Memo

From the House Appropriations Committee (D)

TO: House Democratic Members and Interested Parties

FROM: Rep. Joseph Markosek, Chairman

SUBJECT: House Republicans' Pension Proposal (#A06917, #A07089 & #A07096 to House Bill 1353, PN 2152)

DATE: May 28, 2014

Today, the Public Employee Retirement Commission met to release its draft actuarial analysis of Rep. Tobash's plan to dramatically cut retirement benefits for future state and school employees. According to the analysis:

- **The Tobash plan itself does not produce any short-term savings for the state or school districts, nor does it meaningfully pay down the $50 billion pension debt any faster than Act 120 does.** In fact, no matter how much Gov. Corbett and House Republicans cut retirement benefits for future workers, it will not help to solve the immediate budget crisis.
- **Roughly 40 percent of the long-term savings for the school employees' retirement system would come from eliminating a modest health care supplement for school retirees.** The $100 per month supplement is the only statewide health care benefit for school retirees.

Additionally, although not addressed in the actuarial analysis, the plan's long-term savings will be reduced significantly if it is coupled with the governor's budget plan to shortchange the pension obligations for the next four years. Which begs the question: Is this so-called pension "reform" proposal being driven solely by ideology, rather than by what makes the most fiscal sense?

Gov. Corbett and House Republicans are looking to further reduce worker benefits under the guise of pension "reform" – a diversionary tactic to distract the public from the budget crisis. The governor's budget proposal is now out of balance by more than $1 billion.

- The governor claims Pennsylvania is facing a pension crisis, while in reality, it has a budget problem – largely of his own making. Gov. Corbett cut education funding by $2.8 billion over his tenure, gave businesses more than $2 billion in tax breaks and refused to enact a reasonable natural gas severance tax – all of which have exacerbated the budget pressures for the state and school districts.
- By calling for pension "reform," Gov. Corbett is trying to make state and school workers the scapegoats for his budget problems. Public servants have been faithfully paying their fair share into the pension systems all along – they are not the ones who created the debt.

In the past, Pennsylvania has increased its pension debt by taking a pass on making the necessary payments. **More than half of today's pension payment goes towards paying old debt.** We need to focus on paying down the pension debt – not on making the long-term situation worse just to score political points or free up revenue for an election-year budget. **The only way to reduce the debt is to make the payments.**

In 2010, an overwhelmingly bipartisan majority of the House and Senate voted to end this kind of gamesmanship. Act 120 significantly reduced pension benefits for future employees, required the state and school districts to make their required payments and charted the course for addressing the pension debt. Remember, under Act 120, the state reduced benefits for new employees by 20 percent, for a 60 percent reduction in the cost to employers. (See Act 120 Retirement Changes for New Employees: Fast Facts.)

Now, the governor is proposing to change Act 120 and shortchange the pension systems for the next four years so that he does not have to make the full debt payment while in office. Everyone knows that it is a bad idea to make *less* than the minimum payment on a credit card. That is essentially what he is proposing to do.

The governor's budget plan: Artificially reduces the state's and school districts' pension payments over the next four years; therefore, borrowing billions of dollars from the pension funds.

The Tobash pension plan: Creates a new, complicated, two-part retirement plan for all new state and school employees, including the Pennsylvania State Police who are not eligible for Social Security benefits. The plan:

- Artificially caps the amount new employees can earn in the pension system ("defined benefit plan"), coupled with a new 401(k)-style component ("defined contribution plan").
- Increases the number of years used to calculate the final average salary from three years (or 1 year for the State Police) to five years - which would reduce a retiree's final average salary for benefit purposes.
- Forces current employees who have a break in service and former employees who return to service to move into the new, reduced retirement plan.
- Eliminates a long-standing, modest health insurance supplement for school retirees.

Note: A subsequent amendment by Rep. Vereb (#A07089) would remove the State Police from the Tobash plan, but limits the amount of overtime pay that can be counted towards retirement to 10 percent of base pay.

Only in theory would the two-part Tobash plan provide adequate retirement security for teachers, state troopers and all other public servants.

- First, the defined benefits would be reduced so dramatically that it is unlikely the 401(k) component could adequately rectify the reduction. Second, as designed, the bulk of the 401(k) contributions would be made later in an employee's career, not allowing enough time for the investment to grow.
- By our calculation, the Corbett/Tobash plan would cut teacher retirement benefits by 30 percent, in addition to the 20 percent reduction under Act 120 – for a combined 50 percent reduction since 2010. (Note: In Pennsylvania, women teachers outnumber men 3 to 1; therefore, benefit cuts would disproportionally affect women.)

While House Democrats are open to new pension ideas, Act 120 of 2010 is the benchmark by which to compare the various proposals. As we analyze the Tobash proposal, we will be asking these five key questions:

1) How does the proposal compare to Act 120? (i.e. Does the plan cost the state and school districts more? Does it save more? What is the long-term impact on pension debt? How much further does it cut employee retirement benefits?)
2) What impact, if any, will the proposal have on the pension systems' unfunded liability?
3) How much will future employee benefits be reduced (i.e. the total dollar amount)?
4) How much debt will be added to the state's retirement systems if the state and school districts take a pass on making the full pension payments for the next four years – as proposed in the governor's budget?
5) After the four-year period, how much will the state's and school districts' pension payments increase to account for the additional burden from underfunding the systems?

Additionally, we are concerned the proposal could have many unintended consequences. For example:

- How will this plan affect the state's and school districts' bond ratings?
- What are long-term social consequences of providing such inadequate retirement benefits? Will employees have a financially secure retirement? Will the state still be able to attract high quality teachers, school nurses, law enforcement officers, prison guards, health care workers and all other public servants?
- The Tobash plan contains a "break in service" clause that under certain circumstances would force current employees or former employees who return to service into the reduced retirement plan. **For example, if a woman takes time off work to care for a child, when she returns to work she could be forced into the reduced benefit plan and it would take her an additional 10 years to vest in the new plan.**

The Tobash amendment is hundreds of pages long. As with any bill that size, the devil is always in the detail. Pension changes this dramatic should be fully vetted through public hearings. Most importantly, any changes to the pension systems need to be carefully considered in light of recent warnings from credit rating agencies. We will continue to analyze the pension proposal and provide you with information as it becomes available.