Labor-Relations Strategies to Cut Benefits Costs

Public managers need a game plan for 2011.

Girard Miller | December 16, 2010

In the last *Governing* Management letter, I outlined several key policy strategies for elected officials to pursue in their quest to reform public retirement systems. Before the New Year begins, it's time for public managers to set their strategies for achieving these policy objectives and mitigating the ever-rising costs of retirement plan benefits. This column provides a roadmap.

1. **Get the numbers for the next 15 years.** Graphs with financial projections of pension and OPEB (retiree medical) costs over the next 15 years are necessary to convince procrastinating elected officials and stonewalling union leaders that change is necessary. For pension plans, managers need to demand updated actuarial projections showing:

- Projected employer contribution rates for pension plans over the next 10 to 15 years under the current system — with and without actuarial smoothing. The latter now hides the inevitable cost increases of underfunded pension plans by averaging investment losses over long periods.
- Projected employer contribution rates for pension plans if unfunded liabilities are amortized over the current employees' remaining service lives as the Governmental Accounting Standards Board (GASB) is now considering as the proper basis for cost-allocation. Many employers now amortize over much longer periods, which understates the real costs.
- Projected pension plan costs if the actuarial discount rate is reduced to 7 percent, which is the likely level for many plans under the GASB's preliminary views on that calculation. This will further increase contributions by 10 to 15 percent in many cases.
- Projected annual cost increases for 15 years for OPEB retiree medical plans that are not actuarially funded (pay-as-you-go).
- Projected annual employer costs for OPEB plans if funded actuarially along the same basis as the pension projections above.
- Projected unfunded liabilities of the pension and OPEB plans after 15 years under these assumptions. These data can be converted to bar charts that graphically highlight the massive liabilities facing future taxpayers if action is not taken now to reform the systems, mitigate costs, increase employee contributions and properly fund all benefits.

2. **Get good legal advice**. Before starting a campaign to reform retirement benefits, public managers must first learn precisely what options are legally available to employers in their state. In some states, benefits can be modified more easily than in others. A dozen states have restrictive constitutional limitations or judicial precedents that limit the ability of employers to adjust benefits for retirees and vested incumbent employees. Pension rules are different from OPEB rules, however, so it is important to get the legal lay of the land regarding each type of benefit.

3. **Get the word out to the public and the media.** This data can be shared with the media or presented in an "educational workshop" for elected policy-makers that will focus public attention and public pressure on the labor groups that now receive unsustainable benefits.

4. **Develop a long-term plan.** There are many measures that can be taken to mitigate retirement benefits costs, depending on the state laws that govern employees' vested rights. Usually it is easiest to start with new employees first and craft a new benefits structure that will be affordable, competitive, sustainable and sufficient in the context of today's labor market. This will likely require a "new benefits tier" for new hires that

will be less generous than the provisions for current employees. Lower pension multipliers, higher retirement ages, later starting dates and reduced stipends for retiree medical benefits, and greater use of defined contribution plans are the most common features of a new benefits tier.

For incumbent employees, the first place to start is to raise employee contributions, preferably with a higher contribution rate for those receiving better benefits than the new employees. The next question is whether benefits for incumbents can be adjusted prospectively to reflect the new economic realities facing the employer and the benefits plan. In many states, incumbents' retiree medical benefits are easier to change than pensions. [Note: Pushing the OPEB benefit starting date higher to Medicare age (65) can help reduce pension costs by encouraging longer service careers, which achieves a dual purpose.] Eventually, actuarial projections of the cost savings will be needed. Some benefits consultants can provide back-of-the-envelope estimates of the likely cost savings, or the rank-ordering of the cost impact of various strategies under consideration, to be followed eventually by a more rigorous actuarial analysis as the plan takes shape.

5. **Prepare a campaign strategy**. It's not enough to know how management would like to see the benefits plan ultimately be changed. Especially when collective bargaining and labor arbitration are required by state law, managers must realize that initial proposals are likely to be diluted through the process. Therefore, a more aggressive initial position may be required.

This may require a two-contract strategy in which initial proposals by management are understood by the negotiating team and elected officials to be a multi-year goal in which the first labor agreement will achieve as much savings as possible in the current weak economic environment, and a second round of benefits reforms will be sought in the succeeding labor agreement. The benefit of "thinking big" at the outset is that the magnitude of the long-term problem can be set before labor leaders as an indication that this problem is not going away and needs to be dealt with now. When a first-round proposal by management is dropped, it is important to remind the labor representatives that "we'll be back with this one in the next bargaining round, because it's not going away, as we all know."

Public managers must also remember that they work in a goldfish bowl, and some of their strategies shared with elected officials may leak to the labor groups, especially in jurisdictions with strong union influence in the electoral process. The process should present irrefutable information to such policy-makers so that they are not neutralized by a natural instinct to favor their voting base.

6. **Educate employees.** Many public employees are relatively naïve about their benefits, although increased media attention has made more of them aware of the problems facing their employers. The average public employee is typically risk-averse and is likely to be worried that something really bad will happen to their benefits if the employer fails to address its financial problems and their union doesn't protect them. This core anxiety can be leveraged by public managers who establish good credibility, "talk straight" with employees, share information about the long-term consequences of inaction, and show good faith to construct a path toward long-term sustainability. Employees need to know that the financial problems of the employer will not be taken out of their hides unilaterally, especially if there are other solutions. A solid employee-communications plan is vital to success in achieving long-term retirement benefits reform. Every forum that brings employees together should be viewed as an opportunity to repeat the mantra of sustainable financial strategies and the imperative of long-term benefits reform.

7. **Bargain credibly and flexibly.** Labor representatives can smell a "posturing" pubic manager a mile away. Often they know a lot about the finances of the employer, which are public record, and are well aware of its financial condition. Typically the "personality" of labor relations has been set by prior encounters, and it is important that adversarial personalities be neutralized as much as possible by honest efforts from management to be "straight shooters" and not over-dramatize the problem while persistently presenting the realistic projections outlined in Step 1 above.

Seasoned public managers also know that collective bargaining is indeed a negotiation, and there is an element of give-and-take that must be achieved in order to accomplish end-game objectives. Don't underestimate the ability of labor representatives to express ideas that might work better, and provide clues to a potential settlement strategy. When proposing benefits changes for incumbent employees, for example, it behooves the management team to listen closely to the objections expressed by the labor team, as that may provide clues to the "weak spots" and "hot buttons" they face when trying to win a ratification vote from their membership. Also, some unions respond better to "either-or" choices in which members must decide which option is preferable in their view.

Savvy managers also know that the labor leaders need to save face in their public statements. Notice how many union leaders are taking media credit for knowing that "we have to do something to share the burden, like we always have." Give their leaders a way to make the most of their "sacrifices."

Nobody ever said it would be easy to achieve significant long-term reforms of public retirement benefits plans while working in a goldfish bowl. Public-sector labor laws and union bargaining strength have made the process even more complicated. However, the public's mood has shifted away from sympathy for public workers during the Great Recession and in the "New Normal" economy as watchdog groups and the media have portrayed the employees as much of the problem. Union leaders are well aware of their slippage in the public opinion polls. Next year may be the best year ever for public managers to achieve meaningful long-term reform of their retirement benefits costs, but only if they do their homework in advance and invest the time and energy required to assert the public's interest.