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A Conspiracy against Public Pensions?

By Kerry Pechter *Thu, Oct 10, 2013*

Either paranoid or perceptive, public pension administrators say they are being sandbagged by a pervasive, persistent stealth effort to convert their DB plans to DC and gain greater control over their collectively immense assets. Maybe they're just observing business as usual.

The media have publicized lots of academic research over the past few years about the way public sector defined benefit pensions face a multi-trillion-dollar shortfall and will be millstones around the necks of taxpayers in states and municipalities across America.

But from the perspective of the folks running those pensions, the press has been a tool in a scare campaign conducted for the ultimate benefit of asset managers who'd like to wrest the management of the trillions of dollars *in* those plans from local governments.

The sense of siege among pension administrators found little public expression until two weeks ago when journalist David Sirota's white paper entitled "The Plot Against Pensions," was published by the Institute for America's Future and instantly publicized by reporter Matt Taibbi in *Rolling Stone* magazine.

Since then, of course, the D.C. Shutdown and the baseball playoffs have absorbed most of the nation's limited attention span. But we think it's worth dwelling on this question for another news cycle or two: Is there a plot against pensions? Or are they just paranoid?

Two accused conspirers—economists Andrew Biggs of the American Enterprise Institute and Josh McGee of the Laura and John Arnold Foundation—told *RIJ* they think public pensions are obsolete retirement vehicles but deny a conspiracy.

On the other side, Joe Gimenez, a spokesman for Texas pensions, and a pension official in another state who asked for anonymity, admitted that pensions have problems but told us they've been sandbagged—ambushed unfairly by opponents who are camouflaging their strength. And they felt vindicated by the *Rolling Stone* article.

"I loved it, and I'm guessing that other people like me were dancing all over the place," said the unnamed official. "It just punched them in the face. They were getting a free ride from the press. The [Sirota and Taibbi] articles had a few inaccuracies and wrong assumptions. But they may even the playing field a little."

Under siege

Gimenez is a spokesperson for TexPERS, the association for all of the public pensions in Texas. (Unlike, say, CalPERS, it doesn't manage pensions.) There's been a coordinated effort around the country to generate negative research about public pensions, to educate anti-labor state legislators in states with underfunded pensions like Kentucky, Rhode Island, Louisiana and California, with the goal of passing legislation that will convert a states' defined benefit public plans to defined contribution plans, he told *RIJ*.

"You're talking about basic politics," he said. "People use certain situations to push certain agendas. There's no doubt that that's what's happening here. TexPERS is on the alert and in constant communication with anybody who will listen to the politically-oriented threats to defined benefit plans in Texas."

The apparent broad push against the public pension concept despite the relative health of many plans makes him wary. "The pension systems in Texas are by and large close to or at full funding. What's happening in Rhode Island isn't a problem here. But some people are automatically saying the DB system is broken. They make a blanket statement for all pensions systems and say we have to change them all to DC plans. They're trying to create a top-down approach to pension reform. They say that without understanding the dynamics at the local level."

"It's a plot on the part of some people, and others are going along with it. If a plot can consist of a bunch of individual efforts, then absolutely it's a plot. It's a conspiracy of opportunism," said the state pension official who asked not to be identified.

"I think it crosses over into a conspiracy when they start manipulating public perceptions and facts in order to move that money over," the official added. "That's what has happened. It's easy to manipulate people. You get receptive audiences who are hurting. And the message is that moving [the public plans to defined contribution] will benefit you and lower your taxes. And that's not true."

TexPERS was so alarmed about the perceived stealth campaign that it published a document this year called "The Hostile Threat" to alert and mobilize its members, the various city and firefighter and policemen's unions around the Lone Star State, from humid Houston on the Gulf Coast to arid Amarillo in the west.

The document went so far as to name people and organizations it considered to be enemies: The Laura and John Arnold Foundation, the Texas Public Policy Foundation, the American Legislative Exchange Council (ALEC), the American Enterprise Institute, the Heritage Foundation, Charles and David Koch, and others.

"Many groups and individuals have put Defined Benefit plans for Texas public employees in their sights, erroneously claiming reform is needed and Defined Contribution plans are the only viable option," the document said in part. "Many are true ideologues and only consistent presentation of facts can prevail to counter their misguided assertions. TEXPERS has been monitoring these hostile threats to DB plans and engaging in various public forums as necessary to thwart their efforts. We will succeed!"

The alleged conspirators

Two people named in "The Hostile Threat" document were Biggs (below left) and McGee (below right), of the conservative American Enterprise Institute and the Laura and John Arnold Foundation, respectively. The foundation, headquartered in Houston, is based on the fortune amassed by billionaire John Arnold (pictured below, with wife Laura), who started a hedge fund with money accumulated as an Enron trader.

Biggs, a former deputy commissioner at the Social Security Administration and a well-known Washington academic, has written several research papers arguing that the risk-free rate of return is the only legitimate way to discount the guaranteed obligations of a defined benefit pension.

If they did use the risk-free rate—not the rosy 8% rate that many public pensions use—they'd see that they are deeply underfunded and putting future taxpayers in their states or communities on the hook for huge top-up contributions.

"If this is a conspiracy, it's not broad or deep. And I'm not in on it," Biggs told *RIJ* this week. "A conspiracy requires conspiring, and I have no contact with any of these folks [such as the Arnold Foundation and the Koch brothers]. If it's a conspiracy, where's the Trilateral Commission?

"[I and the public pension administrators] just have different views on measuring pension liabilities. My attitude toward pension plans is that they're exaggerating their funding health by understating their liabilities. If you're looking at me and the Pew Center on the States [which published an influential study critical of public pensions] and Josh McGee, there are some similarities in our views on pensions, but we all have different angles on it."

McGee, speaking for himself and the Arnold Foundation, also denied the conspirator label. "I'm a Democrat and have been one all my life," he told *RIJ*. "The founders of our foundation were Obama supporters. So it's a little strange to be pegged as right-wing. We have never coordinated with the Koch brothers or the American Enterprise Institute. I've not done anything behind anyone's back. We've tried to be open. We've held public meetings. We are a private foundation. I can't advocate. We must operate in a way that's non-partisan.

"I want all employees to have a safe retirement," he continued. "But we allow politicians to make promises that they don't pay for. We saw the same behavior in the public sector that we saw in corporations that have since moved away from defined benefit plans: the companies borrowed from the pension funds to help their bottom lines.

"The public sector is doing the same thing. The model invites bad behavior and underfunding. On the labor market side, it has an accrual structure that puts people on an insufficient savings path. It's a bad model. We need to improve both the funding and the labor market side. I'm not against providing workers with pensions. But it can't be the case where they underfund and do significant harm." McGee has proposed cash balance and hybrid DB/DC plans as well as DC.

Double standard

Public pension administrators claim that the defined benefit pension model is not obsolete or illegitimate. They admit that local officials have often chosen to skip their ARCs during good times (annual required contributions) and apply the funds to other purposes, but they say that doesn't invalidate public pensions.

The see something disingenuous in the fact that many groups are bent on eliminating all public pension funds, even the many that are successful. The see additional evidence of bad faith in the odd failure of critics to apply the same standard to defined contribution plans that they apply to DB plans.

Defined contribution plans are doing an even poorer job at financing an adequate retirement income than DB plans, they say. DC participants face a huge amount of sequence of returns risk when they retire. Most participant accounts are tiny and deeply underfunded. The federal government is patently worried that U.S. taxpayers will be on the hook if millions of baby boomers don't have enough DC savings to supplement Social Security. So why the obsession with the flaws of public plans?

"Public pensions have become a convenient but wholly undeserving scapegoat," said Hank Kim, director of the National Conference on Public Employee Retirement Systems, in a release after the Sirota and Taibbi articles came out in late September.

"Retirement security is not only an issue for public plans but also for private plans," Jimenez told *RIJ*. "If we are honest about the overall retirement income system in America, we have to acknowledge that we can't just look at this whole thing as a just a public employee issue. It's a broader issue. No matter where you're employed, it's a problem.

"We question that about [the protection of the] taxpayer. Fifty-two percent of the public employees in the U.S. don't pay into Social Security. That's from a GAO report. If you're the City of Houston and you're paying 18% of a public employee's salary to his or her pension fund, you're not paying the payroll tax for that individual. If they switch to a defined contribution plan, they will have to switch to Social Security. My point is that none of these groups take any of these considerations into account. They just want to slap on a top-down adjustment to how everybody else does it.”

Hidden agenda?

Members of the public pension community say they recognize that both public and corporate defined benefit pensions all over the world are converting to DC or experimenting with some sort of hybrid plan that balances risk between sponsors and participants.

But they see only one possible motive for what they perceive to be seemingly pervasive, persistent efforts–coordinated or not, but sharing an unnervingly similar dataset—to shift control of the funds out of the hands of elected officials and unions.

“The mutual fund companies would benefit tremendously from having 401(k)-style investment options mandated by the states for the trillions of dollars of investments across the country,” Gimenez said. “They are looking to grow their market share among people who are forced all of a sudden to DC plans. By moving from defined benefit to defined contribution they get a larger base on which to collect fees.”

That view was seconded by another public pension official.

“Whenever anybody in the private sector sees an opportunity to compete for more business, they go after it. That’s OK. But we give people who manage money a green light to make a fortune at the expense of the people they manage money for. They get the cultural adulation. People say, ‘They’re so smart, they deserve the money,” the official said.

“On the positive side, this private sector urge to compete is healthy. On the not-so positive side, they vilify a structure [public pensions] that has worked well for a segment of the population. The fact is that they would love to put us out of business and take the business away from us. The people who are really energized about this right now are the defined contribution industry. They see the public plan money as a golden egg,” the official added.

“I have very mixed emotions about that. If they truly ran the plans for the members’ benefit, that would be great. But they need to make money. That’s a fact of life. They way they run their plans is not for the individual’s benefit. The individual loses when everyone becomes an individual buying unit and there’s no group-buying power and no oversight. For the public plans to have reckoning is not a bad idea. But a total gutting doesn’t make sense.”

A neutral voice

In search of a neutral opinion on this issue, *RIJ* turned to someone who has worked in the nation's capital on retirement issues for many years and knows people of every political stripe. We asked him if there is a plot against pensions. He answered on condition of anonymity.

"As is often the case in Washington, the answer is both yes and no," he said. "Andrew Biggs is not an agenda guy. While it's easy to assume that John Arnold is a stalking horse for Wall Street, based on his background [as a trader at Enron], that's not his goal, directly or indirectly."

But, he continued, "there's a mindset among conservatives—a common mindset, but that's different from a conspiracy—that a DB pension is hard to sustain. They're not surprised that there hasn't been the appropriate level of responsible funding," he said.

"That mindset gets mixed up with the overall conservative agenda, with its distrust and dislike of public employee unions. There are people at conservative think tanks whose goal in life is to destroy unions. So anything that damages the strength of the public employee unions must be good."