Ideas for a Better Pennsylvania
The Keystone Research Center

The Corbett Administration Pension Proposal

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Public Employee Pension Reform in Pennsylvania: What Does it Mean for the Future?
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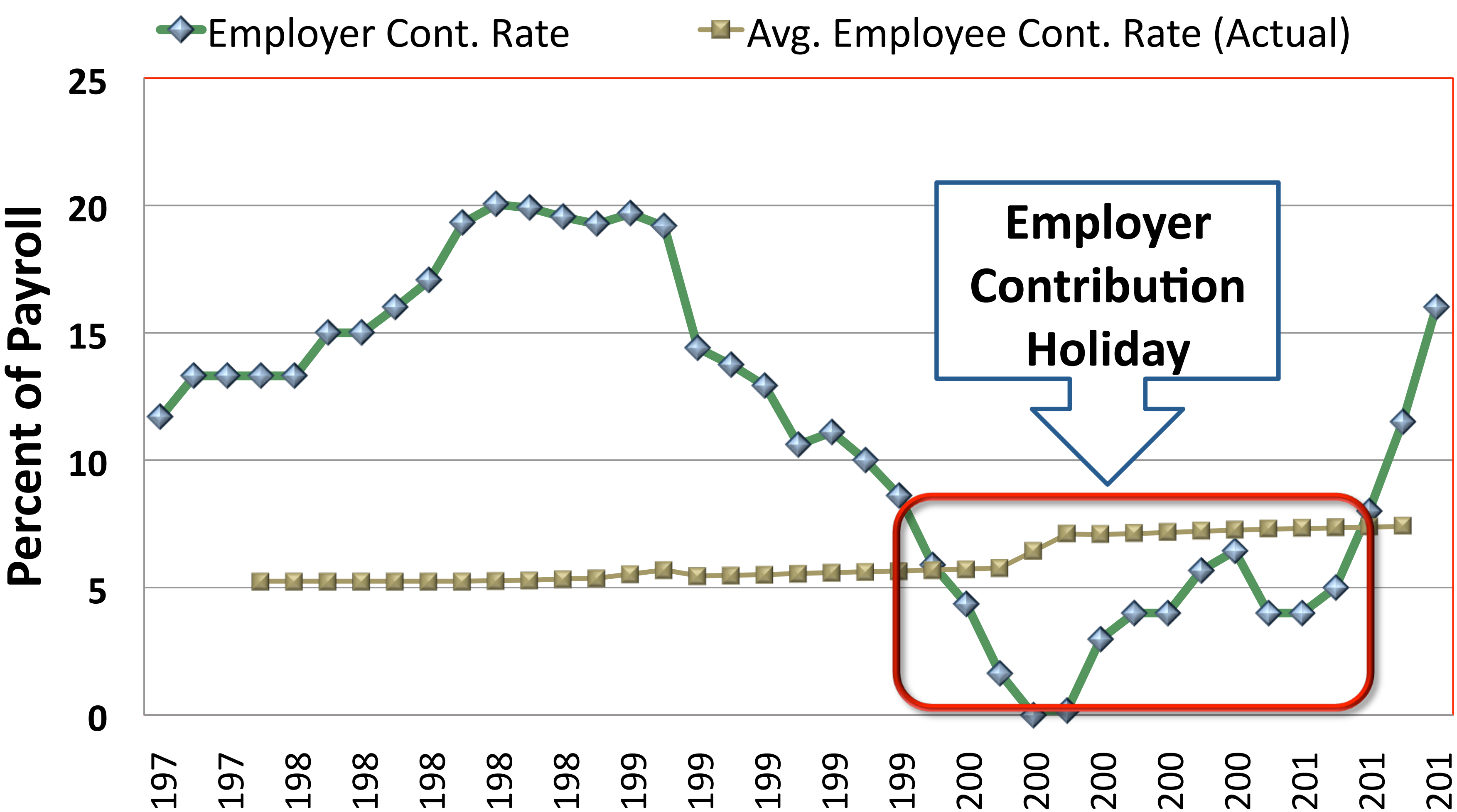
Pensions: the Big (National) Picture

- Half of private sector workers get no pension
- Most of the rest have an (often-lousy) 401(k)-type "defined contribution" plan
- Rising shares of the near-retired will see sharp income drops when they stop working
- The real retirement crisis is the need to improve pensions in the private sector

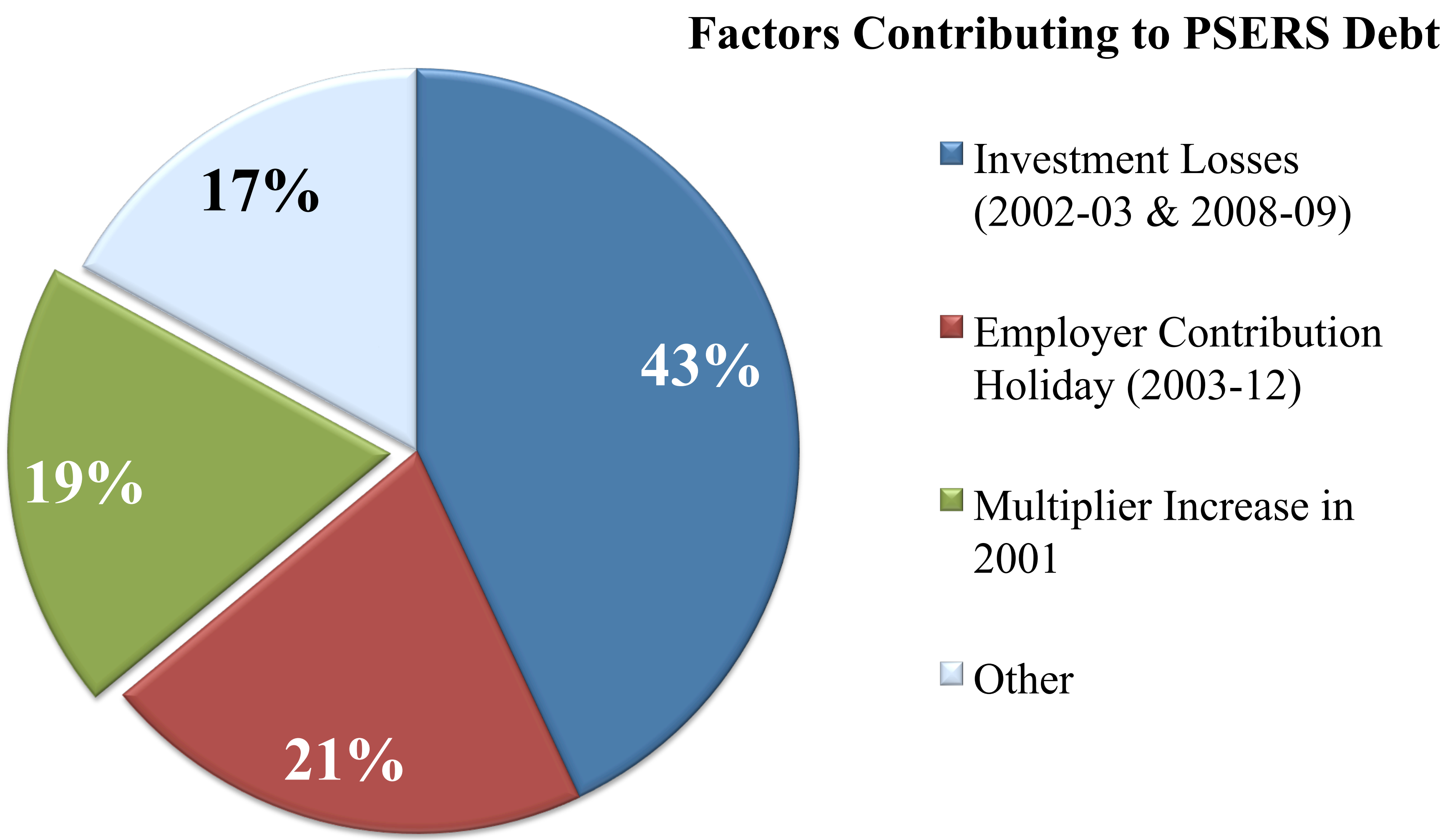
Public Pensions in Pennsylvania

- How did we get here?
- Governor Corbett's pension proposal
- Pensions in perspective
- Solutions

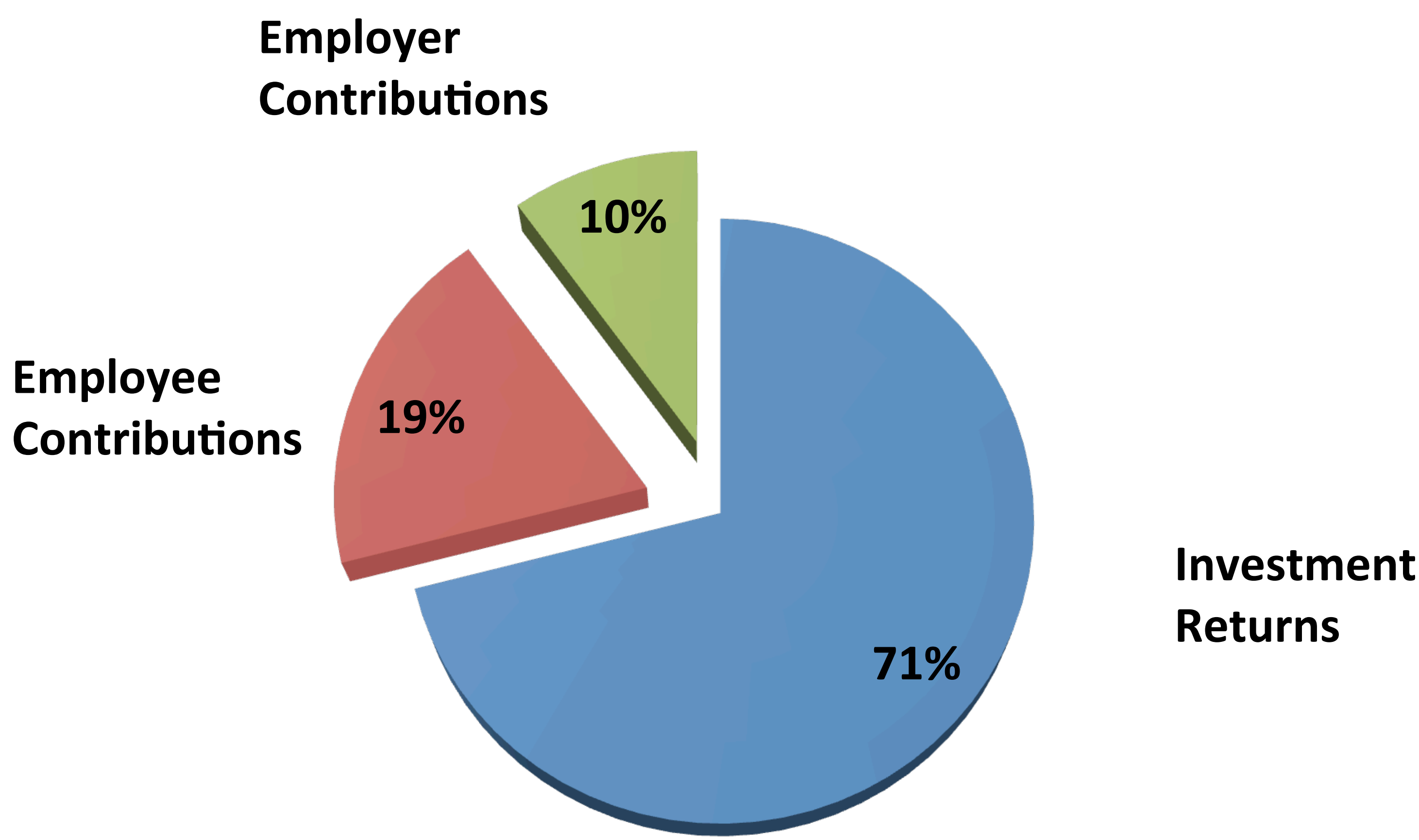
Employer and Average Employee Contribution Rates to PSERS (1976-2014)



The biggest factors contributing to the unfunded liability, in order….



Investment Returns Account for Most PA Pension Benefits in Last Decade



Source. Pennsylvania Office of the Budget, *The Keystone Pension Report,* Exhibit 2, page

Governor Corbett's Pension Proposal

- State lowers its pension contributions for 5 years
- New employees enrolled in a 401(k)-style plan
- Pensions cut for current employees going forward
  - Multiplier falls from 2.5% of final salary per year to 2%
  - Final salary averaged over last 5 years, not 3 years
  - Pensions capped at $113,500
  - If employees withdraw their own pension contributions at retirement, the remaining defined benefit contribution will be lower

Impact of Corbett Proposal For Stakeholders

- Taxpayers
  - PA pension debt
  - Cost of pensions going forward
  - Adequacy of state pension contributions
  - Constitutionality of state pension policies/ predictability of pension contributions
- Employees: pension commitments to teachers, first responders, and other public employees
- Employers: quality of public pensions

Taxpayer Costs Increase to Pay Off PA Pension Debt

- Governor's own charts show $5 billion increase in PA unfunded liability by 2019
- Long-term: taking new employees out of Defined Benefit plans *requires more taxpayer contributions to pay off the pension debt.*
- Why? Lower returns on pension assets result from taking new employees out of the DB plans
  - More assets need to be liquid
  - Composition of assets needs to shift to safer, lower-return funds

Milliman—Administration Consultant—Analysis of Florida Proposal Similar to PA's

"Over time, the State Board of Administration may lose the ability to invest with a long-term perspective…Under a closed plan, as the active population shrinks and the retired population continues to grow, benefit payments will exceed the contributions made to the plan by continually increasing amounts. This will possibly necessitate future changes in asset allocation in order to provide sufficient sources of cash for benefit payments, which in turn could impact the rates of return earned by the Fund's assets…This could jeopardize the ability of FRS's assets to earn the assumed valuation rate of return of 7.75% per annum long-term, thereby putting upward pressure on costs towards the end of the projection period. Our study does not consider the impact of potential asset allocation changes or the impact of the soft freeze on the assumed asset rate of return."

Actuarial Studies in a Dozen States Reach Same Conclusion

- See Appendix to KRC Pension Primer #1 for annotated bibliography of studies on
  - Arizona
  - California
  - Colorado
  - Kansas
  - Kentucky
  - Minnesota
  - Nevada
  - New Hampshire
  - New Mexico
  - New York
  - Texas
  - Wisconsin

Experience in States that Switched to DC

- *Michigan*: Unfunded liabilities since 1997 DC plan up from $697 million to $4.078 billion
- *Alaska*: Unfunded liabilities increased from $3.8 billion in 2006 to $7 billion in 2011
- *West Virginia* adopted a 401(k)-type plan in 1991 but reopened its defined benefit plan in 2005 because individual accounts were not generating adequate retirement income

Taxpayer Costs Increase for New Employee Pensions

- Current pension plans for new employees in SERS and PSERS cost 3% of salary on average
- Employer contribution for new DC plan 4%
- Annual cost increase of $179 million once fully phased in, $112 million to school districts
- Administrative costs of two pension plans and individual accounts
- Higher employee turnover

Irresponsible Cuts in State Contributions

- "There You Go Again"
  - Contribution holidays in last dozen years created the pension debt
  - Now we're going to address the pension debt…by lowering contributions again and making the pension debt higher

The Risk of Court Reversal…and a Higher Pension Debt

- Pennsylvania courts are likely to reject pension cuts for current employees
- Governor's proposal leaves the state uncertain of pension costs until the court rules
- If the court rejects the cuts and the state's already spent the savings, pension debt grows

Governor’s Proposal: Summing Up the Impact on Taxpayers

- Digs a deeper pension hole
  - Increase of $25 billion in pension debt by 2046 according to Pennsylvania Treasure’s office
- One-two punch for taxpayers—higher pension debt & higher pension costs for new employees
- Higher and uncertain pension costs in the future—kicks the can down the road

PA Teachers, Nurses, First Responders, Other Public Employees Not to Blame

- PA public employees contribute about 7% of every paycheck
- PA employees contribute more to their pensions than employees in other states…
- …while the state and school districts contribute less
- Good pensions also compensate for average salaries well below the private sector

Quality of Pensions Would Erode for New Employees

- Precise estimates easier if the Governor would release his detailed DC proposal
- …But research shows defined contribution plans deliver as much as 50% less retirement security for the same contributions

Keeping Pensions in Perspective

- Tax revenues lost to corporate tax cuts and unaccountable tax credits—> $1 billion each year—could have avoided the pension debt
- Over 30 years, the pension debt is modest as a share of the total state budget
- Pension debt is small relative to the "inequality tax"—$40 billion more goes each year to PA's "1%" because of higher inequity

What Are the Solutions?

- Give Pension Reform Act of 2010 time to work
- Implement lessons from well-funded plans: make the required contributions!
- PA needs revenue—to invest in the future, pay for essential services, & meet pension promise
- PA should emulate California in helping private businesses invest in efficient pooled pensions
- *Focus on the real retirement crisis*—the lack of good private pensions