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These States Lead the Way on Pension Reform.

Arizona, Michigan and Texas are showing how to create resilient systems for government retirees.

State and municipal debt has tripled since 2000, with unfunded public pension liabilities mostly to blame. After 20 years of inadequate funding policies, failure to meet overly optimistic investment return targets, and other factors, state and local government pension systems are now $1.5 trillion in debt.

That debt is ultimately borne by taxpayers, and like any debt, when unfunded pension liabilities rise, so do the costs of servicing it. As pension debt payments start to siphon money away from other government priorities, such as education and infrastructure, some lawmakers are now pushing for much-needed reforms.

In Texas, the state Legislature passed a major pension reform that tackles the Employees Retirement System of Texas' nearly $15 billion in pension debt. The ERS serves more than 300,000 current and retired Texas government workers. But driven largely by rosy investment-return assumptions and a history of underfunding by the state, the system's unfunded liabilities have skyrocketed. The ERS's consulting actuary says the plan will be insolvent by 2061 even if it meets its lofty long-term investment return goals, and as early as 2047 if it doesn't.

The reform legislation commits Texas to paying the bill for retirement benefits promised to workers by shifting the ERS to actuarially based funding and a fixed payoff schedule. The new law also enters all future employees into a new low-risk "cash balance" retirement plan that provides a guaranteed minimum 4% return on investment along with the portability of a 401(k). In short, the reforms would enable Texas to keep the promises made to current and retired workers but would stop making unsustainable pension promises to workers in the future.

The pension reform bill will become law this weekend if Gov. Greg Abbott doesn't veto it, which he hasn't indicated he will do. Texas will then join a growing list of states—including Michigan, Arizona, Pennsylvania and Colorado—that have created or expanded retirement plans that reduce financial risks for governments and can help avoid burdening future taxpayers with more unfunded liabilities.

Arizona and Michigan have enacted more than a dozen substantive pension reform bills over the past five years. Credit-rating agencies and national retirement experts have cited Arizona's public-safety pension reforms. Moody's Investors Service gave Michigan's teacher retirement reform a "credit positive" review because the state and participating local governments "will no longer carry the entire burden of investment performance risk for new employee pensions."

Pension reform need not be partisan. After gaining input and buy-in from unions for police officers, firefighters and other public employees, New Mexico Gov. Michelle Lujan Grisham, a Democrat, overhauled her state's public-employee pension plan for workers who aren't teachers. "We must make changes now—the alternative is to saddle New Mexicans with unacceptable risk," Ms. Grisham said, urging fellow Democrats to pass reforms. In 2018, Colorado legislators bridged their differences in a divided government to pass comprehensive reforms that increased employee and employer contributions, reduced cost-of-living adjustments, raised the retirement age, and expanded the use of defined-contribution plans for future employees to address the chronic structural underfunding of the state's main public pension system.

Public pension reforms aren't politically easy. With Republicans in control of Florida's state government and the Florida Retirement System $36 billion in debt, the state Senate passed a bill that would have closed the state pension plan to new hires. But the bill died in the House because lawmakers couldn't agree on how to pay down the state's pension debt.

Meaningful pension reforms are difficult to accomplish but will be increasingly necessary as state and municipal pension debt service eats up larger chunks of government budgets. State and local leaders seeking to make lasting improvements to government finances should look to Texas, Arizona and Michigan. These states are showing that it's possible to create resilient retirement systems that can promote long-term financial security for taxpayers and public employees alike.

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