Wisconsin Retirement System Official Responds to Recent Report About Public and Private Pensions in Wisconsin
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“After nine months of study, the Wisconsin Policy Research Institute has issued a report that clearly shows that the pension benefits earned by public employees in Wisconsin provide an adequate level of income in retirement,” announced David Stella, Secretary of the Department of Employee Trust Funds.

The report entitled “The Imbalance Between Public and Private Pensions in Wisconsin,” notes that plans like the Wisconsin Retirement System (WRS) offer economic efficiencies over private sector defined contribution plans. The report also found that defined benefit plans, such as the WRS, earned consistently higher rates of investment return due to professional management of the plan’s assets and offered secure and predictable retirement income. In fact, the study showed, using a hypothetical example, that the retirement benefit of a public employee earning $48,000 per year and retiring with 25 years of service at age 65 almost exactly equals the recommended retirement income needed for an adequate retirement, whereas the retirement benefit of a hypothetical 65 year old private sector employee earning $70,000 per year falls far short of producing the recommended amount.

How should this imbalance between adequate and inadequate benefits be resolved? The solution, according to George Lightbourn, president of WPRI, is to radically reform the WRS by cutting the adequate benefits of public employees to bring them more in line with the private sector.

“The solution offered by the report badly misses the mark,” said Stella. “There is a retirement crisis looming in this country, but it’s not a crisis of having too much retirement income. When the report points out that only 51% of all private sector employees participated in a retirement plan of any kind and that less than half of all non-union private sector employees participated, the scope of the crisis becomes clear. That’s why it’s so disappointing to see the WPRI advocating for slashing benefits of the men and women who protect our communities, teach our children, and serve the public in so many different ways rather than offering solutions to make sure retirement security is achievable for all. We ought to be talking about improving retirement security of everyone in Wisconsin rather than reducing it for some.”

Stella also pointed out that the report completely ignored the fact that the WRS is a tremendous value to the state. “The WRS not only provides economic security for public employees and their families in Wisconsin, it benefits the whole state when its investments are made in Wisconsin companies and when its benefits are spent in Wisconsin communities, creating jobs and tax revenue for the state and local governments,” said Stella.

Overall, Stella noted, the WPRI has based its recommendations on a report that: compares only a slice of the compensation packages available in the public and private sectors; shows that the WRS is set up very much like private sector defined benefit plans; acknowledges that defined benefit plans offer large employers many economic efficiencies not available in the defined contribution setting; establishes that employer contributions to defined contribution plans
approach those of the WRS; ignores the positive economic value the WRS offers the state; and
demonstrates that the WRS produces a retirement benefit that in most situations is in keeping
with recommended national retirement income replacement standards.”

“In the end,” noted Stella, “the WPRI’s recommendations don’t appear to be supported by its
own study and they do nothing to ensure the retirement security of anyone in Wisconsin.”

Some further observations by Secretary Stella on the WPRI study:

Value to Wisconsin: The report fails to mention that approximately two-thirds of the more than
$3.5 billion in WRS pension benefits paid each year is derived from investment returns, not tax
funds. According to a recent report from the National Institute on Retirement Security, in 2006
alone, expenditures in Wisconsin from public pensions accounted for $4.5 billion in total
economic output, over 33,000 jobs that paid $1.7 billion in wages and salaries, and $732 million
in federal, state and local tax payments.

The State of Wisconsin Investment Board, which manages the investments of the WRS,
regularly invests in Wisconsin companies and companies with ties to Wisconsin. SWIB’s total
investments in companies with economic ties to the state were nearly $8.5 billion at the end of
fiscal year 2008. The Pew Center on the States recently gave Wisconsin high marks for the
financial solvency of the WRS, one of only 4 states to be so recognized.

WRS vs. Private Sector Contribution Rates: The report attempts to compare the contribution
cost of one benefit plan in the private sector, a 401(k) plan, with the contribution cost of a
defined benefit plan. The report points out that the average employer contribution rate for
private sector plans is 8.7% of payroll and is 5.3% of payroll in 401(k) plans. In the WRS, the
employer required contribution rate for most employees is 4.8%. The report points out that
Wisconsin public employers have elected to pay most of the employee contribution as well.
This decision is not a requirement of the WRS, but is made by employers as part of their
compensation setting procedures in which all wages and benefits are considered. It is also a
decision that seems consistent with the private sector. According to the report, of the 78
Northern Illinois and Wisconsin companies that offered a defined benefit plan, 96% were funded
solely by the company (p. 8). Nationally, only 3% of workers covered by such plans are required
to contribute (p. 12).

Although the report focuses on just a slice, albeit an important one, of the benefits and
compensation packages available to employees in the public and private sectors – a fact
acknowledged by the report’s author - the WPRI, without any assessment of the full relative
compensation packages, asserts that making public employees pay half of the contributions,
would be ‘fair.’

In many cases, it may make perfect sense for the employer to pay the employee share of the
WRS contribution rather than provide a comparable wage increase because WRS contributions,
unlike wages, are not subject to Medicare and Social Security taxes – additional costs borne by
both the employer and employee. In some cases it might make sense for the employee to pay
the contribution with post-tax income so that the benefits derived from those contributions are
tax-free in retirement.

The law leaves the decision of who pays the employee contribution to the people with the most
information about local conditions, recruitment and retention needs, and the entirety of the wage
and compensation package, information the report fails to consider.

Defined Benefit/Defined Contribution: The report describes the general features of and
differences between defined benefit plans and defined contribution plans. The WRS is a
defined benefit pension plan, not a defined contribution plan, like a 401(k), but has some defined contribution features. In trying to support the conclusion that there is an imbalance between private sector and public sector retirement plans in Wisconsin, the report spends a good deal of time showing how different the WRS is from private sector defined contribution plans. The author of the study readily admits that such comparisons are difficult and the study is not a comprehensive review of compensation and benefits. However, when the report actually looks at private sector defined benefit plans, the WRS matches up well.

The WRS covers 260,000 active employees around the state and a majority of those covered work for large employers. Large employers are able to take advantage of various economic efficiencies related to a defined benefit plan that aren’t present for defined contribution plans. The report itself points out (p. 6) that these efficiencies include the pooling of longevity risks of large numbers of individuals, enhanced investment returns that come from a balanced portfolio over a long period of time, and higher rates of return due to professional management. International benchmarking studies show that both the administrative and investment costs of the WRS are low compared to peer public retirement systems.

The WPRI report points out that according to a Bureau of Labor Statistics survey published in the fall of 2009, 22% of private sector workers nationally are in a defined benefit plan (p. 12). The report also notes that it is primarily large companies that offer defined benefit plans. As noted above, the report further finds that, according to a 1999/2000 survey, of the 78 Northern Illinois and Wisconsin companies that offered a defined benefit plan, 96% were funded solely by the company (p. 8). Nationally, only 3% of workers covered by such plans are required to contribute (p. 12). Finally, the report concludes (p. 10) that pension formulas used by private employers offering defined benefit plans are “dominated by final average pay formulas, similar to the WRS plan”.

As a practical matter, it would appear that the WRS is very much like its private sector counterparts, except for the fact that the WRS actually requires an employee contribution if the employer doesn’t agree to pay it.

The Future: The WRS is a complex benefit plan and the author of the report did a reasonable job of describing its basics. However, any differences over the factual details that we may have with the report don’t really change the bigger policy issue that the WPRI raises – retirement security.

It is important to acknowledge the foresight of those who established the WRS. The law clearly says that the purpose of the WRS is to aid public employees in protecting themselves and their families against the financial hardships of old age and disability. It does so by providing equitable benefit standards for all public employees and by providing for administrative cost efficiencies. The report does nothing to show the WRS has failed in its mission. For the 557,000 members of the WRS, and their families, who work and live in our communities and who contribute in meaningful ways to our society every day, the WRS represents a fair and reasonable benefit for a career of service.

Most importantly, the WRS is a sustainable benefit program. Due to its creative design, retirees, employees and employers all share in the investment risk of the WRS. When investment experience is good, retirees see their benefits go up, employers see their contributions go down, and employees see their benefit accounts increase. On the other hand, when investment experience is bad, retirees see their benefits go down (a fact not acknowledged in the report), employers see their contributions go up, and employees see their benefit accounts fall. Taxpayers don’t bear all of the risk. This is an unusual feature in the public pension world and it makes the WRS sustainable well into the future.