



# **CYPEN & CYPEN**

## **NEWSLETTER**

**for**

### **June 7, 2018**

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Never Forget September 11, 2001  
and  
Always Remember May 2, 2011

#### **1. NEWS ALERT -- SOCIAL SECURITY EXPECTED TO DIP INTO ITS RESERVE THIS YEAR:**

*The Wall Street Journal* reports that Social Security expects to dip into its reserve this year. The Social Security program's cost will exceed its income this year for the first time since 1982, forcing the program to dip into its nearly \$3 trillion trust fund to cover benefits. By 2034, those reserves will be depleted, and Social Security will no longer be able to send its full scheduled benefits, according to the latest annual report by the trustees of

Social Security and Medicare. Unless Congress acts to bolster the program's finances, beneficiaries would receive about three-quarters of their scheduled benefits after 2034.

## **2. UNINTENDED CONSEQUENCES -- HOW SCALING BACK PUBLIC PENSIONS PUTS GOVERNMENT AT RISK:**

Unintended consequences often flow from policy actions that are made with short-term pressures in mind. There is a real risk that reducing or even dismantling public pension benefits will ultimately backfire. In this installment of ongoing research on the impact of public pensions on the U.S. economy, NCPERS set out to quantify that risk. The question asked is this: How does the payment of defined pension benefits and the investment of pension assets impact state and local economies and revenue generation? It is common sense that consumer spending and investment grow the economy, which in turn grows tax revenues. We hear this all the time in the context of tax cuts. Yet opponents of public pensions seem to believe that pension spending and investment do not grow the economy. True, the pension money comes from taxpayers, but it should be understood that it is part of the compensation of workers providing public services. If these services were privatized, they would cost taxpayers more. The goal of private companies is to make profit. The goal of a public service is to ensure the public good. Pensions play an important role in the recruitment and retention of a quality public workforce to ensure our collective good. Previous research has shown that pension beneficiaries bolster the economy by feeding resources back into local communities where they live, work, and spend their pension checks. However, research on how state economies and tax revenues grow when pension funds invest their assets does not currently exist. Our research fills this gap, and is the first of its kind. We examine the broader question of state and local revenues generated by public pensions, and whether these revenues exceed taxpayer contributions. Our original methodology draws on historical data from various public sources, including the U.S. Census Bureau, Bureau of Economic Analysis, and Bureau of Labor Statistics. These data span the years 1977 to 2016 in most instances. The analysis was done in three steps. First, we developed an econometric model to estimate the impact of investment of pension fund assets on state and local economies and revenues. Second, we estimated the impact of spending of pension checks by retirees on state and local economies and revenues. Third, we assessed whether revenues generated by public pensions exceed taxpayer contributions. If so, how much

would taxpayers have to pay in additional taxes if public pensions were dismantled? We measured the economy in terms of personal income. We found that the economy grows by \$1,088 with the investment of each \$1,000 of pension fund assets. This amount may seem small, but due to the size of the pension fund assets, \$3.7 trillion in 2016, the effect on the economy and revenues is significant. The results show that investment of pension fund assets contributed \$587.5 billion to the economy, which in turn yielded \$125.7 billion in state and local revenues. Similarly, the results show that \$303.1 billion paid to retirees in pension checks during 2016 contributed \$757.8 billion to the economy and \$151.9 billion to state and local revenues. Overall, when we add the impact of investment of assets and spending of pension checks by retirees, public pensions in 2016 contributed \$1.3 trillion to the economy and \$277.6 billion to state and local revenues. Are public pension funds net revenue generators? The results show that in 2016 pension funds generated approximately \$277.6 billion in state and local revenues. The taxpayer contribution to pension plans in the same year was \$140.3 billion. In other words, pension funds generated \$137.3 billion more in revenues than the taxpayer contribution. The state-by-state results indicate that pensions in 38 states had a positive impact on net revenues. In the remaining 12 states, either pensions were revenue neutral or taxpayer contributions were greatly subsidized by state and local revenues generated by public pensions. The data that underpin our conclusions are a powerful rebuke to the argument that taxpayers cannot afford public pensions. The evidence we present here shows that if public pensions did not exist, the burden on taxpayers would rise by about \$137.3 billion just to maintain the current level of services. The implication of our findings is clear: Taxpayers cannot afford continued assaults on public pensions. Instead, policy makers must preserve and enhance public pensions, building on this time-honored method of ensuring a dignified retirement to provide retirement security for all. The argument that taxpayers cannot afford public pensions has taken hold with an almost mythological force, seeping into public opinion as an accepted truth. Opponents of public pensions have advanced an us-versus-them storyline in their concerted efforts to undermine and ultimately dismantle public pensions. The fervor with which they argue their case underscores the ideological imperatives that drive them. Factual information, however, has been in short supply. NCPERS has a long history of providing reliable and verifiable data and analysis on public pensions, which are fundamentally a long-term investment, not a short-term budget issue. Using state and local data for the last quarter century, this study sets out to examine the

following questions:

- How much state and local tax revenue is generated as a result of the mere existence of public pensions?
- Do these revenues exceed taxpayer contributions to public pensions?
- How much would taxpayers have to pay in additional taxes if public pensions were dismantled?

Our hypothesis is that public pensions are significant revenue generators. We also hypothesize that state and local revenues generated by public pensions far exceed taxpayer contributions. If we continue to undermine public pensions, taxpayers will have to make up these revenues to maintain the current level of public services. The burden on taxpayers will increase if we make short-term decisions about these long-term investments. Public pensions generate state and local revenues in two ways. First, when retirees spend their pension checks in local economies, the economy grows. When the economy grows, tax revenues grow. Second, when pension funds invest their assets in the economy, the economy and tax revenues grow. While invested assets flow into both national and international companies, significant economic and revenue impact accrues to individual states. It is logical to expect that the total state and local revenues generated by spending of retiree checks and investment of pension fund assets exceed taxpayer contributions in most states. In the remaining states, these revenues are likely to be almost the same as taxpayer contributions. Policy makers are steadily seeking to undermine and even dismantle public pensions based on misleading information from opponents of public pensions. These opponents disseminate huge unfunded liability numbers by distorting various assumptions. They then compare the 30-year unfunded liability numbers with one-year state and local revenues instead of 30-year state and local revenues. They overlook the positive role pensions play in economic and revenue growth. In the end, they argue that taxpayers cannot afford public pensions. They propose that public pensions should be converted into do-it-yourself retirement savings plans or that benefits should be cut and employee contributions increased. Policy makers do not recognize that dismantling public pensions would increase the tax burden on their constituents. Policy makers' attacks on public pensions are also harming state and local economies. Our earlier study shows that dismantling public pensions increases economic inequities and slows down the economy. If public pensions were dismantled, our economy

would suffer a loss of about \$3 trillion by 2025.<sup>3</sup> Policy makers need to consider the positive role public pensions play in economic and revenue growth. This study examines the revenue impact of pensions for each of the 50 states so that policy makers can see how much additional revenue they would have to generate if they stayed on a path to dismantling public pensions. The study is divided into four sections. Section I examines the existing literature on pensions and economic and revenue growth. Section II describes the data and methodology. Section III presents results, and Section IV offers conclusions.

### **3. TIME FOR POLITICIANS TO KEEP THEIR PROMISES AND INVEST IN PENSIONS:**

Across the United States, there has been a spring awakening for teachers and other public employees this year. Teachers, school support staff students and parents have been rallying at state capitols to demand higher pay and better funding for public education. What started in West Virginia has spread to Kentucky and Oklahoma, Colorado and Arizona, and now possibly North Carolina. While public pensions have really only featured in the Kentucky protests, they deserve consideration as part of the broader conversation about pay and funding. Public pensions are an investment in the public sector workforce. They come with a simple promise that for every year a public employee works serving their community, their employer will contribute toward their retirement. At the end of their career, public employees will have the security and reliability of a defined benefit pension waiting for them. They have earned this part of their compensation over the years and contributed to it themselves out of each and every paycheck. Pensions are an explicit part of the deal when they become public servants. The problem, as most Americans now know, is that politicians do not always hold up their end of the bargain. State legislators have underfunded public pension plans by skipping or deferring payments. This is even worse than it sounds. Since pension plans receive up to three-quarters of their revenue from investment returns, missing employer contributions hurt the fund overall. The more money you invest and the earlier you invest it, the more money you will be able to earn in the years to come. Every time a city or state government skips a pension payment, public employees not only lose that sum, but also the returns it would have earned, so legislators are leaving money on the table. Underfunding public pension plans is not a new phenomenon. However, the past decade has seen an increase in the number of attacks on public pensions. This was driven partly by the financial crisis and ensuing recession. During this time, public pension funds lost, on average, a quarter of the

value of their assets, while individual investors saving in 401(k)'s and other defined contribution plans lost a similar amount. Critics, sensing a moment of weakness, pounced and claimed the sky was falling and that public pensions had to be abandoned altogether. What these critics conveniently ignored, however, is that pension plans have time to recover the value of their assets. Unlike individuals saving in a 401(k), public pension plans do not have an end date. They can continue investing on an infinite time horizon as long as new employees are paying into the fund while retired employees are collecting their benefits. Abandoning public pension plans is both unnecessary and foolish. It is also part of a larger attack on public employees. Just like public pension plans, adequate pay for teachers and robust funding for public schools are investments in the public sector and the common good. Public education makes America great by ensuring future generations of citizens will be knowledgeable and productive members of society. An educated workforce helps our economy thrive. Public education cannot succeed, though, when it is underfunded. Since the recession, those who wish to shrink the public sector have pushed for cuts to education funding, public pensions, and other investments in our communities. Teacher pay has stagnated, classrooms are overcrowded, and a number of states face critical teacher shortages. This lack of investment has consequences, and people are finally pushing back. The teacher strikes in West Virginia, Oklahoma and Arizona have resulted in meaningful increases in teacher pay and education funding. Public pensions were not a factor in these three states, but it is important to remember them. Research has shown that pensions are an important workforce management tool for recruiting and retaining the best workers. Pensions also provide a secure and dignified retirement for our public employees. Poorly funded pensions represent a lack of investment in the public sector, the same as meager education funding and inadequate teacher pay. These inadequate investments threaten future generations, and taxpayers across the nation are beginning to recognize that. Tyler Bond, opinion contributor, prepared this piece for *The Hill*.

#### **4. STATE PENSION FUNDING RISES NEARLY 3 PERCENTAGE POINTS IN FISCAL YEAR 2017:**

The aggregate funded status of 130 state pension plans rose 2.8 percentage points to 70.2% in fiscal year 2017, said Wilshire Consulting's most recent annual state pension funding report released. Of the 130 defined benefit plans analyzed, fiscal year 2017 data

were available for 71. The remaining pension funds' 2017 data were estimated. Most of the plans analyzed had a fiscal year that ended June 30. For the 71 plans that provided fiscal year 2017 data, pension fund assets grew by 9% over the year to \$3.17 trillion, while liabilities increased 5% to \$4.518 trillion. Overall assets were up 9.2% from 2016, while liabilities were up 5% from the year before. "A primary driver of the improvement in the funding ratio was the increase in global equity values for the 12-month period ending June 30, 2017," said Ned McGuire, vice president, on the results. "In fact, the estimated aggregate asset value is the highest since Wilshire began reporting on state retirement system funding levels." Wilshire's report, which also looks at plans' asset allocation, found movement out of U.S. equities and into other growth assets such as non-U.S. equities, real estate and private equity over the past decade. The average allocation to U.S. equities in 2017 was 29.9%, down 11.1 percentage points from 2007. Over the same time period, the average allocation to non-U.S. equities rose 0.5 percentage points to 18.7%, real estate rose 8.7 percentage points to 13.9%, and private equity rose 4.4 percentage points to 9%. Looking at the other asset classes that Wilshire tracks, plans' average allocation to U.S. fixed income fell 4.5 percentage points during the 10-year period to 22.8%, while the average allocation to non-U.S. fixed income and other non-equity assets (cash and cash equivalents, commodities, hedge funds and other absolute-return strategies) rose 2.1 percentage points to 5.8%. James Comtois wrote this piece for Pensions & Investments.

#### **5. FLORIDA SUPREME COURT RULES ON RED-LIGHT CAMERAS; DRIVERS MAY NOT BE HAPPY:**

Miami *Herald* writes that local governments can still use red-light cameras to catch traffic violators, the Florida Supreme Court ruled unanimously, resolving conflicting decisions from lower courts on how the devices should be used in ticketing traffic infractions. The court's decision to uphold a 2010 state law allowing local governments to use the cameras stemmed from a ticket given to South Florida driver Luis Torres Jimenez, who sued the city of Aventura, saying the city had ceded too much authority by allowing its red-light camera vendor to review footage of possible violations. Attorneys acknowledged that Jimenez had committed a traffic infraction by making an illegal right turn on red but argued that allowing American Traffic Solutions, the camera vendor, to initially review footage before sending it to police created an "unconstitutional filter" that ceded too much

enforcement power to a third party. A Miami-Dade County judge had overturned the ticket, after a state appeals court ruled in 2014 that a separate red-light camera program in Hollywood was unconstitutional because the cameras delegated too much enforcement oversight to the private vendor.

## **6. TALLAHASSEE FIREFIGHTERS WANT TO ROLLBACK THEIR PENSION CONTRIBUTION:**

According to Jeffrey Schweers, of the Tallahassee *Democrat*, a request by Tallahassee, Florida firefighters to renegotiate part of their recently approved contract, to lower their pension contribution rate, could cost taxpayers about \$1.3 million. Union leaders asked to reopen contract negotiations for firefighters, saying the proposed bargaining agreement for police officers does not include an increase in the employee contribution rate, and it would be unfair for the city to seek increases from firefighters. Under the contract approved in October, the employee contribution rate is currently 17.47 percent, and is scheduled to increase to 19.08 percent next year and to 20.69 percent in 2020. Firefighters want to rollback their pension contribution rate to 16 percent for the remaining two years of the agreement. If the city were to keep the employee contribution rate at its current 17.47 percent, it would cost the city an additional \$820,464, which would come out of the Fire Services Fee Fund. City Human Resources administrators are recommending the City Commission make no changes to the firefighters' pension plan contributions. The city offers three different pension plans — one for general employees, one for firefighters and one for police. The amounts contributed by employer and employee are established by actuarial studies that forecast the total cost of future benefits and the current investment necessary to fund each plan. As of the most recent actuarial review, the General Employee plan is funded at 92.6 percent, the Police Officer plan is funded at 83.1 percent and the Firefighter Plan is funded at 78 percent. During contract negotiations with the International Association of Firefighters, the firefighters union, staff said, both sides paid special attention to the long-term viability of the pension fund. The plan's benefits and funding level were reviewed, and the overall contribution rate was analyzed. "The IAFF recognized the need to improve the financial health of the plan and agreed to several changes in benefits for new employees," staff said. The IAFF also agreed to increase its contribution to the plan. The new contracts, approved by the union in October, include the graduated increase in employee contributions to the pension plans, as well as an across-

the-board raise of 3 percent each year, a graduated increase in the employee contribution to the pension plan and elimination of employee contribution when the employee enters the Deferred Retirement Option Plan. Those hired after October 1 will see no cost-of-living adjustment while in DROP for future DROP participants, the cost-of-living adjustment moved from age 52 to age 62 and average final compensation calculated upon the highest five years of average compensation rather than the highest three years of average compensation. Those hired after October 1 will also have a 10-year vesting period instead of five years, and the annual accrual rate will be 3 percent for all years rather than 3 percent for the first 20 years of participation.

## **7. MORE PEOPLE NOW WORK FOR THEMSELVES IN MIAMI THAN ANYWHERE ELSE, STUDY SAYS:**

If you are working alone in Miami, you are not alone. A new [analysis](#) shows that Miami has the largest share of independent workers in the country, when viewed as a share of contribution to metro Gross Domestic Product. Fiverr, a marketplace for independent workers and freelancers, analyzed the growth of businesses without any payroll among tech, artistic and professional service occupations. That would include lawyers with private practices, solo contractors like plumbers or software engineers and artists (and leaves out groups like Uber drivers, who did not fit into any of the three occupation categories). Fiverr found that between 2011 and 2015, the number of these solo businesses grew 11 percent across the 15 major metro areas measured. In the Miami metro area, which includes Broward and Palm Beach counties, this group zoomed ahead 23 percent—and revenues grew even faster, at a rate of 32 percent. This workforce now comprises 2.13 percent of the Miami's economy in 2016, the most for any major metro. Perhaps surprising, given Miami's reputation as an arts hub, Miami had the lowest share of independent arts professionals of any city; they made up just 13 percent of the area's independent workers. Miami's largest share was from professional service workers like lawyers, at 54 percent. The independent professionals trend is spreading nationwide. The nature of the full-time workforce has changed, with a variety of structural factors including the Affordable Care Act, a shift from a manufacturing-based to service-based economy in many areas and increasing outsourcing and off-shoring of tech jobs leaving many skilled workers with limited or even no attractive full-time job options. For many of these workers, self-employment or a mix of part-time employment and entrepreneurial work is an attractive

option. The latest report confirms an earlier survey by The Stephen S. Fuller Institute at Virginia's George Mason University, which also ranked Miami as No. 1 in the nation for independent professionals. According to Kevin Greiner, senior fellow at the Florida International University Metropolitan Center, this workforce dominates here because there are fewer large corporations in Miami than in other metros. South Florida also tends to draw highly skilled immigrants who create their own businesses. The Miami *Herald* documented the lives of several of these workers last fall. Joseph Nay, a web designer based in Hollywood, summed up the experience of the unpredictability of finding steady clients. "It has been a fun ride, tiring but fun," he said. This piece is from Rob Wile of the Miami *Herald*.

#### **8. PSCA OFFICIALS SAY NEW DOL GUIDANCE WILL DAMPEN ADOPTION OF ESG INVESTMENT:**

Plan Sponsor Council of America officials say that new guidance from the Department of Labor on ESG investments will likely discourage sponsors covered by ERISA from adding ESG investment options to their lineups. According to Meghan Kilroy and Robert Steyer, the DOL guidance "will make it potentially more difficult" for plan fiduciaries to feel comfortable in offering such options, said Kenneth Raskin, PSCA board chairman. "Fiduciaries will want to play it safe." Mr. Raskin, a partner at the King & Spalding law firm, made his comments in a discussion with journalists at the PSCA annual conference in Scottsdale, Ariz. The DOL guidance, issued through a field assistance bulletin, said in part that "fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision." David Levine, PSCA's Washington lobbyist, said the DOL guidance did not offer a completely clear definition of an ESG investment option. For example, he noted that one footnote in the DOL document added to the uncertainty. The footnote said in part that ESG-themed funds "should be distinguished" from non-ESG funds in which "ESG factors may be incorporated as one of many factors in ordinary portfolio management." Mr. Levine is a principal at the Groom Law Group. So far, ESG funds have not made much of a dent in DC plans covered by ERISA, according to the latest survey by PSCA of its members offering 401(k) or profit-sharing plans. Of 684 respondents covering the 2016 plan year, only 2.4% offered ESG funds. It is still "too early" for ESG funds to play a big role in plan lineups, said Stephen McCaffrey, immediate past board chairman of PSCA and senior counsel of National Grid

U.S. "In time, it will happen." Mr. Raskin added that ERISA plans can overcome concerns by providing access to ESG funds through self-directed brokerage accounts. PSCA officials also said sponsors must be aware of their relationships with record keepers due to the recent overturning of the fiduciary rule by the 5th U.S. Circuit Court of Appeals, which the DOL declined to appeal. The key issue is contracts sponsors may have signed with record keepers when the rule was initially enacted and when some record keepers offered to take on additional fiduciary responsibilities. "Beware of record-keeper contract changes," Mr. McCaffrey said. "Service provider models may change," Mr. Levine added.

### **9. DISASTERS DO NOT PLAN AHEAD, BUT YOU CAN:**

With Hurricane Preparedness Week having ended, IRS reminds taxpayers to prepare for hurricanes and other natural disasters now. By taking a few steps before disaster strikes, taxpayers can reduce their stress when it comes time to file claims or rebuild after the catastrophic event.

Here are some things for folks to consider:

- **Update Emergency Plans.** Because a disaster can strike any time, taxpayers should review emergency plans annually. Personal and business situations change over time, as do preparedness needs.
- **Create Electronic Copies of Documents.** Taxpayers should keep documents – including bank statements, tax returns and insurance policies – in a safe place. Doing so is easier now that many financial institutions provide statements and documents electronically. Even if original documents are available only on paper, people should scan them into an electronic format and store them on DVD, CD or cloud storage.
- **Document Valuables.** It is a good idea for people to photograph or videotape the contents of any home, especially items of higher value. Documenting these items ahead of time will make it easier to claim insurance and tax benefits after a disaster strikes. IRS has a [disaster loss workbook](#), which can help taxpayers compile a room-by-room list of belongings. Photographs can help prove the fair market value of items for insurance and casualty loss claims.
- **IRS is Ready to Help.** In the case of a federally declared disaster, affected taxpayers can call 866.562.5227 to speak with an IRS specialist trained to handle disaster-related issues. Taxpayers can request copies of previously filed tax

returns and attachments, including Forms W-2, by filing [Form 4506](#). They can also order transcripts showing most line items through [Get Transcript](#) on IRS.gov by calling 800-908-9946 or by using [4506T-EZ](#), or [4506-T](#).

**Additional IRS Resources:**

- [Preparing for a Disaster](#)
- [Publication 584-B, Business Casualty, Disaster, and Theft Loss Workbook](#)
- [Publication 547, Casualties, Disasters, and Thefts](#)
- [Publication 583, Starting a Business and Keeping Records](#)

Tax Tip 2018-70

**10. NEW OFFICE ADDRESS:**

Please note that Cypen & Cypen has a new office address: Cypen & Cypen, 975 Arthur Godfrey Road, Suite 500, Miami Beach, Florida 33140. All other contact information remains the same.

**11. LEXOPHILES:**

This girl today said she recognized me from the Vegetarians Club, but I would swear I have never met herbivore.

**12. INSPIRATIONAL QUOTES:**

Few things can help an individual more than to place responsibility on him, and to let him know that you trust him. – Booker T. Washington

**13. TODAY IN HISTORY:**

- On this day in 1929, Vatican City becomes a sovereign state.
- On this day in 1965, the Supreme Court of the United States decides on *Griswold v. Connecticut*, effectively legalizing the use of contraception by married couples.

**14. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.**

