and municipalities will need to set aside the extraordinary sum of $46 billion just to meet the costs of the benefits already owed to current employees and retirees.

The problem is most severe for municipalities. Retiree health care liabilities are overwhelmingly unaffordable for nearly all communities—statewide, unfunded municipal retiree health care liabilities are twice that of their unfunded pension liabilities—because the benefits are exceedingly generous. For example, most current employees are eligible to retire as early as age 55 and need just 10 years of service to qualify for full benefits that include a health care premium contribution of 80 percent from the state or 50 percent or greater from nearly all municipalities.[5]

Without further reforms, the combined pension and retiree health care liabilities for the state and municipalities will be a tremendous burden on budgets for years to come, continuing to siphon resources away from important public services such as education, public safety, and transportation. In the meantime, the state and municipalities must use the tools available to them to control their liabilities, particularly to rein in retiree health care costs.

The Massachusetts Taxpayers Foundation is a nationally recognized, independent, nonprofit research organization whose purpose is to promote the most effective use of tax dollars, improve the operations of state and local governments, and foster positive economic policies. Over the past 15 years the Foundation has won 16 national awards for its work on health care access and costs, transportation reform, business costs, capital spending, state finances, MBTA restructuring, state government reform, and municipal health reform.

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[4] As of 2012, the assumed rate of return ranged from 7.5 percent to 8.25 percent among the 99 local systems, with most using 8.0 percent.

[5] A small number of municipalities—about a dozen very small communities—provide retirees with access to health care but do not contribute to the cost of premiums. In some cases, these communities are so small that many employees are not full-time. In other cases, these communities are members of regional school districts in which case teachers receive premium contributions, so while town employees may not receive premium support, the town still must contribute to teachers' retiree health care premiums.