Evaluating Pension Reform Options with the Public Pension Simulator.

Covering 14 million state and local government employees, public pension plans typically provide lifetime retirement benefits based on years of service and the salary earned near the end of a career. These pensions provide meaningful retirement security to employees covered by a plan for a full career, but offer few benefits to shorter-term employees, a drawback that is becoming increasingly problematic as people change jobs more frequently.

Moreover, many of these plans face serious financial problems, with only a handful setting aside enough funds to cover promised benefits. Conservative estimates place the shortfall at about $1 trillion nationally, but the actual amount may be several times higher. The public contributions necessary to close the funding gap would strain many state and local governments, requiring higher taxes or cutbacks in other services.

Consider Pennsylvania.

Pennsylvania public school teachers qualify for a lifetime retirement pension tied to their salary and years of service once they've worked long enough and have reached the plan's retirement age.

Rules about how much teachers must contribute to the plan, when they can start collecting their pensions, and how large their annual pensions are depend on when a teacher was hired. Teachers hired after July 31, 2011, generally receive smaller pensions than those hired between July 31, 2001, and July 31, 2011.

Furthermore, although Pennsylvania's teacher pension plan is large—in 2015, it covered 260,000 employees and 242,000 retirees and their survivors and held assets worth $51.9 billion—its finances have been deteriorating steadily for nearly a decade.

In 2008, Pennsylvania's pension plan held enough assets to cover 85 percent of future pension obligations. After the Great Recession, that number fell to 70 percent. By 2015, only 61 percent of future pensions were covered, despite an improving economy. To cover these shortfalls, employers must now contribute 30 percent of payroll to the pension fund, creating significant financial burdens for local school districts.

To help legislatures ease these burdens while protecting teachers' retirement security, we used the Urban Institute's new Public Pension Simulator to estimate how potential reforms to Pennsylvania's teacher pension plan might affect employer costs and teacher benefits. Our report looks at various reform options, including eliminating early retirement benefits, raising the normal retirement age, changing the benefit formula, and eliminating cost-of-living adjustments (COLAs) provided to retirees. The results show that eliminating the early retirement option would significantly reduce costs while safeguarding pensions received by teachers with shorter careers.

Teacher Pensions

The current pension plan enables long-term teachers to receive nearly as much income when retired as when they were working. Shorter-term teachers, however, receive smaller pensions. Teachers who were hired at age 22 and who have worked for 35 years can expect pensions worth 12 times more over a lifetime than those with 20 years of service and 44 times more than those with 10 years of service.

Teachers hired at older ages can generally replace a larger share of their inflation-adjusted earnings in retirement than teachers with the same number of completed service years who were hired at younger ages because younger hires must wait years to collect their pension as inflation erodes its value.

Employer Costs

The costs of providing a pension are much lower for Pennsylvania teachers hired today than for teachers hired before 2011, reflecting the sharp benefit cuts passed by the state legislature that year.

How much employers pay for a teacher's pension varies depending on when a teacher joins the plan and how long he or she works. Costs escalate quickly with additional years of teaching.

Employer costs drop sharply, however, for teachers who teach for more than 35 years. Each additional year of teaching means one less year collecting a pension, because teachers cannot collect until they separate.

Employer pension costs for a teacher hired at age 22 range from 1 percent of career salary if she separates after 25 years of service to 31 percent if she separates after 35 years to 20 percent if she separates after 45 years.

The Plan Ahead

Results for Pennsylvania teachers highlight the dramatic disparities in pensions between short-term and long-term teachers and between those hired at relatively young ages and at relatively old ages.

Eliminating the early retirement option could significantly reduce large pensions now received by many long-term employees, while safeguarding the more meager pensions received by employees with shorter careers. These savings could be devoted to raising pension benefits for shorter-term employees.

Download the full report.

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