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An early look at Pa.'s public pension reform

By Colin McNickle

Public employee pension reform now is in full bloom in Pennsylvania. But if the limited data available from the first of two groups is any indication, there hasn't been any rush by employees – new or old -- to embrace defined-contribution plans, suggests an analysis by a researcher at the Allegheny Institute for Public Policy.

And even *with* reform, some school taxes continue to rise.

Act 5 of 2017 places new state and public-school employees into one of two hybrid plans that combine elements of the defined-benefit and defined-contribution plans or a straight defined-contribution plan.

“Hybrid plans combine aspects of defined benefit (based on a formula that considers compensation, years of service and age) and defined contribution (based on money that accumulates in an account with contributions from employer and employee and investment performance) plans,” explains Eric Montarti, research director at the Pittsburgh think tank (in *Policy Brief Vol. 19, No. 29*).

The pension options took effect Jan. 1 for those in the State Employees' Retirement System (SERS) and on July 1 for those in the Pennsylvania School Employees' Retirement System (PSERS).

That, after years of political machinations. Or, as the Public Pension Management and Asset Investment Review concluded, Pennsylvania's “unfunded pension liability was the direct and foreseeable consequence of past policy decisions, primarily deferring actuarially determined contributions as well as investment underperformance.”

The full required payments for PSERS have been made over the last four years, which, combined with the required new employee contributions and investment income, will serve to pay down the unfunded liability.

So, how will a prototypical public-school employee fare under the reformed system? Based on PSERS calculations, a new hire with a \$40,000 starting salary receiving annual pay increases of 3 percent and working for 35 years would receive a total retirement benefit of \$861,721 in the default hybrid plan.

That compares to \$758,243 in the other hybrid plan and \$748,243 in the defined-contribution plan. In other salary and longevity scenarios, the defined-contribution plan produces a benefit greater than the second optional hybrid, mostly for those leaving after eight years.

But in “reform,” actuarially determined school district employer pension contributions will rise in fiscal 2019-20.

“As the contribution rate grows, school property tax increase could follow,” Montarti says. “Several of the 23 Allegheny County districts that raised taxes for this year noted the higher contribution rate as part of the reason for the hike.”

While it is too early to fully evaluate the new PSERS system, there is preliminary data on the new SERS hires.

“Data from the first three months of 2019 show that most stayed in the default hybrid or chose the other hybrid over the defined-contribution plan – 1,900 to 36 new employees,” Montarti says.

The conversion ratio was even worse for SERS workers employed prior to the new pension law taking effect.

“Existing employees of SERS were given a window of time to leave their defined-benefit plan and join one of the new options created by Act 5,” Montarti notes. “Only 70 did (SERS has over 103,000 active members) with 65 choosing the defined-contribution plan.”

PSERS members hired prior to July 1 will be given a similar option window.

That said, members of the Pennsylvania Legislature didn’t set much of an example in the long-needed switch from unsustainable defined-benefit pension plans.

“Of the 218 members of the General Assembly that take pension benefits, only 20 switched from the defined-benefit plan with all choosing to enroll in the defined-contribution plan,” Montarti notes.

Be that as it may, Act 5 does represent reform progress. Though it’s “too bad it took so long for Pennsylvania to get public employees into pension plans that involve defined contribution,” Montarti concludes “fiscal stability should be achieved – absent tinkering that reverses any progress.”

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