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Public Sector Pension Plans: A Case Study of Growing U.S. Income Inequality

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By virtually any metric, income inequality in the United States has grown, and the gap has increased significantly over the last few decades. Since pension payments are a form of income, the decline in pension benefits is seen as a likely contributor to growing income inequality. It has been clear for some time now that U.S. private sector pension benefits are on the decline. In contrast, relatively generous pension benefits historically have been enjoyed by public employees. But it is more recently apparent that U.S. public sector employees are not immune from pension cutbacks. Numerous reductions in pension benefits are described in this paper, including increased underfunding of these plans. Evidence of growing income inequality is presented, followed by an exploration of the roles of government and accounting in creating and/or perpetuating this inequality. Specific examples of state and local pension reductions are used as case studies for the analysis. The premise that pension cutbacks for public workers have become another contributor to the growing income gap in the United States is supported by the analysis.

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1. Introduction and Background

By virtually any metric, there is growth in income inequality in the United States, and the last few decades have seen a significant increase in the gap. The components of this disparity have taken many forms, including but not limited to wages, investment income, employee benefits and retiree benefits. Numerous rationales have attempted to explain this inequality, but evidence of its existence is irrefutable. Blame has often been placed on inevitable economic shifts driven by various global pressures. The general belief that people rise or fall as result of their own efforts is held by Americans, and there is less focus on the role played by government (Hacker and Pierson, 2010, p. 103).

Since pension payments are a form of income, the decline in pension benefits is seen as a likely contributor to growing income inequality. It has been clear for some time that U.S. private sector pension benefits are on the decline. These reductions have taken the form of reduced pension payments to retirees and/or increased employee contributions while still employed. In contrast, relatively generous pension benefits have historically been enjoyed by public employees– at least in part because their pay while working has not traditionally been as high as private sector employee salaries. However, it has more recently become apparent that U.S. public sector employees are not immune from pension cutbacks. Numerous examples abound illustrating that these public employee pension

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benefits can no longer be seen as sacrosanct. The motivation for this study is provided by the dual forces of growing income inequality and declining pension benefits. Calls for interdisciplinary accounting research in the context of public services have been made (Jacobs and Cuganesan, 2014). The impact of public sector pension plans on income inequality has not been previously explored as a research question.

Evidence showing the decline of public sector pensions will be utilized as case studies for further investigating growing U.S. income inequality. A literature review exploring the general decline in pension benefits in the U.S. is presented in Section 2. The theoretical framework for this study is provided in Section 3; both different measures of growing income inequality in the U.S. as well as likely causes are considered. Methodology is presented in Section 4, and the role of accounting in both the public and private pension arenas is explored in Section 5. Case studies and analyses of trends in funding and benefits for public sector employees are provided in Section 6. The conclusions in Section 7 will contribute to the body of knowledge in both income inequality and public sector retiree pension income.

2. Literature Review – General Decline in U.S. Pension Benefits

Over the last quarter century, a significant decline in traditional defined benefit pension plans has been seen by U.S. workers. Transitions have been made by employers into the less costly, and less risky (for the employer) defined contribution plans (Fitzpatrick, 2014). It has been reported by the American Institute for Economic Research that more than 60 million American workers and retirees are covered by defined-benefit pension plans, but a rapid shrinkage has occurred in those numbers in recent years. According to the Employment Benefit Research Institute, 38 percent of U.S. private-sector workers were covered by defined benefit plans in 1979. By 2011, the number of employees covered by those plans had dropped to 14 percent. Correspondingly, the percentage of employees in defined-contribution plans more than doubled during this period to 42 percent (Monga, 2014). More than one in three Americans currently between the ages of 45 and 74 have either retired or have been contemplating retirement. According to Delorme (2014), for most of these 100 million people, the days of pension plans are all but gone.

Accompanying the more general trend toward defined contribution plans was the emergence of cash balance plans (Thomas and Williams, 2009). Cash balance plans are a hybrid that in substance provide for a defined contribution type pension while preserving the tax status of a defined benefit plan. According to the U.S. government, “A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defined the promised benefit in terms of a stated account balance (U.S. Department of Labor, 2014).” Cash balance plans are discussed by others in less glowing terms; they are described by Miller as “defined-benefit plans in drag” (2012). Around 1990, none of the 100 largest U.S. companies had cash balance plans, but by 1999, sixteen companies in that group had these pension plans (Oppel, July 14, 1999). A short time later, it was reported by Coronado and Copeland (2003) that cash balance plans held more than 40 percent of all defined benefit pension assets. There was a rise in the number of cash balance plans from 1,300 in 2000 to more than 7,600 in 2010 (Powell, 2013).

This movement into cash balance benefit plans has continued. After the Washington Post was purchased by Jeff Bezos, a new cash balance plan was created by the newspaper to replace the pensions for nonunion employees and a separate but similar plan for those covered by the union. More recent hires lack traditional benefit plans. According to Taibi (2014), Post employees hired before 2009 who planned on receiving pension payments based on their income and years of service will be hit hardest by the changes. Many thousands of dollars less could be seen by each of those employees over the course of retirement.

First arising in the private sector, there is an emergence of cash balance plans in public pension plans as well. The Arnold Foundation (founded by John Arnold, a former Enron executive), has partnered with Pew Center on the States to advocate for cash balance plans for state government employees (Powell, 2013). Legislation has been passed in Kansas, Kentucky, Louisiana and Nebraska creating cash balance plans for new state employees. However, in Louisiana, where the state's public sector workers are not covered by Social Security, the governor's proposal for pension overhaul was struck down by the Supreme Court when it ruled that the proposed cash-balance plan measure violated the state's constitution (Geisel, 2014).

The literature has clearly documented that pension benefits of U.S. retirees have declined over the past several decades. Reduced benefits when companies transition to cash balance pension plans also have been documented. However, neither the declining pension benefits of public sector employees, nor the impact of those reductions on retiree income has been substantively studied.

3. Theoretical Framework

There has been significant growth in income inequality in the United States over the past several decades. The shift of income toward the top end of wage-earners has been increasing steadily since around 1980. In examining household income, including public and private benefits, from the period between 1979 and 2006, the following data is reported by Hacker and Pierson (2010, pp 22-23):

- There is an increase in the average income of the poorest 20 percent (quintile) of U.S. households from $14,900 to $16,500 – a gain of 11 percent over this 27-year period.

- In the middle quintile (i.e., the 20 percent of households above the bottom 40 percent and below the top 40 percent), there is a rise in average income from $24,900 to $52,100 – a gain of 21 percent. While 21 percent might sound impressive, it is a real gain of only 0.7 percent a year.

- The top quintile (excluding the top 1 percent of wage earners), experienced a 55 percent increase over this time period.

- There is a rise in income for the top 1 percent of households from $337,100 a year to more than $1.2 million – an increase of nearly 260 percent. Stated differently, income for this group more than tripled in slightly over a quarter century.

These numbers have become even more daunting when considering that American households are working significantly more hours than they did in the late 1970s. Among working-age married couples with children, those extra hours totaled more than ten additional full-time weeks in the workplace. Thus much of what has appeared on the surface to be gains in income is merely a result of household members working more hours. This phenomenon is not universal. Europe did not experience this massive rise in income inequality over the same timeframe (Hacker and Pierson, 2010, pp. 22-26).

There are numerous lens through which to view income equality/inequality. In addition to viewing wage increases by quintile, the amount of income earned by various sectors of the population could also be considered. By that metric, the share of income earned by the top 1 percent has increased from around 8 percent in 1974 to above 18 percent in 2007 – a more than twofold increase. Economic growth was even more skewed between 2001 and 2006, during which the share of income gains going to the top one percent was over 53 percent. Stated differently, more than 50 cents of every dollar in additional income earned by Americans over this half decade accrued to the richest 1 in 100 households (Hacker and Pierson, 2010 (pp 3, 15).

The conclusion that the share of national income accruing to upper income groups has increased sharply in recent decades in the United States is supported by other research. According to Piketty and Saez (2013), more than 15 percent of national income was shifted from the bottom 90 percent of wage earners to the top 10 percent income group in the United States over the past 30 years, and most of that shift has come at the very top. In effect, almost 60 percent of aggregate U.S. income growth between 1976 and 2007 was in the top 1 percent alone. Accordingly, low and middle incomes have grown much less than what aggregate GDP growth statistics would suggest. According to the authors, “the fact that so much action has been taking place at the level of the top 1 percent, and relatively little at the level of the next 9 percent, is probably the most staggering evolution (p. 458).”

Income disparity can also be viewed by comparing CEO pay to “average worker” pay. In 1965, earnings of the average Chief Executive Officer of a large U.S. corporation were around twenty-four times earnings of the typical worker. By 2007, average CEO pay was close to three hundred times typical earnings (Hacker and Pierson, 2010, p. 62). According to an AFL-CIO report, CEO pay for companies in Standard & Poor’s 500 stock index was 380 times more than a typical American worker in 2011 (Liberto, 2012).

Though the U.S. economy appears to be regaining momentum lost during the Great Recession, it is suggested by very recent evidence that the economic growth hasn’t translated into higher wages for employees. According to Sparshott (2015), in 2014 the U.S. concluded its best year of job growth in 15 years. There is a drop in the unemployment rate to a post-recession low; a decline from 5.6 percent in December 2014 from 6.7 percent a year earlier was reported. It is typically expected by economists that a rapidly falling unemployment rate will deplete the pool of existing workers and spur competition among employers, thus resulting in higher wages. But those higher wages have not materialized. There is a rise in earnings for hourly workers of 1.7 percent from December 2013 to December 2014, which is barely ahead of inflation. Clearly the gap in U.S. income inequality is not shrinking.

A nonprofit (Just Capitol) was started by Paul Tudor Jones II, a hedge fund billionaire. Its mission is, among other things, to encourage companies to pay workers more fairly, and to publicize their rankings on a list tentatively called the Just 1000. His hope is that publicized rankings will induce more pay equity. In a recent TED talk, Jones noted, “This kind of gap between the wealthiest and the poorest will get closed. History shows it usually ends in one of three ways – either higher taxes, revolution, or war. None of those are on my bucket list (Miller, 2015, p. 89).”

According to Hacker and Pierson (2010), lack of government action is primarily blamed for rising income inequality. Not only is money taken by governments through taxes and redistributed through government transfers, but what people earn is also shaped by government policies. For better or for worse, virtually all aspects of labor and financial markets are shaped by government policy. According to these authors, "The debate should not be over whether government is involved in the formation of markets. It always is. The debate should be over whether it is involved in a manner conducive to a good society" (p. 82). With passage of The New Deal in 1933, a much more active role was taken by the U.S. federal government in redistributing income through the tax code and public programs. But numerous legislative initiatives over the past few decades, as well as legislative drift (the failure to respond to new economic realities), have implicated the government as the primary culprit of rising income inequality. According to Levy and Temin (2007), "The firing of the air traffic controllers, the 1978 defeat of labor law reform and the lowering of tax rates were signals that the third man –government – was leaving the ring" (p. 34). In attempting to achieve their goal of deficit reduction and employing the power of rhetoric, the issue was framed by the Democratic Leadership Council (formed in 1985) in a way that is now familiar but was at the time a substantial change, "entitlements" were identified as the biggest problem. The move involved a subtle but radical rebranding of entitlements from their traditional meaning of earned benefits to one reflecting a something-for-nothing mentality (Hacker and Pierson, 2010, p. 182).

Though income inequality is considered by Hacker and Pierson from an overall perspective, their research is utilized to explore declines in public section pension benefits. Providing for health care and old-age incomes are political decisions; they are not inevitably the result of natural capitalistic economic order since there is diversity among capitalist nations in the means and, consequently, the distribution of these risks among all of the citizens (Thomas and Williams, 2009). Since retirement benefits are a primary source of income, reductions in those benefits will clearly contribute to growing income disparity.

The distribution of pension benefits among retirees is determined by the institutional structures of the country in which individuals work and retire. The U.S. model of retirement income is described by Korpi and Palme (1998) as one of "basic security." Other models exist: "targeted," i.e., social insurance aimed at only the poorest citizens; "voluntary state-subsidized;" "corporatist," i.e., earnings related by occupational category with labor force participation in governance, and "encompassing," i.e., both a flat rate and earnings related (Korpi and Palme, 1998, p. 666). Consistent with their hypothesis, income inequality and poverty rates for the elderly were lowest in those countries employing an encompassing model and highest in those countries employing a basic security model. Of the eleven countries included in the study, the U.S. had the highest Gini coefficient (a measure of income inequality) and the highest poverty rate (defined as the percentage of the population below 50 percent of the median income) (Korpi and Palme, 1998, p. 678).

It is a long adopted fundamental value in U.S. society that public workers are entitled to a reliable measure of retirement security in exchange for their service. That societal value is considered a core promise that governments are obliged to meet (Boyd and Kiernan, 2014). When pension benefits are reduced by governments, it is seen as a reneging on a promise of retirement benefits in exchange for a lifetime of work in the public sector (Cooper, April, 2013).

The impact of the decline of organized labor on U.S. income inequality was considered by Hacker and Pierson (2010). From a peak of more than one in three workers just after World War II, union membership has declined to around one in nine workers (p. 56). Like income inequality, declines in union membership are not global. In the European Union, there was a fall in union membership by less than a third between 1970 and 2003. Despite starting from much lower levels, there was a decline of nearly half in the U.S. during that same timeframe. In Canada, unions have experienced little decline (Hacker and Pierson, 2010, pp. 57-58).

Declining union membership and influence are also attributed to government action by Hacker and Pierson (2010). The capacity of business to shift their operations to right-to-work states was enhanced by The Taft-Hartley Act of 1947, where unions were barred from making union membership a condition of employment in a firm or industry. Additionally, between 1960 and 1980, more aggressive tactics were used by employers to block union organizing. During this time period, there was a fourfold increase in charges of unfair labor practices and a threefold increase in charges of unlawful terminations (p. 128)

In this author's opinion, it is reasonable to consider that decreasing union membership has also coincided with the drastic decline in defined benefit pension plans. An illustration of the cascading impact of government action on unions, and ultimately on employee/retiree income is provided by recent legislation in the state of Wisconsin. Act 10, which severely restricted the power of public-employee unions to bargain collectively, was supported by Governor Scott Walker. As a result, public employees are less interested in paying dues to a union that can no longer do very much to advocate for them. Since the law was passed, membership in the Wisconsin State Employees' Union has fallen 60 percent. An assertion was made by remaining union members that their take-home pay has fallen more than 10 percent in recent years, a decline which they attribute to the union's greatly diminished power (Greenhouse, 2014). To the extent that one of the primary objectives of unions and/or public sector pensions is to create a stable middle class, policies that result in impairing pension benefits may exacerbate growing income inequality.

4. Methodology

A case analysis approach is employed by this paper to explore the linkage between declining retiree benefits and growing U.S. income inequality. The view that the traditional model of old-age income security granted by defined benefit pension plans for private sector retirees is greatly on the decline is clearly supported by the literature. Significant research also exists to support the claim that income inequality in the U.S. is growing. At the same time, while public sector employees' retirement benefits historically have been sacrosanct, and defended by union membership that is now weakening, those benefits are coming under attack. Benefits to retirees represent costs to the employer, and the role of accounting in determining that cost will be explored.

Specific case studies of cities, municipalities, states, and the U.S. military are utilized to illustrate existing and potential reductions in public sector retiree benefits. Since these reductions in the governmental arena are a relatively recent phenomenon, and no general repository of information about the topic exists, specific cases are identified from internet searches describing public sector pension cutbacks. The cases included here are not an exhaustive listing, but they are representative of reductions in retiree benefits across numerous governmental entities. Though it is not the purpose of this paper to establish a causal relationship, it is suggested by the confluence of these numerous forces that declining public sector retiree income is a contributing factor to growing income inequality in the U.S.

5. The Role of Accounting

Historically, state and local government retirement programs in the U.S. have been defined benefit arrangements. Pension liabilities are what governments owe to workers and retirees, and annual pension cost is the value of new benefits earned each year. Underestimated liabilities make pension funds appear healthier than they truly are. The fact that public sector plans are increasingly underfunded is clearly supported in the literature (Boyd and Kiernan, 2014; Healey et al., 2012; CBO, 2011; Pennacchi and Rastad, 2006). It is argued by Boyd and Kiernan (2014) that perverse incentives exist to underestimate pension liabilities as well as the contributions needed to fund those liabilities – "The threatened inability of some state and local governments to keep the core promise to their employees to provide reliable retirement security has national significance" (p. 1).

Accounting standards for public sector pensions are developed by the Governmental Accounting Standards Board (GASB). Because public pension liabilities are not bought and sold on public markets, they must be estimated based on future cash flows, i.e., benefits expected to be paid. The discount rate used for valuing future cash flows should reflect the riskiness of the payments. According to Boyd and Kiernan (2014), in practice the amount labeled as an "actuarial ***liability***" is the amount of ***assets*** that would be required to pay future benefits, if those assets could be counted on to earn the assumed return by the time benefits must be paid. As a rise occurs in the assumed rate, the annual contribution required to fund it drops, and there is an increased risk that actual returns will fall short of assumed returns.

The notion that inappropriate discount rates are used to value pension liabilities is also supported by The Economist (2006.) By embracing the idea that high returns from equities would lead to lower net liabilities, the scene is set by actuaries for an overall level of funding that can leave pension plans vulnerable when equity markets crash. According to Martin Taylor, chairman of the trustee board of WH Smith, a British retailer, the actuarial convention that the composition of the assets should determine the size of the liabilities is "one of the weirdest emanations of the human mind. It's a metaphor – like saying that the advent of jet planes made the Atlantic narrower – and metaphor has limited space in finance."

Pension accounting rules were revised by the GASB, effective generally for fiscal years ending June 30, 2015 and later. Some positive objectives are accomplished by the new GASB standards. First, they make clear that pension funding should not be determined by pension accounting. Second, they ensure that liabilities will be more prominent in financial statements. But the key discount rate questions are not resolved by the new standards, because most pension plans will still discount liabilities using an earnings assumption, and thus many plan liabilities will still not be accurately portrayed. And when liabilities are understated, annual pension costs are also understated (Boyd and Kiernan, 2014). Though the new standard is complex, it will have the effect of requiring lower discount rates (and thus higher resultant liabilities) only for severely underfunded plans. Better-funded plans will generally be unaffected by the new GASB guidance even though current practice also tends to understate their liabilities.

Reporting lower pension liabilities is a general preference of governments. The lower reported liability can politically rationalize lower pension fund contributions, which then frees up funding for other current purposes. The high discount rates are sometimes justified by increasing the allocation of riskier investments – frequently equity securities. During the 1950s, state and local government pension funds were invested almost entirely in cash and fixed income instruments, but their portfolio allocations in equities and, more recently, in other investments including real estate, private equity, and hedge fund investments have been gradually increased. Riskier allocations can camouflage the level of underfunding, which "amplifies the risk that DB plans will run out of assets before they run out of liabilities." (Pennacchi, and Rastad, 2010). According to an International Monetary Fund report (2013),

> "U.S. public pension funds—particularly the lowest-funded ones— have responded to the low-interest-rate environment by increasing their risk exposures. At the weakest funds, asset allocations to alternative investments grew substantially to about 25 percent of assets in 2011 from virtually zero in 2001, translating into a larger asset-liability mismatch and exposing them to greater volatility and liquidity risks."

Overall, state and local plans continue to hold two-thirds of their portfolios in equities Munnell (2014). This allocation is an increase from 38 percent equities in 1990 and 21 percent in 1980 (Boyd and Kiernan, 2014).

The California Public Employees' Retirement System (CalPERS) is one of the largest pension programs in the U.S. Though shifts were made by CalPERS in its asset allocation to reduce the expected volatility of expected returns, there is still considerable risk in the funding of the system. "Unless changes are made, it is likely that there will be a point over the next 30 years where the funded status of many plans will fall below 60% at some point. There is about a 30% chance that we will see funded statuses below 40%" (CalPERS, 2014).

6. Case Studies: Public Sector Pension Reductions

The previous sections have established that many public sector pension plans are significantly underfunded. Underfunded pension plans are more likely to be targets for benefit reductions. Specific examples of pension benefit impairment which will contribute to growing income inequality in the U.S are presented in this section. These examples were gleaned from reviewing popular or financial news publications for reports of public sector pension cutbacks.

The sentiment of many U.S. public sector employees and retirees is captured by Olivia Mitchell, professor of the Wharton School of Business and director of the Pension Research Council, "If I were a retired public-sector pensioner, I'd be worried today" (Semuels, 2013). More than fourteen million workers (about one-sixth of the U.S. workforce) are covered by State and local government retirement systems. Further, approximately one-fourth of these workers are not covered by Social Security, thus many workers, beneficiaries, and their families rely primarily on their public pensions for retirement security (Boyd and Kiernan, 2014). Political pressures have resulted in many governors and legislators' unwillingness to make the needed contributions into their pension plans. Patrick McGuinn, chair of Drew University's political science department, notes that, “There is a lot of incentive for elected officials operating on limited time spans in office to kick fiscal consequences down the road” (Lyman and Walsh, 2014).

The greater the underfunding of a pension system, the more likely it is that an attempt will be made by the government to impair the pension contract. Between 2009 and 2013, major pension changes were adopted by almost every state. The most common kinds of changes have been higher age and service requirements for retirement eligibility. Cost-of-living increases have been reduced by at least ten states. Though most benefit changes apply primarily to new hires, changes affecting existing employees also have been adopted in a few states. By primarily targeting new hires, only “invisible persons” who do not vote in union elections, have no powerful political champions, and who will not make substantive demands on pension systems for a generation are impacted by the changes (Boyd and Kiernan, 2014).

Detroit has been in the news for several years because of a myriad of financial woes. Based on a ruling by U.S. Bankruptcy Judge Steven Rhodes in late 2013, Detroit’s pension funds, like other city creditors, may be impacted during the city’s bankruptcy proceedings. For many years, participants in public sector pension funds have relied on state constitutional provisions that protect pensions. (Many states have these provisions in their constitutions, including Michigan and Illinois.) But the implication of Rhodes’ ruling is that federal bankruptcy laws preempt state constitutions. The ramifications of this ruling are widespread – if their state allows for Chapter 9 protection, any city with underfunded pensions and financial problems may look to bankruptcy to reduce pension costs. In theory, pensions appear to be protected in municipalities that are prohibited from filing bankruptcy. However, there are concerns that changes could be made in the law by state legislatures. In reference to the Detroit ruling, Rick Reimer, who represents the Illinois Public Pension Funds Association, notes, “The people of Illinois that I represent are worried that this might have some sort of domino effect.”

After Central Falls, Rhode Island’s bankruptcy filing in 2011, pension cuts from $27,000 to $12,000 a year were seen by some retired civil servants. Even though Central Falls occupies barely one square mile on the map, concerns reverberated across the state. A campaign was launched by Gina Raimondo, Rhode Island state treasurer, to overhaul the state’s pension system. The “reforms” passed by the state legislature resulted in suspending cost-of-living adjustments until the plan was 80 percent funded, delaying retirement, and moving all public sector employees into a hybrid plan – the employees kept their accrued to date defined benefits, but were switched into a defined-contribution plan going forward. Though lawsuits that resulted in some roll-back of the changes were filed by pensioners and unions who represented 66,000 public workers, public sector workers and retirees have clearly borne the brunt of the changes (“Little Rhody,” 2014).

In 2011, the New Jersey state pension system was overhauled by governor Chris Christie. The changes were hailed as a bold, bipartisan step toward paying down the state’s costly promises to its retired workers. Requirements of the changes are that some employees would have to work longer, some would lose inflation adjustments, and more payments would be made into the retirement system by both employees and taxpayers. Despite these changes, New Jersey is still struggling to make the promised payments into the pension system. New Jersey’s problems date back to 1992 when money was diverted by the state from its pension system to other programs while promising better benefits. In 2010, New Jersey became the first state accused of securities fraud for claiming to be properly funding its workers’ pensions (Lyman and Walsh, 2014).

Some pension reductions are small, and rather than actual reductions, simply are reductions in future cost-of-living increases. In 2013, a bipartisan budget deal was signed by President Obama and passed by Congress reducing by one percentage point the annual cost-of-living increases for working-age military retirees, defined as veterans under the age of 62. The estimated federal budget cost savings over the next decade is $6 billion. No provisions for grandfathering are contained in the law. Many veterans are angry, and feel that the U.S. government has broken a deal made with them during their service career. Lt. Col. Stephen Preston retired after 25 years of military service, and learned of the cutbacks by hearing the news on his radio. Preston said, “I’m not an angry man, but I was very, very angry . . . This is a pact between the greater population of the United States and the fraction of people who served and sacrificed. If you didn’t want to pay us what you promised us, then you probably shouldn’t have promised it” (Montgomery, 2013).

Legal and moral questions of what was promised are raised by military cutbacks. Are the pension benefits explicit contracts of compensation for work performed, including perils undergone? Or are they a voluntary “favor” granted by the government that can be withdrawn at any minute? Previous changes to military compensation resulted in complaints, because the results were such that veterans in similar situations received disparate treatment. However, the few legal challenges that arose never got past the first hearing. The law seems clear that this most recent cut in cost-of-living adjustments for military personnel is legal (Lotterman, 2013).

It is an elementary economic concept that less labor will be supplied when wage rates are lower. And clearly, the reduction of pension benefits results in lower wages. This perceived “changing the rules in the middle of the game” saps current and potential military members’ trust in other benefits that are touted by recruiters and retention personnel, but that are not contractual. The impact of this scenario may well present challenges in recruiting and retaining future military personnel (Lotterman, 2013).

Despite critics’ outcries that it is unfair and potentially illegal to take retirement benefits promised to public employees, legislation was passed by Oregon that will, among other things, reduce cost-of-living-adjustments for retirees. Approximately one-fourth of the state’s unfunded liabilities were erased by the cutbacks, stemming from two sets of legislation passed in 2013 (Cooper, October, 2013). The law was touted as beneficial to taxpayers, specifically estimating that state and local governments would “save” about $480 million over the next two years (Cooper, April, 2013).

An unfortunate example of a double-negative to workers and retirees is provided by pension cuts in Maryland. In 2011, legislation requiring state employees to increase their contributions into the pension fund was passed by the state – an action that constitutes a take-home pay reduction. At the same time, supplemental payments into the pension fund were promised by the state. But in 2014, a vote was made by the state legislature to take $500 million over the next five years from those supplemental payments in an attempt to balance the budget. So in addition to contributing more toward their own retirement, state workers are also faced with a pension plan with decreased funding (Lazarick, 2014).

The state of California has seen several battles with pension plans. In 2010, an agreement was reached by then-California governor Arnold Schwarzenneger with four of the state’s public-sector unions, representing 23,000 of the state’s 170,000 unionized state workers. According to the agreement, contributions to their pensions by newly hired state employees must be increased, and their retirement dates must be later, relative to employees hired prior to the agreement (Anonymous, 2010).

In September, 2014, pension benefits for newly hired firefighters were reduced in San Jose. Though the measure was approved by taxpayers years earlier, the cutbacks went to arbitration because of the firefighters' union concerns over the dramatic changes. Firefighters employed before the effective date can retire at age 50 with pension benefits up to 90 percent of their salary. Newly-hired firefighters will not be able to retire until age 60, and their benefits can only go up to 65 percent of their salary (Rosenberg, 2014).

Whether or not public pension benefits ***should*** be cut is one question, but whether they legally ***can*** be cut is another question entirely. Different challenges are faced by state and local governments in resolving pension problems from those in the private sector (Boyd and Kiernan, 2014). Specifically, public pension benefits are largely defined in law and often have special legal protections. Private employers generally are given the power to change benefits that will be earned in future years by The Employee Retirement Income Security Act (ERISA), but benefits generally cannot be modified by state governments, or change can be made only by statutory amendment. An important legal consideration is whether there is a binding, legally enforceable contract between the employer and the employee that vests at the time of hire, at a point during the employee's work-life, or at retirement. If a contract exists, it is protected by Article One, Section 10, of the U.S. Constitution, which holds that no state may pass any law that diminished or impairs the obligation of contracts.

However, when pension challenges go to court, the results are not always consistent with that premise. When the city of Stockton, California, filed for bankruptcy in 2012, it was the largest city in the U.S. to have filed for bankruptcy protection. Arguments were made by the city that it must make pension contributions for its public employees before credits are paid the entire amount owed. But it was ruled by the bankruptcy judge that pension obligations should be treated like other debt, thereby allowing cuts in pension benefits (Thompson, 2014).

It is clearly illustrated by these collective case studies – including states, cities, municipalities, and the U.S. military – that public sector retiree benefits are under attack. Because of the ambiguity in accounting rules, it is unclear that actual future potential payments to retirees are reflected by reported pension liabilities. Reported pension liabilities are the basis for taxpayer and lawmaker concerns over pension funding requirements, and ultimately payments made to retirees. As illustrated by the cases presented here, when pension plans are underfunded, as determined by accounting rules, there is pressure on governments to reduce pension benefits. These reductions take a variety of forms, from reduction of cost-of-living increases and increased employee contributions to outright benefit reductions, but in each case presented, retiree income is or will be ultimately decreased.

Reductions in defined benefit pension plans, as well as the growing income gap in the U.S., are documented by previous research. Contributions to the literature are made with the cases presented in this section by clearly illustrating that not only are public sector employee retirement benefits currently declining, but changes are being made to the plans that will reduce those benefits for years to come. These reductions in a substantial portion of the population – especially a group previously considered immune to pension reductions – can only contribute to growing income inequality.

7. Conclusion

The contribution of declining public sector pension benefits to growing U.S. income inequality has been explored in this paper. It is shown by these case analyses that, as expected, reduced pension benefits from such a large segment of the population are a likely contributor to the increasing income gap. Though private sector retiree benefits have been in decline for over a quarter-century, until relatively recently public sector pension plans have been sacrosanct. But it is shown by recent reductions in public sector pension benefits – in the form of increased employee contributions and/or reduced retiree benefits – that pension cutbacks have spilled into the public sector. Historically, public sector employment has contributed to the development of a stable middle class.

This analysis adds to the body of knowledge by supporting the premise that pension cutbacks for public workers are another contributor to the growing income gap in the U.S. Even though a limitation of the current study is that the case analysis approach is not intended to establish a causal relationship, the confluence of numerous forces presented suggests that declining public sector retiree income is a contributing factor to growing income inequality in the U.S.

Writing a decade ago about what he sees as a decline in "political civility," government's current role in income inequality is summarized quite well by Brock (2004):

> "We're increasingly moving to a political system that looks, and feels, like a political barbell: one where all the weight is at the ends of the spectrum, leaving those in the center with little voice or opportunity for impact. It's dangerous, it's counterproductive and I think it represents an assault upon the constitutional premise of balance which has so graced the first two centuries of this republic."

Note re data: All information included in this manuscript is publicly available

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