National Taxpayers Union

Statement of Brent Mead
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Before the Pennsylvania House State Government Affairs Committee
Regarding Pension Reform

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I. Introduction

Chairman Metcalfe and Members of the Committee, my name is Brent Mead, and I am the State Government Affairs Manager for the National Taxpayers Union (NTU), the nation's oldest and largest non-partisan advocate for overburdened taxpayers I am honored to testify before you today on behalf of NTU's 17,300 members in Pennsylvania, all of whom share a belief in limited government and low taxes.

I thank you for allowing NTU the opportunity to participate in this hearing on pension reform. Since NTU's founding in 1969, our members and staff have learned firsthand that few issues can match the complexity or controversy of government employee compensation. It is at once a matter affecting the livelihoods of thousands of workers across the Commonwealth, the personnel policies of public and private entities at all levels, the state government's long-term finances, and, of course; the well-being of taxpayers.

II. Background

Before outlining what NTU believes should he the guiding principles for refonn, it *is* vital to note several important trends. Pennsylvania's largest and most generous public employee pension plans are severely underfunded and in need of serious reform. In Fiscal Years 2009-10, Pennsylvania taxpayers paid $843 million toward the Public School Employees Retirement System (PSERS) and the State Employees Retirement System (SERS). That number will jump to $6.1 billion by 2016-17, an increase of over 700 *percent.* For taxpayers, this represents a burden of almost $500 per person to meet obligations in the not-too-distant future. Furthermore, the actual funding ratio for tlte two plans is expected to dip to 60.1 percent for SERS and 50.9 percent for PSERS. Worse still, rhe plans assume unrealistic rates of return on investments of 8 pet-cent for SERS and 7.5 percent for PSERS. If any Members of the Committee received similar rates of return over the past five years, I would be interested in meeting your investment advisor.

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While the recent economic downturn exacerbated the strained finances of Pennsylvania's pension systems. it is not the cause of the crisis, Economic difficulties simply exposed fundamental, structural flaws in the system. For too long Pennsylvania has promised overly-generous benefit packages to government workers that are not sustainable in the iong run. The bill was going to come due eventually; recent events merely shifted the timetable.

Further complicating the funding picture are proactive efforts by the General Assembly in the past decade that made the situation worse. Starting in 2001-02, Pennsylvania increased the size of the benefits to employees. most notably by boosting the cost-of-living adjustment allowance to current retirees. Act 40 in 2003 deferred unaffordable costs unto the future, with "the future" defined as 2012. Finally, Act 120 in 2010 again deferred payments onto future generations giving the illusion of plan solvency, without decreasing benefits or raising taxes. As you are well aware. the game is just about up.

While the state managed to use smoke and mirrors to hide its true obligations, local entities have had no such luxury. For example, according a report issued last month, Susquenita School District, which serves 1,782 students, will increase PSERS payments from $1 million this year to $3.3 million for the 2017-18 school gear. This month. the Department of Education issued 197 exemptions from the school tax referendum requirement; 194 of those exemptions expressly called for higher taxes without voter approval to meet increased pension costs. By dollar amount. over half of the approved $159 million in exemptions will be earmarked for local pension contributions. Taxpayers already face higher burdens at the local level due to past policy decisions. Thus, without action this crisis will only deepen at both the state and local levels.

III. Principles for Reform

Government employee compensation and associated pension costs are among the most politically challenging issues states must deal with, but difficulty does not excuse inaction. Going forward, Pennsylvania should adhere to the following basic guidelines, to both avoid repeating mistakes and improve the future financial stability of the state's major pension programs:

- **Create a single, shared defined contribution plan for ALL new public sector hires.** Pennsylvania should make real reforms to sustain its government employee retirement system, such as moving to defined-contribution retirement plans. These arrangements (like a 401(k)) have become the vehicle of choice in the private sector and have been adopted by other state governments. For example, Michigan saved $4 billion thanks to reforms passed in the 1990s. Furthermore. Pennsylvania should seriously consider the idea of consolidating pensions into a single, unified plan. With over 3,200 local pension plans in Pennsylvania, any serious attempts at an overhaul have become mired in complexity and are difficult to assess over such a wide-array of plans More importantly, moving to a single plan creates political unity rather than a "Balkanization" of various interest groups who seek carve-outs applying only to their members.

- **Prohibit any attempts to defer required payments, or use of financial gimmicks such as pension obligation bonds.** Pennsylvania faces this quandary in part due to the actions of previous General Assemblies. Specifically, Act 40 in *2003* and Act *120* in *2010* pushed the burden of meeting unfunded liabilities onto future generations of taxpayers. As NTU wrote at the time regarding Act 120:

> *HB 2497* (Act *120)* merely defers pension payments well into the future. By putting off payments, HB *2497* docs not fix the plans' underlying problems or save taxpayers money; it only makes the problem worse. In 14 years, taxpayers will have to pay substantially more to sustain the system due to HB *2497's* risky assumptions about plan returns. In short, HB *2947* will force the children and grandchildren of Pennsylvania's current taxpayers to pay for fiscal irresponsibility they did not cause.

- **Transparency and good data are** key. Designing a sustainable and fair retirement system requires more comprehensive comparisons with the entire private sector. not inflexible adherence to government-only benefit benchmarks. It is critical to incorporate tbe best practices and evolutionary experience of the private sector in the design of any public sector compensation package. as ultimately the private sector workforce shoulders a portion of the burden. Furthermore, state and local plans must use more realistic rate-of-rctum targets. In 2011, Wilshire Associates studied 126 state and local plans. including SERS and PSERS, and found that none would meet their assumed rates of return. If a private sector company used an 8 percent expected rate of return as SERS does, it could face serious penalties for financial fraud. Continuing to peddle such unrealistic numbers in the public sector only perpetuates a fraud on taxpayers as well as government employees, whose benefits will he at risk to the plans' financial insolvency

- **Modify benefit packages.** Pension reform cannot live up to its name without benefit reform. A plan that only impacts new hires may not yield adequate savings. Absent structural changes to current benefit packages, taxpayer contributions to the SERS and PSERS plans will increase from $1.7 billion in *2011-2012* to *$6.1* billion in 2016-2017. General fund obligations to the state pension system will increase from *4* pcrccnt of spending to *12* pel-cent of spending, effectively crowding out other priorities No level of reform targeted solely at new hires can avoid this situation. This Committee must undertake the difficult task of modifying current benefits, especially those regarding early retirement subsidies, redetining eligible income for pension calculations, and curtailing the abuse of cost-of-living adjustments.

IV. Emphasis on select bills

With those goals in mind, I will briefly outline NTU's thoughts on the immediate pending legislation.

- **HB 418:** Broadly speaking, NTU supports the goals of HB 418. The legislation would create a mandatory 401(k) defined contribution plan for state legislators. NTU applauds proposals to institute defined contribution plans. This legislation would also help curb past abuses seen in the pension system where legislators qualified for defined benefit pensions with annual payments exceeding 5250,000. Our reservation is that it only applies to a very small group of state employees.

- **HB 551:** NTU supports transitioning all new employees to defined contribution plans. While HB 551 takes a small step toward this goal hy creating a new optional 401(k) - style pension for neu PSERS hires, membership should be mandatory.

- **HB 552:** Similarly to HB 551, HB 552 creates an optional dcfined contribution plan for new SERS hires. Unfortunately, as the plan is voluntary, it is unlikely to attract the necessary enrollment to yield significant savings to the state Such plans need to be obligatory, for the sake of taxpayers as well as the long-term retirement security of government employees in the Commonwealth.

  HB 1676: NTU does not support HB *1476*. This legislation would create a new "cash balance" scheme that would function much in the way the current defined benefit plans do. While potentially cheaper than the current system, HB 1676 contains many of the same failings plaguing SERS.

- **HB 1677:** NTU's concerns about HB *1477* are similar to those surrounding HB 1676 Both bills effectively create the equivalent of mere ledger entries for each employee's benefits, rather than tackle the underlying issues of long-term plan solvency or provide true individual ownership of retirement assets to every worker.

  HB 2200: HR 2200 is an improvement over HB 418 in that if would require all legislative branch employees, not just elected Members of the General Assembly, to participate in a dcfined contribution plan.

V. Conclusion

Chairman Metcalfe and Members of the Committee, Pennsylvania's taxpayers are grateful for your willingness to explore government retirement issues. NTU and its Members are likewise grateful for the forum you have provided for my remarks today. This will no doubt continue to be an important debate moving forward. I stand ready to answer any questions you may have

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