For decades, the enormous costs of providing public pension benefits to retiring baby boomers have been discernible but too-often deferred – in the United States and across the world. Yet other developed nations, from Canada to Sweden and the Netherlands to New Zealand, have done more than the U.S. to ensure that retirement promises will be kept. It’s too late for the U.S. to catch up, but other countries – and a few states – offer lessons worth following on setting the rules of public pensions, aligning the interests of the young and the old, and balancing the stakes of taxpayers and public employees.

To better balance assets and liabilities on pension funds requires setting sensible rules that discourage the temptation to paper over long term problems with expedient short-term fixes.

Politicians who write state and federal budgets too often think in terms of fiscal years, ignoring public pension obligations that will extend decades into the future, said Boyd,
an economist who’s closely followed pension choices made in many public plans in the U.S.

“You’re negotiating a budget the month before the end of the fiscal year for, let’s say, the next 12 months, maybe the next 24 months in some states,” he said. “Nothing that happens outside that window, almost nothing matters.”

Boyd recalled how New York legislators in the 1980’s approved a change in accounting that put future public pension payouts at risk but immediately saved the state $800 million – money it spent elsewhere.

“Whatever consequences it had for the future were valued at almost zero,” he said. “New York may be an extreme. There are certainly other states that are not as fiscally irresponsible, but many are.”

Politicians have a strong incentive to assume that public pension fund shortfalls one day will be erased by sky-high returns on investments. The notion spares them from shoring up deficits with current tax dollars. Result: The shortfall becomes someone else’s problem, in the distant future, growing larger with each passing year.

With baby boomers retiring, pension obligations will mean massive outflows. That means the distant future is not that distant anymore.

The arrangements between money managers and government are complex. It’s important to ensure those relationships protect the interests of retirees and taxpayers.

“…It’s nice to correct bad incentives when you can, but if you can’t, it’s nice to have rules that might counter those incentives, although devising effective rules is really, really hard,” Boyd said.

Discourage politicians from making financial calculations that drive pension fund investments – especially since their motives may be more guided by personal ambitions than by arithmetic.

A few years ago, the governor of Rhode Island, Gina Raimondo, persuaded state legislators to step back from meddling in public pension decisions that stir the support or ire of powerful public employee unions, Winkelmann said.

“…She went meeting to meeting to meeting to meeting and she said, you know, ‘Let’s just stop the politics. This is a math problem. How do we work out the math?’” Winkelmann said.

“And they listened, and she took a lot of political heat.”

In the end, the Rhode Island public pension system settled on hybrid system, melding a defined-benefit plan with a defined-contribution system.

Rhode Island, beset by a myriad of financial problems, today has a smaller unfunded public pension liability – as a share of the state's economy – than it had before the reforms.

“Yes, as an observer, my view is she was absolutely masterful in achieving a partial political solution to a huge problem,” Boyd said.

**PENSION SYSTEM DESIGN: KEY CONSIDERATIONS**

1.) Though solutions are vexing, the way to think about public pensions is no great mystery. How much gets set aside? How will the money be invested? What retirement promises have been made?

2.) The rules of how public pensions money gets invested are critical, but who makes decisions – politicians or independent overseers – can be crucial.

3.) Look across borders to see other models of public pension finance and oversight. The Canadians, the Swedes, New Zealanders and others have adopted tactics worth emulating.

4.) How can the United States – and state and local governments – responsibly act to ensure that public employee retirees get what they were promised without leaving younger workers and taxpayers considerably poorer in the process?

5.) Pension reform requires strong political leadership.

6.) Pension promises must be weighed against cases of extreme financial distress. What’s the plan when promises cannot be kept in full?

**Look for good ideas in pension design and management beyond U.S. borders.**

Be flexible enough in pension rules to change them when the reality no longer matches the assumptions, Lundbergh advised. In 2017, he headed a governmental pilot-study of the mandatory national premium pension, he told the story of how original rules in that country relied upon personal savings accounts – much like 401Ks – as a pillar of the social security system.

Trouble was, the national pension system set few restrictions on who managed the funds and where they were invested. “Some in the industry created funds that were not so good and they would basically do hard-calling [high-pressure phone sales] to individuals because everybody in Sweden was eligible to select funds,” Lundbergh said.

The result was a series of investment scams that blossomed into a national political scandal. Sweden soon imposed restrictions on sellers and pension managers. But it wasn’t an easy sell, he said, because some of the political parties had been sold on the idea of an infinite number of investment choices.

“I explained it to the politicians that it was like America in the Wild West – if you have a lot of outlaws, well, that will make it difficult for good fund managers and ordinary people to do good business,” Lundbergh said. “You need a sheriff to keep order so you can actually vet things coming onto the platform so people don’t get ripped off.”
That argument helped shift the political sentiment in Sweden to accept constraints on the 401(K) pillar of the social security system.

New Zealand offered another lesson in pension governance. That country, years ago, set up a fund putting a little extra money – more than needed to cover current pension obligations – into a retirement fund backup program, Mitchell noted.

This program, a version of the U.S. Social Security system, offers retirement benefits to every New Zealander over age 65. Fifteen or 20 years ago, the country’s minister of finance sounded an alarm – one day the cost of providing pensions would double – from 3.5 percent of gross domestic product to 7 percent annually.

A gradual rise in outlays would be followed by a surge, forced by the retirement of baby boomers. To cushion the future shock to the system, New Zealand leaders chose to raise taxes now to help pay future retirement benefits.

“The government set up a savings institution called the New Zealand Superannuation Fund, which would essentially take the extra taxes they were taking now, putting them aside to pay them out 20, 30, 40, 50 years into the future,” Mitchell said.

That approach, he said, was far less politically toxic than raising the retirement age or scaling back promised retirement benefits. It’s added benefit: Everyone chipped in, not leaving the burden to future generations of younger workers.

**Separate pension fund rules oversight from politics.**

In New Zealand, an independent nominating committee – not legislators or elected government executives – appoints pension fund trustees.

“There was agreement that they would have their political debates around system design but leave the New Zealand Superannuation Fund institution out of that,” Mitchell said.

“…That created a sense within that institution that they could genuinely focus on the long-term and not be worried about three-year political cycles.”

Leaders in Sweden and Canada took similar paths, panelists said.

“We don’t want to have pension as an election issue,” Lundbergh said, citing the Swedish experience.

“They had a big fight in the ’60’s which almost broke the Swedish political system because parliamentarians party affiliation did not predict how they thought about the pension solution,” he said. “The politicians basically said, ‘We don’t want to experience this again. Let’s take pensions off of the political agenda, the four-year election cycle, and strike an agreement.’ And if you want to change that agreement, the parliamentary group has to agree.”

**Confront the fact that future retirees face more risk than current retirees.**

Public pension funds face two distinct challenges: Living up to promises already made to workers and piling on the cost of future retirement payments to current workers in the distant future.

Pensioners on public plans today get what looks like a great compact – many times, workers sacrificed current pay in return for future pension benefits.

Should shortfalls in public pension funds persist, younger workers probably won’t get the same deals in years to come, panelists concluded.

“…The problem is if you’ve promised too much, if you have too generous a deal then you need heroic [investment] returns to make it happen,” Lundbergh said. When retirement funds fall short, “you’re going to be in deep trouble,” he said. “It’s not more complex than that.”
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