



Balancing Act

Evaluating public pension policies and reforms: Five key goals and benchmarks for success

BY TRANG HOANG AND GANG CHEN

Discussions about public pension plans often center on familiar concerns: funding gaps, rising contribution pressure, and investment performance. Across the country, many state and local governments are considering policy changes or broader reforms as pension costs place increasing strain on their operating budgets. These reform ideas may get support from those who support pension cost reduction, but they often trigger strong opposition from unions, employees, retirees, and elected officials who want to protect employee benefits.

One useful way to approach these debates is to step back and ask a couple of big-picture questions. What goals should pension policies and reforms achieve,

and what benchmarks should be used to assess progress toward those goals? Clearly defined goals and benchmarks can provide a roadmap to evaluate a pension plan's current conditions, compare policy options against the benchmarks, identify where gaps exist, and determine whether proposed reforms are appropriate.

Drawing on concepts from the recently published book, *Managing Public Pension Plans: Decisions, Challenges, and Reforms*,¹ as well as the broader literature on public pension management, this article identifies five goals that should guide sound pension decision making: sufficiency of pension benefits, affordability of pension costs, sustainability of pension funding, efficiency of asset management, and good governance. Each goal reflects legitimate concerns of

pension stakeholders, and each can be assessed using commonly discussed standards and best practices.

The central argument is that successful pension reform rarely comes from maximizing a single objective. Efforts that are only focused on lowering costs, increasing funded ratios, or improving investment returns can easily undermine other priorities if pursued in isolation. More sustainable and effective reform is usually built on balancing multiple goals. For finance professionals, pension board members, elected officials, and other stakeholders seeking to navigate the public pension system landscape or to pursue change, keeping these goals in mind can provide a more practical framework for managing pension policy and evaluating reform options.

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A balancing act

Pension reform is often difficult to advance because changes in pension policy can have significant effects on multiple stakeholders, whose goals are often in conflict.

Public pension plans were created to provide retirement security for public employees and help governments attract and retain a capable workforce. That mission remains fundamental. For public employees and retirees, sufficient pension benefits are clearly the primary goal, and that goal is often supported by unions and elected officials aligned with them.

At the same time, pension systems operate within a broader public finance context. When benefit levels, employer contributions, or unfunded liabilities place increasing strain on government budgets, pension costs become a major concern for finance professionals and executives who are already managing other spending pressures.

In that environment, the focus of reform often shifts toward reducing pension costs and liabilities in order to improve affordability and long-term sustainability. But those efforts may require benefit changes, higher employee contributions, or other measures that are unpopular with plan members and beneficiaries. As a result, pension policy changes usually involve extensive negotiation with unions, legislatures, and other stakeholders, while also facing legal, political, and fiscal constraints.

The road to reform is therefore a balancing act. It requires meaningful stakeholder engagement, recognition of different interests and perspectives, a willingness to make compromises, and clear communication about current

challenges and reform objectives. Building support is rarely easy, but successful pension reform is more likely when policymakers can balance these competing goals in a deliberate and transparent way.

GOAL #1

Sufficiency of pension benefits

Sufficiency of pension benefits can be defined as a public pension plan's ability to provide retirement benefits at a competitive level that helps governments attract and retain a stable, capable workforce. This goal also implies benefit security—that is, promised benefits can be protected and reliably delivered. A related aspect of sufficiency is preserving the purchasing power of benefits after retirement. Many plans address this through post-retirement cost-of-living adjustments (COLAs).

Because pension plans are also an important workforce management tool, it is fair to say that providing sufficient and stable benefits is one of their primary purposes. Public pension benefits are widely perceived as being more secure and more adequate than the retirement benefits typically available in the private sector, especially when compared with defined contribution plans that do not guarantee benefit levels. Research also shows that pension benefits can support the recruitment and retention of public employees.²

Benchmarks for benefit sufficiency in public defined benefit plans can be drawn from several indicators, including the replacement rate, the benefit multiplier, and the presence of cost-of-living adjustments. Among these measures, the replacement rate is especially useful because it provides a straightforward way to assess how

well retirement income compares with earnings before retirement.

The replacement rate is the ratio of an individual's retirement income to that person's pre-retirement income. A replacement rate of 100 percent means that retirement income fully replaces pre-retirement income and would, in theory, allow the individual to maintain the same standard of living after leaving the workforce. Most financial advisors consider a replacement rate of 75 to 80 percent to be a desirable target for retirement income adequacy.³

Using an 80 percent replacement rate as a general benchmark, employees who also participate in Social Security may be able to reach that level through a combination of pension and Social Security income. Social Security replacement rates vary by earnings level, but they are often estimated to replace roughly 30 to 40 percent of pre-retirement income for many workers.⁴

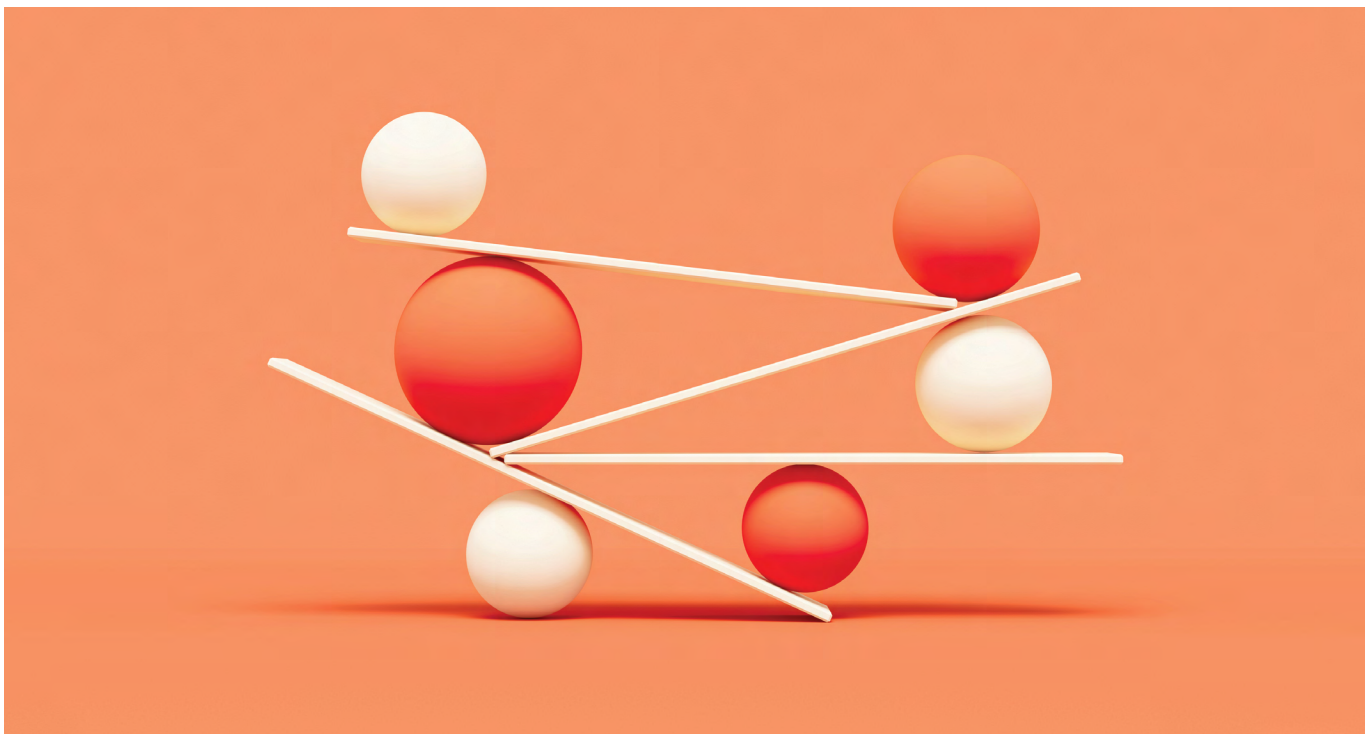
For public pensions, assuming a 2 percent benefit multiplier, a defined benefit plan can provide a replacement rate of around 60 percent for a public employee with 30 years of service. Combined with an estimated 30 to 40 percent replacement rate from Social Security, that level of pension income would allow this hypothetical employee to reach a retirement income level that is generally considered sufficient.

GOAL #2

Affordability of pension costs

Affordability of pension costs means that pension expenses paid by sponsoring governments should be kept at a reasonable level, so they don't crowd out financial resources needed for other core public services. Public dollars are scarce, and governments operate under

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budgetary constraints. Every dollar devoted to pension benefits is a dollar unavailable for other priorities or a potential added burden on taxpayers.

When benchmarking affordability, policymakers often compare annual pension expenses with broader spending or revenue measures. One common approach is to compare the required employer contribution with total payroll, or the sum of salaries paid to employees in a given year. On average, in fiscal year 2021, employer contributions equaled 22.3 percent of payroll in state-administered plans and 35.6 percent of payroll in local government-administered plans.

Another approach is to compare annual pension expenses with a government's overall budget. On average, pension expenses account for about 2.7 percent of total state revenues, while for local governments, pension costs average 7.5 percent of total revenues. The National Association of State Retirement Administrators (NASRA) also estimates that, in the aggregate, state and local governments spend 5.2

percent of their direct general expenditures on public pensions.⁵

When credit rating agencies assign ratings to government entities, the affordability of pension costs is an important factor. Fitch's expenditure framework defines the carrying cost metric as the sum of governmental debt service, pension-required contributions, and other post-employment benefit (OPEB) payments as a percentage of governmental expenditures. Fitch considers a carrying cost metric of less than 10 percent as an "aaa" rating and less than 20 percent as an "aa" rating.

GOAL #3 Sustainability of pension funding

Sustainability of pension funding refers to whether a pension plan has adequate and sustainable funding to meet the liabilities associated with the benefits promised to employees and retirees. The most common measure of funding sustainability is the funded ratio, which is the ratio of pension assets to pension liabilities.

Because public defined benefit plans are prefunded, contributions from employers and employees are set aside in advance to finance benefits as they are earned, and then paid out when workers retire. A decline in the funded level does not necessarily create immediate consequences so long as the plan continues to make benefit payments and receive contributions. For that reason, funding deterioration can be easy to overlook in the short term.

But persistently low funding levels can create both medium-term budgetary pressure and long-term consequences. In the medium term, credit rating agencies may view weak pension funding as an important indicator of a plan's fiscal health and of the sponsoring government's broader financial condition, potentially increasing borrowing costs. Furthermore, lower funding also means fewer assets are available to generate investment returns over time; this often creates the need for plans to maintain greater liquidity, which can limit their ability to pursue long-term investment strategies



required for solvency. In the long term, these dynamics threaten the very sustainability of the plan. Chronic underfunding shifts the financial burden onto future generations of taxpayers and employees—a concept known as intergenerational inequity. Ultimately, the long-term cost of low funding can crowd out essential public services, leaving the government with diminishing fiscal flexibility to meet its future obligations.

Ideally, pension plans should have enough assets to fully cover their future liabilities, meaning a funded ratio of 100 percent. Many regulators and analysts continue to view full funding as the appropriate long-term goal. For example, Standard & Poor's states that "the funding target for public pension and OPEB plans should typically be at least 100 percent."⁶ A broader consensus shared by analysts is that a funded ratio of about 80 percent is a reasonable indicator of long-term sustainability. The Government Accountability Office noted that a funded ratio of 80 percent or more falls within the range that many public-sector experts, union officials,

and advocates view as healthy.⁷ That benchmark has since been widely cited, including in Pew's work on pension funding. Standard & Poor's likewise characterizes a three-year average funded ratio of 80 to 90 percent as "good" and above 90 percent as "strong."⁸

GOAL #4 Efficiency of asset management

Efficiency of asset management means that pre-funded pension assets are invested and managed in a way that allows them to grow consistently and meet appropriate investment performance benchmarks. Investment returns are a major source of pension funding. In fact, from 1992 to 2021, investment earnings accounted for an average of 64 percent of public pension revenue, while employer contributions accounted for 25 percent and employee contributions for 11 percent.⁹

Pension plans often set a long-term rate-of-return target in their investment policies. For many years, the expected rate of return (ERR) for public pension

plans was commonly around 7.5 percent. If pension plans meet or exceed their long-term investment targets, there may be less concern about insufficient benefits, high contribution costs, or weak funding levels. For that reason, achieving the expected rate of return is a widely shared goal among pension policymakers and stakeholders.

Efficiency of asset management also implies strong investment policy, solid investment performance, and reasonable investment and administrative fees. Investment policies establish the fund's return objectives and risk tolerance. Performance is then assessed by comparing returns in each asset class with relevant market benchmarks (such as the S&P 500 for U.S. equities). Fees should also be evaluated carefully when measuring overall investment efficiency. Investment and management costs should be compared with those of funds using similar strategies and portfolio structures, and higher fees should be supported by stronger net returns or other clear advantages. Otherwise, they may reduce rather than improve overall investment efficiency.

GOAL #5

Good governance of pension plans

Governance structure, processes, and practices guide a pension plan's decision making and policy implementation and will eventually affect the other goals. Good governance in this case can be broadly defined as designing appropriate processes and organizational structures for the operation of pension plans.

Rating agencies consider pension plan management and governance when they assign ratings to governments. The governance factors mostly relate to the plan's practices in following accounting and actuarial standards, as well as setting up the due process to control risk, avoiding conflicts of interest, and ensuring balanced representation of diverse stakeholders on the board.

The guidelines and best practices for good governance have been put forward by professional associations.

GFOA's best practices in pension and benefit administration include guidance for preparing pension plan summary documents, educating employees about retirement benefits, selecting investment professionals, reviewing actuarial valuation reports, and disclosing pension funding obligations. According to these best practices, a good pension system "completely, accurately, and clearly describes the significant components of the pension plan for participants" and

should "educate employees about retirement income," "exercise appropriate due diligence in their selection of investment professionals," and "implement appropriate procedures when determining the level of information that needs to be disclosed about their pension funding obligations relative to their financial position."¹⁰

According to the Center for Retirement Research at Boston College, the composition of board members is an important component of board effectiveness.¹¹ A pension board should have the collective skills, experience, and subject-matter expertise to oversee a pension fund's various activities. Additionally, an effective pension board should have adequate stakeholder representation, including plan participants, government officials, and members of the general public. In 2018, 54 percent of public pension board members were plan participants, 15 percent were ex-officio members, and 31 percent were from the general public.¹²

The road to pension reforms

The five goals and their associated benchmarks, drawn from the current literature, are summarized in Exhibit 1.

A practical and sustainable approach to pension reform—and to pension policy discussions more broadly—should be guided by a careful balancing of these five goals. Public pension policy is shaped through a collective and

pluralistic political process in which multiple stakeholders, including pension boards, employers, employees, retirees, unions, finance officers, elected officials, and taxpayers, all have interests and voices. Recognizing these different goals, engaging stakeholders, and being willing to make compromises are essential first steps in any serious discussion of pension reform.

This framework can also help policy-makers communicate more clearly about current challenges by showing where a plan's current condition stands relative to established benchmarks. In that sense, identifying the goals, defining the benchmarks, and assessing the gap between current conditions and those benchmarks can provide a more constructive starting point for pension reform discussions. ■

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EXHIBIT 1 | The Five Goals of Public Pension Plans

Goals	Current consensus on the targets
Sufficiency of pension benefits	Replacement ratio $\geq$ 75–80%, note that Social Security can cover a replacement rate of around 30–40%
Affordability of pension costs	The sum of debt service, pension, and OPEB expenses < 20% of governmental expenditures for an "aa" rating
Sustainability of pension funding	Funding ratio $\geq$ 80%, note that some argue that 100% should be the goal.
Efficiency of asset management	Meeting the long-term expected rate of return (ERR). ERR varies by plan. For most plans, this rate is around 7.5%
Good governance of pension plans	Following best practices in plan governance, accounting, and financial reporting standards, processes, and board composition. Best practices are recommended by professional associations.

¹ Gang Chen, Trang Hoang, and Carol Ebdon, *Managing Public Pension Plans: Decisions, Challenges, and Reforms* (Routledge: 2025).

² Alica Munnell, Jean-Pierre Aubry, and Geoffrey T. Sanzenbacher, "Recruiting and Retaining High-Quality State and Local Workers: Do Pensions Matter?" Center for Retirement Research at Boston College, January 2015; Laura Quinby and Geoffrey Sanzenbacher, "Do Pensions Matter for Recruiting State and Local Workers?" *State and Local Government Review*, August 7, 2020; and Laura D. Quinby, Geoffrey T. Sanzenbacher, and Jean-Pierre Aubry, "How Have Pension Cuts Affected Public-Sector Competitiveness?" Center for Retirement Research at Boston College, April 2018.

³ Peng Jun, "State and local pension fund management," CRC Press/Taylor & Francis Group, 2008; Theodore "Ted" Young, "How to determine the amount of income you will need at retirement," T. Rowe Price insights on retirement, August 3, 2023.

⁴ Kyle Burkhalter and Karen Rose, Replacement Rates for Hypothetical Retired Workers, actuarial note, U.S. Social Security Administration, 2024.

⁵ Issue Brief: State and Local Government Spending on Public Employee Retirement Systems, FY23, NASRA.

⁶ Finance, 2016, 2025.

⁷ State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs, Government Accountability Office, September 2007.

⁸ S&P Global Ratings, State Ratings Definitions, 2016.

⁹ Investment Rate Assumptions, NASRA, 2023.

¹⁰ "Pension and benefit administration best practices, GFOA, 2022.

¹¹ Jean-Pierre Aubry and Caroline Crawford, "Does public pension board composition impact returns?" Center for Retirement Research at Boston College, 2019.

¹² Aubry and Crawford, 2019.