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Governor's Pension Plan Will Cost the State and Taxpayers More

Keystone Research Center releases first in a series of pension primers

HARRISBURG, PA (February 26, 2013) – Key components of Governor Tom Corbett's massive pension restructuring plan would actually increase costs for the state, school districts, and ultimately taxpayers, according to the Keystone Research Center, which released the first two in a series of "pension primers" today.

The Governor's pension proposal, starting in 2015, would enroll new employees in a defined contribution plan akin to a 401(k) account. This transition away from the current defined benefit pension plans for state and school employees will produce significantly higher employer costs that the Corbett administration has not acknowledged.

"The Governor's pension plan is a one-two punch for taxpayers," said Dr. Stephen Herzenberg, executive director of the Keystone Research Center and author of the pension primers. "It increases state and school district debt for current pensions and drives up costs for future pensions. The last thing policymakers should do now is dig an even deeper hole."

State Treasurer Rob McCord joined Dr. Herzenberg to discuss pension issues and the new Keystone Pension Primers during a conference call today with reporters.

The first of the primers looks at how the transition to a 401(k)-like plan will drive up costs for taxpayers. As new employees are enrolled in the new plan, the employees who remain in the existing pension plans will age over time, and increasing numbers will retire. As the timeframe shrinks over which pension assets must be paid out in retirement checks, fund managers will shift to less risky and more liquid assets that have lower rates of return. This means the state and school districts will have to put in additional contributions to meet their pension obligations to current workers and retirees.

At the same time, contributions into individual accounts from new employees matched by employers will be siphoned off from existing pension fund assets, further eroding investment earnings and increasing costs for the state and school districts.

In a budget day briefing on the governor's pension plan, Corbett administration officials ignored the diminished rate of return on defined benefit plan assets that would occur with the switch to 401(k)-type plans for new employees.

"Policymakers should ask the Corbett administration how much will be lost in investment earnings with pension restructuring and how much taxpayers will be on the hook when that happens," Dr. Herzenberg said.

More than a dozen states, including California, Minnesota and Texas, that have carefully examined defined contribution proposals similar to the Governor's have concluded it is not the best course of action, in part because it would increase unfunded liabilities. Studies show that incremental modifications to defined benefit plans that reduce long-term costs and increase contributions – much as Pennsylvania did with the Pension Reform Act of 2010 – are more cost efficient.

States that have actually adopted 401(k)-like plans have no better track record. Since closing its teachers' defined benefit plan in 2005, Alaska has seen the employer contribution rate jump significantly. In Michigan, which began enrolling all new state employees in a 401(k)-type plan in 1997, unfunded liabilities skyrocketed.

In the second pension primer released today, Dr. Herzenberg writes that per employee costs for the state and school districts will be one-third higher for new employees enrolled in the defined contribution plan than for employees in the current pension plans. The total increase in cost will be modest at first – increasing by about $5 million each year. Fully phased in, the increase in cost will be $179 million each year, more than half of which will be paid by school districts and local property taxpayers.

"Paying more for less is not the pension reform that most Pennsylvanians are looking for," Dr. Herzenberg said. "Policymakers should instead build on the 2010 pension reform law to continue to improve the efficiency of the current pension system and save money."

The Keystone Research Center will release additional pension primers in the weeks ahead to help demystify the often complex details at the heart of the pension debate. You can find all of the pension briefs and more resources at http://keystoneresearch.org/issues-guides/pensions.

The Keystone Research Center is a nonprofit, nonpartisan research organization that promotes a more prosperous and equitable Pennsylvania economy. Learn more: www.keystoneresearch.org.