

Retiree benefits are cheating our children

By [Robert J. Samuelson](#)

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Except for those on Social Security and Medicare, government for most middle-class Americans consists mainly of schools, police, fire protection, roads and ambulance service. It's states and localities. How are they faring in the present economy? Conventional wisdom holds that they've been crushed by dramatic declines in tax revenues and have resorted to deep cuts in public services. Well, not exactly.

To be sure, there are cases of severe cuts. Newark recently [dismissed](#) 13 percent of its police force. For two straight years, the University of California has raised tuition sharply for its 220,000 students to help offset reductions in state aid: a [32 percent increase](#) adopted in 2009 and another [8 percent increase](#) this year. Hawaii [shortened](#) its 2009-10 school year by 17 days. But these and other similar cases, though real, exaggerate the situation.

Overall, national changes have been modest. In 2008, [state and local spending](#) totaled \$2.19 trillion. It was almost identical in 2009 and, in the first three quarters of 2010, is running at an [annual rate of \\$2.23 trillion](#). Employment tells the same story. [State government jobs peaked](#) in August 2008 at 5.2 million and dropped about 1 percent to a low of 5.15 million in mid-2009; at last count, they were 5.18 million. Somewhat larger losses for local governments - which employ most teachers, police and firefighters - are still mounting. Since a [high of 14.6 million](#), also in August 2008, their jobs have dropped 360,000 or 2.5 percent.

True, state and local governments were expanding before the recession. Spending typically rose about \$100 billion a year and employment, 100,000 to 200,000. Against those routine increases, the recent stability presents more of a contrast. Still, compared with many sectors that have suffered grievously from the slump - housing, automobiles, finance - state and local governments have been relatively sheltered.

One reason is President Obama's much-maligned "stimulus" packages. Since 2009, they have provided about \$158 billion to states, [estimates the Center on Budget and Policy Priorities](#), a liberal think tank and advocacy group. As these transfers dwindle, state tax revenues are reviving with the economy. Local governments may be less lucky. They rely on property taxes for about a third of their revenues, and because property appraisals are done every few years, "the decline in house prices implies that collections will probably fall in the coming years," concludes a new [Congressional Budget Office study](#).

All in all, the present squeeze on states and localities is overstated. The truly bad news lies in the future with massive retiree pension and health benefits that haven't been prefunded. How big are the shortfalls? All estimates are huge, though they vary depending on technical assumptions and coverage.

Consider. The Pew Center on the States [estimates](#) \$1 trillion of underfunding for the pensions and health benefits of states. Economists Robert Novy-Marx of the University of Rochester and Joshua Rauh of Northwestern University have higher totals for pensions alone; their [gaps](#) are

about \$3 trillion for states and almost \$600 billion for localities. Underfunded health benefits for states and localities together are reckoned by different studies between \$500 billion and \$1.5 trillion, [report](#) economists Robert Clark and Melinda Morrill of North Carolina State University.

Whatever the ultimate costs, they threaten future levels of public services. The generous benefits encourage workers to retire in their late 50s or early 60s after 25 years of service. The health benefits typically provide coverage until retirees qualify for Medicare at 65. To pay for unfunded benefits, government services must either be cut or taxes raised. How much is (again) unclear. Even low [estimates](#) by the Center for Retirement Research at Boston College indicate that annual pension payments for some states could roughly double. In Illinois, they could go from 4.5 percent of spending to 8.7 percent. Covering retiree health benefits would add to that.

So support for schools, police, roads and other state and local activities is undermined by careless - or corrupt - bargains between politicians and their public-worker unions. Promises of generous future retirement benefits were expedient contract sweeteners, with most costs conveniently deferred. Even when pension contributions were supposed to be made, they were often reduced or postponed when budgets were tight. If these arrangements look familiar, they should. The U.S. auto industry adopted the same model; the costs helped bankrupt General Motors and Chrysler.

What states and localities can do about this is limited. Pension promises to existing employees are probably legally inviolate. Retiree health benefits are apparently less so and should be reduced or eliminated to limit incentives for early retirement. Even if politicians manage this arduous feat, past decisions will burden the future. Along with an unwillingness to curb Social Security and Medicare costs, America's leaders have created another way to cheat their children.