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Michigan's GOP Pension Scrap

Some Republicans try to scuttle 401(k)-style reform.

Anyone who thinks pension reform is a partisan issue should check in on Michigan. Republicans run the entire state government, but some of them are blinking like Democrats in Illinois.

Republicans in the state Senate recently committed the good deed of voting to close the public-school employee retirement program to newly hired teachers and move them into a 401(k)-style plan. This is the kind of reform that has long been occurring in the private economy and is crucial to getting pension costs under taxpayer control. The plan would also require that current workers contribute at least 5% of salary to their traditional pension.

Enter the Michigan House, also controlled by Republicans, which promptly dropped the Senate reform in favor of some useful patches that will reduce future liabilities and create an optional 401(k)-style plan. New teachers would be able to choose between a fixed pension and the 401(k)-type plan, which means keeping the gateway to the bankrupt pension system open.

Michigan needs reform, because the combined pension and health-care unfunded liabilities for its 450,000 education employees and retirees is close to $50 billion. Teachers can retire at age 55 (and in some cases earlier) with full benefits and take another job. The average retiree pays only 10% of health-care premiums, and teachers hired before 1990 contribute almost nothing to pensions.

The virtue of 401(k)-style plans, by contrast, is that they fix taxpayer costs, instantly reducing future liabilities that contributed to the bankruptcy of GM and are crushing California and Illinois. Politicians can no longer raid pension funds to balance the budget in the short-term, and workers can't load up on overtime and sick leave in their final years to pad their lifetime pensions.

Part of the current debate concerns the transition costs of moving to the new system. Opponents claim that without new workers to pay for current retirees, short-term taxpayer costs can increase. Representative Chuck Moss, who wrote the House pension bill, says that closing the defined-benefit program for new workers "incurs an up front cost of $700 million—$1.4 billion over five years, with $400 million due the first year," thanks to Governmental Accounting Standards Board (GASB) rules.

But Mr. Moss's accounting claim is very much in dispute. A study by the Laura and John Arnold Foundation says that GASB rules don't mandate shorter pay-out schedules when defined-benefit plans are closed, because they concern only financial disclosure and reporting, "not payments or funding policy." Andrew Biggs of the American Enterprise Institute says GASB guidelines are likely to be clarified so that reforms to defined-benefit systems aren't stymied.

As construed by Mr. Moss, the rules would mean that the more financially unsustainable a pension system, the more prohibitively expensive it is to end. That's hardly consistent with sound accounting principles.

As it happens, Michigan has its own example of reform success. In 1996 John Engler became the first Governor to close a defined-benefit pension, and about 30,000 non-education state employees are now in 401(k)-like plans. Taxpayer liabilities have fallen by an estimated $4 billion, according to the Michigan-based Mackinac Center. Mr. Engler got around the GASB issue by marking to market the stocks held in the retirement fund, which had risen during the rally in the 1990s.

Michigan shows that many politicians prefer short-term pension fixes, but the current defined-benefit system is unsustainable. Pension costs are already crowding out vital current services like schools, roads and police. If Michigan's House Republicans are too timid to adopt the Senate plan, the least they could do is amend theirs to increase the incentives to choose the 401(k)-style plan by requiring that employees contribute 15% or more of their salaries to the traditional pension.

Michigan's GOP Governor Rick Snyder has asked lawmakers to delay closing the school-employee pension system until the transition-cost argument is sorted out. But the sooner states reduce long-term liabilities, the better for their fiscal well-being. Mr. Snyder could take a lesson from his neighbor in Wisconsin and show more leadership.