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Sarah F. Anzia* and Mark Spindel

# Labor's Capital: Public Pensions and Private Equity

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**Abstract:** This article describes the large and growing interdependence of public pensions and private equity – and the unusual politics that drives it. By any definition, public pension funds represent government money: they are funded through contributions of government employers and employees for the purpose of providing retirement benefits to public-sector workers. Public-sector unions play important roles at virtually every stage of public pension management, from representing the beneficiaries in state and local politics to serving in fiduciary roles on pension governing boards. In a descriptive analysis, we show that public pensions have allocated increasing amounts of capital to private equity in the last two decades, regardless of the party in control of the state legislature, and even in states with strong public-sector unions. To explain this departure from the conventional left-right structure of American politics, we offer an account of the economic incentives that underpin public pensions' increasing reliance on private equity – and how these developments stand to have enormous consequences for the American political economy. Here, we find entities with acrimonious relationships in public, partnering on over a trillion dollars of private investments. We see signs that public employee unions attempt to influence the practices of private equity-owned companies that employ an increasing share of the American workforce. We also detail how the retirements of millions of state and local government employees and the fiscal health of thousands of American governments are increasingly commingled with the fates of the private equity industry.

**Keywords:** public pensions; private equity; government; union; state politics

Few topics have captivated the minds of American politics scholars as much as party polarization and rising economic inequality. Recent research shows that the intense partisan divisions of national politics have spread to state governments (Hopkins 2018), such that today, Democratic-controlled states tend to embrace certain policies and Republican-controlled states tend to adopt different ones

***Corresponding author: Sarah F. Anzia**, University of California, Berkeley, CA, USA,
E-mail: sanzia@berkeley.edu
**Mark Spindel,** Potomac River Capital, LLC, Washington DC, USA,
E-mail: mark.spindel@potomacriverfund.com

(Caughey and Warshaw 2022; Grumbach 2022), resulting in a growing left-right divide. These polarized party dynamics, moreover, may have contributed to economic inequality (e.g. Bartels 2008; McCarty, Poole, and Rosenthal 2008). Hacker and Pierson (2010), for example, highlight how the weakening of unions and the rise of corporate political power since the 1970s have affected party politics, structured markets, and kept policy reforms off the agenda. Hertel-Fernandez (2019) argues that this, too, now extends to the states.

More generally, growing concern about inequality and polarization has inspired research on "the American political economy," meaning the deep and regular interactions of government, financial markets, and the economy (Hacker et al. 2022). This new focus has been highly generative, much of it underscoring the importance of organized interests, and some of it questioning the left-right dimensionality of politics in certain contexts (Anzia 2022). To date, however, the literature still mostly hews to certain foundational assumptions about the structure of the American political economy. The first assumption – supported by ample evidence – is that as corporations have become more politically active, union representation in the private sector has declined (e.g. Schlozman et al. 2012; Drutman 2015). As data from the U.S. Bureau of Labor Statistics show, labor's share of national income relative to capital (e.g. shareholders, corporations, investors) is at its lowest point in 75 years (e.g. Mullin 2019). The second assumption is that the policy interests of unions and corporations are opposed, and that their divergent interests are better represented by the Democratic and Republican Parties, respectively. Even as scholars have noted the growing influence of money on *both* political parties (e.g. Bonica et al. 2013; Kelly and Morgan 2022) and some fragmentation in the labor movement (e.g. Hertel-Fernandez 2022), American politics research generally considers unions (labor) as aligned with Democrats on the left and corporations (capital) in a coalition with Republicans on the right, with the two sides working against each other – operating as countervailing forces (Hacker et al. 2022; Rahman and Thelen 2022).

We highlight a political and economic relationship of enormous consequence to the American political economy that defies this structure: the connection between government employees' pension funds and private equity. By any definition, public pension funds like CalPERS (California Public Employees' Retirement System) represent government money: they are funded through contributions of government employers and employees for the "exclusive" purpose of providing retirement benefits to public-sector workers. Government employee unions, moreover, play important roles at virtually every stage of public pension management, from representing beneficiaries in state and local politics to serving as fiduciaries on pension governing boards, where they oversee asset allocation and even specific investments. These financial decisions are critical, moreover, because public pensions depend heavily on investment returns to help pay for benefits. As a result of government contributions and asset appreciation, public pensions have over $6 trillion in assets – among the largest pools of institutional capital in the country. And in the last two decades, most pension governing boards have allocated increasing amounts of capital to private equity, run by firms that many assume to be associated with wealthy constituencies. This growing, trillion-dollar interdependence of public pensions and private equity connects the fates of governments, government employees, labor unions, the American economy, and wealthy Americans in ways few appreciate. As we will show, it gives rise to a consequential departure from the archetypal left-right polarities of American politics, the implications of which extend to issues like health care and housing development – and virtually all policy areas in which private capital is directed.

We begin with some background on both private equity and public pensions, highlighting foundational features that are key to untangling their significant and growing relationship. We then show how public pensions' investments in private equity have increased since 2001 and present estimates of the importance of public pension funds to the private equity industry. Next, we present data establishing descriptive political patterns that are hard to square with conventional understandings of the structure of American politics: 1) that public pensions' investments in private equity have grown in most states, regardless of the party in control of the state legislature, and if anything *grown more* in states with Democratic unified government, and 2) that states with high public-sector union membership rely just as heavily on private equity as states with weaker public-sector unions. We then explain the powerful economic incentives that likely underpin both public pensions' increasing reliance on private equity and the industry's reliance on public pensions.

This highly unconventional form of politics has major consequences for the American political economy. Financially co-dependent entities with highly acrimonious relationships in public are partnering on over a trillion dollars of private deals. We see signs that labor attempts to use its influence in state and local politics and its role on pension governing boards to shape the practices of the private equity-owned companies that employ an increasing share of the American workforce. We also see how the retirements of millions of state and local government employees and the fiscal health of thousands of American governments are increasingly commingled with the fate of the private equity industry.

# 1 Background on Public Pensions and Private Equity

Discussion of the interconnectedness of public pensions and private equity must begin with a description of the basic mechanics of each, because both pensions and private equity are complex, technical, and often opaque.

The first feature of public pensions to appreciate is the magnitude of the system: Nearly all of the nation's roughly 15 million people who work full-time for state and local governments are eligible for a defined-benefit retirement plan, or a traditional pension, in contrast to the defined-contribution or 401(k)-style plans much more common in the private sector today. This means that when government employees retire, they earn a set payment (or, annuity) for as long as they live, with the amounts defined by formulas based on the employee's final average salary and years of service. Often the retirement annuity is adjusted for the rate of inflation. In 2023, state and local public-employee pensions paid out approximately $393 billion in benefits to around 12.2 million public-sector retirees (U.S. Census Bureau 2024).

Most state and local government employees are enrolled in a relatively small number of large state-sponsored pension plans – approximately 120 of them – but there are also thousands of smaller and locally-administered public plans. Regardless, the basic funding model is the same: Public pensions are supposed to be prefunded. Government employees and employers contribute funds today to pay for the future benefits accruing to current employees. Furthermore, this model rests on assumptions that contributions made by governments and public workers today, invested over time, will deliver sufficient returns to meet the retirement benefit promises that have been made. Equally importantly, in most states, public pension benefits are backed by strong legal guarantees – often state constitutional requirements (Monahan 2010). Therefore, if contributions are insufficient or if investments underperform relative to expectations, public employees' pensions still have to be paid, and someone has to make up for the shortfall.

To gauge the fiscal health of pension plans, experts calculate the funded ratio: the ratio of a fund's assets to its liabilities. Even these quantities, however, depend on several unknowns, including investment performance, asset valuation, the employment tenure and life expectancy of annuitants, and the future size of the employee pool as state and local governments expand or contract their workforces. Actuarial assumptions are therefore built into the funded ratio, and paramount among these are the discount rate and expected returns. To determine the present value of future liabilities, the value of promised obligations must be discounted.[1]

**1** In short, one dollar *n* years forward is worth 1/(1 + discount rate) ˆ *n* today.

Higher discount rates reduce the present value of liabilities; lower discount rates make liabilities appear larger. Government accounting standards suggest basing discount rates on a blend of low-risk municipal bond rates and an expected return on their asset portfolio.[2] An important implication is that if plans assume high investment returns, the discounted liabilities will be smaller.[3]

Pension administration is therefore highly technical and depends on a range of experts like actuaries, accountants, and financial specialists, and as public trust funds, virtually every decision about them – and each part of the actuarial math – is steeped in politics. Pension benefit levels are functions of employee salaries, multipliers, retirement ages, and service credits, and each one of those can be subject to decision-making by an array of public authorities: state legislatures and governors, local elected officials, and collective bargaining negotiations between public officials and unions. Decisions about employer and employee pension contributions and accompanying policies on discount rates, amortization, and mortality tables are most often made by boards of trustees with the support of agency staff and benefit specialists. Usually, the same boards also make decisions about investments, assisted by a chief investment officer and external consultants, but some plans have separate investment boards. The size and composition of these boards of trustees vary: most include ex-officio members and political appointees, but most also reserve large shares of seats for government employee or retiree trustees (Anzia and Moe 2019).

Public-sector unions are often highly engaged and involved in pension policymaking (DiSalvo 2015, 2024; Anzia and Moe 2017). The funds ensure the retirement income of their members – a vital component of public-sector compensation. Through collective bargaining and political activity at the state and local levels, public-sector unions work to influence post-employment benefits. And through both their political activity and their direct engagement on pension boards of trustees, public-sector unions also play an elemental and oftentimes fiduciary role in determining policies on contributions, funding, and investments.

Private equity would seem to be an entirely separate universe, equally technical and economically important. Private equity firms raise pools of capital from a range of investors including public pension funds, insurance companies, sovereign wealth funds, endowments, foundations, and wealthy individuals. These co-mingled partnerships (private equity funds) seek to invest in and often control a portfolio of

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**2** For an overview, see Weinberg and Norcross (2017). Appropriate accounting to determine pension discount rates has been debated. See, e.g., Novy-Marx and Rauh (2014) and Schraeger (2024).

**3** The assumed expected rate of return can also affect the numerator if it influences asset allocation (e.g., by compelling the plan to make more aggressive investments). Also, if interest rates fall, as they did during the financial crisis of 2007–08, the present value of liabilities increases, and absent an offsetting increase in asset prices, funded ratios would fall. Thus, interest rates and the discount rate impact the funded ratio, sometimes in offsetting ways.

private companies or public companies they privatize. The classic leveraged buyout involves borrowing even more money to underwrite these acquisitions. Private equity funds intend to own these companies for five to 10 years and ultimately sell their holdings to other businesses, private equity funds, or public offerings. During the time they control a company, the managers implement a range of actions including operational, financial, and governance changes to enhance the company's valuation. If successful, returns to investors can be substantial.

In exchange for their services and modest investments of their own money, private equity firms can profit in two key ways. First, they charge the fund (and its investors) a management fee, often up to two percent of committed capital. More importantly, the general partners receive lucrative profit interests, up to 20 % of realized gains – the so-called "carried interest."

As their qualifiers suggest, public and private equity disclosures differ comprehensively. Shares of public companies are listed on regulated stock exchanges, offering liquid, real-time valuation, and have highly transparent, regulated reporting requirements. Private equity investments offer no such sunshine. Information about funds and their underlying portfolio companies are veiled behind non-disclosure agreements; company valuations are closely held; and basic performance information is difficult to accurately determine.

## 2 The Interconnectedness of Public Pensions and Private Equity

Most Americans probably spend little time thinking about either public pensions or private equity, as economically significant as they both are. Even for the select set of people who do occasionally think about them, most probably imagine separate universes: one representing large amounts of government money highly valuable to unionized middle-class workers like public school teachers, police officers, and firefighters, and the other dominated by wealthy investment bankers engaged in cutthroat dealmaking.

This condensed depiction misses the interdependence of these multi-trillion-dollar forces. Public pension funds are allocators of capital, investing money across a diverse array of assets, and anticipating rates of return sufficient to meet actuarial obligations to their members. Private equity funds are consumers of capital, raising money to invest in a handful of companies, earning management fees for their services and an important share of the profits (carried interest). The U.S. Census Bureau (2024), which tracks over 4,500 state and local pension plans, reports that public pension funds nationwide had over $5 trillion in investable assets as of 2023;

by the second quarter of 2024, the Federal Reserve (2024) put the figure close to $6 trillion. As we have described, most investment decisions of public pensions are governed by boards of trustees (usually comprised of political appointees, representatives of active and retired government employees, and ex-officio members), and public-sector unions care a great deal about (and are often closely involved in) their decisions. In this way, public pensions are both "labor" and "capital."

Historically, public pension funds mainly invested in simple income-generating securities like government and corporate bonds. That began to change after the U.S. Congress passed the Employee Retirement Income Security Act (ERISA, 29 U.S.C. § 1001 et seq.) in 1974. While ERISA regulates *private* pensions – it does not cover public pensions – public funds later adopted many of its prudential guidelines, enabling them to substantially increase their holdings of higher-returning assets like public equities (Norcross and Biggs 2010). Over time, pension portfolios became more diversified, allocating less to traditional bonds and more to stocks, real estate, commodities, and other so-called alternative assets. And in the last two decades, many public pensions have increasingly invested in private equity, shifting money away from their public stock portfolios.

The *Public Plans Data* (PPD 2001–2023) of the Boston College Center for Retirement Research contain information from the Annual Comprehensive Financial Reports of all major state pension plans as well as the largest local plans in the United States. We examine plans' target allocations to private equity, which reflect in-depth, medium-term plans for the funds' overall asset allocation and a detailed roadmap for how the funds intend to meet their actuarial goals.[4] In Figure 1, we show the distribution of plans' private equity percentage targets as of fiscal year 2022 – the most recent year for which PPD has the private equity information for a large number of plans (117 state and 89 local plans). Of these 206 plans, the median private equity target was 10 % in 2022. But those targets varied considerably. 55 plans had 0 % private equity targets. Another quarter had targets of 14 % or more, and some had targets of higher than 25 %. In terms of actual exposure, moreover (not shown), the median plan had approximately 12 % of its assets invested in private equity in fiscal year 2022.[5]

Plans' private equity targets have also increased steadily over the last two decades. In Figure 2, we summarize the distributions of private equity targets by

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**4** The various experts engage in a deliberative process to define goals for how the trustees want the money invested. More than aspirational, these targets govern actual investment decisions. The process incorporates financial forecasts and return expectations for every asset class, controlled for risk, liquidity, and anticipated benefit obligations.

**5** This excludes real estate. Combining plans' exposure to private equity and real estate, the median exposure was 21.5 % in 2022.

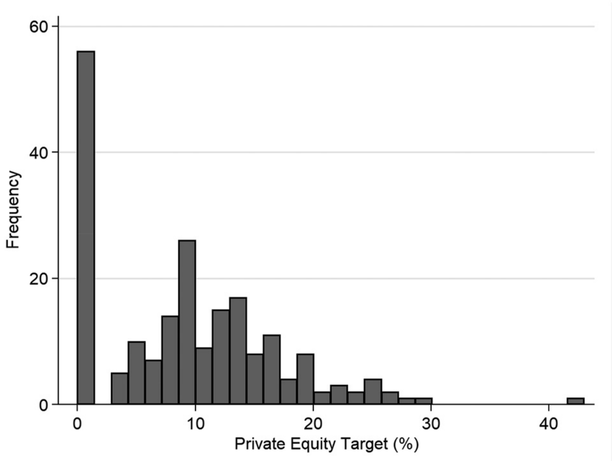


**Figure 1:** Public pension plans' target allocations to private equity, FY2022.

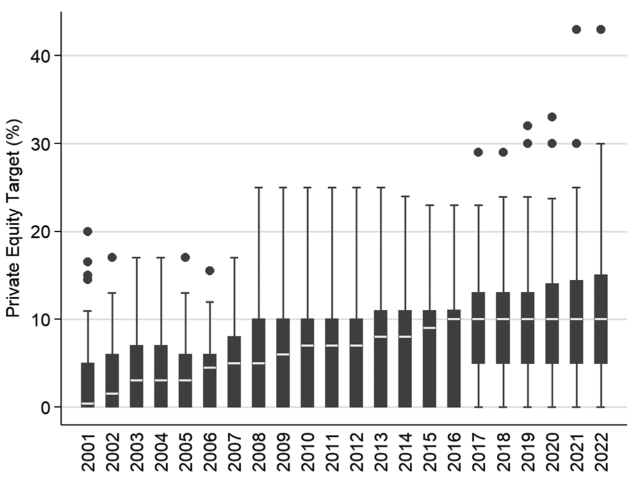


**Figure 2:** Public pension plans' private equity targets by year.

year from 2001 to 2022 for the 109 plans (80 state, 29 local) for which the data are available for all years.[6] The figure shows that typical private equity targets gradually increased during this 22-year period. In 2001, the median target was 0.4 % and the third quartile 5 %, with only a few outliers having targets closer to 15 %.

6 The figure does not look appreciably different if we include all plans.

Over the next two decades, the distribution shifted higher. By 2017, targets of 15 % or higher were common.[7]

The steady increase of median private equity targets belies the fact that public pension investment decisions are often highly contentious. In state and local governments across the country, policymakers routinely debate whether too much or too little capital is going into private equity, often centering on how much the general partners (private equity managers) receive. In North Carolina, for example, which has an unusual structure whereby the elected state treasurer makes decisions about pension investments rather than a board of trustees, a candidate recently challenged (and beat) the incumbent on the grounds that the state pension fund imprudently allocated too little to private equity and too much to conservative, low-yielding cash and government bonds (McElhaney 2024).

The private equity industry's dependence on pension fund allocations is equally, if not more, substantial. Private equity firms bank heavily on public pension commitments to capitalize their funds. Lack of transparency of the total pool of private equity capital under management makes it difficult to say definitively what percentage public pension funds comprise, but even with wide confidence bands, the dollars involved are enormous. Our own estimates suggest that public pension plans have close to $1 trillion of private equity exposure – with further capital already committed.[8] Considering the 2 % fees and the 20 % carried interest, it is easy to see how pension funds represent a multi-billion-dollar bonanza for private equity partners. According to one estimate, private equity funds receive up to 67 % of their assets from public pensions (Mittal 2024). This estimate strikes many as surprisingly large, especially considering that other institutional investors such as insurance companies and university endowments are also sizable private equity investors. However, these other institutional investors invest less in private equity than public pensions, and they are not as coordinated: there is evidence of "herding" in pension fund asset allocation (Blake et al. 2017), such that when one pension fund invests in a particular direction, many others follow.

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7 Even if target allocations had remained the same, strong overall asset performance since the 2007 financial crisis implies that public pensions allocated even more dollars to private equity.

8 We estimate roughly 15 % exposure to private equity out of $6 trillion of total public pension assets. However, measuring public pension funds' private equity allocations is difficult because 1) valuing non-public companies entails a number of assumptions and 2) the commitment and return of capital happens over a long horizon and is rarely publicly disclosed. When one invests in a private equity fund, one commits to a series of capital calls over several years. This means that when the general partners find a company to buy, they will call capital from their investors. To take a hypothetical example, a pension fund that invests $100 million in a private equity fund might be counted by the general partner as $100 million, but the capital isn't deployed immediately, and so the pension fund may not yet have ramped up its reported private equity exposure.

The impact of private equity on the macroeconomy is large and growing. Around the time that public pension funds began to increase their private equity allocations, the number of listed public companies in the United States peaked at over 8,000.[9] Today, there are fewer than 5,000, but there are hundreds of thousands of private companies (National Center for the Middle Market 2024). Jovanovic, Sai Ma, and Peter 2020, 1) also find that private equity funds "account for a growing share of real investment in the U.S. economy, averaging more than six percent of private domestic investment since 2001." Private equity-owned companies also employ approximately 12 million people, or 7 % of the American labor force – and that is not including the suppliers, customers, and financiers who support the underlying portfolio companies (American Investment Council 2023).

This, then, is the quintessential case of the intersection of governments, markets, and economy. The private equity industry is heavily reliant on the flow of investment capital. The American macroeconomy is increasingly dependent on that same flow of private funding and the investment decisions of private equity firms. And public pension funds – with their collective $6 trillion in public money – are wrestling with investing huge sums of money. With the allocation of public money, moreover, comes politics – and it is an interesting brand of politics, indeed.

## 3 The Peculiar Politics of Pensions and Private Equity

By itself, the trillion-dollar connection between private equity and government workers' pensions fits poorly within conventional understandings of the "sides" in the American political economy. But recognizing the financial overlap between the two is just the beginning. Along with the relationship between public pensions and private equity comes a peculiar form of politics – one that scrambles any semblance of a left-right structure.

As a starting point, it helps to consider what dynamics one might expect given the demonstrated importance of partisanship, polarization, and conservative-liberal ideology to modern American politics. It is well known that unions have long been aligned with the Democratic Party (Dark 1999). Even though they receive far less attention from political scientists than private-sector unions, the same is generally true of government employee unions (DiSalvo 2015; Moe 2011).[10] As we

9 See World Bank Group, "Listed domestic companies, total – United States," https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US (accessed September 27, 2024).

10 Notable exceptions are correctional officers' and police unions, which regularly contribute to both political parties (see Page 2011; DiSalvo 2022).

have said, moreover, government employees and their unions are heavily invested in all aspects of pension fund policymaking.

Meanwhile, critics of private equity takeovers regularly highlight massive layoffs of the workforce and active discouragement of employee unionizing (Morgenson and Rosner 2023). For example, Prospect Medical Holdings, a private equity-owned operator of safety net hospitals, is under investigation by the U.S. Department of Justice, the National Labor Relations Board, and multiple states attorneys general for a range of regulatory failings. In attempting to keep current on their buyout-induced debt payments, the owners laid off hundreds of staff at hospitals across the country, allegedly compromising critical patient care. The employers are also accused of unfair labor practices and violation of the NLRA.[11] And critics argue this is not an isolated example. Gupta et al. (2024), for example, find that private equity ownership of nursing homes causes higher short-term mortality rates.

Moreover, many private equity executives are among the ultra-wealthy (Klebnikov 2022), and most understand the ultra-wealthy to be relatively more conservative on economic issues than other groups of Americans (e.g. Page et al. 2013, Suhay et al. 2021). Compared to public companies, private equity firms benefit from fewer reporting and regulatory requirements and highly favorable tax conditions. Many political observers associate these policy principles more with the Republican Party. For example, as the 2012 GOP presidential nominee, Mitt Romney was roundly attacked by the left for his leadership of Bain Capital, a private equity investment firm. Thus, it might be tempting to think of private equity as primarily pro-capital and Republican – and an anathema to pro-labor Democrats and unions.

Putting this together, one might think that pension funds in Democratic states, and in states with stronger public-sector unions, would be less likely to invest in private equity. That wouldn't be right. In the 14 states with Democratic unified government in 2022, the average private equity target for state-administered plans was 12.9 %, compared to 10.8 % in the 23 states with Republican unified government and 9.1 % in the 12 states with divided government.[12] Figure 3 provides more detail, showing the distribution of state plans' 2022 private equity allocation targets broken down by state partisan control. Substantial allocation to private equity can be found in all states, regardless of party control of the state government. However, a large number of plans in states with divided or Republican unified government had private equity targets at or near 0 %, which was rare in states with Democratic unified government. That said, the variance is highest in unified Republican states. In

**11** "Crozer-Chester Medical Center v. NLRB." 2020. *2020 Decisions*. 930. https://digitalcommons.law.villanova.edu/thirdcircuit_2020/930.

**12** We exclude Nebraska when examining state partisanship because of its nonpartisan, unicameral legislature.

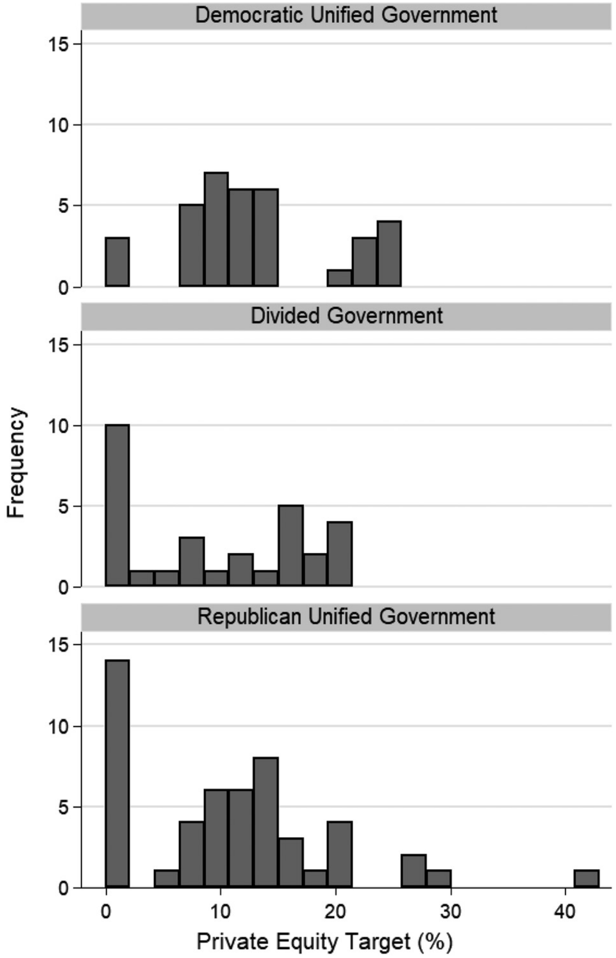


**Figure 3:** Public pension plans' 2022 private equity targets by state party control.

addition to a large number of plans with little to no private equity investment, this category includes an outlier – the near $50 billion Texas County & District Retirement System with a 43 % private equity target – as well as three Arizona plans with targets of over 25 %.

We do not claim that party control *causes* changes in private equity targets, but this descriptive pattern runs counter to what one would expect based on traditional understanding of how groups align with the two major political parties. Moreover, it holds beyond this single-year snapshot. In Figure 4, we plot the average target for plans in Democratic unified governments, Republican unified

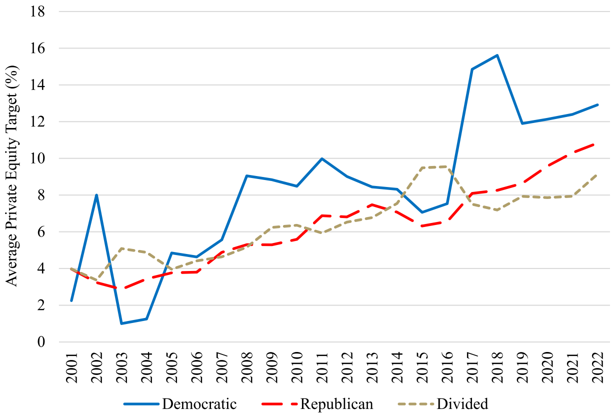


**Figure 4:** Average private equity target by state party control.

governments, and divided governments in each year from 2001 to 2022. It overall shows a pronounced upward trend over time, but even two decades ago, when most plans were not investing in private equity at all, the plans in Democratic unified governments were more likely to make modest private equity commitments. In most years starting in 2005, average plan private equity targets were higher in Democratic states than in either Republican states or states with divided government. Funds in Democratic states are often leaders in private equity allocation, rather than holdouts.

In Figure 5, we examine the correlation between 2022 private equity targets and the percentage of government employees in the state who are members of unions, which in 2022 ranged from less than 5 % in South Carolina to 66 % in New York (Hirsch et al. 2024). To the extent there is a relationship between the two, it is weakly positive, even with the aforementioned high targets in Texas and Arizona. Overall, plans with higher private equity targets are somewhat more common in states with higher public-sector union membership.

Furthermore, this is not a new phenomenon. As of 2001, when most states had 0 % private equity targets, the small number of state plans that had private equity targets of over 9 % were from Connecticut, Michigan, Minnesota, Oregon, Pennsylvania, and Washington – all states where public-sector union density is 45 % or higher. In Table 1, we consider whether some of this pattern could be due to a typical larger size of pension funds in states with higher union membership. (It is possible, for example, that larger funds have greater capacity to invest in private equity due to the substantial fees and expertise involved.) We present coefficient estimates from an OLS regression of 2022 private equity targets on public-sector union density, indicators for divided government and Republican unified government (because

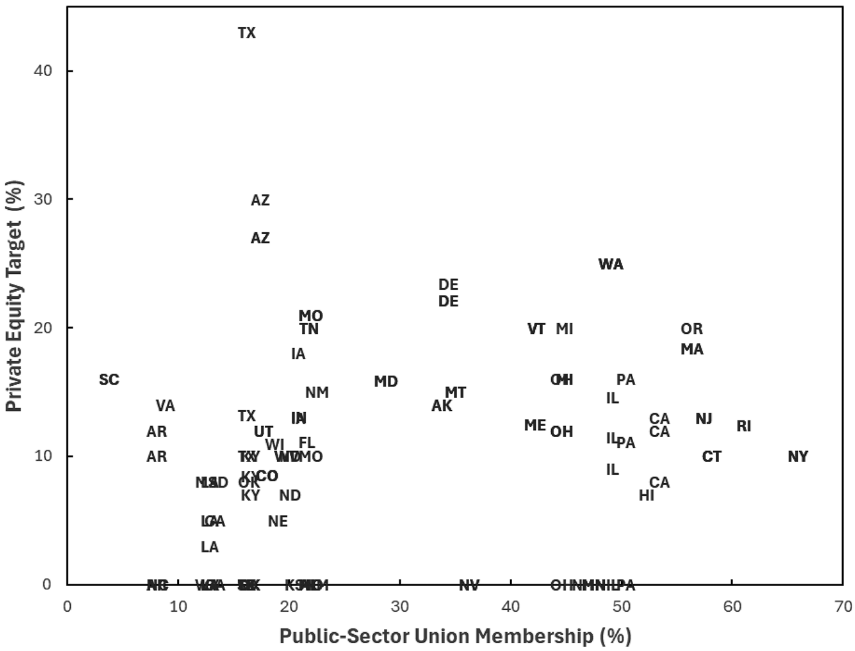


Figure 5: Private equity targets and public-sector union membership, 2022.

Table 1: State pension plans' private equity targets, 2022.

| | |
|---|---|
| Public-sector union membership | 0.107 |
| | (0.072) |
| Divided government | −0.018 |
| | (0.036) |
| Republican unified government | 0.008 |
| | (0.030) |
| Ln (Beneficiaries) | −0.009 |
| | (0.006) |
| Constant | 0.17 |
| | (0.075) |
| R-squared | 0.07 |
| Observations | 116 |

Notes: Standard errors clustered by state in parentheses. The unit of analysis is the pension plan.

union membership is highly correlated with state party control), and the number of beneficiaries of each plan (logged), clustering standard errors by state. Even controlling for plan size, we do not see a negative relationship between public-sector

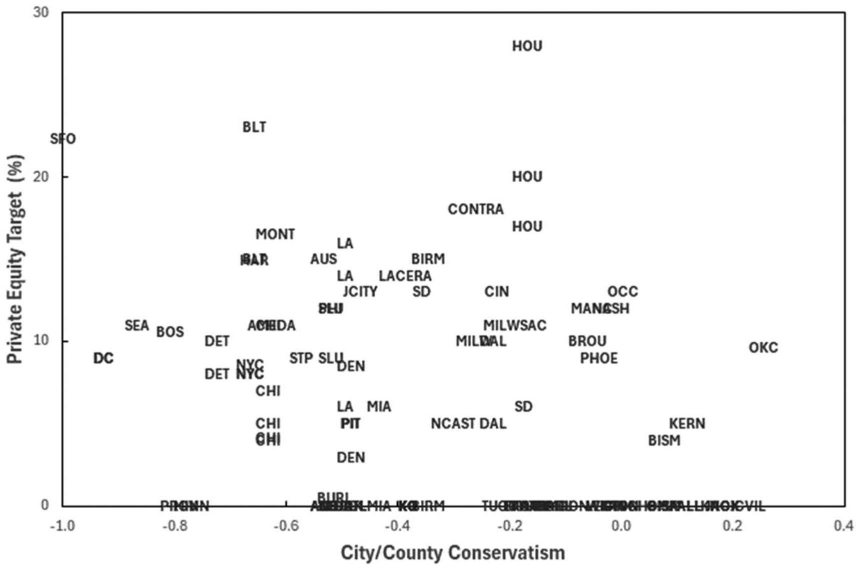


**Figure 6:** City/county conservatism and private equity targets, 2022.

union membership and private equity targets. In Table 1, the coefficient on union membership is statistically insignificant.[13]

Figure 6 shows a similar pattern for the large locally administered plans in the PPD. Most local governments are formally nonpartisan, and there are no existing data on modern public-sector union density in American cities, so in the figure, we use the Tausanovitch and Warshaw (2014) measures of the conservatism of the mass public in U.S. cities and counties. On the horizontal axis, higher scores indicate the local government has more conservative residents. Again, the relationship suggested by the figure is *not* that cities and counties with more liberal residents tend to have lower private equity targets. If there is a pattern, it is the opposite, with plans in more liberal cities like San Francisco and Baltimore showing high private equity allocation and relatively more conservative cities like Oklahoma City and Bismarck lower allocation. Here, the negative relationship is well explained by the size of the plan: when we regress the targets on city/county conservatism and the logged number of plan beneficiaries, the coefficient on conservatism is statistically insignificant (not shown). Even so, these patterns are not consistent with an account of pension boards in liberal cities and counties more forcefully resisting investing in private equity.

**13** As we discuss below, some state pension plans are managed by the same board. The relationships in Table 1 do not substantively change when we analyze the data at the board level.

Overall, then, this descriptive analysis reveals a set of patterns that might seem puzzling in light of today's partisan, polarized American politics. In Democratic and liberal places, and in places with strong public-sector unions, public pension plans' private equity investment decisions actually look quite similar to the investment decisions in Republican and conservative places and those with weaker unions.

## 4 Boxed In: How Pension Politics Paved the Road to Private Equity

To understand the close relationship between public-employee pensions and private equity, the familiar left-right model of American politics is of limited use. Instead of starting from modern liberal-conservative ideology and thinking through what policy positions that implies, it is helpful to start by considering the entities involved and their economic interests on specific policies. In this case, moreover, the key entities and their constituencies often have competing interests, and it is not always obvious which ones will prevail.

Consider the perspective of public pension funds, in particular the interests of government employees and the unions that represent them. As DiSalvo (2015, 119) explains,

> To understand public employee unions' lobbying agenda, it is helpful to think of a set of concentric circles. At the core are the bread-and-butter occupational interests of the unions' membership. This includes the things that affect workers' lives on a day-to-day basis: salary, benefits, job protections, and working conditions. At the second level are broader issues affecting workers more generally, including issues such as labor law, healthcare policy, and the minimum wage. At the outer edge are broad liberal causes that unions support – sometimes half-heartedly – in order to forge alliances and good will with other progressive groups.

Applying this logic suggests that when it comes to investing in private equity, public-sector unions' interests are much more conflicted than they might first appear. Antipathy toward the industry and its actions – especially its treatment of workers and unions – is one consideration. But it is not the only one, and it may not be the most important. To the extent private equity firms sometimes lay off large numbers of workers and obstruct union organizing, those actions mostly affect *private*-sector not public-sector employees. Perhaps public-sector unions and government employees on pension boards do not see a direct downside of investing in private equity for their members. They probably want to support the broader labor movement, but they may prioritize their members' retirements and pension solvency if there is a tradeoff.[14]

There is good reason, moreover, to think there is often a tradeoff. Pulling in the opposite direction, and at the core of the occupational interests of *their* members, is the combined force of: 1) interest in (more) generous pension benefits, 2) interest in moderating government employees' contributions, government employers' contributions, and taxes, and 3) the actuarial investment and benefit assumptions that make all of this possible, especially in the face of the pension funding shortfalls. To understand how this works, we need to explain each one in turn.

## 4.1 Benefits

The simplest place to start is with the promised pension benefits, including both those of annuitants receiving pensions and the active workers who are contributing now for future receipt. While economists and actuaries debate how large pension liabilities are (Novy Marx and Rauh 2014; Lenney et al. 2021; Giesecke and Rauh 2023), the Federal Reserve (2024) puts total state and local public pension liabilities in 2021 at $9.4 trillion – an enormous debt to be paid. The amounts are sizeable in every state (relative to population), regardless of which party controls the statehouse, and regardless of whether public-sector union membership looks like that of South Carolina or Rhode Island. As we explained above, there are only three primary funding sources: employee contributions, employer contributions (from governments and thus taxpayers), and investment returns. All states have pension systems with very large accumulated liabilities, and the overall options for funding them are largely the same.

That said, there is meaningful variation in pension liabilities across states, and state politics likely plays a role. Government employees almost certainly prefer larger pension benefits to smaller ones. Through their lobbying, campaign contributions, membership on pension boards of trustees, and pressure in collective bargaining, public-sector unions work to protect pension benefit structures and increase them if possible. This can mean resisting pressures to switch to defined-contribution plans, advocating for cost-of-living adjustments, ensuring salary multipliers stay high and retirement ages low, and even pressuring for salary increases: because salaries are a key determinant of public pension payouts, unions' activities in local politics and at the bargaining table would also influence pension generosity

**14** Indeed, when they have fiduciary positions on pension boards of trustees, they have a legal mandate to do so.

and total liabilities. In short, there is reason to think that public pensions would be more generous in states with stronger unions.

This is more difficult to evaluate than it might seem. First, there is a question about whether unions would prioritize larger salaries and future benefits per worker versus higher public-sector employment (Anzia and Moe 2015). Second, measuring pension generosity is not straightforward: many plans have multiple pension tiers, and within each, pension payouts are a function of multipliers, salaries (across different types of employees with different levels of experience), retirement ages, eligibility for Social Security, and years of service.[15] Third, the inferential challenges are considerable. Public-sector union membership by state has changed little since the 1980s, and the basic structure of pension benefits has been in place for decades, making it hard to determine what effect unions may have had on pension benefit generosity.

We do not endeavor to address all of those issues here, but in Figure 7, we plot 2021 Federal Reserve data on total public pension liabilities as a proportion of gross domestic product (GDP) by state and public-sector union membership.[16] On average, relative to the size of the state economy, public-sector employees in states with higher public-sector union membership have earned larger sums in pension benefits. This positive relationship suggests that one key part of the puzzle presented above may be that states with stronger unions (and more likely governed by Democrats) generally have accumulated higher promised obligations.

## 4.2 Contributions

Differences in pension promises would matter little if governments reliably funded their obligations. But they have not. In most states, for decades, employer and employee contributions to pension funds were lower than actuarially determined funding requirements. Today, even as most governments are more consistently making their required contributions, most states have funding shortfalls. In some places, the shortfalls are massive.

**15** Some studies measure pension generosity using "normal cost" as a percent of payrolls, where normal cost is the amount a plan would have to contribute to fully fund the pension benefits being earned in a given year (e.g., Munnell et al. 2011). Estimates of normal cost, however, depend on assumptions like the discount rate. Moreover, we would also like to consider the value of benefits earned in past years. And if unions can increase salaries, that could increase both the numerator (normal cost) and denominator (payrolls) – and mask the effect of unions.

**16** State GDP data are from the U.S. Bureau of Economic Analysis, Q4 2021. Total pension liabilities reflect both pension generosity per worker and public-sector employment. They also reflect all the benefits that have been earned – not only benefits earned in a given year.

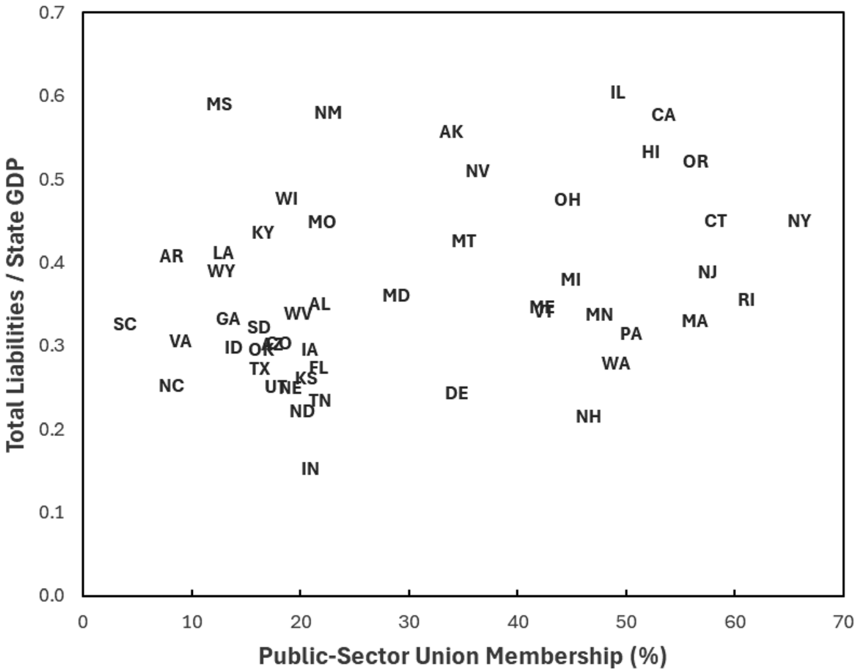


**Figure 7:** Total liabilities/state GDP, 2021.

In many cases, state and local governments have simply not paid their full actuarially determined contributions, and that has surely contributed to pension plan underfunding. But another factor is the actuarial and accounting assumptions, especially the discount rate. While financial economists largely agree that liabilities should be discounted based on the risk that they will not be paid (which, in the case of public pensions, is low), pension plans themselves almost universally discount future liabilities using the expected rate of return on their investments. Those rates are higher. At the start of the 21st century, most state pension funds had discount rates of around 8 %.[17]

This under-the-radar approach helps plan sponsors massage the extent of pension underfunding. Higher discount rates lower the estimates of future pension liabilities, and *that* means that the contributions required to “fully fund” pensions appear lower than they otherwise would be. Furthermore, this whole setup creates perverse incentives: by investing in riskier assets, plans can achieve a higher

17 Note that the pension funds may earn 8 % but may not, and regardless, the pension payments have to be made.

expected rate of return, and that higher discount rate then gets plugged into the calculations of liabilities and required contributions.

This has proven to be powerful calculus. As we have explained, the pension boards of trustees that are responsible for the major decisions about contributions and investments are inherently political: all trustees have a fiduciary duty to act solely in the best interest of the fund, and yet at the same time, these are state bureaucratic agencies made up of elected officials, political appointees, and representatives of government employees and retirees. For ex-officio trustees and political appointees, few political rewards come from making very large increases to contributions. For Democrats and Republicans alike, it is almost always more appealing to use that money for something else, whether it be government programs and services or tax cuts. Some might suspect that employee trustees would be relatively more committed to fully funding their own pensions, but they, too, have other incentives. Many of these trustees are current or former union leaders, who would also like to see that money appropriated today, for salary increases or greater hiring of government employees. They presumably want to avoid large increases in contributions that would put the spotlight on how expensive pensions are for governments, which could increase pressure for reform and increase *employees'* contributions as well. Besides, employee pensions are backed by strong legal guarantees. In an analysis of pension board composition and funding decisions from 2001 to 2014, Anzia and Moe (2019) show that boards with greater employee representation are no more responsible in making contributions – and may even be somewhat less responsible.

The bottom line is that virtually everyone involved has some incentive to keep contributions low. And today, almost every public pension is underfunded. Figure 8 shows total unfunded pension liabilities by state in 2021 as a percentage of state GDP, again using the Federal Reserve data. The bars are sorted by union membership in the state, with New York at the top (highest union membership) and South Carolina at the bottom (lowest union membership). The relationship is weak, and there are certainly states with low union membership with large unfunded liabilities and states with high union membership with smaller unfunded liabilities. But again, the pattern overall is one of higher union membership states having larger unfunded liabilities as a share of state GDP.

The national setup, then, is one in which many public pensions are trying to prevent their funding health from dipping dangerously low and also present a flattering view of the funding ratio. To see how this all connects to private equity, one has to consider the different levers pension managers have within their reach – and how many of the strategies they might *want* to use to address this challenge are difficult or impossible for them to actually use.

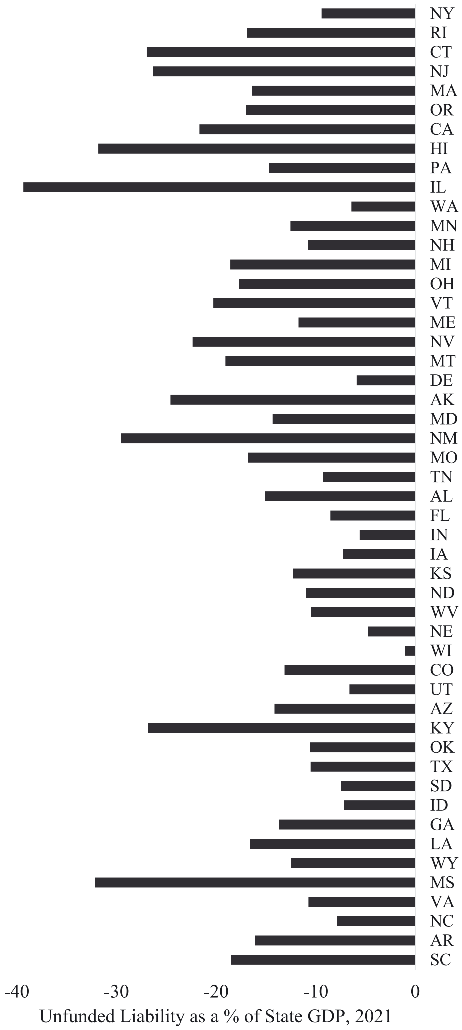


**Figure 8:** Funding status as % of state GDP, 2021.

Reducing liabilities or slowing growth in liabilities turns out to be extremely difficult. In most states, pension benefits cannot be reduced for current employees even for future years they have not yet worked. Following the Great Recession and the momentum for reform it generated, many plans reduced benefits for newly hired employees, but there remains political pressure from public-sector unions to increase their benefits—pressures exacerbated by high inflation and demand for cost-of-living adjustments. In Oklahoma, for example, after a decade-long effort to shore up its dwindling public pension fund, mostly through benefit reduction, Oklahoma police officers lobbied successfully to increase some benefits (Monies 2024).[18] In Illinois, lawmakers successfully negotiated a lower-benefit tier for new public-sector employees, only to run into political interference from the AFL-CIO and encouragement from the Democratic governor to slow the phase-in of lower benefits (Meisel 2024).

On the contributions side of the ledger, one outcome of the post-financial-crisis reforms has been that plans have lowered discount rates (somewhat), increased contributions, and made contributions more consistently (Moody and Randazzo 2024). These contributions have put considerable fiscal pressure on participating governments (Kiewiet and McCubbins 2014). But the funding shortfalls remain large. The reality is that closing the $3.58 trillion funding gap with contributions would devastate many state and local government budgets: it would require some combination of big tax increases, big spending decreases and program cuts, and even possibly many more bankruptcies (see Schleicher 2023).[19] Presumably no one involved sees this as a desirable or politically palatable path forward.

## 4.3 Investments – and Private Equity

That leaves the investment lever. If you are playing a losing game and running out of time, you have to take some calculated risks. A hockey team trailing by two goals in the last minute of the third period often pulls the goalie. And if pension underfunding is a chronic ailment, then private equity seems like a panacea. One can imagine the thinking going: private equity will deliver the high returns needed to reduce the funding shortfalls so that contributions do not have to increase more than they have. For pensions, private equity has the added advantage of increasing the assumed rate of expected returns and possibly preventing further lowering of the discount rate.

Public-sector unions may not love private equity. But pension boards – including those in states with strong public-sector unions – have incentives to support investment in private equity *because every alternative is worse.* The allure of generous pension benefits, low employee and employer contributions, and the hope of high investment returns motivate most funds to allocate to private equity. While representatives of public employees might bristle at decisions to send billions of dollars from public pension funds to private equity, they also want to preserve their benefits without starving governments of the limited resources needed to provide salary increases and public-sector jobs (and other public services). Thus, notwithstanding

18 Often these efforts pit current employees against retired annuitants, exposing additional conflicts in labor's priorities.

19 This $3.58 trillion figure is from the Federal Reserve (2024).

their antipathy toward private equity, they have strong economic incentives to allocate public pension money to those kinds of investments (see e.g. Weissmann 2012).

In 2012, for example, even as the American Federation of State, County and Municipal Employees (AFSCME) criticized then-presidential candidate Mitt Romney for his role at Bain Capital, AFSCME members across the country had their pension funds invested in private equity and also sat on many state and local pension boards approving those investments (Corkery 2012). Similarly, in 2024, the thirteen-member board of CalPERS, which has six government employee or retiree trustees, ramped "up its exposure to private equity and private credit in a $34-billion bet that riskier assets will fuel higher returns" (Kamisher 2024). At the same time, however, "major unions, which can sway the CalPERS board, have criticized the labor practices of some private equity dealmakers and pushed the fund to adopt a more watchful stance while adding to its investments" (ibid).

This much suggests that public-sector unions and government employee trustees might not aggressively work to block investment in private equity. But if states with stronger unions have even higher liabilities and are not more committed to increasing contributions to fund them, that could further amplify pressure on strong-union states to embrace private equity. Absent a greater willingness to rely on contributions, states with bigger obligations chase higher returns through investments.

## 5 Confrontation and Collaboration

As for where, exactly, public-sector unions and government employee trustees stand on private equity investments, and what positions they take when boards are faced with such decisions, it is difficult to say. At a minimum, they are conflicted, and this could shake out in different ways. Perhaps, in some cases, government employee trustees weigh the tradeoffs described above and accept private equity allocation. Alternatively, perhaps unions' strong opposition to private equity firms' labor practices limits their willingness to underwrite those investments. Moreover, if government employee trustees are relatively less concerned about addressing funding shortfalls than other board members – because, again, their pension benefits are legally protected regardless of funding ratios – that may even lessen pressure they might otherwise feel to invest in private equity.

Without data on the positions taken by individual trustees, which are rarely available to the public,[20] we cannot know how government employee trustees and public-sector unions navigate these competing interests. But to gain some insight into

20 Pension board meeting minutes typically include little detail on the substance of disagreements, and usually, conflicts are worked out *in camera*.

**Table 2:** Private equity targets and employee trustees.

| | |
|---|---|
| Public-sector union membership | 0.092 |
| | (0.050) |
| % Employee-chosen employee trustees | −0.059 |
| | (0.035) |
| Ln (Beneficiaries) | 0.002 |
| | (0.006) |
| Constant | 0.064 |
| | (0.072) |
| R-squared | 0.08 |
| Observations | 83 |

Notes: Standard errors clustered by state in parentheses. The unit of analysis is the pension board.

this, we examine the relationship between private equity targets and government employees' share of seats on the state boards of trustees that have authority to oversee the funds' investments.

Specifically, for each of the 120 state plans in the PPD, we identified the board with investment authority, located the current statute that determines its composition, and calculated the proportion of trustee positions that are reserved for government employee representatives chosen by employees or their unions, following the coding of Anzia and Moe (2019). This was a non-trivial task. Pension governance is highly complex, and it can be difficult to determine which entity has authority over different aspects of pension administration. Some state plans share a pension board. Some plans have a board for benefit and/or contribution administration and a separate board in charge of investments. Some plans within a state share a board that handles actuarial decisions but have separate boards for investments, or vice versa. In our data collection, we identified 87 unique boards or entities that have investment authority for the 120 major state plans in the PPD.[21]

**21** This excludes the University of California Retirement Plan because it is governed by the Board of Regents. Using the statutes (and often confirming with boards' webpages), we determined the total number of voting board members as well as the number who are: employee or retiree trustees chosen by employees (including positions for which an appointer must choose from a list of nominees supplied by employees or their organizations), employee or retiree trustees appointed by politicians, ex-officio trustees, politically-appointed trustees representing employers, and citizen or other trustees. For plans that have a separate investment board, we code the composition of that entity. In New York, Connecticut, and North Carolina, investments are made by a sole executive official rather than a board, and we code them as having a sole ex-officio trustee. In some cases, there remains ambiguity about which entity makes investment decisions and how certain positions should be coded. We have made this board dataset available at https://gspp.berkeley.edu/research-and-impact/faculty/sarah-anzia.

In Table 2, we analyze these board-level data, regressing their 2022 private equity targets on both state public-sector union density and the share of board seats held by employee-chosen employee trustees, controlling for plan size.[22] On average, the estimates suggest that private equity allocations are somewhat higher for boards in states with stronger unions ($p$ = 0.07) and lower for boards with larger shares of employee-chosen employee trustees ($p$ = 0.096).[23] We cannot say for sure what explains this pattern, but it is consistent with an account in which 1) stronger union states in general have invested more in private equity, perhaps because they have accrued larger liabilities and possibly larger unfunded liabilities, 2) relative to other trustees, employee-chosen employee trustees on the boards may work to limit private equity allocation, perhaps because they are more concerned with the labor practices of private equity-owned corporations, the fees and financial risks associated with private equity commitments, or even the political views of private equity partners. Even so, many plans with large shares of employee trustees have substantial private equity investments. For boards with *majorities* of employee-chosen employee trustees, the median private equity target was 7 %, indicating that many government employee trustees tolerate some private equity exposure.

For those who might still wonder why they would do this, consider that some public pension fund trustees (influenced by public-sector unions) see private equity allocations as leverage to help reshape labor practices of private equity-owned portfolio companies. Jacoby (2021) describes how large public pension funds, like CalPERS, used proxy votes of their significant shareholdings to influence the governance of public companies, often advocating for more progressive policies, including labor rights and environmental sustainability. There are signs that many pension funds use a similar approach with private equity, absent the transparency and regulatory framework. In a 2024 manifesto, for example, New York State's public employee pension fund – one of the largest public pension plans and private equity investors – makes its priorities clear:

> The New York State Common Retirement Fund ("CRF")…believes that investment managers in its private equity asset class (PE Managers) should develop robust workforce management practices at companies where they have made an equity investment (Portfolio Companies) that prioritize workers' rights and protections, health and safety, fair compensation, skills development and training, and health and retirement benefits. (New York State Common Retirement Fund 2024)

**22** In this board-level dataset, the correlation between public-sector union density and percent employee-chosen employee trustees is only 0.007. Four of the boards are missing 2022 private equity target data in the PPD. We sum the number of beneficiaries over all plans governed by a single board.
**23** When we add the percentages of other trustee types, excluding the share of trustees who are ex-officio, the coefficient on *% Employee-chosen employee trustees* is not significant.

Similarly, the American Federation of Teachers (AFT 2024) has declared that private equity labor "practices generate unacceptable fiduciary risk for the workers whose retirement savings comprise a significant proportion of" private equity capital. Yet public teachers' pension funds still invest heavily in private equity. CalSTRS (California State Teachers' Retirement System), the largest pension fund for public school teachers, has over $50 billion invested in private equity (CalSTRS 2024). Why not divest? The simple explanation is that the pension funds need the money. Rather than seeking to exit private equity, these pension funds and the unions who have a large hand in governing them use their leverage as massive providers of capital to try to influence the labor policies of private equity-owned companies.

How far that influence runs, and where the limits are, is hard to know. Much about private equity is opaque. Presumably, at a minimum, manifestos and statements like those of the New York State and California teachers' public pension funds and the AFT enable unions to justify these investments to members, some of whom are skeptical of pension funds' support for private equity. But the extent to which private equity firms actually adopt these practices and accommodate the requests of pension funds and unions is unclear.

One sign that these strategies may have some effect can be seen in the interesting, albeit modest, programs to share potential upside with private equity portfolio company employees. Specifically, some private equity firms offer compensation akin to Employee Stock Ownership Plans to workers at firms they acquire, giving the employees an equity-like profits interest in their companies' success (e.g. Arlinghaus et al. 2024). Perhaps some firms have implemented such programs in response to pressure from public pension funds or unions, or perhaps – as many hope – the programs will motivate employees to deliver better outcomes (DePillis 2024). Whatever the motivation, it suggests that pension funds and unions can and do use their capital to influence private equity's labor practices.

Other signs point to limits to the influence of public pensions on private equity. In 2023, for example, the SEC adopted a series of rules "to enhance the regulation of private fund advisers" (U.S. Securities and Exchange Commission 2023). The industry pushed back and sued the SEC,[24] after which a consortium of public pension funds filed an amicus brief in support of the SEC (Institutional Limited Partners Association 2023). In the brief, the public pension funds argued that the SEC's "Private Fund Adviser Rules seek to address the systemic imbalance between advisers and investors, allowing institutions to better carry out their missions and ultimately benefit their members – teachers, police officers, fire fighters, students, judges, and others" (ibid, 4). Thus, in spite of the (limited) partnership between public capital allocators and private equity investors, in this case, they were adversaries. Notably, moreover,

**24** National Association of Private Fund Managers v. SEC, No. 23–60471 (5th Cir. 2024) the 5th U.S. Circuit Court of Appeals agreed with private equity managers, concluding that the SEC's 2023 rule exceeded its regulatory authority.

This was not the first time unions tussled with the private equity industry. Examples abound of unions representing public-sector and other employees confronting large private equity stewards, pressuring them to pay more attention to labor and to adopt sound labor practices. The 2007 SEIU "behind the buyouts" campaign, for instance, called out Blackstone, Carlyle, KKR, and others by name and accused them of maltreatment of workers. SEIU (2007, 6) concluded that "the buyout deals and money-generating strategies that are generating immense wealth for the private equity buyout industry and many of its investors can have harsh consequences for workers and companies they buy and sell." Moreover, they wrote, "in every case, the workers themselves had almost no voice in the process, little information about the firms that now controlled their employers, and no role in developing plans that were going to change their lives for the worse…"

By pressuring for changes to private equity transparency and labor practices, moreover, unions like SEIU are not merely tinkering at the edges of the American economy. Private equity firms have become some of the largest employers in the United States thanks to the size and breadth of their portfolio companies and the amount of dollars they manage. Private equity firms responded to the SEIU crusade, emphasizing the pension fund benefits of the industry's strong investment returns and accusing the union of seeking to organize a broad swath of service employees, such as in healthcare and fast food (Janis 2007; Moyers 2007).

All the while, even with this confrontation, the same parties continued to collaborate on investment opportunities. Pension funds for state and municipal employees – large numbers of whom are represented by SEIU locals – increased their investments in these private equity funds. The confusing posture of a large union publicly attacking an industry for unfair labor practices or siding with regulators while ramping up investment from member pension funds underscores our point that something special is going on here. From the annuitants' perspective, their arch-adversary is their all-star investor.

This much helps to explain the what and the why but not the when. Why did public pensions ramp up their private equity exposure when they did? Three interrelated points are important. First, the private equity industry was much smaller in 2000. The failure of Enron and the collateral damage inspired the Sarbanes-Oxley Act of 2002, ushering in a new regime of transparency and regulatory disclosure requirements for public corporations (FASB 2003). In the years that followed, there was a big shift toward taking or keeping companies private, increasing the need for private capital. And what are some of the largest pools of investment capital in the country? Public pensions. Expansion of the private equity industry during the 2000s was thus fueled by both a bipartisan act of the U.S.

Congress (and its regulatory and accounting directives) backed with money from state and local governments' retirement systems.[25]

A second factor important to the timing is that after 2008, money was cheap. In an effort to stimulate the economy after the financial crisis, the Federal Reserve lowered interest rates to close to zero, making the cost of borrowing money practically free. The low cost of capital was a boon to both private equity and public pensions. In leveraged buyouts, companies borrow significant amounts of money to purchase a target. Near-zero interest rates lowered the cost of capital, fueling an increase in the quantity and scale of private equity deals. This environment amplified successful buyouts, generating high returns for private equity investors and their public pension partners. From the ashes of the financial crisis, private equity investments promised a novel, profitable return stream.

Third, at the same time, public pensions were in obvious crisis. With the financial downturn, the asset value of public pensions plummeted. The same low interest rates and reform momentum generated a trend of lowering expected rates of return and discount rates, and thus the present value of pension liabilities skyrocketed. This challenging combination tanked their funding ratios. Suddenly, public pensions' substandard funding practices and excessive promises were in the spotlight. A wave of reform followed, leading state and local plans to create new tiers of reduced benefits for new hires, some defined-contribution plans, lower discount rates, and new and more reliable reporting and funding structures.

However, the reforms that were politically and legally possible could only go so far in limiting liability growth. Most of the benefit changes only applied to new hires, which would take years to affect liabilities, and which have been challenged by public-sector unions in the years since. Contributions also went up, but not enough to reduce unfunded liabilities in a meaningful way. The underlying structure and problems remained intact. And in this situation, with the old ways of keeping the system afloat closed off, private equity opened a new door.

# 6 Discussion

In *Winner-Take-All Politics*, Hacker and Pierson (2010) explain how corporate interests can influence political and economic systems in quiet, hard-to-detect ways. The unlikely partnership between public pensions and private equity shows how state and local governments can also affect the American political economy in less visible, underappreciated ways. Desperate for higher returns, state and local governments helped to fuel the growth of private equity. Moreover, to understand how

25 See U.S. Securities and Exchange Commission (2000).

this relationship came to be – and to understand how it developed as it did – standard accounts that assume a left-right ideological structure, or polarized partisan conflict over policy, or competition between countervailing forces of "labor" and "capital," are inadequate. States run by Democratic unified governments and with stronger public-sector unions have invested their pension funds in private equity just as much as more Republican, weaker-union states.

To make sense of these patterns, we consider the complex economic interests involved in public pension fund management – especially of public-sector unions. Our argument is not that unions or union members are supportive of private equity. Rather, it is that in spite of any objections they have to private equity – that the executives are among the ultra-wealthy, benefit from favorable tax structures, or encourage labor practices they abhor – they have turned to private equity to satisfy their *other* goals. The pension promises have been made, and members value them greatly. Chronic underfunding over the years, combined with the devastating effects of the Great Recession, reforms that followed, and an ongoing unwillingness to drastically increase contributions, has increased the appeal of private equity. Perhaps private equity returns will bail out the state and local governments. At a minimum, the riskier investments (and the higher discount rates that come with them) are used to justify lower contributions. This is a powerful calculus, and, we argue, one that has often outweighed the effects of any antipathy toward private equity among pension board trustees.

Academics and practitioners fiercely debate whether private equity does actually deliver higher returns than other investments (e.g. Phalippou and Gottschalg 2009; Harris et al. 2014). Performance is influenced by various factors, including the specific funds and managers chosen, the timing of investments, and the performance of other asset classes, making it difficult to assess any one pension plan's experience. And past performance may not be indicative of future results. Research should also consider whether efforts by labor unions to leverage their capital commitments to advance workers' rights might affect future private equity returns (Andonov and Rauh 2022; Kahn et al. 2023). If there are tradeoffs between financial returns, political motives, and social impact, it could raise interesting questions about the priorities of pension boards and public-sector unions.

Our findings also raise questions about the implications of public pensions and private equity for economic inequality – and how the political patterns we have highlighted may extend to other alternative investments such as real estate (in which private equity is also deeply involved). Consider a recent *Los Angeles Times* article describing how private equity acquisitions of apartment complexes have led to large rent increases that displace existing middle- and lower-class tenants (Khouri and Poston 2024). Major funding for those real estate investments, the article notes, *also* come from middle-class workers – through public employees' pension funds. Today, Blackstone is the largest owner of commercial real estate in the world and the largest private landlord (Bonislawsk 2021; Farrell 2022). In some places, tenants of Blackstone-owned housing are forming unions to push back on evictions (Abraham 2023). An interesting twist, then, is that middle-class dollars are making things harder for the middle class, with new unions rising up to resist efforts in which other unions have had a hand. Others might argue, however, that lack of housing supply is a bigger underlying problem. If that is the case, blame hardly lies with private equity-funded developers, who have incentives to build more housing. Instead, as political science research shows, the main chokepoint is city government: zoning regulations, public meeting requirements, and the selective participation of residents who are opposed to multifamily housing (e.g. Einstein et al. 2019). Regardless, future research should further investigate the role of private equity – and public pensions – in today's housing affordability crisis.

Here we have made an important start on surfacing these issues and the curious politics they create. This is a case in which labor is capital: where government workers and the unions that represent them provide an enormous source of funding that has helped to reshape the American economy. It is an area in which public-sector unions find common ground with Wall Street – if not in their rhetoric, in their actions. When it comes to private equity, public pension trustees and unions can be quick to criticize their labor practices and opacity. But at the same time, the necessity and desire to bolster the retirements of millions of government employees – after decades of underfunding, and continued unwillingness to drastically increase contributions – has led them to funnel their capital into private equity. In today's polarized political environment, this is one issue on which Left and Right seem to have found some common ground.

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