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New Ideas on Pensions: Use States

By MARY WILLIAMS WALSH

As growing numbers of baby boomers face retirement with inadequate savings, some state officials are considering a novel proposal to rebuild America's ailing retirement system — having state pension funds run retirement plans for companies.

Because more companies are ditching their own pension plans or not offering retirement benefits at all, the idea would be to give companies an easy way to offer a firm pension without having to run the plan themselves.

On Monday, the labor economist Teresa Ghilarducci, who developed the proposal, held a public forum at the New School for Social Research with New York City's comptroller, John Liu. The forum explored whether companies might want to start offering pensions through a pooled system run by the Bureau of Asset Management, a unit of the comptroller's office.

Mr. Liu said he was interested because New York City was in "the early stages of a burgeoning retirement crisis," where more than a third of all retirement-age households had nothing to rely on except Social Security.

He said that more elderly people were turning up in the city's homeless shelters and that a program to make it easy for employers to offer better retirement benefits might reduce future strain. Lawmakers in Connecticut and California have introduced bills to either study or create such a program and the Pennsylvania state Treasurer has expressed interest, although he has no power to introduce legislation himself. Mr. Liu said he had talked to lawmakers, but had no firm legislative plans.

At the heart of the proposal is something called a cash-balance pension, a hybrid that combines features of a 401(k) plan with those of a traditional pension plan. Workers can watch their benefits grow each year as an account balance, but the assets that secure the benefits are held in a pooled trust.

The structure could be attractive because it would be flexible — employers could reduce the rate of increase during recessions, saving money and reducing the chance of a runaway pension obligation. But the idea could be controversial, because the role of managing the money would fall to state pension systems, now under fire in many places for their handling of city and state workers' pensions. Republicans have tended to see the idea as one more manifestation of "big government."

Ms. Ghilarducci said that the survey research she commissioned showed that small business owners in particular wanted a better option. They feared taking on big legal liabilities if they ran their own retirement plans but expected to be hit with hidden fees if they gave the job to an outside vendor.

Ms. Ghilarducci said fees would be less of an issue with an existing state system and the fiduciary duty would be borne by the states, not the companies.

Not everybody sees it that way. The big public pension systems have been criticized in recent years for, among other things, underestimating the cost of providing conventional pensions and failing to anticipate market crashes that have left local taxpayers to bail out investment failures. Participating cities and taxpayers are rebelling in some places but have no legal way to drop out of state-run plans.

Giving new duties to California's giant state pension system, known as Calpers, would be "fraught with problems," said Daniel Pellissier, president of California Pension Reform. "They've been having trouble with the mission that they've been entrusted with. It would be silly to give them another job that would distract from protecting the retirees and the taxpayers."

Ms. Ghilarducci said that if a public system like Calpers adopted her idea, the money it managed for companies would be kept separate from the money for cities and other local governments. And the benefits for workers at companies would be more affordable than the pensions public workers get because of the cash-balance design.

She developed her proposal in part by studying countries like Sweden and Latvia, where the World Bank assisted with national pension reforms. There, she found, modified cash-balance pensions were used to help keep governments from promising more retirement income than their national economies could deliver.

Not long ago, cash-balance pensions were stirring an entirely different uproar in the American workplace, setting off unionization drives, Congressional hearings and class-action lawsuits.

Companies were setting them up almost exclusively to replace older, richer pension plans that they no longer wanted to operate. The older plans had rewarded loyalty by letting workers build up the biggest part of their benefit in the final years of their careers.

The switch to a cash-balance plan snatched away those lucrative years, just as many older workers were reaching them. People complained they had been cheated out of tens of thousands of dollars. Some filed lawsuits.

The most closely watched lawsuit was a class action at I.B.M. covering about 140,000 people. The workers, who argued that the pension switch constituted illegal age discrimination, won at the trial level, lost on appeal, and were denied a review by the Supreme Court in 2007.

For about seven years, while the I.B.M. employees' complaint was before the courts, other companies shied away from cash-balance pensions because of the legal uncertainty. The painful controversy prompted many companies to give up on pensions and offer 401(k) plans instead.

“I always thought that cash-balance pensions were really good, but if you started talking about them everybody got angina,” said Ms. Ghilarducci, director of the Schwartz Center for Economic Policy Analysis at the New School. Ms. Ghilarducci envisions using cash-balance pensions differently — not as a consolation prize for the loss of a better pension plan, but as a supplement for workers whose companies offer little or no retirement benefits at all.

For them, a cash-balance pension is not a cut — it is a significant improvement. A pooled plan offers financial efficiencies and lets workers give the job of investing their money to someone else.

The federal government's Pension Benefit Guaranty Corporation could guarantee the benefits, something it does not do for public pensions or 401(k) plans.

“All we really need is an orderly exit from single-employer pensions to another platform,” Ms. Ghilarducci said. “And that's either the states or the federal government, because those are the only entities designed to last in perpetuity.”

Ms. Ghilarducci floated her idea in Washington but found little interest. When she tried the states, she got a toehold, especially in states led by Democratic governors or legislatures.

In California, Senator Kevin de León, who represents Los Angeles, said he saw the cash-balance option as offering a lifeline to millions of private sector workers who had no retirement benefits at work, “without a cost to taxpayers.” Bills were introduced in both houses of the Legislature and a hearing is scheduled for next month.