Public Pensions Are a Disaster. Here’s a Fair Solution.

Employees and governments need to share risks.

Connecticut is at the cutting edge of a crisis unfolding across the U.S.: States and municipalities have promised their employees some $4 trillion in pension benefits that they can’t afford to pay. Now the state needs to help lead the way out, by setting aside partisan politics and moving to a better system.

Thanks to decades of mismanagement by politicians from both parties, Connecticut has one of the largest pension funding deficits in the country, amounting to one fifth of its annual economic output. The burden crowds out investments in infrastructure and education, eroding the foundation for future growth.

So far, no one has offered a viable solution. Ripping up contracts would risk costly litigation. Requiring employees to make their own contributions, as in a 401(k) plan, won’t work: It could apply only to new workers, and — even if it could get existing workers to change their contracts — the state would have to borrow the money to cover what it owes them (at least $34 billion). Given that Connecticut already has the largest debt-service burden of any state, this is an irresponsible way forward.

Policy makers need to focus on reality. Legislatures made promises that they had no ability or intention to keep. Taxpayers are starting to vote with their feet, further undermining the state’s capacity to pay. The system needs a complete overhaul.

Fortunately, models exist. Consider New Brunswick, Canada, which moved to a shared-risk system in 2012. Instead of promising full, generous pensions, the government guarantees only a “base” level of benefits and pays added “ancillary” benefits if circumstances allow. Regular stress tests determine what the government can afford: If it falls short, it can increase required contributions or reduce benefits — within a narrow, agreed-upon band. If performance improves, the changes are reversed in an agreed-upon order.

To be sure, concessions must be made. Workers must agree to terms that are more in line with programs such as Social Security. This can entail, for example, calculating benefits using average career earnings (excluding overtime) rather than the last several years, capping payments at a reasonable amount and, in some cases, extending the retirement age. Politicians, for their part, must relinquish the power to make generous promises that require funding only after they’ve left office. Once the terms are set, professionals do the managing.

Such a system leaves everyone better off. Workers get a fair pension system with payments they can count on, rather than unrealistic promises. Government finances improve immediately: New Brunswick reduced its liabilities by 30 percent, allowing it to set a more realistic target for the return on its pension investments. Residents and businesses benefit from greater budgetary certainty.

Many ask: Why would unions agree to this? The answer is that they don't have a choice. Recent trends — such as the growing number of states with "right to work" laws and the recent Supreme Court decision outlawing mandatory fees — are highly unfavorable to them, so they would be wise to reach a deal before they are further disempowered. Connecticut's unions would do well to heed the example of Wisconsin, where risk-sharing has allowed the pension plan to remain 100 percent funded, with relatively low contribution rates and market-driven cost of living adjustments. No other major public pension plan in America can make those claims.

Connecticut can't put the issue off until 2027, when its current collective bargaining agreement expires. At this fall's election, voters must recognize the difference between realistic solutions and campaign slogans like "Tear up the contracts!" or "Convert everyone to a 401(k)!" The risk-sharing model works elsewhere and would be a game-changer for the state, improving its credit rating, delivering the budget certainty needed for economic recovery, and setting an example for the rest of the country.

Bloomberg Opinion

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August 2, 2018, 5:00 AM PDT

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