Discussion: Risk on the Run

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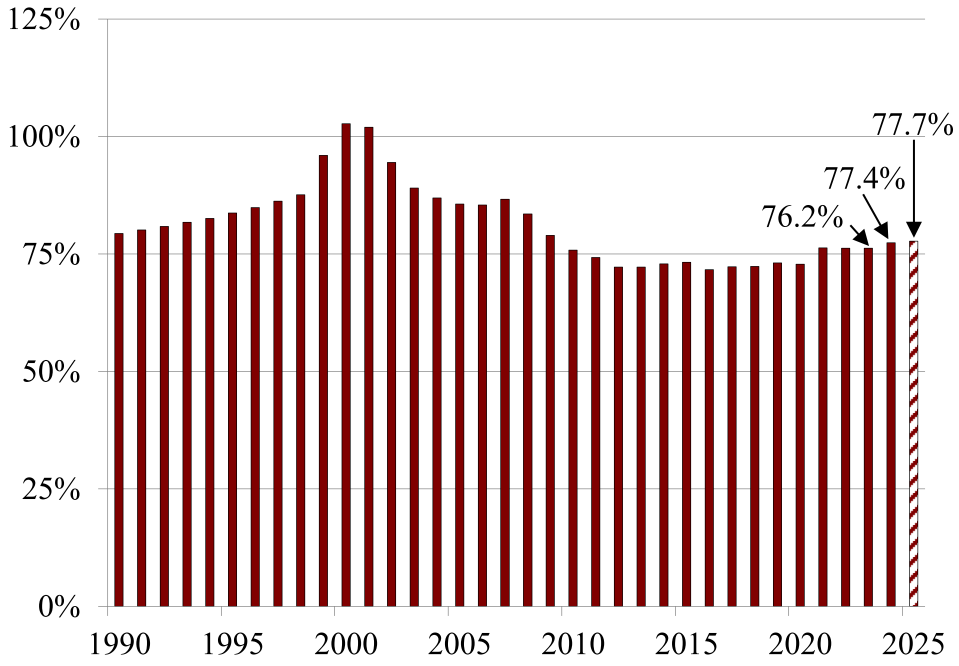
Public pension funding has steadily improved since the financial crisis, but the road ahead is long.

Aggregate Funded Ratio for State and Local Pension Plans, FY 1990-2025



Source: Jean-Pierre Aubry and Alicia H. Munnell. 2025. "The Funded Status of Public Plans Keeps Improving – Albeit Modestly." *Issue in Brief* 25-15. Chestnut Hill, MA: Center for Retirement Research at Boston College.

A large literature studies the implications of the funding gap.

- How states and localities are responding to rising costs
    - Kim et al. (2021); Randazzo et al. (2021); Dambra et al., (2023); Anzia (2024); Auby and Quinby (2025); Fan (2025).
- Impacts on the municipal bond market
    - Munnell et al. (2011); Aubry et al. (2017); Boyer (2018); Martell et al. (2013).
- Whether states can maintain partial PAY-GO funding
    - Lenney, Lutz, Schüle, and Sheiner (2021).
- How plan sponsors reach for yield
    - Campbell and Sigalov (2022); and Begenau, Liang, and Siriwardane (2025).
- Whether pension finances impact migration and vice versa.
    - Aubry and Crawford (2016); Hoang (2022).

This paper points out that plan sponsors are constrained by taxpayer mobility.

- Sponsors who try to improve pension funding by raising taxes or reducing other spending experience out-migration.
- Governments particularly susceptible to out-migration respond to shocks by investing more heavily in alternative assets.
- Note: these alternatives have not performed well for many public plans (Aubry 2022; Aubry and Yin 2024).

While intuitive, I have a few questions about aspects of the model.

- Public plans historically operated as partial PAY-GO systems.
  - The pressure to fully fund comes largely from the bond market.
  - Is there a point at which the improvement in bond ratings is not worth the loss of the tax base?

- Are taxpayers forward looking? Well informed?
  - Why are taxpayers suddenly reacting to liabilities that have been on the books for decades?
  - Do they perceive a risk of future shocks in currently well-funded locations?

Moreover, I was surprised that pension funding has a large effect on migration given prior literature on state taxes.

- Some studies find that higher taxes strongly encourage migration:
  - (Hsieh and Wang 2022; Moretti and Wilson 2023; Rauh and Jaros 2022; Rauh and Shyu 2024)

- Others find weak/negligible effects:
  - (Conway and Rork 2012; Young and Varner 2011; Young et al. 2016; Young and Lurie 2025)

Identifying the causal impact of pension shocks on state fiscal policy and migration is very challenging.

- One approach in the literature is to use quasi-random investment returns.
- This paper operationalizes that approach as follows:
  - Take the cumulative average return on equities and fixed income (weighted by the state's 2001 allocation);
  - Subtract the state's assumed return in 2001;
  - Run a regression where this "synthetic return shock" is an instrument for funded status;
  - With controls for year and state.

Where is the variation in the instrument coming from?

- What drives differences across states and over time, after controlling for year and state?

- The variation comes from the **joint interaction** between:
  - The state's risk preferences in 2001;
  - How they expected their specific stock and bond holdings to perform;
  - National trends in equity and bond markets.

- The exclusion restriction requires this joint interaction to be uncorrelated with any other factors that could also affect state fiscal policy and migration.

Ultimately, this interesting paper raises a practical question: what should state policymakers do?

- There are no easy answers.

- Most states and localities have been slowly modernizing their contribution policies and benefit structures – but investment policy could be improved.

- It would also be interesting to know whether migration is sensitive to the specific way in which sponsors close the gap (benefit cuts, reduced amenities, higher taxes).

Thank you!

Visit the Public Plans Database (PPD) to learn more:

https://publicplansdata.org/

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