You Decide: Are There Changes Ahead For State Pensions?

By Dr. Mike Walden, North Carolina Cooperative Extension: My wife has now been retired for ten years. This taught elementary school for 32 years, usually putting in 12 to 14 hour days when classroom time, after-school grading and lesson plans were included. She was a teacher for so long that many times she taught the children of former students. She took pride in the accomplishments of her pupils, and even today is thrilled to see some of them – of various ages – about town.

You can tell I am proud of my wife and happy she gets to pursue her hobbies and public service activities now that she is retired. But I’ve also noticed another change in her. After largely ignoring it while she was working, she now is very interested in the public pension system for teachers and state worker retirees. So any article that may bring up possible changes in North Carolina’s public pension plan immediately gets her attention.

I’ve recently been getting an earful of questions from my wife about the state pension. This is because there have been some ideas and proposals put forth for changing how the system is operated and how payments would be made to future retirees.

North Carolina’s state pension plan is big – covering about 900,000 working and retired individuals and with almost $100 billion in assets. It is considered to be one of the most financially sound public pension systems in the country. But like all public pension plans, it does face some issues.

One is the simple fact that retirees are living longer – indeed longer than when the pension rules were established. This means that pension systems face an increased shortage of money to meet pension promises. Some of those estimated shortages are enormous – such as for Boston public pensioners. North Carolina’s calculated shortfall is much less, but still, it does exist based on analyses by academic and other professional evaluators.

The other issue is management fees. In an effort to boost earnings from the pension investments, many public pension funds – including North Carolina’s – have hired professional investment companies to manage at least some of their pension money. However, these management companies charge fees that – in the case of North Carolina – can total hundreds of millions of dollars annually. The question is whether such fees more than pay for themselves in higher earnings. Some analysts suggest the management companies may not always deliver.

There is one thing certain in these decisions. If there are looming problems, addressing both the type of pension plan and the way those pension plans are invested would only affect newly hired employees. Most people considering hiring on to a pension plan today would not be covered by any potential changes. People who are already retired would still receive the same payments they were promised.

The second issue – about the value of paying higher fees to investment firms for managing the state pension funds – is a part of a larger debate over the value of active investment management. There is a substantial body of academic research suggesting it is extremely difficult for investment managers to consistently meet the market average.

This research has led to a debate about whether paying higher fees leads to higher investment returns. Those who advocate cutting these costs argue that paying higher fees reduces money that might have been used to purchase higher-performing investments.

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