POLICY BRIEF

An electronic publication of
The Allegheny Institute for Public Policy

June 26, 2008 **Volume 8, Number 39**

State Pension Aid System is Fair to Pittsburgh

Pittsburgh's Mayor wants to see the state's system of pension aid to municipalities reformed. This should come as no surprise in view of Pittsburgh's current pension difficulties. According to the 2007 Comprehensive Financial Report, the City's accrued pension liabilities exceed pension fund assets by $523.8 million, or stated another way, Pittsburgh's pension plans are only 42 percent funded. The Mayor is appealing to the state for help and to the leaders of other municipalities for support in his reform efforts.

The Mayor recently asserted that the system of state pension aid to municipalities "puts municipalities like Pittsburgh at an unfair disadvantage because we are receiving about 50 percent less than we used to under the same formula and there are overfunded municipalities that are in very strong [financial] situations"—presumably he means fiscally sound municipalities are taking advantage of the pension aid program.

The Mayor's assertion warrants some scrutiny. Here's how the pension aid system works: the state levies a two percent tax on insurance premiums collected by out-of state fire and casualty companies. Those proceeds provide the money for the state's municipal pension aid fund. Municipalities submit a form to the state that has a unit count (uniformed employees are counted as two units, non-uniformed as one unit). The pool of available pension aid is divided by the number of units statewide. This produces what is called a unit value, the amount of aid available for each unit. The dollar amount of aid for each municipality is then determined by multiplying the unit value by the number of units in each municipality.

Seems straightforward: so why the charge of unfairness? First, as a municipality reduces its headcount, the amount of aid returned decreases because the number of units falls. The problem with the Mayor's argument is that reducing headcount and not filling those positions means there is no further accrual of pension liability for those employees. Thus, the state's pension assistance for terminated employees is justifiably cut off. What the Mayor is really saying is that the state system should help him deal with the City's massive failure to fund its pensions adequately during previous decades.

Second, any municipality can apply for the aid. It is not means-tested. Statewide the number of municipalities receiving the full reimbursement for their pensions has fallen from 75 percent in 1985 to 48 percent in 2005.

Here's the real issue facing Pittsburgh. The City's three pension plans—one for police, one for fire, and one for all other employees (including the Water and Sewer Authority)—are in trouble. Data from the Controller's report shows that in 2002 the combined liabilities of the three plans were $752.7 million. As of 2007, the combined accrued liabilities stood at $899.2 million, a 19 percent increase. This rise has occurred despite a significant drop in pension plan participants—the total number of active (still working) members and retirees (along with beneficiaries of retirees and terminated but vested members) in the three plans fell by 763 (9%) from 8,549 to 7,786 between 2002 and 2007.

The data below shows that the combined pension contributions (City and state contributions for all three plans) grew from $18 million to $38 million in five years. The state aid ranges from around $15 to $18 million.

Pension Contributions, 2002 through 2007

Year	Combined Pension Contributions ($, millions)	Combined State Contributions ($, millions)	State as % of Combined	Year over Year % Change in State Contributions
2002	18,426	16,000	87	
2003	23,875	18,214	76	14
2004	31,558	17,901	57	-2
2005	36,720	17,166	47	-4
2006	37,979	14,630	38	-15
2007	38,127	15,182	40	4

Clearly, when the Mayor was referring to a decline in what the City gets in aid he was referring to the state share of the total. But the state formula does not set a minimum threshold; it is based solely on the employee counts submitted by the City. The rising share the City has been forced to pay reflects the need to prevent unfunded liabilities from worsening even faster. Clearly, Pittsburgh's huge and rising unfunded pension liability has come about because of generous promises made in earlier union contracts and the failure of the City to fund pensions adequately years ago. That failure compounded itself over the years and is now very hard to deal with.

It is also interesting to consider the state aid in light of the number of active employees and retirees participating in the system. As noted, there were 8,549 active/retired members vested in 2002: with $16 million in state aid, that translates into $1,871 in state aid per member. Last year, with $15.1 million in aid and 7,786 active/retired members, the state aid per member rose to $1,949.

Does that smack of being unfair? It is hard to see how. Maybe it is unfair that, according to the state Public Employees Relations Commission data from 2005, Pittsburgh received 27 times more state pension aid than the next nearest municipality (McKeesport received $628,000 to Pittsburgh's $17 million) in Allegheny County. And maybe it is unfair that the state's counties and authorities can't partake of the state aid. Or maybe it is unfair that Allegheny County and some of those same authorities in the City (Housing, Parking, and URA) are well funded while the general City pensions are seriously underfunded.

Clearly something must be done about Pittsburgh's pensions, but a few million dollars in state aid is not going to do it. Changes like moving new hires to defined contribution plans and limiting pension enhancements in future contracts will likely have more of a positive long term impact. Reducing the number of employees to stop further liability accrual is also a good way to start bringing the problem under control. Outsourcing or eliminating non-core functions are two good ways to accomplish the needed job count downsizing. Offering early retirements is not a useful option as that just depletes pension assets faster.

Eric Montarti, Policy Analyst **Jake Haulk, Ph.D., President**

For more information about this and other topics, please visit our website:
www.alleghenyinstitute.org

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org