

The Effects of Political Competition on the Generosity of Public-Sector Pension Plans

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Abstract

In politically competitive jurisdictions, there can be strong electoral incentives to increase the generosity of public pensions and simultaneously, to not fund them fully, in order to keep taxes low. I examine the relationship between political competition and generosity of public pensions using a panel dataset for 3,000 municipal plans from Pennsylvania for the period 2003–2013. I find that as the level of political competition in a municipality increases, pension plans become more generous but this relationship holds true only for plans run by municipal governments. A one standard deviation increase in the level of political competition is associated with an increase in the generosity of municipal plans by about 3 percent (\$426–507/ retiree/ year) with no effect on plans run by municipal authorities. The effects of political competition are driven by municipalities that have a higher proportion of uninformed voters and are absent for defined contribution plans.

Intuition for why higher political competition at the municipal level results in more generous benefits

- Competition for votes creates incentives for politicians to promise generous retirement benefits to workers in the public sector AND
- Simultaneously, to not fund them fully, in order to avoid raising taxes on workers in the private sector.
- These incentives are stronger in environments of significant political competition, when neither party has a systematic electoral advantage.
- Higher degree of political competition is thus expected to lead to an increase in the generosity of retirement benefits and a decline in the funding status of pension plans run by those municipalities.

However, political competition is unlikely to affect municipal authorities in a similar manner

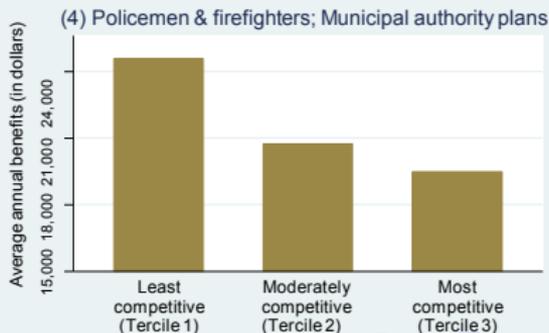
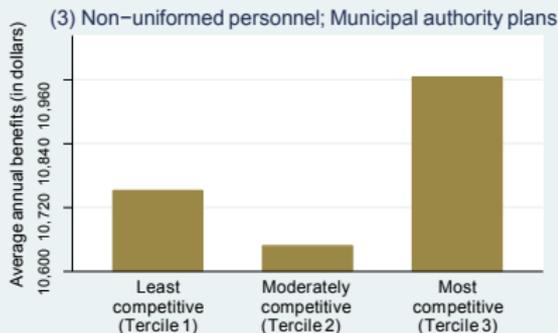
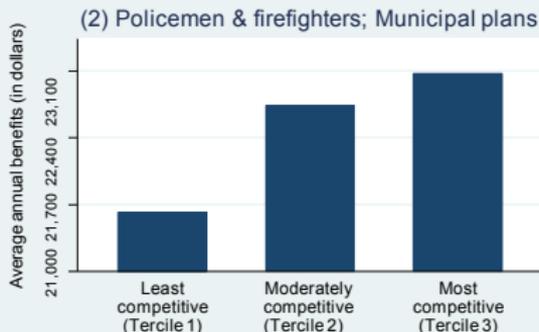
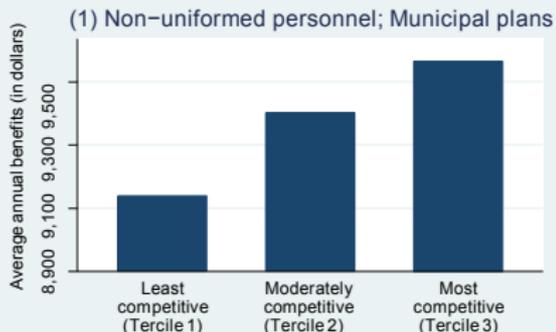
- Municipal authorities are special-purpose govts. that perform a limited number of functions (e.g. Scranton Sewer Authority).
- Municipalities opt to providing some services through these authorities as their governance is more conducive to running efficient business-like operations.
- Authority boards are appointed for 5-year overlapping terms. Thus unlike a city council that can change *en masse* after an election, authority boards are insulated from the will of voters.
- This insulation of municipal authorities from political influence along with their ability to establish pensions forms the basis of our differences-in-differences approach where we compare plans run by municipalities with those run by municipal authorities.

For our empirical analysis we turn to Pennsylvania

- Pennsylvania provides a rich setting for us because its local governments offer over 1,400 retirement systems that account for *over 40% of all public-employee retirement systems nationally*.
- The state has so many local plans because (a) it has the 2nd highest number of local governments in the country and (b) there has never been a consolidation of local plans at the state level.
- Given the political landscape of the state, we also observe wide variation in the level of political competition, our independent variable of interest.
- We are also able to use a high-quality administrative panel dataset spanning 2003–2013 for our analysis. The data do not suffer from non-response bias and cover all local pension plans.

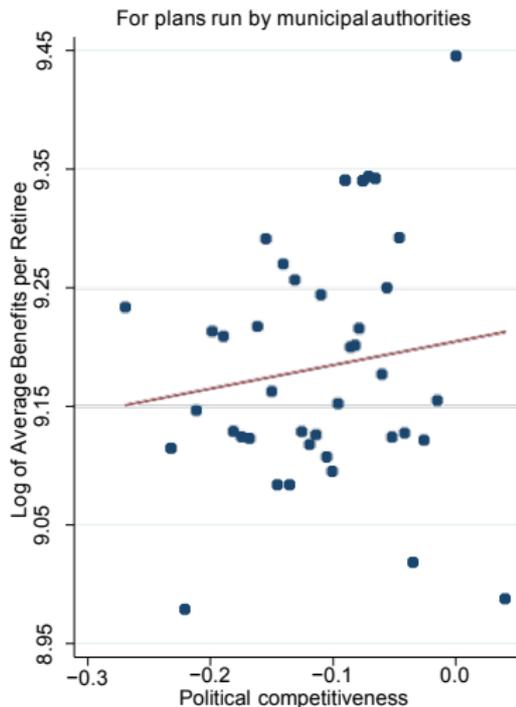
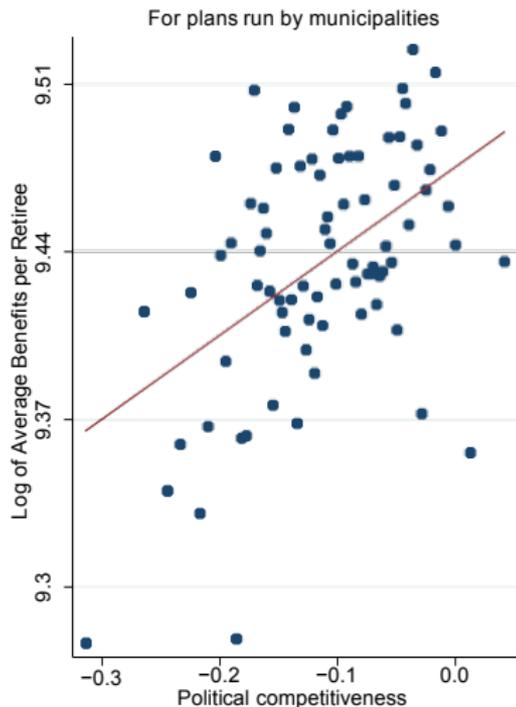
Variation in Benefit Levels w/ Political Competition for Municipal Plans & Plans run by Municipal Authorities

Variation in Benefit levels with Political Competition for Retirees of Various Plans
Split by terciles in the underlying level of political competition



Effects of Political Competition on Benefit Levels for Municipal Plans & Plans run by Municipal Authorities

Effects of political competition on generosity of benefits



Two other key analyses: Examining Effects of Pol. Comp. on Defined Contribution plans & Distinguishing municipalities based on voter awareness

- Examining the effects of pol. comp. on Defined Contribution plans:
 - About 1/4 of the PA pension plans are defined contribution (DC).
 - Because a more generous DC plan requires higher employer contributions TODAY –which require tax increases today –the effects of political competition on DC plans are likely muted.
 - Those predictions are confirmed in the data: Political comp. has no effect on the employer contribution rate for DC plans.
- Distinguishing municipalities based on voter awareness:
 - Underfunding DB pensions can persist only if private-sector voters don't realize that they will bear the burden of pension funding shortfalls through a combination of tax increases and service cuts.
 - Using data on the prevalence of newspaper readership at the local level as a proxy for voter awareness, I find that the effects of political competition are muted (in fact, absent) in municipalities where a larger fraction of residents subscribe to a newspaper.

Effects of Political Competition on Benefit Levels for Municipal Plans that differ by Voter Awareness

Effects of political competition on generosity of benefits

