Grant Proposal
NBER Retirement and Disability Research Center
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Focal Area #6: State and Local Pensions for Non-Covered Workers

Does the Net Value of Public Retirement Plans Depend on Whether Employees Are Covered by Social Security?

The Social Security Administration is interested in learning more about the recent changes in state and local pensions for public employees who are not also covered by Social Security (SS). Most public employees are covered by both SS and an employer pension. Together these benefits provide a retirement income for most career employees equaling 80 to 90 percent of their final salary. Of course, workers with fewer years of tenure will earn lower benefits from their public pension. However, one quarter of public employees are not covered by SS. For these uncovered workers, the employer pension is the main source of retirement income.[1]

Over the past 20 years, the financial status of state and local pension plans has received considerable attention. Low funding ratios and rising annual government expenditures have led government employers and legislatures to amend their pension plans in an effort to reduce annual pension expenditures and increase funding ratios. The funding challenges of the 21st century have resulted in substantial changes in plan characteristics including both benefit formulas and employee contributions. These reforms have reduced future retirement benefits for public employees while at the same time increasing employee contributions. And yet, low levels of funding in many plans mean that it is likely that there will be further reductions in the net value of public pensions.

An important policy question is whether the changes in state and local plans in which workers are not covered by SS have been larger and more widespread compared to reforms in those plans where workers are also covered by SS. The proposed study will examine changes in plan characteristics for state and local plans to determine whether the resulting changes have reduced the value of plans not covered by SS compared to plans covered by SS. A recent study of 85 large state-managed retirement plans covering general state employees, local employees, and/or teachers found that in 68 of the plans, employees are also covered by SS while employees in 17 plans are not covered by SS.[2] The study will compare plan changes in these two sets of public plans to determine if reforms vary by SS coverage.

By sorting the plans by type of workers covered one can explore which types of public workers have been most affected by recent pension reforms. Most of the plans where employees are not covered by SS are plans that only cover teachers; however, there are non-SS plans that cover

[1] Of course, many public employees also work part-time or in some years full-time in jobs in the private sector. These individuals may earn SS benefits from this employment though their ultimate SS benefits will be subject to both the Windfall Elimination Provision and the Government Pension Offset Provision.
[2] Wisconsin Legislative Council, "2017-2018 Comparative Study of Major Public Employee Retirement Systems." February 2019.

only general state employees, cover both state and local employees, and cover state employees, local employees, and teachers. The study will explore differences in the change in the value of public pension for SS and non SS plans and whether these changes differ by type of employees covered.

The analysis will report whether changes in plan type from traditional defined benefit (DB) plans to cash balance plans, defined contribution (DC) plans, and or hybrid plans differ by SS coverage, i.e. have plans not included in SS been more likely to shift from DB to other types of retirement plans? Next, the project will report changes in benefit formulas and how these modifications have altered expected replacement rates for hypothetical workers. Other changes in plan provisions that will be examined include age of normal and early retirement, vesting provisions, and COLAs. Clark, Craig, and Sabelhaus (2011) reported that the replacement rate for career employees provided by public pensions where workers were not covered by SS was 8 to 12% greater than the pension benefits from pension when workers were covered by SS.[3] This estimate was based on data from 1982 to 2006. Their findings indicated that the differential in the replacement rates had grown during this period by about 2 percentage points. A key question is how the difference in replacement rates by SS coverage has changed in the last 15 years. It is important to identify the changes in plan provisions that have resulted in the lower replacement rates.

Finally, the analysis will report changes in employee contribution rates by types of pension plans. Using information on both benefit reductions and employee contributions, we will derive how the net value of public pensions has change during the 21st century and whether declines in value have been greater for plans in which workers remain outside of the SS system.

Key questions that will be examined include:

Is the shift away from offering only traditional DB plans greater among government agencies whose workers are not covered by SS? Is this change influenced by Federal safe harbor rules for these plans?

Have plan modifications reducing future retirement benefits been greater among plans that are not covered by SS? Have pension reforms increased the risk of insufficient retirement income for non-covered public employees relative to retirees who are covered by SS?

Do distribution options (lump sum and annuities) in plans covered by SS differ from those where employees are not covered by SS? Do these differences make retirement income riskier for public retirees not covered by SS?

Have employee contributions risen faster for plans whose workers are included in SS compared to those that are not? Do these changes further reduce the net value of public plans not included in SS?

[3] Robert Clark, Lee Craig, and John Sabelhaus. *State and Local Retirement Plans in the United States*, Northampton, MA: Edward Elgar, 2011.