

The Looming Crisis in State and Local Government Employee Compensation and Pensions

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Executive Summary

Alabama's state and local government workforce is imposing an enormous burden on taxpayers. First, policymakers should be concerned that Alabama's state and local governments employ 20.86 people for every 100 employed in the private sector—the 11th highest ratio in the country. If this ratio was brought down to the national average (17.67), state and local governments would save up to \$2.4 billion annually.

Second, Alabama's state and local government workers earn significantly more than the average private sector worker. In particular, benefits are 64.3 percent higher than the private sector, the 12th highest ratio in the country. If Alabama's compensation levels were lowered to the national average, another \$945 million could be saved each year.

Both the employment and compensation problems are significant contributing factors to Alabama's unfunded pension and retiree health care liability. According to official state estimates, Alabama's pension system in FY 2009 was underfunded by \$10.9 billion while the retiree health care system is underfunded by another \$15.3 billion.

As a result of these liabilities, the amount of money needed to pay for Alabama's pension and retiree health care system (called Other Post Employment Benefits, or OPEB) is larger than it would be otherwise. In fact, the required (not actual) FY 2009 state pension and retiree health care contribution combined (\$2.5 billion) would have consumed almost all of the state's individual income tax (\$2.7 billion).

Because contributions to Alabama's OPEB are lower than needed, one estimate suggests that the state's pension system is underfunded by \$47.8 billion—nearly five times official estimates—and will run out of assets by 2023.

If these obligations are to be met, the existing system must be reformed using five policy objectives:

- 1—Fix the Public Sector Over-Employment Problem
- 2—Transform the Defined Benefit System into a Defined Contribution System
- 3—Increase Retiree Contributions
- 4—Do Not Raise Taxes
- 5—Do Not Issue Pension Obligation Bonds