State and Local Government
Retiree Benefits

Retiree Health Care Benefits: Structures, Protections, and Funded Status

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Key systems for providing retiree benefits to state and local workers:

- **Pensions**
  - Mostly defined benefit plans with a formula; once accrued cannot be diminished.
  - Managed as trusts with oversight by boards of trustees.
  - Prefunded—that is, monies are set aside and invested.

- **Retiree Health Benefits**
  - Extent of premium cost sharing varies widely and benefit plans can change for current and future retirees.
  - Managed as operating expenses along with other employee benefits.
  - Pay-as-you-go — that is, paid from annual operating funds as costs are incurred.
Group health coverage for retirees is widely available with varying levels of employer support.

- Laws provide less protection for retiree health benefits.
  - Retiree health benefits are subject to change.
  - Retiree health benefits are treated as an operating expense.

Percentage of Premium Paid by Employer for Health Insurance Coverage for Retirees under Age 65 (Pre-Medicare-Eligible), by State in 2006
Funding Status of Pensions and OPEB

- The funded status of state and local governments pensions is reasonably sound.
- Unfunded liabilities for retiree health benefits are significant
  - Compared to the future payments for pension benefits, payments for health care benefits are significantly more unpredictable because projecting future costs of health care is difficult.
  - Unfunded liabilities for retiree health benefits are high because unlike pension plans, nearly all state and local government retiree health benefits have been financed on a pay-as-you-go-basis.
  - Studies indicate that total retiree health benefits for all state and local governments have liabilities of between $600 billion and $1.6 trillion.
- Other post-employment benefits—dental, vision, life insurance—are often funded primarily, if not entirely, by the beneficiary.
State and local governments have not prefunded retiree health benefits for several reasons:

- Retiree health benefits viewed as an extension of active employee health care benefits.
- Retiree health benefits were established at a time when health care costs were more affordable.
- Given that retiree health benefits are generally not guaranteed by law, employers are freer to modify benefits.
- The inflation rate for health care is not predictable.
- Changes in national health care policy and health insurance markets can affect what benefits state and local governments cover.
GAO Simulation of Fiscal Outlook for the State and Local Sector

• For pensions, our simulation shows that the current contribution rates are generally on track but could still fall short of future pension needs.
  • We assumed a 5 percent rate of return on assets.
  • Our simulation is highly sensitive to rates of return.

• Retiree health care costs could more than double as a percentage of salaries over the next several decades.
  • Currently retiree health benefits run about 2 percent of salaries.
  • Assuming that health care costs continue to rise faster than GDP, by 2050 retiree health care would grow to 5 percent of salaries.
GAO Simulation of Fiscal Outlook for the State and Local Sector

Projected Health and Non-health Expenditures of State and Local Governments through 2050

Source: GAO analysis.
Concluding Observations

- Persistent fiscal challenges lie ahead for state and local governments.
- The growth in health-related costs is a primary driver of these fiscal challenges, as is true with the federal sector.
- State and local governments need to find strategies for dealing with unfunded pension and OPEB liabilities, which
  - will take time,
  - will require difficult choices that will made in the context of the sector’s overall fiscal outlook,
  - could be affected by changes in national health policy.
GAO Work on Public Sector Retiree Benefits

• Recent reports:
• Ongoing work:
  • Options for State and Local Government Funding of Retiree Health Benefits.
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