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Iceberg Ahead:
The Hidden Cost of Public-Sector Retiree Health Benefits in New York

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EXECUTIVE SUMMARY

New York taxpayers spend billions of dollars a year on health insurance coverage for retired state and local government employees, many of whom are too young to be eligible for Medicare. But the mounting "pay-as-you-go" bill for retiree healthcare is just the tip of a much larger iceberg.

Now, thanks to a new government accounting standard, the true cost of this long-term entitlement is finally emerging from the murky depths of state and local finances. Based on a review of financial reports for the state and its largest local governments, school districts and public authorities, this report estimates that New York's total unfunded liability for public-sector retiree health insurance comes to **$205 billion**.

This figure represents a mammoth potential transfer of wealth from future taxpayers to current government employees and retirees—for a type of benefit that is not available to the vast majority of private-sector workers.

The burden of retiree health care is clearly unsustainable and unaffordable. This report, designed as a primer on the issue for taxpayers and government officials, recommends a four-step plan for curbing retiree health care costs before it is too late.

About the Author

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ICEBERG AHEAD

The Hidden Cost of Public-Sector Retiree Health Benefits in New York

INTRODUCTION

New York taxpayers spend billions of dollars a year on health insurance coverage for retired state and local government employees, many of whom are too young to be eligible for Medicare.[1] Classified by accountants as Other Post-Employment Benefits, or OPEB, retiree health insurance is rarely offered by private sector employers—but it's among the fastest-growing components of public-sector employee compensation at every level of government. OPEB accounts for nearly 40 percent of annual employee health benefit costs at the state level, and for more than one-third of the annual total in New York City. Buffalo, the state's second largest city, already spends more every year on retiree health insurance than on coverage for active workers.

But the annual "pay-go" expense of health insurance for retired employees is just the tip of a very large iceberg. Under current laws and contracts, most of New York's 1.3 million state and local government employees can look forward to receiving taxpayer-subsidized health coverage for the rest of their lives. This amounts to a mammoth wealth transfer from future taxpayers to current employees.

Now, thanks to a new government accounting standard, the true cost of this long-term entitlement is finally emerging from the murky depths of state and local finances. The unfunded retiree health care liability for New York's 89 largest state and local government employers totals at least **$165 billion**, according to their most recent financial reports.[2] These estimates suggest the total unfunded liability for all of New York's state and local employers comes to **$205 billion**, as shown below.

Table 1. Summary of Unfunded Retiree Health Care Liabilities in New York State

	($000's)
New York State	60,218,545
New York City	61,978,363
Largest local governments other than New York City	
Counties	13,848,489
Cities	4,818,450
School Districts	6,512,084
Towns	2,822,861
Villages	685,080
Largest public authorities	14,396,964
Subtotal: Officially reported liabilities	**$165,280,836**
All other local governments and school districts (estimate)	39,720,688
	$205,001,524

Sources: UAALs for 2008 and 2009 as reported in annual financial reports, official statements and financial disclosure reports. New York State estimate for April 1, 2010. Estimates for "all others" are extrapolated from data in reports for largest employers, assuming OPEB liabilities of other employers are distributed in proportion to total medical benefits and personal service expenditures as reported to the Office of the State Comptroller, adjusted to reflect the percentage of employers in each category offering retiree health coverage.

In other words, New York's state and local governments have promised more than $205 billion in post-retirement health care coverage that they have set aside no money to pay for. Thanks to its relatively large government payrolls and generous benefits, New York represents an outsized chunk of a nationwide state and local unfunded OPEB liability estimated at between $1 trillion and $1.5 trillion.[3]

New York's largest cities and counties all have massive unfunded liabilities for retiree health care. New York City leads the pack with an unfunded liability of about $62 billion as of June 30, 2008, one of two largest liabilities reported by any state or local government in the country in the same period.[4] New York's state government OPEB liability, which stood at $60 billion as of April 1, 2010, is third largest among the nation's public employers. The state's 20 largest counties have combined OPEB liabilities exceeding $14 billion, and the Metropolitan Transportation Authority (MTA) has promised more than $13 billion in future retiree health benefits.

Potential for change

Unlike pension benefits—which pose a growing financial problem of their own—the OPEB promises of New York's public employers are not collectively pooled and partially pre-funded out of a few large multi-employer trust funds. Each of the literally thousands of local government units, special districts and public authorities in New York State is fully and solely responsible for its own retiree health care promises.

Because these liabilities are now beginning to count against government balance sheets, OPEB poses a more direct threat to their solvency than rising pension costs. The economic decline of upstate cities such as Buffalo will only accelerate if they continue to pile a growing OPEB burden onto their shrinking tax bases. Even in more affluent suburban areas, the rising cost of health insurance for retirees and their dependents threatens to consume more and more scarce resources needed to fund basic services.

Unfunded liabilities for retiree health coverage are starting to erode the balance sheets of state and local governments, undermining their fiscal solvency to an even greater degree than rising pension costs.

The good news for New York taxpayers is that public-sector retiree health benefits, unlike pensions, are not guaranteed by the state Constitution. Elected officials can still change course on retiree health care by restructuring benefits for both current retirees and active employees.

As reviewed in this report, a few elected officials around the state are trying to get a grip on the problem. Unfortunately, however, most are steaming full-speed ahead on a collision course with financial reality. It certainly doesn't help that current New York State law restricts the ability of public employers to sequester money in trust funds to pay for future retiree health costs. Efforts to curb retiree health care costs also are hindered by a recent state pension "reform" law that has locked an estimated $38 billion of long-term OPEB liabilities into school district collective bargaining agreements. Unions representing other types of local government employees have been lobbying for similar "protection."

In fact, the vast majority of New York taxpayers work for private firms that do not offer *any* retiree health coverage. Even compared with the shrinking number of private employers that still offer such a benefit, retiree health coverage in New York's public sector is significantly more generous; for retirees of New York City and an untallied number of local governments, retiree health care is free of charge.

Charting a new course

This report is intended as a guide to the OPEB funding issue for elected officials, the news media, and the general public in New York. The first section summarizes the current array of benefits available to the state's retired public employees. The second section explains how the new accounting rule works, and highlights estimated health care liabilities for the state and its largest public employers. The third and final section presents four steps to retiree health care reform, designed to fairly balance the interests of government workers and their ultimate employers—New York's heavily burdened taxpayers.

Those steps can be summarized as follows:

1. Preserve health benefits for employees who have already retired, but require them to pay a larger share of their own premiums.

2. Reserve the greatest benefit to those who have worked the longest.

3. Establish trust funds to cover adjusted OPEB liabilities, but calculate required contributions to these funds based on assumed returns from conservative, low-risk investment strategies.

4. Eliminate retiree health insurance coverage for all new hires and for employees who have been on the payroll for less than 10 years, and shift these workers into a retirement medical trust. Government workers would make tax-free contributions to accounts managed by their unions, which would pool and invest the money to cover medical expenses.

The state government's OPEB reform strategy can serve as a model for other levels of government, linked to other statutory changes establishing minimum health insurance premium contributions for all employees and prohibiting collective bargaining of retiree benefits.

As summed up by the legal boilerplate in many government financial statements: "These [OPEB] costs may be expected to rise substantially in the future." Governments need to act sooner rather than later to chart a new course for retiree benefits that will avoid potential fiscal shipwrecks in the future.

1. CURRENT RETIREE COVERAGE

Public-sector workers in New York are generally entitled to much more generous fringe benefits than their counterparts in the private sector. These include constitutionally guaranteed pensions, which provide a stream of post-retirement income to all employees who achieve a minimum vesting period.

In addition to pensions, the vast majority of state and local government employees in New York are eligible for other post-employment benefits (OPEB).[5] These benefits consist principally of employer-sponsored health insurance coverage—often including prescription drugs as well as hospitalization and major medical care. (Throughout this report, "OPEB" and "retiree health benefits" will be used interchangeably.)

Pensions are based on length of service, with the biggest benefits flowing to those who have worked the longest. However, as explained below, most of New York's state and local governments offer the same full employee health coverage to all vested retirees, regardless of years of service. Early retirees, who have not reached the Medicare eligibility age of 65, comprise a disproportionately large share of public-sector retiree health costs.

Like pensions, health coverage in retirement is a form of deferred compensation – earned now, paid later. Yet, for decades, the entire bill for current retiree health care promises in New York has been routinely shifted to future taxpayers.

State & local government benefits

While there is no comprehensive source of information on retirement health benefits offered by New York's 3,200 government employers, survey data and financial statements indicate most state and local workers belong to health plans sharing at least these elements:

- Members of a public-sector employee health insurance plan can remain in that plan if they are eligible to begin collecting a public pension and belong to a public employer health plan when they retire, after putting in a minimum of five to 15 years of government service.

- Health insurance premiums for retirees, including those for supplemental Medicare coverage, are heavily subsidized if not fully paid for by employers.

- Retiree health insurance is budgeted as a current expense and financed on a pay-as-you-go basis, usually combined with health insurance for active workers in the general budget category of employee benefits.

The leading source of retiree benefits for government workers in New York is the New York State Health Insurance Program (NYSHIP), administered by the state Department of Civil Service. NYSHIP consists of a broad indemnity program known as the Empire Plan, plus an array of managed-care options offered by HMOs on a regional basis. NYSHIP, the sole source of health insurance for state employees, is also open to local governments and public authorities.

NYSHIP provides benefits to over 1.2 million state and local government retirees and their dependents. Nearly one-third of NYSHIP's members are current or retired employees of state government agencies, including the State University of New York. The rest are current or retired employees of the more than 800 local governments and other participating agencies also offering Empire Plan benefits. (Another 2,400 entities—roughly two-thirds of the state's government employers--are covered by different plans whose costs and benefits have not been centrally tallied by the state.)

When NYSHIP was first created in 1957, the employer share of the premium was 50 percent for individual coverage and 35 percent for additional dependent coverage. The employer share grew over time; for employees hired prior to 1983, the state pays 100 percent of the premium for individual coverage. Since 1983, the employer share has been set at 90 percent for individual coverage and 75 percent of additional dependent coverage. The minimum employer contribution for local agencies participating in NYSHIP is still set at the original levels of 35 to 50 percent, but can go as high as 100 percent.

There is no central source of information on employee contribution rates at the local level, but many of the largest plans are similar to the state plan, which yields an average employer premium share of 83 percent for active workers. To remain eligible as a retiree for continuing subsidized health insurance on the same basis as an active employee, a state worker must have spent at least 10 years on the state payroll and must have reached the minimum retirement age, which is 55 for the vast majority of current employees other than police and corrections officers. (The minimum retirement age will be 62 for non-police and fire employees hired after Jan. 1, 2010.)

State employees can apply their unused sick time to offset health insurance premiums once they retire. This reduces the retiree share of premiums by 6%, on average.

State employees can apply the value of up to 200 unused sick days to further reduce their share of NYSHIP health insurance premiums once they retire. Since most civil servants are entitled to at least eight sick days a year, and since few need to use all those days, this generates significant additional savings for many retirees. The average sick leave credit claimed by fiscal 2007 state retirees amounted to $110 a month--enough to pay the full employee share of an individual premium in the Empire Plan, or fully half the employee share for family coverage. Sick leave credits offset six percent of the premium cost for retiree health insurance, leaving retirees to pay nine percent of the premium, according to the Department of Civil Service.

NYSHIP charges the same premium for all plan members, active and retired. This means that active workers subsidize premiums for retirees, whose health care costs are generally higher. In addition, as noted, retirees can to further defray their own contributions with sick leave benefits. If NYSHIP premiums for family coverage reflected claims experience, early retirees would be paying 45 percent more, and active employees would be paying 5 percent less.[6]

Big Apple benefits

New York State's largest public employer, the City of New York, sponsors its own self-insured employee health insurance coverage. Like NYSHIP, the New York City Health Benefits Program consists of both a comprehensive indemnity program and a variety of managed-care options. Prescription drug, dental, eye care and other benefits are provided by union-run "welfare funds" subsidized by the city. The city government is even more generous than the state--covering 100 percent of both individual and family premiums for basic coverage.

Eligibility guidelines for the city plans are similar to those on the state level: employees qualify for continuing health coverage if they are eligible for a pension and retire after at least 10 years on the city payroll (or 15 years in the case of newly hired teachers starting in 2009.) Employees hired before Dec. 28, 2001, can qualify for a lifetime of free health benefits after just five years of working more than 20 hours a week for the city.

Both the state and city health care plans have an important additional caveat: continuing coverage is available only to employees who are members or "vestees" of the health plans at the time of their retirement. In other words, former city or state workers who otherwise qualify for a public pension cannot receive health coverage if they retire from another place of employment. As will be noted later, this creates a significant incentive for former state and city workers who have already attained the minimum 5- or 10-year service period to get back on a government payroll before reaching the minimum government retirement age, as a way of qualifying for subsidized health benefits.

Medicare interaction

The federal Medicare program offers health insurance coverage to all Americans 65 or older. Under the original two-part Medicare program, Part A provides insurance that can help pay for inpatient hospital care, inpatient care in a skilled nursing facility, home health care, and hospice care. Part B covers medically necessary physicians' services, outpatient hospital services, home health services and a number of other medical services and supplies that are not covered by the hospital insurance part of Medicare. The Part D program, effective in 2006, covers prescription drugs.

Under both the New York State and New York City employee insurance plans, Medicare is treated as "primary" insurance for all retired employees aged 65 or older; in other words, the state and city will pay for no cost that is already covered by Medicare.

With Medicare in place as the primary payer for most over-65 government retirees in New York, why does health coverage for retired workers cost so much? The answers:

- Since Medicare Parts A and B include substantial co-pays and deductibles for hospital and physician care, along with limits on hospital and nursing home stays, those two parts of the program leave uncovered a substantial share of health care costs of the elderly. The New York State and New York City employee health insurance plans make up the difference, providing what amounts to supplemental "Medigap" coverage for their retired members.

- While Medicare Part A is financed through a payroll tax, roughly 25 percent of Medicare Part B costs are financed by premiums charged to beneficiaries. Both New York State and New York City, as well as many local employers, also cover the entire Part B premium for their retired workers. As of 2010, the premium was set at $110.50 a month.

- Most state and local government workers retire years before they are eligible for Medicare. As noted, members of the state and city pension systems can retire as young as 55. Police officers and firefighters can retire when still in their 40s after as few as 20 years of work. For this reason, retiree health care costs tend to be highest for cities and counties, which employ the highest concentration of public safety officers. Early retirees were barely one-third of all retirees in NYSHIP'S statewide Empire Plan but accounted for more than half of the Empire Plan's gross claims in 2005.[7]

The legal status of OPEB

Article V, Section 7 of New York's state constitution treats pension income as a contractual entitlement that cannot be "diminished or impaired." However, the state's highest court has ruled that this provision does not apply to retiree health insurance.[8] The legal status of retiree health benefits varies by employer, as determined in a series of other state court decisions over the past 30 years. This much is clear:

1. Under the state Taylor Law, employee health insurance is a mandatory subject of collective bargaining between government employers and public employee unions.[9]

2. Unions do not represent retired employees, but unions can bargain with government employers over the benefits that active employees will receive after they retire.

3. In cases where retiree health benefits have been stipulated in a union contract, they can only be changed through collective bargaining.

4. If retiree health benefits are not stipulated in a union contract, they can be restructured, reduced or eliminated by an employer unilaterally, without collective bargaining.

In many local jurisdictions across the state, retiree health benefits for public employees were granted by laws or resolutions but have *not* been enshrined in union contracts. In other cases, only a portion of the benefits can be considered contractual.

For example, New York's collective bargaining agreements with its largest state employee unions, the Civil Service Employees Association (CSEA) and Public Employee Federation (PEF), give employees covered by NYSHIP plans "the right to retain health insurance after retirement upon completion of ten years of service." The contracts also create the entitlement to "a sick leave credit to be used to defray any employee contribution toward the cost of the premium."

Crucially, however, these contracts do not stipulate that retirees are entitled to the *same* coverage under the *same* terms as active employees. Benefit levels for retired state workers, including premium shares and reimbursement for Medicare Part B premiums, are determined by a combination of state law, NYSHIP plan design, and other regulations. This means the governor and the Legislature retain considerable leeway to unilaterally reduce the state's massive OPEB liability by restructuring benefits. In fact, Governor Paterson has attempted do to just that (see "False Starts, Sidesteps and Baby Steps in Albany" on p. 20).

Public school retirees are an exception to this rule, however. Under a temporary law first enacted in 1994 and regularly extended thereafter, the governing boards of school districts outside New York City have been barred from making any change in retiree health benefits unless the same change is collectively bargained for active employees, regardless of whether those benefits were contractual to begin with. This restriction was made permanent as part of a pension "reform" law passed with Governor Paterson's support in late 2009.

The bottom line

Given the constitutional prohibition on diminishment or impairment of pensions, changes in pension benefits, such as the newly enacted "Tier 5" plan, have only applied to newly hired employees. As a result, these changes take many years to produce significant savings.

Retiree health coverage, unlike public pensions, can be reformed and restructured for current beneficiaries, subject to contractual constraints that vary by employer.

Unlike pensions, however, retiree health benefits for government employees can be restructured in ways that produce bigger savings sooner. This is especially true in situations where the benefits were established by local law or custom. Even in school districts and localities where retiree health benefits are contractually created, change is at least possible – if employers are sufficiently determined to make it a an issue at the bargaining table.

It's critically important for taxpayers and their elected representatives to understand the difference in both legal and financial status between pensions and retiree health benefits. As noted, while pensions are largely pre-funded, the prevailing method of funding and accounting for retiree health insurance means the cost of current compensation is being both obscured and shifted to future taxpayers.

Benefit comparisons

Health benefits for retirees are increasingly uncommon in the private sector. Only 28 percent of firms with more than 200 employees, and 3 percent of smaller firms, offered health benefits to any retirees as of 2010.[10] Even among larger firms offering such coverage, retired employees are asked to share more of the cost burden than their government counterparts. For example, only 8 percent of the largest employers replicate New York City's practice of insuring early retires completely free of charge, according to a recent survey. New York State covers an average of 91 percent of premiums for all retirees; in the private sector, by contrast, early retirees in large employer plans must pay an average of 51 percent of their medical costs.[11]

One of the reasons for the drop in retiree health coverage among private firms was the implementation in the early 1990s of an accounting rule requiring corporations to begin measuring the long-term liabilities associated with their OPEB costs. As those costs began hitting corporate balance sheets, many firms responded by reducing benefits or eliminating them altogether. (The private sector OPEB accounting rule was the inspiration for the similar standard adopted more recently in the public-sector, as explained in the next section.)

In some significant respects, state and local retiree health benefits in New York are more generous than those available to federal employees. For example, the federal government covers only 72 percent of the health insurance premium—and, notably, not Medicare Part B premiums—for its retired employees. On the other hand, federal employees can qualify for continuing health coverage if they retire after only five years, which is half the vesting period for New York State employees and city workers hired since 2001.

Most state and local government employees are entitled to a package of generous retirement benefits that their private sector counterparts can only dream of.

New York's state and local retiree health benefit packages also are more generous in key areas than those offered in many other states. Only five states, other than New York, reimburse the Medicare Part B premium for all retired employees.[12]

Combined with guaranteed pensions, health benefits give retired public employees a deferred compensation package that most of their private sector counterparts can only dream of. For example, a $60,000-a-year Tier 3 or 4 retirement system member (hired since 1976 but before 2010) who retires at age 55 after 30 years on the state government payroll is entitled to a $36,000-a-year pension – the equivalent of a job paying nearly $40,000, since pension income is exempt from both payroll taxes and state income tax. On top of that, she can retain NYSHIP health insurance currently priced at roughly $14,000 a year for family coverage, while contributing little or nothing to the premium. In 10 more years, when she becomes a Medicare enrollee at 65, her Part B premium will be fully reimbursed and the NYSHIP plan will cover the holes in Medicare.

Free or steeply discounted health insurance starting in early retirement is not a bad deal, to say the least. But it's also a very costly one for taxpayers.

2. GASPING AT GASB

State and local government finances typically command the public spotlight at budget-making time, when elected officials decide how to raise and spend the taxpayers' money. But government budget documents can be both superficial and misleading. They typically understate both the current costs and long-term obligations associated with employment compensation, in particular. A balanced budget does not mean a government is financially sound in the long run.

For a more comprehensives view of a government's financial condition, credit analysts and potential bond buyers turn to the information in annual financial reports and bond offering statements. Subject to uniform standards, these documents don't simply list annual revenues and expenditures. They also include balance sheets tallying up the value of assets (such as property, equipment, and accounts receivable) and liabilities (such as accounts payable and outstanding debt). Accompanying these tables are narrative "notes" providing essential additional background and explanation for the numbers. Because they also serve as disclosure documents, subject to federal anti-fraud statutes, they are held to a fairly high standard of accuracy.

The main elements of public sector financial reports are effectively mandated by an independent rule-making body, the Government Accounting Standards Board (GASB), which determines the Generally Accepted Accounting Principles (GAAP) used in financial statements by state and local governments.[13] A newly adopted GASB rule will force government officials to begin reckoning, for the first time ever, with the true costs of the promises they have been making to their workers.

What's in a liability?

Like most of their counterparts across the country, New York and its local governments pay for current retiree benefits out of their annual budgets, a practice also known as "pay-as-you-go," or simply "pay-go." They also typically lump health insurance premiums for both retirees and active employees into a single category of current expenditures. The cost of the retiree health insurance coverage promised to current workers has been ignored in part because the current cost has been obscured. Table 2 breaks out these costs for New York State and New York City.

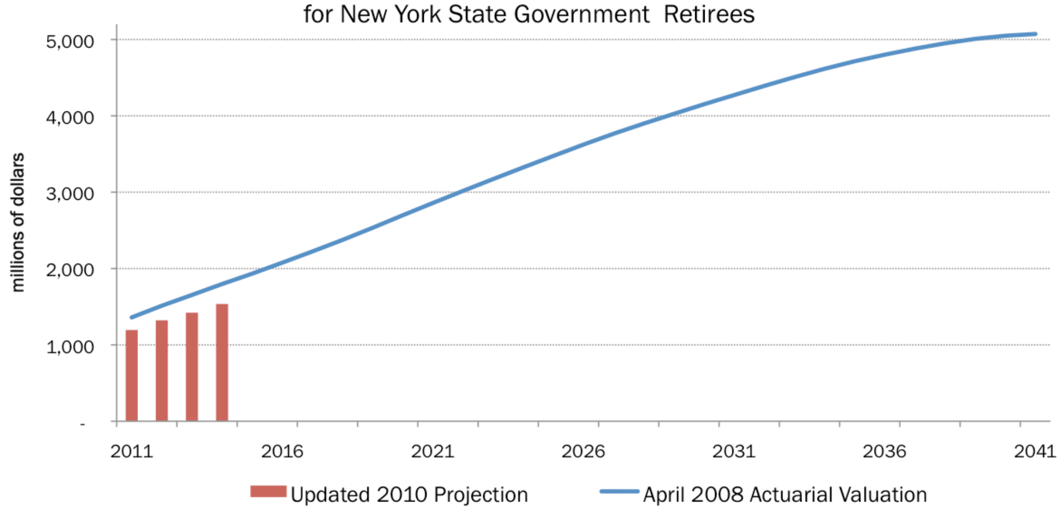
Table 2. Actual and Projected Annual Health-Related Benefit Costs
(in millions of dollars)

	New York State			New York City		
FY Ending	Active Employees	Retired Employees	Total	Active Employees	Retired Employees	Total
2006	1,331	885	2,216	2,400	1,200	3,600
2007	1,518	913	2,431	2,500	1,400	3,900
2008	1,390	1,182	2,572	2,800	1,500	4,300
2009	1,639	1,068	2,707	3,100	1,500	4,600
2010	1,542	1,139	2,681	3,400	1,700	5,100
2011	1,826	1,195	3,021	3,500	1,800	5,300
2012	1,992	1,322	3,314	3,600	2,000	5,600
2013	2,171	1,422	3,593	3,900	2,200	6,100
2014	2,119	1,536	3,655	4,300	2,300	6,600

Source: NYS Division of the Budget; NYC Comptroller; NYC Office of Management and Budget. July 2010 forecasts.

These annual outlays—a continual shift of past liabilities into the present—are steadily rising and are projected to continue rising in the future. Figure 1 illustrates the projected annual retiree health care cost trend for the state government.

Figure 1. The Shape of Things to Come?
Projected Annual "Pay-Go" Cost of Health Coverage for New York State Government Retirees



Source: Buck Consultants, New York State/SUNY GASB 45 Postemployment Healthcare Benefits, April 2008 Actuarial Valuation. Updated actual and projected outlays from state Division of the Budget.

As shown, the state's annual expenditure on health insurance for retirees is expected to nearly double (from $1.4 billion to $2.7 billion) by the end of this decade, and to triple by 2026. While the same detailed data are not readily available for other government employers, the slope of future payments is likely to be similar for entities with plans like the state's.

What's wrong with "pay-as-you-go"? An analysis by the Federal Reserve Bank of Boston put it this way:

> Because this accounting method provided no incentive to set aside current funds to meet the growing demands of these benefits, it quietly shifted the true burden of payment to future generations. This burden would rest not only with future employees, who might see reduced benefits, but also with communities, which could see services cut or taxes increased to cover growing benefit payments. Allowing tomorrow's citizens to pay for the retirement of today's workers is inconsistent with the … concept of inter-period, or inter-generational, equity.[14]

The long-standing method of funding OPEB benefits, like all financial arrangements that shift current costs into the future, can also be viewed a form of borrowing. Today's government employees earn a valuable benefit, while tomorrow's taxpayers are left to foot the bill. And until recently, there wasn't even an honest accounting of what that bill will be. This stands in stark contrast to the treatment of pensions, which are at least partially pre-funded through employer-sponsored trust funds.

When it came to obfuscating OPEB, private-sector companies used to be as guilty as most government employers. But this began to change in the early 1990s, when the Financial Accounting Standards Board (also known as FASB, the non-governmental counterpart to GASB) issued a rule requiring corporations to recognize their retiree health insurance promises as a long-term liability with real financial consequences.

FASB's Statement 106, issued in 1990, prompted many private employers to reduce benefits, to share more costs with employees, or to eliminate OPEB altogether rather than promise benefits they could not truly afford to fund as a long-term liability.

GASB followed the private-sector accounting precedent with the issuance in 2004 of a rule known as Statement 45, or GASB 45.[15] Like the FASB standard, GASB 45 is rooted in the idea that retiree benefits are a form of deferred compensation whose costs should be recorded when earned, not when paid. GASB 45 was phased in starting in fiscal 2007 for the largest governments (those with revenues above $100 million), and became fully effective in 2009 fiscal years for government entities of all sizes that produce GAAP-based financial statements.

The rule does not require states and local governments to immediately begin spending any more money. It does, however, require them to take these steps:

- Calculate the present value of future retirement benefits that have been promised to and earned by current employees and retirees. The resulting number is called the "actuarially accrued liability," or AAL.

- If any funds have been put aside to support the health plan's future benefit payment, deduct the value of any fund assets from the AAL to produce a second figure, the "unfunded actuarially approved liability," or UAAL. This must be reported in notes to government financial statements.

- Determine the "annual required contribution," or ARC, which combines the UAAL with the present value of health benefits earned during the past year, including the "pay-go" amount. Employers can spread (or "amortize) the UAAL amount over 30 years. Even with this adjustment, however, the ARC typically is three times as large as the existing annual payment for retiree health coverage. To the extent an employer fails to meet its ARC target, the shortfall is added to its total liabilities.

Again, GASB 45 does not actually require governments to make their "required" payments to begin paying off OPEB liabilities. However, as GASB's guide to the issue points out, "the more of its annual OPEB cost that a government chooses to defer, the higher will be (a) its unfunded actuarial accrued liability and (b) the cash flow demands on the government and its tax or rate payers in future years."[16]

Governments that ignore the issue will experience a rapid deterioration in their balance sheets, due to the compounded growth in the liability represented by their annual required contribution. Wall Street rating agencies have indicated that they will take OPEB funding into account in evaluating a government's creditworthiness for the public finance markets—which directly affects borrowing costs.

Table 3 on pages 16 and 17 presents a breakdown of the unfunded retiree health care liabilities for 89 of New York's largest public employers based on data gleaned from their most recent annual financial reports and disclosure statements.

First blush estimates

As shown Table 3 beginning on page 14, the unfunded retiree health care obligations in the financial reports for these 89 entities add up to more than $165 billion. Based on this sample, it can be estimated that OPEB obligations for all other public employers total nearly $39 billion, three-quarters of which could be attributed to school districts. That would bring the estimated unfunded OPEB liabilities for all levels of government in New York to $205 billion.

OPEB liabilities reflect the total value of retiree health insurance coverage that the state, its local governments and largest public authorities have promised to provide in the future to currently active and retired employees. The benefits in question have been "accrued," or earned, under current laws and collective bargaining agreements, but won't actually be collected for years or even decades to come.

These figures are enormous in any context. New York City's unfunded liability of nearly $62 billion is the second largest of any state or local government employer in the nation. It exceeds the city's own total bonded indebtedness as of 2008. New York State's unfunded liability of $60 billion, second only to California among state governments, is nearly equal to its $63 billion in outstanding debt. The total estimated liability of $205 billion for all public employers in New York equates to roughly three-quarters of New York's state and local government debt as of 2008.

The liabilities are also growing rapidly. Between the end of fiscal 2008 and the start of fiscal 2010, New York State's unfunded OPEB liability increased by $10 billion, or 20 percent. Between fiscal 2006 and fiscal 2008, New York City's OPEB liability increased by $9 billion, or 17 percent. OPEB liabilities will increase at a similar rate for all government entities in New York that fail to either rein in retiree health benefits or to begin setting aside more money to pre-fund them.

Comparing OPEB burdens

Table 3 also translates unfunded liabilities of counties and municipalities into per-capita values, to allow for comparisons among different jurisdictions and to underscore the exclusive responsibility of residents in each community for the liabilities incurred by the local governments to which they pay taxes.

In the case of large school districts, for which population data are not readily available, the relative OPEB burden is expressed as a percentage of property values; public authority liabilities are expressed as ratios of total payroll. Some key findings:

- With unfunded liabilities of roughly $3.5 billion and $4.2 billion respectively, Nassau and Suffolk have built up the largest OPEB burdens among counties in both absolute and per-capita terms. The next largest per-capita liabilities were reported by two much smaller counties—Rockland and Schenectady.

- Cheektowaga in Erie County, Clarkstown in Rockland County, and Greenburgh in Westchester County have the largest OPEB burdens among towns, while Babylon, Brookhaven, Greece, North Hempstead and Babylon are much lower.

Table 3. Unfunded Liabilities (UAAL) for Other Post-Employment Benefits

		UAAL $000	Population	Per-Capita
New York State		**$60,218,545**		
State government		50,086,013	**19,541,453**	**$3,082**
SUNY		10,132,533		
New York City		**$61,978,363**	**8,391,881**	**$7,343**
Most Populous Counties Outside New York City				
	Region	UAAL $000	Population	Per-Capita
Albany County	Capital	542,364	298,284	1,818
Broome County	Southern Tier	186,314	194,630	957
Chautauqua County	Western	42,776	133,503	320
Dutchess County	Mid-Hudson	267,000	293,562	875
Erie County	Western	736,192	909,247	810
Jefferson County	Northern	174,400	118,719	1,469
Monroe County	Western	488,670	733,703	666
Nassau County	Long Island	3,467,000	1,357,429	2,554
Niagara County	Western	226,839	214,557	1,057
Oneida County	Central	48,643	231,044	211
Onondaga County	Central	700,900	454,753	1,541
Orange County	Mid-Hudson	358,355	383,532	934
Oswego County	Central	23,599	121,377	194
Rensselaer County	Capital	117,500	155,541	755
Rockland County	Mid-Hudson	607,312	300,173	2,023
Saratoga County	Capital	62,429	220,069	284
Schenectady County	Capital	337,800	152,169	2,220
Suffolk County	Long Island	4,170,000	1,518,475	2,608
Ulster County	Mid-Hudson	114,095	181,440	629
Westchester County	Mid-Hudson	1,087,000	955,962	1,137
		$13,759,188	**8,928,169**	**$1,517**
Most Populous Cities Outside New York City				
	County	UAAL $000	Population	Per-Capita
Albany	Albany	251,935	93,836	2,685
Binghamton	Broome	130,998	44,401	2,950
Buffalo	Erie	1,227,967	270,240	4,544
Long Beach	Nassau	68,070	35,889	1,897
Mount Vernon	Westchester	70,940	68,878	1,030
New Rochelle	Westchester	184,670	74,323	2,485
Niagara Falls	Niagara	214,500	51,295	4,182
Rochester	Monroe	593,924	207,294	2,865
Rome	Oneida	47,506	33,443	1,421
Schenectady	Schenectady	The city has not yet complied with GASB 45.		
Syracuse	Onondaga	853,766	138,560	6,162
Troy	Rensselaer	168,906	47,556	3,552
Utica	Oneida	68,609	58,040	1,182
White Plains	Westchester	260,660	57,442	4,538
Yonkers	Westchester	676,000	201,162	3,360
		$4,818,450	**1,382,359**	**$ 3,486**
Most Populous Towns				
	County	UAAL $000	Population	Per-Capita
Amherst	Erie	133,824	115,535	1,158
Babylon	Suffolk	119,684	221,044	541
Brookhaven	Suffolk	256,700	490,416	523
Cheektowaga	Erie	128,888	87,496	1,473
Clarkstown	Rockland	133,900	82,777	1,618
Colonie	Albany	74,036	81,518	908
Greece	Monroe	46,381	93,405	497
Greenburgh	Westchester	116,092	90,276	1,286
Hempstead	Nassau	810,403	764,982	1,059
Huntington	Suffolk	188,943	202,197	934
Islip	Suffolk	159,642	337,565	473

Continued on next page

Most Populous Towns (continued)

	County	UAAL $000	Population	Per-Capita
North Hempstead	Nassau	117,768	227,058	519
Oyster Bay	Nassau	314,470	302,564	1,039
Ramapo	Rockland	88,230	115,885	761
Smithtown	Suffolk	133,900	121,817	1,099
		$2,822,861	**3,219,000**	**3,486**

Selected Large Villages

	County	UAAL $000	Population	Per-Capita
Garden City	Nassau	59,118	22,500	2,627
Harrison*	Westchester	129,112	26,746	4,827
Hempstead	Nassau	130,268	53,971	2,414
Lynbrook	Nassau	33,715	19,883	1,696
Mineola	Nassau	33,900	19,120	1,773
Ossining	Westchester	43,100	23,945	1,800
Port Chester	Westchester	50,050	28,243	1,772
Rockville Centre	Nassau	61,640	24,473	2,519
Scarsdale	Westchester	59,960	17,755	3,377
Spring Valley	Rockland	47,247	23,810	1,984
Valley Stream	Nassau	36,970	36,311	1,018
		$685,080	**296,757**	**$2,309**

School Districts

	County	UAAL $000	% of Property Value
Albany City	Albany	298,388	5.8%
Brentwood	Suffolk	345,347	4.8%
Buffalo City	Erie	1,206,245	19.7%
East Ramapo	Rockland	294,702	3.0%
Great Neck	Nassau	86,181	0.5%
Greece	Monroe	27,099	0.7%
Half Hollow Hills	Suffolk	214,386	1.6%
Haverstraw-Stony Point	Rockland	246,241	4.2%
Longwood	Suffolk	236,596	3.2%
Middle Country	Suffolk	279,694	3.7%
Mount Vernon	Westchester	128,868	2.0%
New Rochelle	Westchester	70,814	0.6%
Newburgh	Orange	336,266	5.7%
Rochester	Monroe	360,956	6.3%
Sachem	Suffolk	322,000	2.7%
Smithtown	Suffolk	185,575	1.8%
Syracuse	Onondaga	698,100	17.2%
White Plains	Westchester	145,126	1.4%
William Floyd	Suffolk	123,100	2.6%
Yonkers	Westchester	906,400	4.2%
		$6,512,084	**3.7%**

Largest State Public Authorities

	UAAL $000	Covered Payroll	% of Payroll
Bridge Authority	41,329	10,788	383%
Dormitory Authority	156,647	48,319	324%
Metropolitan Transportation Authority	13,165,000	4,212,000	313%
Thruway Authority	981,684	167,067	588%
Urban Development Corp.	52,304	34,100	153%
	$14,396,964	**4,472,274**	**322%**

Subtotal: Major public employers	**$165,280,836**
All others (estimated)	**$39,720,688**
GRAND TOTAL	**$205,001,524**

Sources: UAALs for 2008 and 2009 as reported in annual financial reports, official statements and financial disclosure reports. New York State estimate for April 1, 2010. Estimates for "all others" are extrapolated from data in reports for largest employers, assuming OPEB liabilities of other employers are distributed in proportion to total medical benefits and personal service expenditures as reported to the Office of the State Comptroller, adjusted to reflect the percentage of employers in each category offering retiree health coverage.
* Harrison is a combined town and village

- The Westchester County town and village of Harrison far exceeds the per-capita norm for all municipalities, with unfunded OPEB liability that translates into $4,827 for each of its 26,000 residents.

- The Buffalo school district's OPEB liability is almost 20 percent of property value, more than five times the average for large districts. At the other end of the spectrum, the OPEB liabilities of the Greece, Great Neck and New Rochelle school districts equate to less than one percent of property value.

- The MTA's $13.2 billion unfunded liability is the third largest among all New York public employers, exceeded only by the long-term OPEB number of the state government and New York City. Expressed as a ratio of payroll, however, the Thruway Authority's liability is half again as large as the MTA's.

Differences in relative OPEB burdens within the same class of government may be explained, in part, by the actuarial assumptions and methods used to produce their liability estimates,[17] and in part by differences in the size and composition of their payrolls. Nassau and Suffolk, for example, employ large county police forces, whose members retire early with generous health benefits; this also explains why the OPEB values for most large Long Island towns, cities and villages are relatively low, since these municipalities do not need extensive police forces of their own (although some employ their own police nonetheless).

Long liability tails

New Yorkers live in multiple jurisdictions and are responsible for a share of the unfunded OPEB cost of every level of government to which they pay taxes. To provide a fuller picture of the OPEB burden on residents of New York's largest cities, Table 4 presents combined unfunded liabilities for overlapping municipal governments and school districts.

Table 4. Combined Municipal and School OPEB Liabilities for Selected Cities*

	$000				
	Municipal	School	Combined	Population	Per-capita
Albany	251,935	298,388	550,323	93,836	5,865
Binghamton	130,998	144,834	275,832	44,401	6,212
Buffalo	1,227,967	1,206,245	2,434,212	270,240	9,008
Mount Vernon	70,940	128,868	199,808	68,878	2,901
New Rochelle	184,670	70,814	255,484	74,323	3,437
New York City			61,978,363	8,391,881	7,386
Niagara Falls	214,500	262,309	476,808	51,295	9,295
Rochester	593,924	360,956	954,880	207,294	4,606
Syracuse	853,766	698,100	1,551,866	138,560	11,200
Utica	68,609	182,262	250,872	58,040	4,322
White Plains	260,660	145,126	405,786	57,442	7,064
Yonkers	676,000	906,400	1,582,400	201,162	7,866
			$70,916,633	**9,657,352**	**$7,343**

* List represents most populous cities that overlap with city school districts, excluding Schenectady, whose municipal government is in non-conformance with GASB 45. New York City reports a single OPEB liability for all municipal and school operations. A very small portion of the Binghamton School District is in a neighboring town.

Syracuse leads all New York cities with a combined-municipal OPEB liability $11,200 per capita, based on a total unfunded liability of nearly $1.6 billion for the municipal government and school district combined. Buffalo's unfunded OPEB liability of $2.4 billion was the largest in absolute terms for cities other than New York City.

Buffalo's municipal government also has reached a fateful tipping point: as of fiscal 2010-11, it is spending more on health coverage for retirees ($35 million) than for active employees ($30 million).[18] The nearby city and school district of Niagara Falls, which has experienced many of the same fiscal and economic problems on a smaller scale, has an even larger per-capita OBEP burden than Buffalo.

Syracuse, Buffalo, Niagara Falls and other fiscal struggling upstate cities are facing the same kind of retiree legacy cost that became a crippling financial drag on General Motors before its bankruptcy and takeover by the federal government last year.

False Starts, Sidesteps and Baby Steps in Albany

New York's enormous OPEB iceberg was first spotted by state officials at least as far back as 1995, when newly elected Governor George Pataki's first contract with the Civil Service Employees Association (CSEA) added these two sentences to a provision entitling union members to retiree health coverage:

> "However, in recognition of the forthcoming changes to the Government Accounting Standards Board (GASB) requirements, both the State and CSEA recognize the need to address the inequity of providing employees who serve the minimum amount of time necessary for health insurance in retirement with the same benefits as career employees. Prior to the expiration of this contract CSEA and the State shall, through the Joint Committee process, develop a proposal to modify the manner in which employer contributions to retiree premiums are calculated."[a]

No such proposal was developed, however, and the passage did not reappear in post-1999 CSEA contracts. The state's recent contracts with its second largest union, the Public Employees Federation (PEF), have featured similar language committing the parties to "develop a proposal to modify the manner in which employer contributions to retiree premiums are calculated in order to recognize and underscore the value of the services rendered to the State by its long-term employees."[b] While no proposal has been developed for PEF members, either, the passage remained in the union contract due to expire March 31, 2011.

Consistent with the goals of the PEF language, Governor David Paterson's 2009-10 Executive Budget would have created a sliding scale of retiree health insurance coverage, reserving full coverage only for those with 30 years or more of active service.[c] The tax-funded state share of the premium would have been reduced to 50 percent for individual coverage and 35 percent for dependent coverage for employees retiring after 10 years of service, increasing by two percent a year for each additional year. The proposal sank without a trace in subsequent budget negotiations with the Legislature, even though Paterson had estimated it would have saved $8 million in 2009-10 and $17 million in 2010-11—figures that undoubtedly would have increased in subsequent years. Despite the continuing fiscal crisis, the governor did not revive the proposal in his 2010-11 budget.

A December 2009 law[d] creating a new "tier" of pension benefits for state and local employees also made permanent a temporary measure, dating back to 1994, that prohibited school districts from making any change in retiree health coverage that was not first negotiated with unions representing active employees. Earlier in 2009, Paterson had become the third consecutive governor to veto a union-backed measure extending the same "protection" to other types of employees at every level of government. To placate its supporters, however, he formed a temporary Task Force on Retiree Health Insurance, which reported in 2010 that it could not reach a consensus on whether to support legislation that would limit the ability of employers to alter retiree benefits. This effectively punted the issue to the next governor.[e]

Paterson and the Legislature did take one very small step towards curbing another element of retiree health insurance: the Medicare Part B premium for retirees over age 65, which New York is one of only six state governments in the nation to reimburse. Under the 2010-11 state budget, Medicare Part B premium costs will be "blended" into the entire rate base for NYSHIP's Empire Plan and HMO coverage, effectively requiring active and retired employees to cover the same 10-25 percent share of Medicare premiums. The change will save the state $30 million a year, or about 2.3 percent of projected retiree health care outlays for 2011-12.

a. See, for example, Section 9.20 of CSEA Administrative Services Unit contract for 1995-99, posted at http://www.goer.state.ny.us/Labor_Relations/Contracts/1995to1999/cseaasu/02art09.html.
b. Article 9.13(b) of 2007-11 PEF Contract at http://www.goer.state.ny.us/Labor_Relations/Contracts/Current/pefpst/index.cfm.
c. 2009-10 Public Protection and General Government Article VII Memorandum posted at http://www.budget.state.ny.us/pubs/0910_budgetPublicationsAll.html.
d. Chapter 504 of the Laws of 2009.
e. http://www.ny.gov/governor/reports/pdf/HealthCareRetiree.html

3. STEPS TO REFORM

GASB 45 doesn't just force public employers to disclose the true cost of their long-term retiree health care promises; it also creates an avenue for catching up with these unfunded liabilities.

Nearly all of the New York state and local governments affected by GASB 45 have chosen to calculate and report how much they would need to pay, with interest, to fully fund their OPEB liability over a 30-year period. The resulting number, known as the annual required contribution, or ARC, typically is much higher than the current pay-as-you go amount. For example, New York State's ARC of $3.3 billion is fully three times its current annual expenditure on retiree health care.

As explained in Section 2, payment of the ARC is not actually "required." However, the difference between the ARC and the annual pay-go expenditure must now be counted as a "net liability" on the employer's balance sheet. Thus, for example, in the two years since GASB 45 took effect, the state of New York has amassed $8 billion of unfunded liabilities for OPEB due to its failure to pay the full ARC. The longer the state fails to pay the ARC, the larger those liabilities will grow. At this rate, within 10 years, the state's total liabilities will exceed its total assets, a condition accountants call "balance sheet insolvency."

Thanks largely to its unfunded OPEB liability, New York City is technically "balance sheet insolvent." Investors apparently assume these retiree benefits will not actually be paid.

New York City has already arrived at that point. Unlike other major state and local governments with unfunded retiree health care liabilities, it did not amortize its liability over 30 years for accounting purposes. Instead, even before GASB 45 took effect in 2008, the city booked the *entire* OPEB liability all at once. The result: as of fiscal 2008, New York had negative net assets of $97 billion.[19] The city is still financially liquid; it has a broad and deep tax base, and its cash flow will cover its bills for the foreseeable future. But the fact remains that the amount the city owes to retirees and to more traditional creditors in the long term is at least $97 billion more than the value of everything it owns—including land, buildings, equipment and infrastructure.

A private corporation in a similar situation would be viewed as financially troubled, to say the least. New York City, however, has a relatively high credit rating and strong markets for its bonds. Investors must assume that the municipal OPEB obligation is not really binding in the same sense as general obligation debt.

If that's the case, someone needs to break the news to municipal labor unions, whose members *do* assume they will receive lifetime health coverage if they retire from the city payroll. Other public employees around the state no doubt assume the same thing. Meanwhile, as these employees continue to accrue benefits, the cost is being shifted to future generations. This is why it is essential for elected officials to begin confronting the full financial implications of their retiree health care promises.

To fund or not to fund?

GASB does not recommend any particular policy approach to dealing with OPEB, but Statement 45 nudges governments toward emulating the long-established method of financing public pensions: create off-budget trust funds and invest in a diverse portfolio of financial assets, including corporate stocks. Under this scenario, governments would be allowed to assume that compounded investment returns can help cover the rising cost of future benefits.

As of 2009, however, only 18 states had set aside any assets to pay OPEB liability, according to a U.S. Governmental Accountability Office (GAO) study.[20] A separate report by the Pew Center for the States found that only six states were on track to have fully funded OPEB obligations during the next 30 years, and only three (Wisconsin, Arizona and Alaska) had pre-funded more than 50 percent of the retiree health care liability. At least two states, Ohio and Vermont, were pre-funding a portion of their OPEB liability through sub-accounts in their existing pension funds. [21]

New York's annual required contribution for catching up to its unfunded retiree health care liability is the largest of any state's.

Most states and local governments, like New York, are still financing retiree health coverage strictly on a pay-as-you basis. As of 2008, according to the Pew report, most of the nation's OPEB obligation was concentrated in the northeast, among New York and its neighboring states. The same report said New York's annual required contribution for retiree health care was the largest of any state—although, as noted, New York City has an even larger total OPEB liability than any state but California.

There are two problems with the OPEB trust fund approach. First, according to State Comptroller Thomas DiNapoli, New York State law does not explicitly authorize the kind of trust funds encouraged by GASB 45. DiNapoli has sought to remedy this by proposing legislation that would allow localities the option of creating their own trust funds in the comptroller's custody.[22] Notwithstanding the state comptroller's legal opinion, New York City created its own Retiree Health Benefits Trust (RHBT) in 2006. Over the next two years, the City contributed $2.5 billion in surplus funds to the RHBT, which had grown to over $3 billion by 2009. Money deposited in the trust cannot be spent on any purpose other than retiree health care. However, since the city's annual pay-go bill is so large—$1.8 billion as of fiscal 2011—this has not prevented Mayor Michael Bloomberg from planning to withdraw $1.1 billion from the RHBT over a three-year period to help balance the city's operating budget, which will have the effect or raising future OPEB liabilities.[23]

The larger problem with the trust fund approach is that it would replicate a serious flaw in GASB's own public pension accounting rules. The flaw involves the interest "discount rate" used to calculate the present value of future obligations. This is a crucial determinant of a system's necessary funding levels: the higher the rate, the lower the contributions required to maintain "fully funded" status.

Private pension plans must discount their liabilities based on a market rate—typically, a AA-rated corporate bond rate—which is often much lower than the plans' targeted rate of return on investments. Public funds, however, are allowed under GASB standards to discount their long-term liabilities based on the target rate—which, for most public funds, is pegged at an optimistic 8 percent or higher. In other words, the risk premium in the investment target is compounded in the liability estimate. By discounting liabilities based on optimistic rate-of-return assumptions, pension funds have substantially under-estimated the money they will need to pay out to beneficiaries over the next several decades, a growing number of independent financial and actuarial analysts believe.[24]

The initial estimate of New York State's unfunded OPEB liability was based on a discount rate of 4.155 percent, but a qualified OPEB trust fund would be permitted under GASB guidelines to discount its future liabilities based on a higher assumed investment return rate, now set at 7.5 percent for the state pension fund. As if by magic, this would make nearly half the liability disappear; for example, the comptroller's office estimated in 2008 that committing to pre-fund retiree health care over 30 years would have reduced the initial estimate of the state government's OPEB liability from $50 billion to $28 billion.[25] The ARC would also be reduced significantly.

GASB rules for retiree health care trusts would replicate a flaw in the accounting standards for public pension funds, allowing governments to recalculate obligations based on assumed returns from risky investments.

"The benefit that comes from putting money in a trust is that it starts to earn interest and, over time, that interest becomes another funding source for the benefits, replacing some of the contribution that would otherwise come from taxpayers," the Pew study said. However, even if it created such a trust fund for currently promised retiree health benefits, New York's annual outlay for retiree health care would still be roughly twice as high as the current level.[26] The mathematics of full funding under these circumstances would be similar for the state's local governments and authorities. Faced with a sluggish economic recovery and skyrocketing costs for pensions and benefits for active employees, state and local governments obviously cannot afford to fully pre-fund current retiree health care obligations under *any* circumstances.

Cost saving opportunities

GASB 45 was intended to generate more of the information necessary "to assess the cost of public services and to analyze the financial position and long-run financial health of a government."[27] If the emerging OPEB numbers tell us anything, it's that the cost of retiree health care is much higher than anyone had previously recognized. These liabilities threaten to undermine the long-run financial health of New York's state and local governments, which are already having difficulty balancing competing priorities for scarce resources in the wake of a severe recession.

As explained above, establishing trust funds alone will not reduce the current cost of retiree health benefits. State and its local governments need to begin restructuring and reducing the cost of these benefits.

A temporary Task Force on Retiree Health Insurance created by Governor David Paterson in 2009 was presented with several options for reducing retiree health costs, including increases in retiree premiums, elimination or reduction of Part B premium reimbursements, creation of a sliding scale of benefits based on years of service, and establishment of a fixed-dollar contribution.[28]

Similar options have been implemented or are under active consideration in several states, according to the Pew study; other studies find that many large employers still offering retiree health care have made or are considering such changes in their plans. However, in its June 2010 final report, the Task Force limited its recommendations to a series changes in financial and benefit design changes without making significantly restructuring benefits in ways that would reduce the unfunded OPEB liability.[29]

Meanwhile, some public employers below the state level have begun to take matters into their own hands. Potentially the most significant large-scale changes have occurred in Erie County, where County Executive Chris Collins negotiated a series of agreements with smaller county employees unions that will reduce or eliminate retiree health coverage for members hired since a previous round of contracts expired

The Federal Wild Card

The federal Affordable Care Act signed into law by President Back Obama in March 2010 will bring significant changes to health insurance markets. One of the law's more obscure provisions also cracked open a door to federal involvement in the financing of retiree health care.

Health and Human Services (HHS) Secretary Kathleen Sibelius recently announced that 2,000 employers throughout the country had applied for a piece of a $5 billion "Early Retirement Reinsurance Program" set up under the new federal health care law to subsidize employer-sponsored health insurance for retirees who haven't yet reached the Medicare eligibility age of 65.[a] Specifically, the plan will reimburse 80 percent of claim costs between $15,000 and $90,000 for early retirees.

Of the 156 New York employers applying for subsidies from the reinsurance fund, 66 were government entities, including counties, municipalities, school districts and public authorities. Another 33 were unions or union trust funds, including several representing government employees. Of the remaining 57 applicants, only 33 were for-profit businesses.

By far the biggest New York employer on the applicant list was the New York State Health Insurance Plan (NYSHIP), which said it expects to receive $346 million—fully seven percent of the entire nationwide trust fund. Civil Service Commissioner Nancy Groenwegen said the money would be used to reduce premiums for "all participants" in the plan, including both active employees and retirees.[b]

On a NYSHIP premium base estimated by DCS at $12 billion over the next two years, $346 million works out to a little less than 3 percent. So, from the state government's standpoint, a projected 19 percent increase in health insurance premiums over the next two years will be shaved down to about 16 percent. That works out to a two-year savings of about $180 million–not all that much, really, in the context of a two-year budget gap of at least $20 billion.

What happens after the reinsurance program expires in two years? The HHS press release said the fund was "created … as a bridge to the new health insurance Exchanges in 2014," a reference to the federally subsidized insurance plans that will become available then under the health care law.

Is the Obama administration inviting or expecting states and local governments to dump $1.5 trillion in unfunded retiree health care liabilities into Washington's lap? Stay tuned.

a. "Nearly 2,000 employers and unions approved into new program," August 31, 2010 news release at http://www.hhs.gov/news/press/2010pres/08/20100831a.html
b. DCS TK

in 2006. In May, Collins reached a tentative agreement on a similar changes with the county's largest union, which could have significantly reduced the county's $909 million unfunded OPEB liability. However, the tentative contract was rejected by union members.[30]

The White Plains City Council took a different approach to the problem, voting in May 2010 to end free retiree coverage and require a 15 percent contribution to health insurance premiums for city employees hired before 1995 who retired with at least 20 years of service. Unions for police and firefighters immediately sued, winning a pair of temporary restraining orders blocking the change. [31]

Four steps to retiree health care reform

On the state level, as noted in Section 1, the Legislature and Governor have broad leeway to craft changes in retiree health benefits outside of collective bargaining. Pursuing the following strategy would allow them to strike a politically appealing balance between the competing interests of employees and taxpayers:

1. Preserve health benefits for workers who have already retired, but stop reimbursing Medicare Part B premiums for those over 65, and require early retirees to pay a larger share of their own premiums.

2. Reserve the greatest benefit to those who have worked the longest, along the lines initially proposed by Governor Paterson in his 2009-10 budget.

3. Clarify existing law to allow trust funds to cover adjusted OPEB liabilities, but mandate that required contributions to the fund are based on returns from conservative, low-risk investment strategies.

4. Eliminate retiree health insurance coverage for all new hires and employees on the payroll for less than 10 years, and shift these workers into a "retirement medical trust." Government workers would make tax-free contributions to accounts managed by their unions, which would pool and invest the money to cover medical expenses after they retire.

The proposed retirement medical accounts for new hires and less senior employees would be based on a plan recently adopted by the state of New Hampshire after being pioneered by local governments in California, Oregon and Washington, and elsewhere.[32] This model would give employees and their unions a stake in managing health costs, with the added advantage of removing liability for their benefits from the state's balance sheet.

Adoption of this four-part plan strategy would immediately save the state more than $300 million a year, assuming early retirees were immediately required to pay one-third of premium costs now covered by state government (lowering the average employer share to 61 percent).[33] These changes also would significantly reduce the state's unfunded OPEB liability.

The state government's OPEB reform strategy can serve as a other levels of government, but should be linked to these statutory changes:

- repeal the 2009 state law restricting the ability of school districts to alter retiree health benefits;
- require all active and retired public employees in New York to contribute at least 10 percent to individual coverage and 25 percent to family coverage premiums (the same level as state workers), as recommended in 2008 by the state Commission on Local Government Efficiency and Competitiveness;[34]
- amend the Taylor Law to flatly prohibit future collective bargaining of retiree health benefits in New York's public sector.[35]

Elected officials who feel their hands are now tied by collective bargaining agreements need to seize on the opportunity created by GASB 45 to acquaint their taxpayers and employees with the hard fact that these promises are simply unsustainable in the long run. In the short term, budgets already stressed by the economic downturn will be squeezed harder by rising pension bills as well as health insurance costs over the next few years. Something has got to give on this front—and soon.

ENDNOTES

[1] While there is no precise tally of annual state and local government expenditures on retiree health insurance, New York State and New York City will spend about $3 billion for this purposes in fiscal 2011. School districts outside the city spend roughly $1.2 billion on retiree health care, assuming one-third of their reported medical insurance costs are for that purpose. A safe estimate would be that the annual pay-go cost for retiree health care at every level of government in New York comes to at least $5 billion.

[2] Since many of the reports date back to 2008 fiscal years, the total has almost certainly grown since then.

[3] The $1 trillion estimate first reported in a 2005 New York Times article ("The Next Retirement Time Bomb,"Dec. 11, 2005). An October 2006 analysis by the Cato Institute put the figure at $1.4 trillion (Chris Edwards and Jagadeesh Gokhale "Unfunded State and Local Health Costs: $1.4 Trillion," Cato Tax and Budget Bulletin, No. 40. In a 2007 analysis, Credit Suisse estimated the total at $1.5 trillion ("You Dropped a Bomb on Me, GASB," Equity Research, Accounting & Tax Note, March 22, 2007).

[4] More specifically, New York City's estimated unfunded liability for OPEB was $61.98 billion for the fiscal year ending June 30, 2008. The estimated liability for California's state government, including the entire University of California system, was $62 billion as of June 30, 2008.

[5] Retiree health coverage is offered by 98 percent of New York's school districts and 67 percent of its other local governments, according to surveys compiled by the Governor's Task Force on Retiree Health Benefits. The state's largest public employer, New York City, offers retiree health coverage to all of its employees, as does the state government.

[6] This is derived from a table entitled "Reconfigured 2009 Monthly Premium - Based on Cost Differential of Each Group," which was prepared by the Department of Civil Service (DCS) for the governor's Task Force on Retiree Health Care. All members of NYSHIP paid a blended monthly premium of $1,132.44 for family coverage in 2009, but the DCS calculated that if premiums were reconfigured to reflect cost differentials in 2008, the premium for active employees would be reduced to $1,071.96, the premium for retired members with NYSHIP as their primary plan (i.e., early retirees) would increase to $1,642.59 and the premium for retirees with Medicare as their primary plan (i.e., those over 65) would increase to $1,190.99.

[7] Buck Consultants, "New York State/SUNY GASB 45 Postemployment Healthcare Benefits, April 1, 2006 Actuarial Valuation."

[8] *Lippman vs. Board of Education of the Sewanhaka Central High School District*, 66 N.Y. 2d 313 (1985).

[9] Article 14 of the Civil Service Law.

[10] Kaiser Family Foundation, *Employer Health Benefits, 2010 Annual Survey*, p. 162.

[11] Towers Perrin, 2009 Health Care Cost Survey: 20th Annual Results Report, p. 8.

[12] Citizens Budget Commission, "The Case for Redesigning Retirement Benefits for New York's Public Employees," April 29, 2005.

[13] Government entities ignore GASB standards at their peril; a financial report that does not conform to GASB standards will be noted on an independent audit and potentially lead to a credit rating downgrade.

[14] Federal Reserve Bank of Boston, New England Public Policy Center, "GASB 45 and other post-employment benefit promises: the fog is clearing," *Policy Brief* 07-7, September 2007.

[15] Government Accounting Standards Board, *Summary of Statement 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (Issued 6/04)*, at http://www.gasb.org/st/summary/gstsm45.html.

[16] Government Accounting Standards Board, *Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits*.

[17] Employers are allowed by GASB to use several different actuarial methods, as well as slightly different discount rates for calculating the "present value" of promised future obligations. Most of the financial statements reviewed for this report used the projected unit credit (PUC) actuarial method and a discount rate of 4 to 4.5 percent.

[18] City of Buffalo, General Fund, 2010-11 Adopted Budget, Section II: General City Charges, at http://www.city-buffalo.com/files/1_2_1/Mayor/2010-2011AdoptedBudget/Section_II_GF_General_City_Charges.pdf.

[19] City of New York., *Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 2009*, Statement of Net Assets, p. 34.

[20] U.S. Government Accountability Office, "State and Local Government Retiree Health Benefits: Liabilties Are Largely Unfunded, But Some Governments Are Taking Action," GAO-10-61, November 2009.

[21] Pew Center on the States, *The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform,* December 2007.

[22] Office of the State Comptroller, Local Government Issues in Focus, "GASB 45: Reporting the True Cost of Other Post-Employment Benefits,"Vo. 4, No. 1, May 2008. The comptroller's bill, A.11038, did not move out of committee during the Legislature's 2009-10 session.

[23] Office of the State Comptroller, "Review of the Financial Plan of the City of New York," July 2011, Report 4-2011, p. 34.

[24] Robert Novy-Marx and Joshua D. Rauh, "The Liabilities and Risks of State- Sponsored Pension Plans," *Journal of Economic Perspectives*, Vol. 23, No. 4, Fall 2009, pp 191–210.

[25] At the time, the pension fund rate of return of 8 percent was assumed.

[26] *Op. cit*, Office of the State Comptroller, Local Government Issues in Focus, "GASB 45: Reporting the True Cost of Other Post-Employment Benefits."

[27] Government Accounting Standards Board, *Other Postemployment Benefits: A Plain-Language Summary of GASB Statements 43 and 45*, at http://www.gasb.org/project_pages/opeb_summary.pdf.

[28] Meeting Minutes and the Final Report of the Task Force are posted at http://www.state.ny.us/governor/reports/pdf/HealthCareRetiree.html.

[29] The 15 Task Force recommendations included encouragement of municipal cooperative health plans, prescription drug carve-out plans, and adjusted co-pays to encourage primary and preventative care.
[30] *Buffalo News*, "CSEA rejects proposed contract," June 12, 2010.
[31] *Journal News*, "Federal judges put brakes on White Plains retiree health costs," July 9, 2010.
[32] Pew Center on the States, "In New Hampshire, a new way on retiree health costs," May 12, 2010, http://www.stateline.org/live/details/story?contentId=484070.
[33] Empire Center for New York State Policy, "Blueprint for a Better Budget: A Plan of Action for New York State," estimated workforce savings on p. 26.
[34] New York State Commission on Local Government Efficiency and Competitiveness, Final Report, p. 53. Posted at http://www.nyslocalgov.org/report_page.asp.
[35] Civil Service Law Article 14, Section 201.4.

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