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OPINION | ROBERT POZEN

Boston must rein in retiree health plans

By Robert Pozen | JANUARY 05, 2014

WHILE THE problems of Detroit have highlighted the large deficits in municipal pension plans, less attention has been given to the even larger unfunded obligations of cities to pay the health care benefits of their retired employees — called retiree health care plans, or RH plans.

Most recently, in 2011 Boston reported an unfunded deficit of $3 billion for its RH plan, an ostensible decrease from $4 billion in 2009. In fact, if Boston had not raised by two full percentage points its assumed expected returns on current and future plan assets, its unfunded RH plan deficit would have increased from $4 billion in 2009 to approximately $5 billion in 2011.

That change in assumptions is particularly dubious because Boston's RH plan in 2011 held assets of only $111 million. To pay billions in health care obligations as they become due, Boston will have to rely mainly on future tax revenues.

How did Boston dig itself into such a deep hole? Until 2004, no city was required to report publicly its unfunded obligations in any RH plan, so politicians could quietly expand the health care benefits of municipal employees. Under Boston's RH plan, the highest costs are for city employees who retire at age 50 or 55 and will be covered by the city until they join Medicare at 65.

The health care benefits are quite generous. For example, a married couple (both age 58) would pay roughly $1,000 per month for the medium bronze plan offered by the Massachusetts Health Connector under Obamacare. The bronze plan is the least expensive of the three levels of Obamacare (below silver and gold), so all bronze plans have hefty annual deductibles.

Under Boston's RH plan, however, the least expensive health care policy available to that same couple would cost at least $1,500 per month, with a relatively low annual deductible. Boston pays 70 percent to 80 percent of these costs for most of its retired employees.

Retiree health care benefits have historically been justified as necessary to retain long-term city employees who, according to their union representatives, earn lower salaries than their private-sector counterparts. Even if this justification remains valid to some extent, Boston is particularly generous with its short-term and part-time employees. The city picks up a portion of the health care premiums for any retiree with as little as 10 years of city service. Part-time work, meanwhile, counts as if it were full-time for this purpose.

Moreover, even when city employees join Medicare, Boston pays 50 percent of their premiums for Medicare Part B as well as more than 70 percent of the costs for supplemental Medicare plans like Medigap. Many municipalities in Massachusetts pay no portion of Medicare Part B premiums for their retirees, and almost none pay more than 20 percent of such premiums.

Fortunately, Boston's RH plan is legally easier to amend than its pension plan. So what should be done by the incoming administration?

1. Accurately compute the unfunded obligations of the RH plan so we can have an honest debate. Do not arbitrarily change assumptions to make the plan look less costly.

2. Start making significant advance contributions to the RH plan. These contributions should be invested prudently to help defray future benefit obligations.

3. Limit retiree health care benefits by statute to Boston employees with at least 20 full years of city employment. Part-time work should count only partially, on a proportionate basis.

4. Contribute no more than 20 percent of any Medicare-related premiums for city retirees. Medicare premiums are already less for low-income members than for high-income participants.

5. Require all members of the RH plan, before age 65, to obtain their health insurance through the Massachusetts Connector. That way, many will be eligible for federal premium subsidies, which can help reduce the cost of the RH plan to Boston.

6. Reconsider the benefit package provided by the RH plan, including deductibles and co-payments. Possible benchmarks would be the bronze and silver policies offered by the Massachusetts Connector.

Implementing these reforms will take political courage and skill on the part of the new mayor. To reduce backlash, he should introduce them gradually, with grandfathered benefits for those city employees who have already retired.

The unfunded deficit of Boston's RH plan is a long-term problem requiring a long-term solution — but we need to get started on that solution now.

Robert C. Pozen is senior lecturer at Harvard Business School and senior fellow at the Brookings Institution. His latest book is "Extreme Productivity: Boost Your Results; Reduce Your Hours."

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