THE PEW
CENTER ON THE STATES

ISSUE BRIEF

The Widening Gap Update

States continue to lose ground in their efforts to cover the long-term costs of their employees' pensions and retiree health care, according to a new analysis by the Pew Center on the States, due to continued investment losses from the financial crisis of 2008 and states' inability to set aside enough each year to adequately fund their retirement promises. States have responded with an unprecedented number of reforms that, with strong investment gains, may improve the funding situation they face going forward, but continued fiscal discipline and additional reforms will be needed to put states back on a firm footing.

$1.38 trillion
The gap between states' assets and their obligations for public sector retirement benefits in fiscal year 2010

- **$757 billion** for pension promises
- **$627 billion** for retiree health care

In fiscal year 2010, the gap between states' assets and their obligations for public sector retirement benefits was $1.38 trillion, up nearly 9 percent from fiscal year 2009. Of that figure, $757 billion was for pension promises, and $627 billion was for retiree health care. While there are many differences between states' liabilities for pensions and retiree health benefits, both represent a sizable financial promise to workers and retirees for benefits they have earned that states will have to manage. Fiscal 2010 is the latest budget year for which complete numbers are available from all 50 states.

Though states have enough cash to cover retiree benefits in the short term, many of them—even with strong market returns—will not be able to keep up in the long term without some combination of higher contributions from taxpayers and employees, deep benefit cuts, and, in some cases, changes in how retirement plans are structured and benefits are distributed. Many states have begun to take action on this problem—nearly every state has reduced pension benefits or increased employee contributions in the last three years, but in many cases these have been relatively minor changes. Some states, such as Colorado, have gone for deeper cuts to their traditional pension plans; while a handful of states have concluded that the reforms already made will not be sufficient to control rising long-term retirement costs and reduce the risk of future underfunding, and that the best alternative is switching to a new pension system, such as the re-designed pension plan that Rhode Island introduced in November 2011.

Many experts say that a healthy pension system should be at least 80 percent funded. In 2000, more than half of the states were 100 percent funded, but by 2010 only Wisconsin was fully funded, and 34 were below the 80 percent threshold—up from 31 in 2009 and just 22 in 2008.

Connecticut, Illinois, Kentucky, and Rhode Island ranked the worst; all were under 55 percent funded in 2010. At the other end of the spectrum, four states were funded at 95 percent or better: North Carolina, South Dakota, Washington, and Wisconsin.

ABOUT PEW'S ANALYSIS

Pew's analysis of states' public sector retirement benefit funding, its fourth since 2007, uses states' own actuarial assumptions about how much money they expect the pension fund to earn, on average, on investments now and in the future. The numbers do not reflect the benefit cuts that many state legislatures enacted in 2010 and 2011 to shore up their pension funds in the future; the condition of some states may have improved because of those reforms. Rhode Island, for example, reduced its unfunded liability by an estimated $3 billion through a series of benefit cuts enacted in 2011.

Pew assessed each state's management of its pension and retiree health care obligations as of fiscal year 2010 based on funding levels and contribution policies. States were rated as "solid performer," "needs improvement," or "serious concerns." (See methodology for more details.)

The pension ratings are based on a state's projected investment rate of return, which for most states is 8 percent. States factor in their expected investment gains when they estimate how much they need to set aside. The Governmental Accounting Standards Board (GASB) is considering new rules that would prompt many states to use a lower rate of return to estimate their bill coming due, which would increase the liabilities states acknowledge.[1] If these rules are adopted, as expected, retirement plan funding ratios would drop, increasing reported pension plan shortfalls. The Center for Retirement Research at Boston College analyzed a database of state and local plans and found that if the new rules had been in effect in 2010, those plans' funding levels would have dropped from 77 percent funded to 53 percent.[2]

50-STATE GRADES

How Did The States Fare?

	Pensions	Retiree Health Care
Alabama	serious concerns	needs improvement
Alaska	serious concerns	solid performer
Arizona	serious concerns	solid performer
Arkansas	serious concerns	serious concerns
California	serious concerns	serious concerns
Colorado	serious concerns	solid performer
Connecticut	serious concerns	serious concerns
Delaware	solid performer	needs improvement
Florida	solid performer	serious concerns
Georgia	solid performer	serious concerns
Hawaii	serious concerns	serious concerns
Idaho	needs improvement	solid performer
Illinois	serious concerns	serious concerns
Indiana	serious concerns	needs improvement
Iowa	needs improvement	serious concerns
Kansas	serious concerns	needs improvement
Kentucky	serious concerns	solid performer
Louisiana	serious concerns	serious concerns
Maine	serious concerns	needs improvement
Maryland	serious concerns	needs improvement
Massachusetts	serious concerns	needs improvement
Michigan	serious concerns	needs improvement
Minnesota	needs improvement	serious concerns
Mississippi	serious concerns	serious concerns
Missouri	serious concerns	needs improvement
Montana	serious concerns	serious concerns
Nebraska	solid performer	N/A
Nevada	serious concerns	needs improvement
New Hampshire	serious concerns	serious concerns
New Jersey	serious concerns	serious concerns
New Mexico	serious concerns	serious concerns
New York	solid performer	serious concerns
North Carolina	solid performer	needs improvement
North Dakota	serious concerns	solid performer
Ohio	serious concerns	solid performer
Oklahoma	serious concerns	N/A
Oregon	needs improvement	solid performer
Pennsylvania	serious concerns	needs improvement
Rhode Island	serious concerns	serious concerns
South Carolina	serious concerns	needs improvement
South Dakota	solid performer	serious concerns
Tennessee	solid performer	serious concerns
Texas	solid performer	serious concerns
Utah	needs improvement	solid performer
Vermont	needs improvement	needs improvement
Virginia	serious concerns	needs improvement
Washington	needs improvement	serious concerns
West Virginia	serious concerns	needs improvement
Wisconsin	solid performer	solid performer
Wyoming	solid performer	serious concerns

solid performer needs improvement serious concerns

SOURCE: Pew Center on the States 2012.

States have not done nearly enough to set aside money for their retirees' health care and other non-pension benefits such as life insurance. As of fiscal year 2010, they had put away only 5 percent of their total bill coming due for those benefits.

Seventeen states set aside no money, and only seven states had funded at least 25 percent of this long-term liability. In contrast, Alaska and Arizona had nearly 50 percent of their health care liabilities covered by assets on hand. No other states came close to that percentage.

Many states have not held up their end of the bargain when they should have been paying for the promises they made. All told, state and local governments participating in state-run retirement systems should have set aside $124 billion in fiscal year 2010 to pay the recommended contribution for their pension and retiree health care obligations. Policy makers were able to make 78 percent of the recommended contribution toward their states' pension plans but set aside just 34 percent of what actuaries recommend should be set aside to pay for retiree health benefits. While it is currently difficult for states to make contributions toward their retirement systems, given the drop in revenues and fiscal stress from the recession, many of these states also failed to make the recommended contributions when times were good.

Investment losses suffered by pension funds during the Great Recession have been a key driver of growth in states' unfunded liabilities. About $6 of every $10 in the funds comes from earnings on investments; employee and employer contributions make up the rest.[3] Most plans projected a gain of 8 percent in 2008; instead, the median loss was 25 percent.[4] The rebound in the market over the last three fiscal years—the median gain was 21.6 percent in 2011—has not made up for those losses or for the underfunding in state retirement systems that preceded the financial crisis.

Higher employer contributions are anticipated for many years, according to a March 2012 survey by the U.S. Government Accountability Office (GAO) of state and local pension fund officials in eight states. Georgia's public pension fund managers told the GAO they expect their state's contribution rates to nearly double in the next five years.[5] In addition, demographic pressures and rising medical costs will increase the price tag of offering retiree health care.

The plunge in tax proceeds during the recession made it even harder for states to make their annual retirement contributions. Tax revenues are up in most states but have not returned to previous levels.[6] At the same time, competing, non-pension costs such as Medicaid are rising. Often, elected officials must choose among funding retirement benefits, raising taxes, or paying for schools, roads, and public safety.

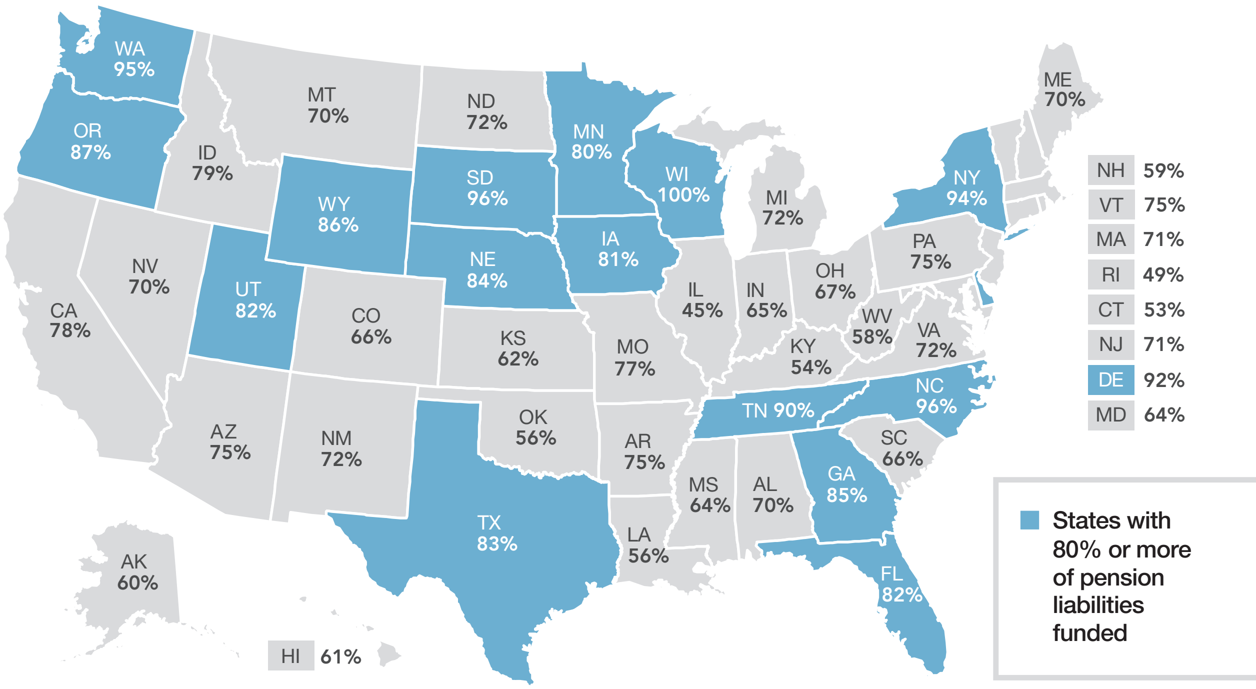
While the Great Recession exacerbated the public sector retirement crisis, it did not create it. Before the downturn, many states drove up their pension liabilities by increasing employee benefits early in the decade, either without considering the price tag or assuming that market gains would cover the cost. In 2001, 11 states expanded retirement benefits; others followed suit in subsequent years. While the trend of increasing benefits without paying for them ended before the Great Recession, many of these states compounded the problem by failing to make recommended contributions in both good times and bad. In 2007, states faced a pension funding gap of $361 billion and a shortfall for retiree health benefits of $370 billion.

Pensions

States' public sector retirement funding gap for both pensions and retiree health benefits grew by $120 billion, from $1.26 trillion to $1.38 trillion, from fiscal year 2009 to 2010. The largest part of that year-over-year growth was the increase in pension liabilities ($126 billion), which outpaced the growth in pension assets ($29 billion). The total public pension liability in 2010 was about $3.07 trillion; assets were $2.31 trillion, leaving a $757 billion gap.

Pew rated 11 states as "solid performers" in managing their pension obligations in fiscal year 2010—overall, these states

The Widening Gap Update: Public Sector Pensions



(Figures are in thousands.)

State	Liability	Percent funded	Required contribution	Percent paid
Alabama	$42,942,101	70%	$1,165,133	100%
Alaska	16,592,762	60	397,137	83
Arizona	46,500,674	75	1,108,252	101
Arkansas	23,822,512	75	567,869	106
California	516,306,424	78	13,320,725	75
Colorado	59,338,149	66	1,346,763	66
Connecticut	44,826,900	53	1,472,000	87
Delaware	7,922,174	92	148,586	97
Florida	148,116,907	82	2,856,920	107
Georgia	81,093,057	85	1,330,043	100
Hawaii	18,483,700	61	536,237	102
Idaho	12,589,300	79	265,835	113
Illinois	138,794,302	45	4,761,507	87
Indiana	39,005,478	65	1,476,131	94
Iowa	27,057,850	81	524,877	89
Kansas	21,853,783	62	682,062	72
Kentucky	37,006,999	54	1,023,900	58
Louisiana	41,356,966	56	1,599,612	84
Maine	14,799,200	70	330,300	103
Maryland	54,498,265	64	1,544,873	87
Massachusetts	63,937,435	71	1,869,172	65
Michigan	77,848,000	72	1,646,859	86
Minnesota	57,604,243	80	1,325,843	65
Mississippi	32,201,243	64	762,327	100
Missouri	57,205,874	77	1,283,551	89
Montana	$11,029,954	70%	$243,754	81%
Nebraska	9,969,089	84	202,150	100
Nevada	35,163,755	70	1,394,802	92
New Hampshire	9,013,758	59	271,582	100
New Jersey	123,234,638	71	4,506,227	32
New Mexico	30,184,912	72	692,779	88
New York	156,572,000	94	2,344,222	100
North Carolina	79,558,260	96	771,800	100
North Dakota	4,977,500	72	107,524	66
Ohio	175,368,439	67	3,770,640	67
Oklahoma	36,368,239	56	1,514,350	70
Oregon	59,329,500	87	472,400	100
Pennsylvania	118,165,428	75	2,795,100	29
Rhode Island	13,382,099	49	306,428	100
South Carolina	43,963,133	66	956,643	100
South Dakota	7,502,301	96	98,876	98
Tennessee	35,198,741	90	836,727	100
Texas	163,417,834	83	3,363,531	82
Utah	25,711,658	82	695,221	100
Vermont	4,090,537	75	89,514	94
Virginia	75,889,000	72	1,594,447	67
Washington	61,747,228	95	1,880,100	53
West Virginia	14,986,050	58	602,221	93
Wisconsin	80,758,800	100	686,700	108
Wyoming	7,740,611	86	152,973	82

NOTE: Based on Fiscal Year 2010 data.
SOURCE: Pew Center on the States 2012.

were 90 percent funded. (See the sidebar on page 2 for a description of the grading methodology.) Two states—Texas and Wyoming—are new to this list since Pew rated states in 2008. Wyoming improved its funding status, while Texas found ways to contribute more toward its pension bill from 2008 to 2010.

Two states—Idaho and Utah—slipped from "solid performer" in 2008 to "needs improvement," joining Iowa, Minnesota, Oregon, Vermont, and Washington, which were in the "needs improvement" category in both 2010 and 2008. The 32 remaining states, all of which were less than 80 percent funded, were judged to be in the "serious concerns" group.

Keeping up with the annual required contribution is perhaps the most effective way that states can responsibly manage their long-term liabilities for public sector retirement benefits. Pew's research shows that states that consistently make their full payments have better-funded retirement systems and smaller gaps. States that paid the full annual contribution for their pensions were 84 percent funded in 2010, while states that did not were only 72 percent funded.

Retiree Health Care And Other Benefits

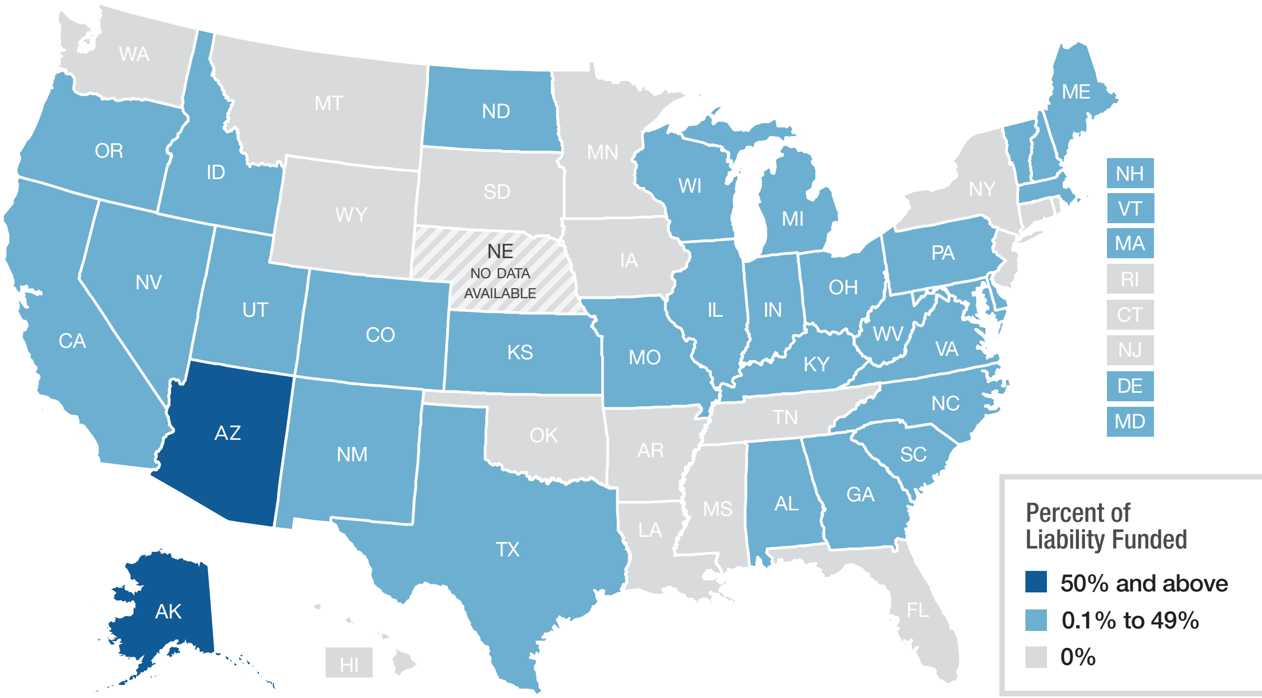
The total bill for retiree health care and other benefits went up less than 4 percent from 2009 to 2010. The liability in 2010 was $660 billion; states had assets to pay $33.1 billion, leaving a $627 billion hole. While individual states have experienced increases and decreases in their unfunded retiree health care liabilities, the overall total went up by about $22 billion from 2009 to 2010.

Just seven states funded 25 percent or more of their retiree health care obligations: Alaska, Arizona, North Dakota, Ohio, Oregon, Virginia, and Wisconsin. Overall, 10 states were assessed as "solid performers." (See sidebar on page 2 for a description of the grading methodology.) Sixteen states earned a "needs improvement" rating, and 22 states had cause for "serious concern." Two states—Nebraska and Oklahoma—do not acknowledge significant obligations for retiree health and did not receive ratings.

Overall, states should have set aside nearly $51 billion to pay for these promises in fiscal year 2010, but they contributed just over $17 billion—about 34 percent of what was annually required. Only Arizona made the full contribution to pay for retiree health care and other non-pension benefits. Thirty-six states set aside less than half.

States set aside pension dollars in advance, but most pay health care costs or premiums as retirees incur those expenses. Soaring health care costs and new accounting standards that call for a more transparent disclosure of these liabilities are forcing some states to consider other ways to provide reliable retiree health care funding in the future.

The Widening Gap Update: States' Retiree Health Benefits



(Figures are in thousands.)

State	Liability	Percent funded	Required contribution	Percent paid
Alabama	$15,746,241	5%	$1,181,606	39%
Alaska	12,419,995	50	1,112,645	77
Arizona	2,284,190	69	121,374	100
Arkansas	1,866,079	0	193,770	24
California	77,371,000	0.1	5,922,899	29
Colorado	2,162,506	14	112,951	80
Connecticut	26,697,800	0	2,267,058	25
Delaware	5,884,000	2	498,300	35
Florida	4,545,845	0	336,419	31
Georgia	19,804,096	3	1,809,514	22
Hawaii	14,007,480	0	887,064	24
Idaho	155,332	12	14,916	78
Illinois	43,949,729	0.1	3,301,420	48
Indiana	402,466	5	54,290	23
Iowa	538,200	0	56,844	42
Kansas	562,152	2	93,045	42
Kentucky	8,754,555	15	901,848	34
Louisiana	10,030,052	0	915,712	25
Maine	2,625,963	6	156,951	52
Maryland	16,530,102	1	1,230,052	28
Massachusetts	16,568,600	2	1,163,000	32
Michigan	45,476,000	2	3,914,806	36
Minnesota	1,172,129	0	124,894	44
Mississippi	727,711	0	55,991	63
Missouri	3,180,260	3	268,307	49
Montana	$540,894	0%	$53,276	0%
Nebraska	NA	NA	NA	NA
Nevada	1,706,543	2	220,709	21
New Hampshire	3,291,683	2	237,508	36
New Jersey	71,371,700	0	5,470,600	28
New Mexico	3,523,665	5	298,000	38
New York	56,826,000	0	3,367,000	37
North Carolina	33,993,147	3	3,091,397	29
North Dakota	161,982	30	14,493	60
Ohio*	43,200,585	32	2,484,569	36
Oklahoma	2,918	0	160	79
Oregon	767,586	31	48,524	69
Pennsylvania	17,465,836	1	1,206,184	59
Rhode Island	774,665	0	55,785	69
South Carolina	9,657,947	5	794,840	38
South Dakota*	70,548	0	7,676	39
Tennessee	1,713,394	0	153,981	40
Texas	55,949,044	1	4,533,005	26
Utah	510,391	22	46,250	96
Vermont	1,628,934	0.5	116,964	19
Virginia*	5,910,000	26	334,854	64
Washington	6,935,749	0	706,251	20
West Virginia	7,410,241	6	347,700	19
Wisconsin*	2,506,683	38	209,799	49
Wyoming	261,545	0	21,148	35

NOTE: 2010 data for all states except Ohio, South Dakota, Virginia, and Wisconsin, which are for 2009.
SOURCE: Pew Center on the States 2012.

Recent Reforms

To manage long-term pension obligations, nearly every state has moved to reduce its retirement bill in the last three years. Between 2009 and 2011, 43 states enacted benefit cuts or increased employee contributions, or did both, according to the National Conference of State Legislatures.[7] The trend continued in 2012: Alabama, Kansas, Louisiana, New York, Virginia, and Wyoming were among the states that adopted major reforms.

The most common actions included asking employees to contribute a larger amount toward their pension benefits; increasing the age and years of service required before retiring; limiting the annual cost-of-living (COLA) increase; and changing the formula used to calculate benefits to provide a smaller pension check. States also have cracked down on abuses, such as the practice of "spiking" final pay to get a larger pension check by including overtime pay and sick leave. While these benefit cuts will help reduce pension plan costs, some states, such as Rhode Island and Utah, have pursued more comprehensive reforms to ensure that their retirement systems will not be a future source of financial distress.

The reforms that states have enacted in the last three years mostly affect future state workers, as it is legally difficult to reduce benefits for current employees and retirees. However, seeking to gain immediate cost savings, some states are testing pension laws. Since 2010, 10 states—Arizona, Colorado, Florida, Maine, Minnesota, New Jersey, Oklahoma, Rhode Island, South Dakota, and Washington—have frozen, eliminated, or trimmed their annual COLA increase for current retirees. Judges in Colorado, Minnesota, New Jersey, and South Dakota have upheld the COLA cuts; legal challenges are pending in some of the others, and some rulings will be appealed.

In 2011, Rhode Island lawmakers approved an unprecedented overhaul of the state's traditional defined benefit pension plan.[8] If the legislation survives a likely legal challenge, it will cut benefits for current as well as future employees and trim the state's unfunded liability by an estimated $3 billion. Current workers will keep the retirement benefits they have earned already, but beginning July 1, 2012, they will earn new benefits at a lower rate. These workers will also get access to a newly created individual retirement account, which will add to their benefits based on the retirement contributions by both the worker and the state. The overall plan is called a hybrid because it combines features of the traditional defined benefit and defined contribution plans. Thirteen states—including Georgia, Indiana, Michigan, Ohio, Oregon, Utah, and Washington—have hybrid plans for teachers or general state workers. Virginia lawmakers approved a hybrid approach in March 2012. For the most part, changes to a hybrid plan affected, or will affect, future hires, not current employees.

Before adopting its new plan, Rhode Island lowered its projected investment returns from 8.25 percent to 7.5 percent to reflect greater uncertainty in the financial markets. Currently, most states estimate annual returns of 8 percent based on historical performance over the past 30 years. But a number of states have decided that their previous investment assumptions were unlikely to be met in the short term and understate the true value of what the governments owe. In 2010 and 2011, 18 public pension plans in 14 states lowered their return assumptions, according to an analysis by Gabriel, Roeder, Smith & Company, an actuarial consulting firm based in Michigan.[9]

While lawmakers have taken more action to curb pension costs, some states have acknowledged the fiscal pressure from their retiree health care promises and have moved to address them. From 2009 to 2011, at least 11 states changed how they offer these benefits.[10] In 2011, Delaware increased the time it takes a worker to earn retiree health benefits from 10 years to 15 years. New Jersey increased employee contributions for retiree health benefits. New Hampshire increased eligibility requirements and capped the subsidy offered to retirees, reducing the state's share of retiree health care costs. In March 2012, West Virginia became the first state to pledge tax revenue to help finance its retiree health care system.

Methodology

The main data sources used for this report were the Comprehensive Annual Financial Reports produced by each state and pension plan for fiscal year 2010. State actuarial valuations were another key source. In total, Pew collected data for 233 pension plans and 166 retiree health care and other benefit plans. Pew was able to obtain fiscal year 2010 data for all major state pension plans. Because of lags in financial reporting, fiscal year 2010 is the most recent year for which comprehensive data are available for all 50 states.

When reporting retirement plan data, Pew used each state's actuarial assumptions. These assumptions include the expected rate of return on investments and estimates of employee life spans, retirement ages, salary growth, marriage rates, retention rates, and other demographic characteristics. States also use one of a number of approved actuarial cost methods and also may smooth gains and losses over time to manage volatility.[11]

These funding figures represent the long-term liabilities for retirement benefits incurred by state-run plans. Our data include both pension benefits and obligations to pay for retiree health care. These types of retirement benefits have some key differences: pension benefits have greater legal protections, while some states may choose to end most or all of their retiree health promises; while some states offer substantial retiree health care promises, others offer minimal benefits that might not require prefunding; pension funding levels are currently vulnerable to stock market swings, while retiree health costs will be impacted by future trends in medical inflation. Despite these differences, the similarities between these two obligations suggest that it makes sense to look at them together—a practice followed by the rating agencies and the GASB. Both are promises to workers that will impose a fiscal cost to the state and participating localities that can be estimated with a reasonable degree of accuracy. These estimates are, of course, based on current policies and estimates. Reforms and benefit cuts can change the size of the future liabilities facing a state; and costs can change as well, if investment returns, longevity, or medical expenses deviate from what states are currently assuming. However, these data give the best estimate of the fiscal challenges facing states for both pensions and retiree health benefits and can help policy makers as they try to manage these twin liabilities.

Pew assigned ratings to each state based on how well the states have managed their public sector retirement benefit liabilities. The pension rating is based on being above 80 percent funded (two points), having an unfunded liability that is less than the payroll for active members (one point), and paying at least 90 percent of the recommended pension contribution over the last five years (one point). Plans that received all four points were solid performers, plans with two or three needed improvement, and plans with one or no points had cause for serious concern.

Ratings for retiree health benefits were based on whether the state's benefits had a funding level above the 8 percent national average (one point), whether 90 percent of the recommended contribution was made in the most recent year (one point), and whether the state's plans were better funded based on the most recent data than they were in the prior year (one point). States with two or three points were solid performers, those with just one point needed improvement, and states with no points had cause for serious concern. The national average for funding these benefits (8 percent) is higher than the aggregate funding level (5 percent) because some states with very large retiree health care obligations—such as California, New Jersey, and New York—have left them almost completely unfunded, which skews the national figure. Because there is no set benchmark for the funding of retiree health benefits, and because states have largely ignored these obligations until recently, Pew chose a relative benchmark to meet states where they are. When states' funding of these benefits has improved, it will be possible to hold them to a higher, fixed standard.

ENDNOTES

1 “Accounting and Financial Reporting for Pensions” and “Financial Reporting for Pension Plans,” Governmental Accounting Standards Board, July 2011.

2 “How Would GASB Proposals Affect State and Local Pension Reporting?” State and Local Pension Plans brief 23, Center for Retirement Research, Boston College, November 2011.

3 “Issue Brief: Public Pension Plan Investment Returns,” National Association of State Retirement Administrators, October 2011.

4 “Public Fund Survey Summary of Findings for FY 2008,” National Association of State Retirement Administrators, October 2009.

5 “State and Local Government Pension Plans: Economic Downturn Spurs Efforts to Address Costs and Sustainability,” U.S. Government Accountability Office, March 2012.

6 According to Pew’s analysis, as of the fourth quarter of 2011, the tax revenue for all 50 states remains 6.2 percent below peak. Only seven states have surpassed their previous peak levels: Illinois, Minnesota, Nevada, North Dakota, South Dakota, Vermont, and West Virginia.

7 “State Pension Reform, 2009-2011,” Ron Snell, National Conference of State Legislatures, March 2012.

8 “Rhode Island Plan Enacts New Approach to States’ Pension Woes,” Pew Center on the States, March 2012.

9 “Governor’s Public Employees’ Retirement System Study Commission,” State of Mississippi, December 2011, p. 17. The states that changed their assumptions are Arizona, California, Colorado, Hawaii, Illinois, Indiana, Missouri, New Hampshire, New York, Ohio, Pennsylvania, Rhode Island, Virginia, and Wisconsin.

10 The states that changed their retiree health care plans from 2009 to 2011 include Connecticut, Delaware, Kentucky, Maine, Maryland, Michigan, New Hampshire, New Jersey, New Mexico, Texas, and Vermont.

11 “Smoothing” is a process where states acknowledge unexpected gains and losses over time to keep assets and liabilities from being volatile due to random fluctuations. This is most prominent with investment returns—when pension plans that use smoothing experience investment gains beyond what they project, they don’t account for all of the gains at once but instead smooth them out over time by acknowledging part the first year and additional parts in subsequent years. So a plan that smoothed over five years and expected to get 8 percent returns but instead got an 18 percent return would acknowledge the expected returns (8 percent) and one-fifth of the gain (2 percent) in the first year, dividing the rest of the gain equally over the next four years. Similarly, when investments drop, as they did in fiscal year 2009, plans will smooth out the losses, meaning that for many states the investment losses will continue until 2013.

The Pew Center on the States is a division of The Pew Charitable Trusts that identifies and advances effective solutions to critical issues facing states. Pew is a nonprofit organization that applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

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