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Public pension reform bows in Pa.

By Colin McNickle

Pension reform at long last is being phased in for newly hired state workers in Pennsylvania. But it will be decades before those pension plans' health is restored. And some taxpayers could see their taxes rise before relief comes, finds a review by the Allegheny Institute for Public Policy.

"Too bad it took this long to get public employees … and school districts into pension plans that involve defined contribution," says Eric Montarti, research director at the Pittsburgh think tank.

A series of misguided legislative actions left the State Employees' Retirement System (SERS) and the Public School Employees' Retirement System (PSERS) a combined 58 percent funded at the end of the 2016-17 fiscal year.

"Laws passed in 2001 (Act 9), 2002 (Act 38) and 2003 (Act 40) that provided a substantial increase in pension benefits, lowered the vesting period, gave cost-of-living increases to retirees and capped employer contributions and spread out obligations are primarily pinpointed as a major cause of the current situation," Montarti notes (*in Policy Brief Vol. 19, No. 4*).

Neither did the Great Recession of 2008 help.

To wit, an analysis of the PSERS shortfall – by a study commission mandated by Act 5 of 2017 -- calculated an unfunded liability of $44 billion. Of that, $18.3 billion (41 percent) was attributed to "employer underfunding"; $16.2 billion (37 percent) was blamed on flagging "investment performance"; $7.8 billion (18 percent) was attributed to "benefit enhancements" and $2 billion (4 percent) was due to "changes to actuarial components." Employer contributions for both PSERS and SERS were $5.8 billion in fiscal 2016-17.

Enter Act 5. Its thrust is to place new hires (excepting "hazardous duty" employees) into one of three pension tiers of the employees' choosing.

Beginning Jan. 1 for new SERS-covered workers and July 1 for new PSERS-covered employees, two hybrid plans combine aspects of defined-benefit and defined-contribution plans while the third is a pure defined-contribution program. The retirement age is increased and a longer time period is used to calculate final average salary on which benefits are determined.

The benefits of those employed prior to Jan. 1, 2019 -- a legal contract which, per the Pennsylvania Constitution, cannot be impaired -- are not affected.

"Based on an analysis for prospective SERS members, an employee who would work for 35 years with an average salary of $40,000 that chooses one of the two hybrid plans would retire with somewhere between a $14,000 to $17,500 annual pension and an investment lump sum of $165,244," Montarti says. "One choosing the defined-contribution plan would retire with a $330,448 lump sum."

While pension reform was long overdue, its effects are far from immediate. It will take 11 years, not until 2030, for SERS and PSERS to become 70 percent funded and 21 years, not until 2040, for the respective pension programs to become 100 percent funded.

There could be additional savings of between $2.8 billion and $3.4 billion (on a present-value basis) over a 30-year period should the state adopt other reforms recommended by the study commission – everything from funding, stress testing, transparency and investing and asset allocation.

"Hopefully the change will benefit taxpayers after several years, many of whom have seen their school districts raise taxes for several years to meet pension funding obligations," Montarti says.

But, he cautions, "(T)ax hikes for 2019-20 are quite likely because of pensions and other benefits."

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