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Vermont's pension experiment

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Vermont officials have reached agreement on a teacher pension plan that could become a model for financially-strapped states seeking ways to reduce the rising cost of employee retirement benefits.

The accord between the Legislature, the state treasurer and Vermont's largest public employee union will result in most teachers working additional years and making higher contributions to the pension fund but receiving a larger pension check on retirement. The state will initially save $15 million a year, or about 10 percent of Vermont's current budget shortfall.

Among the experiment's biggest boosters is Vermont Treasurer Jeb Spaulding, a key figure in the deal who, as chairman of a state commission examining pension costs, originally had urged more drastic benefit cuts without any gains for teachers.

The lesson for states may well be: sit down with your unions. "Usually the pattern in states is to cut, cut, cut benefits without the unions involved," says Darren Allen, spokesman for the group that represents Vermont teachers, the 11,000-member Vermont-NEA.

The unusual Vermont agreement runs counter to the tendency in many states for lawmakers to fight with unions over reductions in pension benefits, especially when current employees are targeted as well as new hires. It also helps make a case for states to keep defined benefit plans when costs can be lowered instead of changing to a 401(k)-style defined contribution plan in which the level of pensions is not guaranteed.

The Vermont accord "reflects a core value of defined benefit plans," says Keith Brainard, research director for the National Association of State Retirement Administrators.: "They are flexible and can be designed to accommodate everyone's interest. The answer doesn't have to be, 'Let's switch to a 401 (k) plan.'"

Most of the pension benefit cuts states have made in the last few years affect newly hired employees, but some state officials are aiming at current employees in their efforts to slash costs. Kansas lawmakers are weighing a first-time increase in employee pension contributions; when New Mexico enacted a temporary increase in the worker contribution rate last year, the state employee unions sued. Rhode Island Gov. Don Carcieri has proposed eliminating cost of living adjustments for employees who retire after Sept. 30, 2009. New Hampshire lawmakers recently voted to reduce the state's share of public employee pension costs and increase the amount contributed by local governments, which sued.

State pension plans, however, generally are hard to modify for current employees and retirees. The U.S. Constitution and many state constitutions consider them a contract that cannot be broken. “Legislators would rather take the political step [of trimming benefits] and let the courts be the bad guy” in overturning their actions, says Robert Klausner, a Florida lawyer and expert in state pension law. “In years past, when there have been other attempts to cut benefits, the courts have always been the guardians of the gate.”

But if the government and employees agree to change the rules, as in Vermont’s case, a legal challenge can be avoided. And unions are beginning to realize it may be in their best interest to compromise because the future solvency of some pension funds may be at stake. States as a whole are $1 trillion short of the money needed to finance their workers’ retirement over the next 30 years, according to a recent report by the Pew Center on the States.

Minnesota’s largest public employee union recently endorsed a cut in the annual cost of living adjustment for retirees’ pensions. Kentucky teachers agreed to pay more for retiree health care because of doubt about the future of the health insurance fund. “We are committed to a shared solution,” Brent McKim, president of the Jefferson County Teachers Association, which includes Louisville, told the Louisville Courier-Journal.

Interviews with the principal players in Vermont show that the teacher pension deal was not a certainty. Only after hours of closed door negotiations between teachers and state officials did the agreement come together.

Teacher union officials initially were furious at treasurer Spaulding after the retirement commission he headed proposed higher individual pension contributions and raising the retirement age. The panel, appointed by the Legislature to reduce burgeoning pension costs, said the plan would shave 28 percent a year in pension costs. Vermont-NEA officials threatened to sue the state if the Legislature adopted the proposal, saying Vermont’s constitution prohibited such changes to existing pension contracts.

“I took a lot of personal flak,” Spaulding says. “But someone had to set the stage and make the case to the Vermont-NEA how serious the financial challenges were and that the Legislature was likely to make changes whether they participated or not.”

Senate President Pro Tempore Peter Shumlin and House Speaker Shap Smith said they felt strongly that the 2010 Legislature needed to bring down pension costs. Governor Jim Douglas said he wanted even more savings than the retirement commission proposed. Vermont-NEA officials agreed to a series of meetings with legislative leaders and Spaulding. Including the union in the talks was crucial, Shumlin said, because the tension that had been created “was more about the teachers feeling excluded than it was an unwillingness to join us in solving the problem. So we worked together.”

At the first meeting, state officials asked the Vermont-NEA what they hated the most about the retirement commission’s proposal and what the teachers most wanted to preserve about their pension system. From there, the two sides started trading ideas, which culminated Jan. 29 with the landmark agreement. By getting the teachers’ union to back the plan, the state avoided a certain lawsuit while reducing Vermont’s annual pension contributions.

“It would have been a Pyrrhic victory if we forced through a plan that was enjoined or overturned and we didn’t have any savings at all,” Spaulding said.

Under the agreement, the retirement age for most educators will go from 62 to 65 or rule of 90, a combination of years of service and age. The maximum retirement benefit will be increased from 50 percent of average final pay to 60 percent, with the multiplier used to calculate benefits increasing from 1.67 percent to 2 percent after 20 years. Most teachers will contribute 5 percent of salary towards benefits, up from 3.4 percent now. Retiree health care benefits will be available to spouses, providing teachers work additional years.

“What we’ve all produced is better: teachers working a bit longer, paying a bit more, but getting more when they retire,” says Vermont-NEA president Martha Allen.

The Vermont Senate is planning to vote soon on the House-passed pension legislation; Shumlin said it will be approved and sent to Douglas. The governor’s spokesman, David Coriell, said Douglas will sign the legislation even though he preferred a deeper cut. “The governor has said it is a great step in the right direction because we’re at a point that we can’t continue to live up to promises made in the past. We have to make sure there’s a pension system for teachers and workers that Vermont can afford.”