Dear Clients and Advisors,

There has been so much inflammatory rhetoric surrounding Public Employee Pensions and incomes that it is hard to determine what is truth and what is fiction. We have all watched the ongoing drama in Wisconsin and seen it spill over to other states. Public employees are the new "fat cats" and have been accused of padding their incomes and benefits at the "expense" of taxpayers. The defense, on the other hand, has been vocal that these employees are paid a fair and equitable wage that is not much out of line with the "private" sector. Their benefits are the result of years of ongoing contract negotiation and development that had sought to rectify an imbalance between public and private benefit structures which for a long time favored the private sector. Sorting out what is "political" hype and "red meat" rhetoric for the partisans on either side has been next to impossible. So, it was surprising that I stumbled across the attached article published today in the McClatchy Newspapers. It presents the efforts of its staff reporters to find evidence that the pay and benefits of public employees is a major cause of the insolvency of local and state governments. What they found will surprise you. Please read the article and let me know what you think.

The land mine field is of my own making because I wanted to share my own perspective on this issue. The recession has been "officially" over for more than a year and yet most main street Americans would tell you that it still feels like a recession to them. People are still hurting and the unemployment rate, although down to 8.9%, is still very high and most would say that it feels as if it is still higher than 10%. Americans are normally of a sunny and optimistic nature, but I have seen that change over the past several years. We have become angry and are looking to blame someone for what has happened to the American Dream which now looks hopelessly beyond the reach of so many. There isn't enough wealth to go around – we look at everything as if it is a "zero sum" game. For someone to win someone else must lose. Government is to blame. We have come to believe that Government is not the solution but the very essence of the problem. And now Public Employees are the culprits in the collapse of our cities', states' and American economy.

What we sometimes forget is that Government is what provides clean air and drinking water, parks in which to recreate and appreciate the natural beauty of our land. It is why we can drive coast to coast on interstates in less than 4 days; it is why we can fly without crashing into another plane; it is why the poorest of us do not die of want in the richest country in the world.

What we also sometimes forget in all of this blame casting is that Public employees are our neighbors, our relatives, our friends. They are tax payers. They are the middle class which has seen its real income stagnate for 30 years (fact), and they are the ones out there educating our children, fighting fires, keeping us and our streets safe, helping us recover from disasters and keeping us healthy and free of catastrophic diseases. They are the ones who perform marriage ceremonies, repair the streets, pick up our garbage and clean our streets of snow and debris. They are us. There is no us vs. them. There is only an "us" getting more disillusioned and bitter as we are exposed to the negative media onslaught that fills our lives. This frightens me as both an American and as a wealth advisor. As an American, I fear that we will be unwilling to make the sacrifices necessary to reinvigorate our society. I fear that we will have made the American Dream one only for the very richest 1% of our fellow citizens. The rest will have to live with second best, if that. As a wealth advisor, I am concerned that we, through our elected representatives, will attempt to "balance" our federal, state and local budgets in such a way as to preclude real growth in the future. We will make short sighted decisions and cut where we should spend and spend where we should cut. We will insist on this, or, claiming that they speak for us, our representatives will, and it will be disastrous for our long term prosperity.

I only hope that we each can find it in our hearts to recognize that there is no potential enemy greater than the one staring out at us when we look in the mirror. We need to rein in the crazies who would pit us one against another and realize that just as in WWII a shared sacrifice made us a better people with a real future.

Why employee pensions aren't bankrupting states

Kevin G. Hall | McClatchy Newspapers
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WASHINGTON — From state legislatures to Congress to tea party rallies, a vocal backlash is rising against what are perceived as toogenerous retirement benefits for state and local government workers. However, that widespread perception doesn't match reality.

A close look at state and local pension plans across the nation, and a comparison of them to those in the private sector, reveals a more complicated story. However, the short answer is that there's simply no evidence that state pensions are the current burden to public finances that their critics claim.

Pension contributions from state and local employers aren't blowing up budgets. They amount to just 2.9 percent of state spending, on average, according to the National Association of State Retirement Administrators. The Center for Retirement Research at Boston College puts the figure a bit higher at 3.8 percent.

Though there's no direct comparison, state and local pension contributions approximate the burden shouldered by private companies. The nonpartisan Employee Benefit Research Institute estimates that retirement funding for private employers amounts to about 3.5 percent of employee compensation.

Nor are state and local government pension funds broke. They're underfunded, in large measure because — like the investments held in 401 (k) plans by American private-sector employees — they sunk along with the entire stock market during the Great Recession of 2007-2009. And like 401(k) plans, the investments made by public-sector pension plans are increasingly on firmer footing as the rising tide onWall Street lifts all boats.

Boston College researchers project that if the assets in state and local pension plans were frozen tomorrow and there was no more growth in investment returns, there'd still be enough money in most state plans to pay benefits for years to come.

"On average, with the assets on hand today, plans are able to pay annual benefits at their current level for another 13 years. This assumes, pessimistically, that plans make no future pension contributions and there is no growth in assets," said Jean-Pierre Aubry, a researcher specializing in state and local pensions for the nonpartisan Center for Retirement Research at Boston College.

In 2006, when the economy was humming before the financial crisis began, the value of assets in state and local pension funds covered promised benefits for a period of just over 19 years.

At the bottom of Aubry's list is Kentucky, which would have enough assets to cover 4.7 years. Other states do much better: North Carolina local government pensions are funded to cover 19 years of promised benefits; Florida's state plan could cover 17 years; and California's plans about 15 years.

"On the whole, the pension system isn't bankrupting every state in the country," Aubry said.

States having the biggest problems with pension obligations tend to be struggling with overall fiscal woes — New Jersey and Illinois in particular. Many states are now wrestling with underfunding because they didn't contribute enough during boom years.

Most state and local employees government across the nation have defined-benefit plans that promise employees either a percentage of their final salary during retirement or some fixed amount. The Bureau of Labor Statistics estimates that 91 percent of full-time state and local government workers have access to defined-benefit plans.

Several states_ including Florida, Georgia, Ohio, Colorado andWashington_ have adopted competing defined-contribution plans, or a hybrid plan that provides government employees both a partial defined benefit in retirement and a supplementary defined-contribution plan.

Defined-contribution 401(k) plans divert on a tax-deferred basis a portion of pay, generally partially matched by the employer, into an account that invests in stocks and bonds. In 1980, 84 percent of workers at medium and large companies in the U.S. had a defined-benefit plan like those still predominate in the public sector. By last year, just 30 percent of workers in these larger companies were covered under such plans.

Defenders of the public pension system say anti-government, anti-union elected officials and interest groups have exaggerated the problem to score political points, and that as the economy heals, public pension plans will gain value and prove critics wrong.

"There's a window that's closing as market conditions improve and interest rates rise, the funding of these plans is going to look better than depicted by some," insisted Keith Brainard, the director of research for the National Association of State Retirement Administrators in Georgetown, Texas.

Critics of public sector pensions paint the problem with a broad brush.

"Unionized government workers have tremendous leverage to negotiate their own wages and benefits. They funnel tens of millions of dollars to elect candidates who will sit across from them at the negotiating table," said Thomas Donohue, the chief executive of the U.S. Chamber of Commerce, in a Feb. 24 blog post. "This self-dealing has resulted in ever-increasing wage and benefit packages for unionized government workers that often far outstrip those for comparable private-sector workers."

In a Feb. 23 radio interview, Rep. Devin Nunes, R-Calif., called federal stimulus efforts to rescue the economy "essentially a federal bailout of public employee unions." Nunes described money owed to state pensioners as a crisis "about ready to happen."

Except that two out of every three public-sector workers aren't union members.

The Bureau of Labor Statistics reported in January that 31.1 percent of state public-sector workers were unionized in 2010, compared with 26.8 percent of federal government employees. The highest percentage of unionization, 43.3 percent, was found in local government, where police officers and firefighters work. Teachers can fall into either state systems or local government.

Ironically, inWisconsin, where Republican Gov. Scott Walker is trying to weaken public-sector unions and reduce pension benefits, he's exempted police and firefighters, who are among the most unionized public employees. AndWisconsin's public-sector pension plan still has enough assets today to cover more than 18 years of benefits.

The most recent Public Fund Survey by the National Association of State Retirement Administrators showed that, on average, state and local pensions were 78.9 percent funded, with about $688 billion in unfunded promises to pensioners. Critics suggest that the real number is at least $1 trillion or higher, using less-optimistic market assumptions.

The unfunded liabilities would be a problem if all state and local retirees went into retirement at once, but they won't. Nor will state governments go out of business and hand underfunded pension plans over to a federal regulator, as happens in the private sector. State and local governments are ongoing enterprises.

The flow of employees into retirement matches up with population trends in states, with Northeastern states with declining populations, particularly Rhode Island, seeing more stress on their pension systems than Southern andWestern states, where there's been vibrant population growth.

Another misperception tied to the pension debate is that while the private sector has shed jobs during the economic crisis, state and local government employment has grown — and pensions along with it.

Since September 2008_ when state and local government employees numbered 19,385,000 and the economic crisis turned severe — the governments' payrolls shrunk by 407,000, to 18,978,000 this January, according to Bureau of Labor Statistics data.

When calculating from December 2007_ the month that the National Bureau of Economic Research determined was the start of the Great Recession_ state and local government employment has fallen by 703,000 jobs amid a downturn that cost the nation more than 8 million jobs overall.

"The down economy has had an effect, and the loss of employment outside the public sector has created a contrast" said Brainard, of the National Association of State Retirement Administrators.

Also fueling backlash is the perception that state and local workers don't contribute to their own retirement funds the way private sector workers do.

Four states have non-contribution public pension plans_ Florida, Utah, Oregon and Connecticut.Missouri until recently had a noncontribution policy for state workers, as did Michigan until 1997.Michigan workers hired before 1997 still don't pay toward their pensions, and some teachers in Arkansas don't have to contribute toward theirs. Tennessee doesn't require contributions from most workers and employees in the state higher education system.

Those notable exceptions aside, most states require employee contributions. The midpoint for these contributions for all states and the District of Columbia is 5 percent of pay, according to academic and state-level research. That contribution rate climbs to 8 percent for the handful of states whose workers or teachers are prohibited from paying into the federal Social Security program.

By comparison, private-sector workers shoulder a bit more of the burden.

In its data for 2010, Fidelity Investments, the largest administrator of private-sector 401(k) retirement plans, showed employee contribution rates in its plans averaged 8.2 percent of pre-tax pay.

Separately, the Employee Benefits Research Institution estimates that most private-sector employers match up to 50 percent of employee contributions up to the first 6 percent of salary.

The utility or burden of either type of retirement plan depends on whether the plan is measured by what it delivers to an individual, or by how much it delivers to all workers receiving retirement benefits from their employer.

"It really comes down to what you are attempting to do," said Dallas Salisbury, the president of the nonpartisan Employee Benefit Research Institute.

Viewed through the lens of an employee, defined-benefit plans are more cost-effective at providing a pre-determined level of benefits to an employee. But the shortcoming of these plans is that they reward seniority. For workers with a shorter tenure, they're far less generous in retirement.

This fairness issue is one reason why 401(k) plans have grown steadily in prominence since the mid-1980s. From the payroll perspective of an employer, these defined-contribution plans produce at least some retirement income for the greatest number of employees, and the plans can move with employees who change jobs.