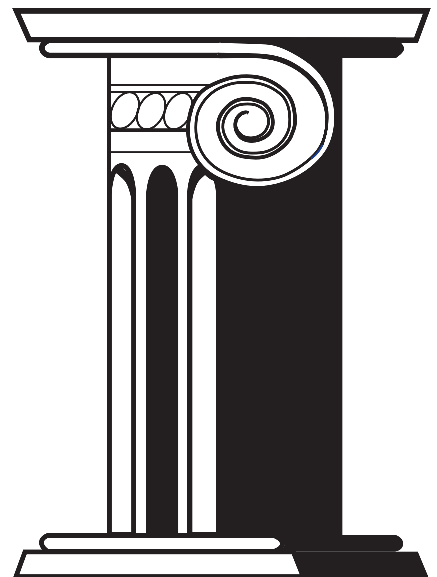
January 2012

Iowa's Privileged Class: Time for a Change!

POLICY STUDY

No. 12-1



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Iowa's Privileged Class: Time for a Change!

POLICY STUDY
January 2012
No. 12-1
Public Interest Institute

Dr. Don Racheter, President

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Executive Summary

As documented in the March 2011 Public Interest Institute (PII) *Policy Study*, "Iowa's Privileged Class: State Government Employees," we have the largest government/private-sector pay gap in the nation.

Amy Frantz, Vice President for Research at PII, stated, "Iowa has held that status not only since 1996, but has held the top spot among states for the largest Pay Gap between government workers and private-sector workers for over two decades.

"In 2008, Iowa's state-government workers received an average wage that was 148.07 percent of what the average private-sector worker in Iowa was paid. That means that for every $1.00 an average private-sector worker earns in Iowa, an average state-government employee in Iowa earns $1.48. Iowa's Pay Gap was larger than in any other state."[1]

One reason offered for the continuing pay gap is that in 1975 the Public Employment Relations Act, or collective bargaining law, took effect.

This law, signed by then-Governor Robert Ray, "grants employees of the State and its political subdivisions, including cities, counties, and school districts, the right to join and participate in employee organizations, and the right to bargain collectively through such employee organizations."[2] It allowed unions such as the American Federation of State, County, and Municipal Employees (AFSCME) and the National Education Association (NEA) an entry to government workers.

An important part of collective bargaining negotiations are retirement benefits. The benefits negotiated by these unions and the resulting impact on state government budgets and long-term liabilities are significant.

Though the Legislature made changes to the state pension system, called IPERS – the Iowa Public Employees' Retirement System – in 2011, the changes do not take full effect until 2012.

These changes include increasing the employment time required for full vesting, a longer period of time for figuring average pay, and higher contribution amounts for both the government and the employee. The changes are expected to increase the overall viability of the IPERS system, but problems remain.

For example, the changes only apply to forward hires, not those currently in the system. Thus any improvements to the overall financial health of the system will only be seen in the long term.

The most recent report on IPERS shows current funding for payable benefits at less than 80 percent of the long-term pay-out requirements. Another issue is that a significant number of retired employees, almost 6,000 or 6 percent of

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the total, are drawing benefits of over $3,000 per month. Of these, many are receiving over $5,000 per month. This is in addition to amounts they may be drawing from Social Security and other pension or retirement amounts.

The Occupy Wall Street (OWS) movement has been concerned about a wide variety of issues. One is the lack of jobs for younger workers.

PII would not support many of the issues and goals advocated by the OWS groups. However, the fact that retirement plans and health-care liabilities of government workers in Iowa, as well as other states, are at significant financial risk of under-funding and are overly generous is of concern.

If additional reforms are not implemented, the amounts owed to both current and future beneficiaries must be paid by future taxpayers — the younger workers of today. And many of these future taxpayers are already finding their financial future constrained because of a lack of jobs.

Recent reports show one of five people under the age of 35 with incomes under the federal poverty level. This is a significant change from 24 years ago, when only one of ten was in poverty. There are many factors impacting these numbers, including more people over 65 continuing to work, and many younger workers assuming significant educational debt, housing liabilities, and remaining unmarried even as they have children.

In contrast, the number of retirees over 65 years of age whose income places them in a "poverty" status is only one of every ten, dropping from one of three in 1967.[3] Certainly many of the IPERS retirees, even if they have not saved another penny for their retirement, are not at risk for poverty.

As the economy continues in a "jobless" recovery, the pension plans paying out income to retirees – especially to government workers – must have significant reforms, so that the burden on future workers and taxpayers will not be onerous.

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Introduction

The concept of "retirement" from the workforce and of having income or pension during that retirement is a very new idea in the overall timeline of human society.

By 1940, only about 15 percent of the labor force in the United States had a pension. People worked until they could not, and either saved for old age, were supported by children or family members, or worked until death.

Between 1940 and 1975, this changed until almost half of the private-sector workers had pensions, mostly Defined Benefit (DB) plans.[4] According to an article in the *National Tax Journal*, "increasing tax rates, wartime wage and price controls, and changes in collective bargaining rules" drove this.[5] Offering pensions was

also found to increase worker loyalty and retention, and correspondingly reduce training costs.

The passage of the Employee Retirement Income Security Act (ERISA) in 1974 caused a decline in defined benefit plans in the private sector and resulted in an increase of Defined Contribution (DC) plans.

This was because costs for DB plans increased and tax-law changes enabled employees to take advantage of pre-tax payroll deductions. A less unionized and more mobile workforce also contributed to the decline.

As of 2008, only 24 percent of private-sector workers have a DB retirement plan, down from 76 percent in 1986.[6]

However, this was not the case in the public-employee area. By 1961, 45 states had DB pension plans, first for teachers, then the remaining government workers.[7]

According to the National Compensation Survey by the Bureau of Labor Statistics (BLS), 92 percent of the state and local government workforce are offered retirement benefits, such as a pension, and in many cases this is in addition to Social Security.[8]

Today the majority of the states still offer DB plans to their workers. This is because of both regulatory and workforce differences, including the fact that public-sector workers are "older, more risk averse, less mobile," and, importantly, more unionized.[9]

In contrast to the private sector, where only 6.9 percent of workers are unionized, over 36 percent of government workers are union members, according to the Bureau of Labor Statistics.[10] As of 2010, over 7.6 million public-sector employees were union members, compared to just over 7 million private-sector workers. The unionization of government workers is also continuing to grow, while private-sector unionization is falling.

On a nationwide basis the highest unionization rates are in the education, training, and library (37.1 percent) and protective service (34.1 percent) occupations.[11] These are the same areas of concentration as in Iowa, where in 2010 almost 11.4 percent or 158,000 workers out of the total worker population were unionized.[12]

Overall Status of State Government Pension Plans

There are significant concerns with the funding levels and payment liabilities of government DB plans for state government workers. These concerns began in 2000 with the stock market crash of that year, and continued following the 2008 recession and stock market retrenchment.

Retirement accounts of all types — private defined benefit, private defined contribution, and state and local government accounts — all fell by 25 percent or more in 2008.[13] Their recovery since then has

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been uncertain, inconsistent, and weak.

According to the Boston College public plans database, using 2009 data, only two states have fully funded pension plans: New York and Wisconsin.

The five states with the lowest funding levels are Illinois (51 percent), West Virginia (56 percent), Oklahoma (57 percent) and Kentucky and New Hampshire (58 percent).[14]

The total national underfunding was almost $700 billion in 2009. That is up from an estimate of $452 billion in unfunded liabilities in 2008.[15] For 2010, the shortfall continued to increase, to almost $800 billion. The data for 2011 is not yet available for all states.

The funding amount considered "acceptable" or "standard" for a pension plan is 80 percent of liabilities. In FY2008, according to the Pew Center on the States, 41 states met the standard; however, as of FY2009, only 31 did.

This drop is indicative of the negative impact the 2008 recession and stock market drops had on the pension plans. As the Boston College data show, by 2010 the overall national funding had fallen to only 77 percent.

Another aspect of DB pension funding is whether or not the state government is actually paying into the fund all of the projected required contributions needed to meet the promised retirement payments. Many states do not fully fund their pension system each year because of budget issues.

This is similar to an individual not fully funding their IRA. In the short term it is a way to balance your budget, but in the long run the penalty is significant.

The states with the worst funding record in 2009 include Pennsylvania (31 percent paid), New Jersey (36 percent), and Kentucky (58 percent).[16] Pennsylvania and New Jersey appear to have made short-term cuts in order to balance their state budgets, but Kentucky seems to be continuing a long-term pattern of under-funding. So not only is the Kentucky plan currently under-funded, they are not making up the actuarial shortfall.

Aggregate Funding for All PPD Plans (in billions)

Fiscal year	Plans	Market assets	Actuarial assets	Actuarial liabilities	Shortfall	Funded ratio
2009	126	$2,111	$2,611	$3,307	$696	79.0%
2010	126	$2,361	$2,659	$3,454	$795	77.0%

Source: Boston College Center for Retirement Research, Public Plans Database <http://pubplans.bc.edu/pls/htmldb/f?p=198:3:3870419981768520:::::> accessed on December 8, 2011

" The total national underfunding (of state employee pension plans) was almost $700 billion in 2009."

Pension Reform Options

The recent reforms made to government pension plans addressing the shortfalls include changes for both future and current employees.

The five broad types of changes include "keeping up with funding requirements; reducing benefits or increasing the retirement age; sharing the risk with employees; increasing employee contributions; and improving governance and investment oversight."[17]

According to the National Council of State Legislatures (NCSL), "Sixteen legislatures enacted increased employee contribution requirements in 2011 (compared with 11 states in 2010)." These changes included both current and new employees. In some cases, while employee contributions increased, employer or direct government contributions decreased.

"Fifteen legislatures increased age and service requirements for normal retirement." In most cases the age was moved closer to 65 and the years of employment increased. Thirteen states have increased the vesting period requirements, generally from five or six years to eight or ten, according to NCSL.

Between 2010 and 2011, fourteen Legislatures increased the "high salary" periods used for determining benefits, generally from 36 months to 60 months. Florida made the greatest change, going to a full eight years of salary consideration.

During the same period eighteen states changed their automatic Cost of Living Adjustment (COLA) provisions.[18]

Another reform option, which has been widely adopted by the private sector, is switching from a Defined Benefit to a Defined Contribution plan, or a combination of both.

The National Institute on Retirement Security issued a report in September 2011 stating that currently 10 states offer employees either a choice of Defined Benefit/Defined Contribution (DB/DC) or a Defined Contribution (DC) plan only.

Those states are Alaska, Colorado, Florida, Montana, North Dakota, Ohio, Oregon, South Carolina, Utah, and Washington.[19] According to their analysis, as of 2008, nationally there were 14.7 million current state and local government employees receiving DB pensions.

In 2008, over 84 percent of government workers with retirement plans had a DB plan, and two-thirds of workers had access to multiple options within those plans.[20]

The DB retirement system is "pre-funded" and is supposed to offer a "predictable" monthly benefit for the employee's entire life after retirement. The benefit is based on a percentage of income earned by the employee, and is based on a combination of factors

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including the income earned in the last three to five years of their employment, or their "high" three to five years of earnings, length of employment, and age at retirement.[21]

Many policy analysts argue that the increasing unionization of the government workforce has been a key factor in the continuation and growth of these benefit plans. The research done by Boston College seems to indicate that while unionization has an impact on increasing salaries, as this is a negotiated or bargained item, there is less impact on pensions – which are generally determined by state Legislatures.[22]

In either case, it is important to recognize that the contributions to these plans primarily come from state taxes paid by private-sector workers.

In some cases, but not all, government employees make contributions to their own DB plan, but the majority of the contributions come directly from government, via the taxpayers, in addition to the salary earned by the worker.

The most controversial changes to government-worker retirement plans in 2011 occurred in Ohio and Wisconsin, where new Governors proposed and made significant changes to the current systems. The Ohio changes were cancelled by a statewide vote, while in Wisconsin there is an attempt to recall the Governor as a result of pension reforms.

"It is important to recognize that the contributions to these plans primarily come from state taxes paid by private-sector workers."

Overall State Budget Issues

Of additional concern, nationwide, is the overall slow recovery of state revenue or tax collections – combined with the inability of many State Legislators and Governors to sufficiently cut spending. Coming out of the 2008 recession there are still significant gaps in many states between projected spending and revenue. These gaps directly affect state employee pensions, as the majority of state spending is for salaries and benefits.

The total budget gaps reported by the states between fiscal year 2009 and 2011 were approximately $230 billion. The problem continues, as according to data gathered by the National Governors Association (NGA) and National Association of State Budget Officers (NASBO), "39 states had to close $95 billion in gaps for fiscal 2012."[23]

Responses to the budget gaps vary widely from state to state. In fiscal year 2012 some states chose to delay or cancel state employee salary increases and some increased the pension and health insurance contributions – either personal, state, or both. Still others thought the overall budget situation was in good shape and chose to enact or allow scheduled compensation increases.[24]

The Stock Market: a Key Factor

DB pension plans operate on the presumption of both additional incoming funds and growth in currently held and invested funds.

If either funding stream is significantly reduced, the ability of the plan to pay promised benefits might be compromised. One major impact of the 2008 recession was the drop in the stock market. This affected state-controlled pension funds as well as individual private-sector IRAs. In FY 2009 the median drop of a state pension fund was 19.1 percent.[25]

Part of the discussion concerning DB pension funds is the anticipated return rate used to figure the growth in assets. Many states use 8 percent as their assumed average annual return. Historically, this was probably a good figure, as the median return from 1984 to 2009 was 9.3 percent. For the period 1990 to 2009 the median was 8.1 percent – lower but still beating the baseline.

However, from 2000 to 2009 or basically the last ten years the median return was only 3.9 percent.[26] The lower the return is – without a corresponding adjustment to the required pension pay outs – the larger the long-term liability and the more money the taxpayers are potentially expected to add to the funds.

Some experts have recommended using an expected return rate ranging from 5.22 percent, the private-sector standard, to 4.38 percent, the return rate on a 30-year Treasury bond.[27]

Using these figures, which may be more realistic going forward, will result in significant increases in the amount of unfunded liabilities. And correspondingly, significant increases in state budgets and state contributions to make up the difference.

Retiree Health-Care Benefit Issues

On the retiree health-care benefit side, many states – 19 in FY2009 – have zero funds set aside to fund these benefits. Another seven have only funded 25 percent of their liability.[28] With the continuing growth in health-care expenses, this will be a significant problem for these states and their taxpayers in the future.

Only two states, Arizona and Oregon, have over 50 percent of their health-care liabilities funded. Iowa is one of the states, according to the Pew data, which has not set aside funds to pay retiree health-care benefits. Instead, state government has been paying these expenses from current tax funds.

As of FY2009, the amount anticipated for health-care expenses of current and future government retirees in Iowa was just over $538 million, or over half a billion dollars.

Based on this expectation, the "required" annual

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contribution for Iowa retiree health-care costs in FY2009 was $56.8 million. This money should have been set aside in reserves, as the IPERS money is, to grow and be available to pay the health-care costs of retirees. In FY2009 only 42 percent of that amount ($56.8 million) was paid in.[29]

Retiree health-care costs are a significant liability to future taxpayers, especially as the employee population continues to age and the Baby Boomers retire with high expectations for medical treatment.

Most Iowa State government workers do not pay for their health-care insurance. We are one of only six states that pay 100 percent of health-care insurance costs for employees and their families. Approximately 84 percent of state government workers take advantage of this major benefit and pay nothing.[30]

According to the 12th annual Iowa "Employer Benefits Study," done by David P. Lind and Associates, the average amount paid by private-sector workers in Iowa for their family health-care plans is $346.66 per month, up from only $180 a decade ago.[31] The average amount paid by private-sector workers for an "individual only" plan is $70.

In contrast, those state government workers who are required to help pay for their individual insurance pay only $14 per month. This is $56 less per month than an average private-sector worker.[32]

State Government Payroll Changes

The NGA/NASBO report also provides a summary table of the number of filled full-time equivalent (FTE) positions in state government over the last few years. The total Iowa FTE increased by 1.6 percent from FY2010 to FY2011, then fell slightly in FY2012. Iowa now has a total of 41,790 FTEs, up from 41,572 in FY2010. In contrast, states such as Michigan and South Carolina reduced their state government FTEs from 12 to 16 percent during the same time period.[33]

As widely reported in November 2010, outgoing Governor Chet Culver (Democrat) acted to limit incoming Governor Terry Branstad's (Republican) personnel funding options by signing a two-year contract with the American Federation of State, County, and Municipal Employees (AFSCME) union immediately following his re-election defeat.

That contract required a 2 percent salary increase last July, and another 1 percent this January (2012).

In addition, according to the contract signed by Governor Culver, the FY2012 salary increases are followed by another 2 percent across-the-board increase in July 2012 – at the beginning of FY2013 – and another 1 percent increase in January 2013.[34]

The total amount of the increases is expected to be over

$200 million in permanent additions to the state budget, plus the corresponding increases in pension and health-care contributions.

These raises were higher than those enacted in all other states for fiscal 2012, except Hawaii, which allowed a 5 percent across-the-board pay increase.[35] Nationally, according to the Bureau of Labor Statistics, the average increase for state government workers was 1 percent.

So in November 2010 Governor Culver gave a Christmas present to state government workers that was three times bigger than that received by workers in other states. The speculation was that this lame duck action was a "thank you" gift to union workers for their support of Governor Culver in the election. Unfortunately, Iowa taxpayers will have to keep on funding this gift for a very long time.

The raises given to Iowa government workers were not only better than those given to government workers in virtually all other states, they were significantly better than the raises received by most private-sector employees, who generally received only a 1.6 percent raise in 2010 and 1.7 percent 2011.[36]

With this gift by the former Governor, the well-documented Iowa government/private-sector employee pay gap continues to widen. The most recent idiscussion of the Pay Gap in Iowa was in the March 2011 Public Interest Institute (PII) *Policy Study*, "Iowa's Privileged Class: State Government Employees."

Iowa's Current Pension System and Status

The Iowa Public Employees' Retirement System (IPERS) was originally set up in 1953 and is a traditional DB system. The amount an employee receives in retirement is based on "years of service, a multi-year average covered wage, and a multiplier."[37] IPERS covers a wide range of government employees, including those working for public schools, state agencies, counties (99), cities, and townships.

As of 2010, there were 165,660 active, working members and 93,700 retired members. At that time there were almost $21.5 billion in assets.[38] Of all workers in the state of Iowa, approximately 13.5 percent are covered by IPERS as government workers.[39]

Within the broad employer types there are 20 individual employment category codes used for IPERS purposes. The codes are broadly grouped into

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Categories of IPERS Employees

Employer	Percent
Education/Schools	51%
County Employees	16%
City Employees	15%
State Employees	15%
Other	3%

Source: Judy Akre, Director of Communications, IPERS via personal e-mail, December 2, 2011

Iowa's Privileged Class:

"While private-sector employees are limited in their IRA contributions by both actual contribution amount...and by adjusted gross income level – this is not the case for Iowa government employees."

three categories: Regular, Protection Occupations, and Sheriffs/Deputy Sheriffs. Ninety-five percent of IPERS members are in the "Regular" class.[40]

The required worker contributions, as well as state contributions, for each are different and range from 5.38 to 19.66 percent.[41] The average contribution by state government workers to the DB plan is 6.3 percent, similar to that required by Social Security until recently.[42]

The table below outlines current plan contributions.

The maximum wage covered by IPERS as of 2010 is $245,000.[43] A "Regular" category worker who makes $245,000 or more per year – of which there are many in Iowa's government – would have $13,181 withheld from their paychecks and deposited to IPERS.

That same worker would have another $19,771 contributed directly by Iowa state government, for a total of almost $33,000 per year added to IPERS. Some examples of these workers include the administrators and doctors of the state Regent schools and associated medical facilities, as well as some county/city and K-12 administrators.

As of 1999, the employee contribution is done "pre-tax" for both Federal and state taxes, with no cutoff limit.[44] While private-sector employees are limited in their IRA contributions by both actual contribution amount ($5,000 annually and $6,000 if over 50 years old) and by adjusted gross income level – this is not the case for Iowa government employees.

At this time the IPERS benefit for "Regular" class members is 65 percent of their highest salary. As we shall see, for some retirees this benefit is over $5,000 per month in retirement. For the Protection occupation and Sheriffs categories it is 72 percent.

Additionally, the Federal Social Security program also covers employees covered by IPERS. Contributions are made to this system by both the state government as the employer

Iowa Public Employees' Retirement System

Contribution rates from July 1, 2011 – June 30, 2012

Occupation Code	Member Share	Government Share	Total Contribution
Regular	5.38%	8.07%	13.45%
Protection Occupation	6.65%	9.97%	16.62%
Sheriffs and Deputy Sheriffs	9.83%	9.83%	19.66%

Source: Employer Handbook, Section 5: IPERS Plan Contributions, p. 44, <http://www.ipers.org/publications/employer/pdf/handbook/handbooksection5.pdf> accessed on November 17, 2011.

and the employee, as is done in the private sector.

An issue which resulted in some concern after former Governor Terry Branstad was re-elected Governor in 2010 is that of re-employment by those who have already retired and are drawing pensions.

After retiring, most Iowa government employees only have to wait four months before becoming eligible for re-hire. In the case of licensed health-care professionals, they only have to wait one month.[45] This double dipping is looked upon unfavorably by many taxpayers. Some of the Legislative changes to IPERS in 2010 were intended to stop the practice.

Taxpayer Liability

The IPERS Board, in consultation with various financial advisors, invests the pension funds – both from the employee and from state government. The goal is to make a large enough return on the funds – without losing money – to pay all future benefits.

Interestingly enough, in the "Facts" section of the IPERS Website, following the question, "Do I decide how to invest my contribution or worry if stocks go down?" the IPERS staff state in response, "IPERS makes all investment decisions and IPERS, not individual members, bears the investment risk."[46]

This is not a completely accurate statement of what actually happens. Because the pension benefit is guaranteed to the worker by union negotiation and Legislative action, the taxpayer actually bears the investment risk.

Even if the investments chosen by the IPERS staff and their investment advisors prove completely unsound and the money is lost – as much was during the 2008 recession – the government of the state of Iowa and the taxpayers who fund that government are required to pay the pension.

A negative aspect of the DB plan for workers is that the money held on their behalf may only be issued to them as a pension, disability, or death benefit. For example, personal contributions may not be withdrawn in a hardship situation such as serious illness or family catastrophe, and may not be used as collateral for loans.[47]

In contrast, funds held in other personal and private DC retirement plans such as IRAs, 401(k)s, 403(b)s, or the federal government's Thrift Savings Plan accounts may be accessed or borrowed against for a wide variety of reasons.

These include home purchases, education, or a general purpose. In the case of needing to borrow against a retirement account, the worker does not lose the opportunity for those funds to continue growing, as the interest paid on the loan is credited back to their individual account.[48] They in effect pay themselves.

Time for a Change!

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Iowa's Privileged Class:

"Interestingly, though the Legislatures of almost all states acted in 2011 to address their pension issues, the Iowa Legislature did virtually nothing."

Recent Pension System Changes

The Iowa pension funds are managed by the IPERS Board and considered in the custody of the State Treasurer. There are two additional, significantly smaller pension funds, the Judicial Retirement Fund and the Peace Officers' Retirement Fund which, are also in the custody of the State Treasurer.[49] There is also a Municipal Fire and Police Retirement System, also separately funded. This study is not addressing issues of those funds in depth, other than to say there are under-funding issues with them as well as IPERS.

Interestingly, though the Legislatures of almost all states acted in 2011 to address their pension issues, the Iowa Legislature did virtually nothing. The only legislation passed was a minor bill, HF484, which directs the IPERS and other pension boards to divest themselves of any investments in Iran and requires an annual report on this activity.[50]

The most recent changes made to IPERS were all done in the 2010 Legislative session, under former Governor Culver. These changes are currently in their first full year of implementation.

As reported by the National Council of State Legislatures, HF2518 increased contribution rates for both IPERS and the Peace Officers' Retirement System (PORS).

The PORS plan already called for a generous employer contribution of 27 percent of salary by FY2013 – the upcoming fiscal year. The employer's rate will now increase at 2 percent per year to 37 percent in FY2018. The 2010 change increases the employee contribution rate from 9.35 to 11.35 percent in FY2013. It also requires a "catch-up" contribution by state government of $5 million per year until it reaches a funding ratio of "at least" 85 percent.[51]

The current PORS funding ratio is 67 percent. Even with the catch-up funding of $5 million per year, the current estimates are that an 85 percent funding ratio will not be reached until 2031 – 20 years from now.[52]

The PORS fund has reflected typical investment returns over the last 10 years, averaging only 3.84 percent, though the goal is 8 percent. In addition to the changes made in 2010, it might be wise to revise the expected rate of return downward to reflect reality. In doing so, this will push meeting the 85 percent funding ratio out beyond the 2031 timeframe.

A police officer that is 50-54 years old, making an average salary of $81,400 and after retirement drawing a maximum pension of 88 percent can be expected to draw annual benefits of over $71,000.[53] Children who today are only five years old will be the taxpayers expected to support these current workers in their retirement.

For the regular IPERS participants, contributions were

already scheduled to increase on July 1, 2011 – the beginning of FY2012, the current fiscal year — to a total of 11.95 percent, 4.7 for employees and 7.25 for the government. The 2010 legislation increased the total contribution to 13.45 percent last July, and gave the IPERS board flexibility to increase or decrease the rate by 1 percent per year.[54]

Other changes passed in HF2518 and signed into law do not take effect until July 2012. These include increasing the years for vesting from four to seven, and the retirement age from 55 to 65. This only affects employees not vested by July 1, 2012.

The retirement benefit will now be figured based on a high-five salary, instead of a high-three, with a phased implementation for currently vested employees.

The penalty for early retirement was increased to 6 percent of each year the employee retires before age 65. The current penalty is only 3 percent, and is applied to the "normal" retirement age for an individual employee, which previously could be as early as 55.[55]

A final change to IPERS done in 2010 was the implementation of early retirement incentives, SF2062. This incentive program has now ended. Employees who were 55 years old or older, with 10 years of service, had until June 24, 2010 to take early retirement. The incentives included five years of health insurance and other financial benefits.

Specifically, "the incentive includes payment over five years of an amount consisting of the value of the employee's accrued but unused vacation leave plus $1,000 for each year of state employment service up to 25, paid at the rate of 20 percent of the total per year."

Employees were also prohibited from being re-hired in any way – temporary, part-time, by contract, or full-time – unless they return as elected officials. The agencies were prohibited from filling the vacated positions without specific authorization. This program was estimated to result in savings of $57.4 million in FY2011.[56]

The October 2011 report submitted by the Iowa Department of Administrative Services indicated that of 2,067 "retired" positions, 765 have been refilled and 1,302 remain vacant. Agencies participating in the program included the Central Payroll, Department of Transportation, and Community-Based Corrections.

The costs for the first annual years of service payouts and health insurance premiums for the three agencies totaled almost $31 million ($30,717,073).[57] The actual, versus projected, savings are not yet available.

The total number of IPERS eligible employees who retired in FY2011 was 7,360, according to Donna Mueller, CEO of IPERS.[58]

Retirees and their residual beneficiaries combined are

Time for a Change!

"Employees (who took the SF2062 early retirement) were also prohibited from being re-hired in any way – temporary, part-time, by contract, or full-time – unless they return as elected officials."

Iowa's Privileged Class:

"The data reported by the Boston College Public Plans Database for 2009 shows the IPERS funded at 81 percent. The actuarial assets are listed at $21.1 billion, with liabilities of $26 billion."

almost 100,000 at this time (98,312), up from 93,513 in FY2009.[59] "Active" membership or the number of employees paying into the system, for which the state government pays into the system, is declining, from 165,626 in FY2009 to 164,436 in FY2010. To some extent, this reflects the special retirement incentive of 2010.

IPERS Performance Issues

The data reported by the Boston College Public Plans Database for 2009 shows the IPERS funded at 81 percent. The actuarial assets are listed at $21.1 billion, with liabilities of $26 billion.[60]

The Cavanaugh Macdonald accounting and consulting firm of Nebraska does IPERS's annual investment and experience report. They have provided these services to IPERS for several years. The FY2011, or most current, report was issued on November 15, 2011. It revealed several interesting items.

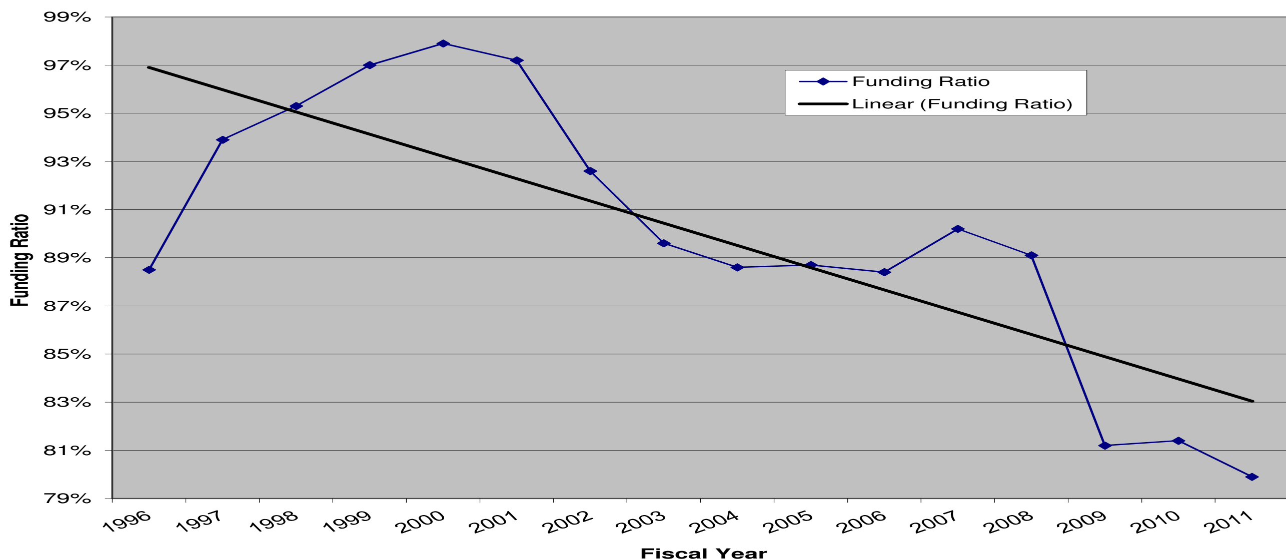
Most importantly, the total Unfunded Actuarial Liabilities (UAL) as of June 30, 2011, were $5,682 million. While significant, this is less than the $5,765 million expected.

The IPERS "Regular" employee commitments, which make up the vast majority of employees, are currently funded at 79.2 percent and make up $5,565 million of the unfunded liability.

The two "Special" categories dealing with law enforcement and others are funded at the 87.9 percent and 94.2 percent levels, representing $110 million in unfunded liabilities.[61]

When combined, the IPERS pension liability is funded at an overall rate of 79.9 percent, slightly less than the recommended 80 percent level.

The total actuarial liability as of FY2011 is $28.26 billion, with an actuarial value of the assets at $22.58 billion.[62]



The "actuarial" figures differ from the "cash value" figures, and are adjusted based on the various factors influencing real pension payments.

As the graph shows, the IPERS funding ratio has been on a fairly steep downward trend for the last ten years. This was especially impacted by the stock market losses of FY2008-2009.[63]

Total assets are valued at $22.8 billion, an increase of $3.2 billion from FY2010. Following the problematic market value returns (-16.3 percent) of the previous fiscal year, FY2010, the market-return rate jumped up to 19.91 percent for FY2011.[64]

The experience of the "Great Recession" has negatively impacted returns and retirement accounts of virtually all plans, DB and DC, as well as personal IRA, 401(k), or 403(b) plans.

"Smoothing," a process used by actuaries to balance the investment returns of long-term pension funds and adjust for wide market fluctuations, addresses some of the negative impacts and risks of the last few years, but not all.

The low returns of the past three, five, and ten years (-2.03 percent, 3.97 percent, and 3.98 percent) will continue to negatively impact the IPERS liability balances for the foreseeable future. This is especially true if

Time for a Change!

IPERS Fund Performance

Fiscal Year	Return
Target	7.5%
2008	-1.3%
2009	-16.3%
2010	13.8%
2011	N/A

Source: Iowa Public Employees' Retirement System, Center for Local and State Government Excellence, 2010

"Smoothed" IPERS Fund Performance

	FY2010	FY2009
1-year	13.82%	-16.27%
3-year average	-2.03%	-1.33%
5-year	3.97%	3.50%
10-year	3.98%	3.91%
15-year	7.94%	8.00%
20-year	8.22%	7.96%
30-year	10.15%	NA

Source: IPERS Investments, 2010

http://www.ipers.org/publications/misc/pdf/financial/cafr/cafrinvestments.pdf

"The low returns of the past three, five, and ten years (-2.03 percent, 3.97 percent, and 3.98 percent) will continue to negatively impact the IPERS liability balances for the foreseeable future."

Iowa's Privileged Class:

the long-term economic recovery remains stalled as it has in the last six months.

Though the Legislature increased the total contribution rate for IPERS to 14.45 percent beginning in FY2013, according to the projections by Cavanaugh Macdonald – based on historical market returns, previous employer/employee contributions, and current and projected benefit payouts – the total being contributed is still 0.32 percent short.[65]

Unless the Legislature acts again to either further increase the employee contributions, the employer contributions, or both, the projected shortfall in funding will have to be made up through increased investment returns. These returns are not controllable by the IPERS Board.

Another option is making reductions in pension payments, something which is controllable – by the Iowa Legislature.

IPERS Pension Payments

There are three legs to the IPERS stool – incoming contributions, whether by the state government directly or through payroll deductions, the investment returns, and finally, the amount of benefits paid out. The investment return leg is heavily influenced by factors outside management's control, as demonstrated from 2008 to 2011. The contribution levels and promised benefit payouts are directly controlled by the State Legislature.

In FY2011 the "Average Annual Benefit" of retired employees was $13,939, up from $13,139 the previous year. While $14,000, or about $1,150 per month, does not seem to be much to retire on, most retirees also receive Social Security payments and should have their own, privately invested assets.

However, the "average"

"The contribution levels and promised benefit payouts are directly controlled by the State Legislature."

IPERS Pensions of $5,000/month or more

Employer Type	Total	Percent
City	29	6.8%
County	28	6.6%
Schools	214	50.5%
State	114	26.9%
Community College	31	7.3%
Universities	4	0.9%
Utilities	2	0.5%
28E Agencies	1	0.2%
Other	1	0.2%
Total	**424**	**100.00%**

Source: IPERS FY2011 Monthly Benefit Payments Greater Than $2,000 Received from Judy Akre, Director of Communications, IPERS. December 2, 2011

does not present the full picture. There are a large number of retirees making significantly more than $1,150 per month in IPERS benefits. There are 21,140 retirees, or 21.5 percent of the total 98,312, who make more than $2,000 per month, or about two-thirds of the average annual income of a working Iowan.

Within that group, at the high payout end, there are 424 retirees who receive at least $5,000 per month, or over $60,000 per year in retirement. The total cost to the state and taxpayers for these 424 people is almost $25.4 million annually.

There are, in fact, 37 individuals who receive over $7,000 per month, or over $84,000 per year.[66]

Of those 424 individuals receiving $5,000 or more per month, over 50 percent worked for our local school districts.

The vast majority of these districts (248 of 359) have less than 1,000 students total K-12. Only eight districts have more than 9,000 students.[67] Yet 214 public education retirees are receiving $60,000 or more per year in retirement.

The education establishment continues to argue that the schools are not receiving enough tax funding; that salaries are not sufficient. Governor Branstad's proposed teacher pay structure reforms were dropped from his overall education reform proposal based on significant pushback from the teachers' union and educational establishment. Certainly the retirement salaries of at least some educators would seem to be more than sufficient.

Summary and Recommendations

I recognize that each of us is entitled to go out and earn as much as we can convince someone to pay us. Those 424 people were successful at convincing the Legislators, state-wide elected officials, City Council members, County Supervisors, School Board members, and most importantly, taxpayers, of the state of Iowa that their skills and abilities were worth a significant amount to their agencies while they were employed and being productive workers.

Government salaries are public record, and any interested taxpayer can see the amount that elected officials, whom they have elected to make decisions on their behalf in these matters, have agreed to pay the government workers. By re-electing the officials who made these decisions, taxpayers are in effect stating that they agree with the decisions.

Yet part of the stated reason many people go into "government work" is to serve the public and their fellow citizens. Expecting those same citizens and taxpayers to fund retirement payments of well over the average annual working income of most Iowans (around $38,000) is problematic. It is time for a change in the

Time for a Change!

"At the high payout end, there are 424 retirees who receive at least $5,000 per month, or over $60,000 per year in retirement. The total cost to the state and taxpayers for these 424 people is almost $25.4 million annually."

Iowa's Privileged Class:

"Resolving the long-term unfunded liabilities of the IPERS pension system is going to have to go beyond mere 'tweaking' around the edges."

government-funded privileged class.

When the FY2011 IPERS valuation report was released in early December, showing the unfunded liability amount of over $5.7 billion dollars, the question of reinstating caps on the top pension benefits and payouts was raised.

A *Des Moines Register* newspaper article quoted State Representative Mary Masher (Democrat – Iowa City), who is both a retired teacher, a leader in the Iowa State Teachers Association – the main teachers' union – and a nonvoting IPERS Board Member, as saying that "Iowa lawmakers were wise to eliminate the pension cap."[68]

Masher added that Iowa was losing good public employees to other states, and that it "becomes a competition thing." I respectfully disagree; it does not appear to have been wise. Representative Masher needs to seriously re-evaluate her conflicts of interest and work to ensure that she represents all Iowa taxpayers, and not just the teachers' union members and public school superintendents.

Otherwise she should resign from the IPERS Board – voting member or not.

Back in December 2008, State Auditor David Vaudt, a Certified Public Accountant – who is well-known for taking his role and responsibility as "The State's Watchdog" seriously, said in an interview with *The Des Moines Register's* government reporter David Yepsen, "I think every government is going to have to take a very hard look at [IPERS] because if you look at private industry defined benefit plans have gone away a great deal because of the commitments and you're not sure how you're going to fund those commitments.

"So, we have to take a look at going forward is the defined contribution plan a better way to go for Iowa? And is there a more affordable way but still allowing for our citizens to put money away?"[69]

As a result of concerns expressed by Vaudt and others, legislative changes were made to IPERS in 2010, as detailed earlier.

By 2011, over 40 states had made legislative changes to their government pension plans.[70] These changes mostly affect new employees and vary widely, from revising the benefit formula to increasing the retirement age and years of service. Some states are attempting to delay or prevent cost-of-living raises for current retirees. Yet others, including Iowa, have raised either or both the employee and employer contribution. Additionally, many of the actions by Legislators and Governors have centered on addressing union bargaining issues, and a wide variety of eligibility and benefit factors.[71] These changes do not go far enough.

Resolving the long-term unfunded liabilities of the IPERS pension system is going to have to go beyond mere "tweaking"

around the edges.

The Iowa Legislature needs to take a hard look at the pension benefit payout amounts and the retiree health-care liabilities.

Reinstating benefit caps is an important part – one that could, as we have seen, have significant long-term results.

Local officials also need to consider what salaries top government workers should be originally paid.

Revising the retirement benefit formula, extending vesting, addressing early retirement, and eligible age changes to current employees, not just new hires, is part of the solution.

The Iowa Legislature needs to take another look at IPERS in 2012 and seriously consider whether or not the burden of supporting the "privileged class" should be born by the "average" working taxpayers of the state.

We cannot keep kicking the can down the road and hope that a significant, long-term surge in the stock market and IPERS investment returns will restore full solvency.

It's time for a change.

Time for a Change!

"Reinstating benefit caps is an important part – one that could, as we have seen, have significant long-term results."

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