The recent economic downturn has negatively impacted Americans on many fronts. Beginning in 2007, the stock market began a rapid drop, hurting investors of all stripes—from large financial institutions, to pension funds, to individual families. Soon, the economy slowed to a halt and even more Americans felt the pain as unemployment began to rise and states struggled to balance their budgets.

You may have wondered—what do these trends mean for my retirement? How have these trends impacted my pension plan? This fact sheet provides some basic information that might help.

It’s important to remember that even in the midst of all the bad economic news, there are some bright spots when it comes to public pensions:

• Group-based pension plans weathered the economic storm better than individual account plans. This continued a long trend of pensions outperforming individual accounts.

• Most states had done a good job of building up their pension plan reserves when the economy was in better shape. When the recession hit, pension plans had enough on hand to continue paying benefits—in most cases, for many years to come.

• Although some changes might be needed to ensure that pensions stay healthy for the long haul, in most states, policymakers can take a measured, careful approach to reforms.

• Pensions are keeping the promise. They provide a critical lifeline for middle-class American seniors.

**Historic Market Decline and Recession**

The stock market decline that began in the fall of 2007 and lasted through the spring of 2009 was unprecedented in recent history. The Standard & Poor 500 Index (a measure of the stock market value of 500 of the largest companies in the U.S.) fell from a high of 1565 in October 2007 to just 676 in March 2009. That’s a 56% drop!

![Figure 1. Performance of the Standard & Poor 500 Index](image)
According to *The Wall Street Journal*, the wealth of American families in 2008 plunged 18%, or $11 trillion during the market meltdown. The decline marked the biggest loss since the government began keeping track after World War II.¹

The stock market crash was only the prelude to a long, deep recession that brought pain to every element of our economy—businesses, workers, and state and local governments.

---

### The Impact of the Stock Market Drop on Pensions

Pre-funded pension plans (whether in the public or private sector) work like this: over the course of an employee’s career, funds are set aside (by the employer, the employee, or both) and contributed to a group pension fund. These monies are invested by professionals in a range of assets—stocks, bonds, real estate, etc.—with the goal that by the time an employee retires, the initial contributions to the plan will have grown enough to pay benefits for the rest of the retiree’s days.

Like all investors, pension plans were hurt in the stock market crash. According to figures from the Federal Reserve, public pensions saw their holdings fall in value by $889 billion between 2007 and 2008. Since that time, as the stock market has rebounded, so has the value of public pension funds—their holdings increased by $346 billion by the end of 2009.² But those gains have not fully made up for the huge prior losses.

One measure of a pension’s financial health is its funding ratio—that is the ratio of assets held by the plan to the value of benefits it is obligated to pay in the future. For example, if a fund is holding exactly the same amount of assets that it needs to pay all current and future benefits, the plan is 100% funded. If the plan has fewer, the funding ratio will be less than 100%. The recent stock market decline has caused the aggregate funding ratio of the nation’s largest public pension plans to shift from 86.7% in 2007 to 85.3% in 2008.³

One bright spot is that most states had done a good job of building up their pension reserves back when the economy was in better shape. Like the ant in Aesop’s famous fable, states have socked away an average of about 87 cents for every dollar in future benefits they will need to pay before the recession hit.⁴ This pre-funding strategy was in place to ensure that if (or when) the economy hit a rough patch (taking state budgets down with it), pension plans could keep on paying benefits as they come due.⁵

This pre-funding strategy has been a success—even during the worst days of the economic crisis, retirees have been able to count on their pension check arriving, just as always. Most public pensions have enough on hand to keep paying benefits for decades.⁶

The other bit of good news is that group pension plans (also called “defined benefit” pensions) weathered the financial storm better than other investors, particularly, individual investors in so-called “defined contribution” plans. A recent analysis by the consulting firm Towers Watson found that defined benefit pensions outperformed defined contribution plans in 2008,⁷ continuing a long-term trend of superior investment returns.

As shown in the graph, an initial investment of $10,000 grows much faster in a group pension plan than in an individual account.
That doesn’t mean pensions are totally out of the woods though. Just as the stock market has yet to return to its pre-crash levels, so pension funds have some work to do in recovering from the economic storm.

Pensions might need additional contributions from employers, employees, or both. If employers and/or employees can’t afford these additional contributions, pensions may need to make adjustments to the benefits they will pay in the future.

For public pension plans, the recovery process will be made more difficult by the tough shape of state budgets.

The Economic Crisis and State Budgets

The economic crisis has negatively impacted state budgets across the country in major ways. According to the National Conference on State Legislatures, the states had a cumulative gap of $145.9 billion in their 2010 budgets, which they have managed to close. States have implemented various changes in order to balance their budgets, including furloughs and layoffs for state employees. However, significant challenges remain.

As the economy continues to struggle, state budgets continue to feel the pinch. Many states are forecasting even larger budget gaps in 2011 and 2012.

Additionally, federal stimulus funds provided to states by the American Recovery and Reinvestment Act (ARRA) are set to end by 2011. With the termination of this very significant source of funding, states may find themselves struggling with even larger deficits in that year.

As a result, many state and local governments are in the process of evaluating the need for, and even implementing, adjustments to their pension systems to ensure that they will be on a strong footing for the long-term. Fortunately, because most states acted like Aesop’s “ants” before the economic winter, there is ample time to make any additional modifications that may be prudent. But like the fabled “grasshopper,” other states may have a harder time. The small number of states that were less diligent about pre-funding will need to grapple with tough choices sooner and may have fewer options to manage through the tough times.

The good news is that legislatures around the country are, by and large, taking a careful approach to examining benefit levels and financing structures to ensure that pension plans will have what they need to be sustainable over time. While public pension systems have a long term horizon that allows for a patient approach, the uniqueness in plan design, benefit structure, and governance arrangements may dictate different responses among different systems.

According to the National Conference on State Legislatures, the actions taken by states to date have been quite substantive and varied. In the past four years, 12 states have increased employee contributions to their pension funds; 11 states have changed the way benefits are calculated; 10 states have increased the age and service requirements to receive a pension; 7 states have implemented provisions to limit “spiking” abuses; 9 states have changed post-retirement increases; and 6 states have increased the time period for “vesting.”

The Economy and Your Pension

Figure 2. How $10,000 Invested Grows Over 30 Years

|$100,627| $76,123

Figure 2: How $10,000 Invested Grows Over 30 Years

Table 1: Projected Benefits Comparison

<table>
<thead>
<tr>
<th>Benefit Type</th>
<th>DB Plan</th>
<th>DC Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Benefit</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>5-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>10-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>15-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>20-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>25-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>30-Year Increase</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

NRTA Pension Education Toolkit | The Economy and Your Pension
Despite Tough Times, Pensions Are Keeping the Promise of Retirement Security

The market downturn and economic recession have surely affected all Americans. But the evidence suggests that employees and retirees who can count on group-based, defined benefit pensions are in the best position to weather the storm.

Employees and retirees with pensions can count on a stable and secure retirement income that isn’t subject to the wild volatility of Wall Street. This is possible because group pension plans can do something individual account plans cannot—provide better time diversification of financial market risks. This means that, because pension plans invest for very long time horizons, they are able to diversify their portfolios across broad time periods, and can better withstand market swings. Economists have shown that because of this ability, group pension plans can more effectively capture the excess returns that come from investing in stocks over long periods of time—to the benefit of employees, employers, and taxpayers.

The economic crisis has taught Americans many lessons about getting back to basics. Recent research reaffirms the importance of the traditional “three-legged stool” approach to retirement. A combination of Social Security and a group based defined benefit pension, supplemented with individual savings in a defined contribution plan, affords ordinary Americans the greatest chance to maintain their middle-class standard of living into retirement.13

Pensions are a critical lifeline to America’s middle class seniors. More than 4.5 million retired public employees and nearly 10 million retired private sector employees rely on a pension to make ends meet.14 Keeping these vital systems healthy should be a high priority for decision-makers at every level, so that pensions can continue to keep the promise for future generations.

---

5 Standard and Poor’s. 2009. No Immediate Pension Hardship For State And Local Governments. Standard and Poor’s, June.