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Getting Serious About Public Sector Pensions

A Tribune Review article of November 8 reminds once again just how desperate the unfunded pension plan situation is for many Pennsylvania communities, including the two largest cities as well as several midsized cities. With assets to liabilities ratios below 50 percent in Pittsburgh, Philadelphia and Scranton and others below 65 percent, there can be little doubt that a crisis is at hand.

Legislators are saying it is time to get serious. But if the plans being contemplated are not more forceful than the municipal legislation passed in 2009 or the pending legislation drafted to deal with the state's own pension difficulties with SERS and PSERS, we can expect little correction of the underlying problems and no lasting improvement in the underfunding situation.

Drastic steps need to be taken and very soon.

Dealing with the pension difficulties will require legislators to face up to the real problem. Simply put, most of the troubled public sector pension plans are too generous. Many municipalities and school districts, along with the Commonwealth, are saddled with long term obligations to retired and current employees that cannot be met without: (1) diverting large amounts of revenues from fundamental, core functions of those governing bodies or (2) raising taxes to such a punitive level that the affected economies and tax bases suffer diminished growth or shrink.

Attempts to fix this legacy cost problem by having the state assume more of the responsibility to fund school district and municipal pensions as well as its own will choke off efforts to reduce spending and lower the business tax burden that is and has been so detrimental to the Commonwealth's ability to grow economically.

The search for effective and meaningful answers must address the size and growth in pension liabilities—what is owed to retirees and eligible employees. Several proposals have been discussed such as having new employees put in 401 (k) or similar defined contribution plans. Clearly, that is a major initial step but unfortunately will not make a significant dent in the problem for many years.

It is time to tackle the issue head on. Pennsylvania needs to make two fundamental legislative changes. First, the legislature must make it easier for municipalities to enter into Chapter 9 bankruptcy to deal specifically with massive unfunded pension obligations for which there is no solution other than ruinous tax hikes or crippling service cuts. As we pointed out in a *Policy Brief (Volume 10, Number 8)* earlier this year, the Act 47 process might be too tedious and cumbersome for a municipality in a drastic and dire situation. We are recommending changes to

Act 47 to facilitate declaration of distressed status as well as some specific language regarding municipality entry into Chapter 9.

Second, the state might want to think about extending the permission to seek Chapter 9 bankruptcy to its authorities and school districts. Our report on municipal bankruptcy (#09-05) noted that states are free to prohibit or place as many pre-conditions it wishes on its local subdivisions when it comes to Chapter 9 bankruptcy. As a result of amendments to the U.S. code nearly twenty years ago there has to be explicit permission by the state for a municipality to file for Chapter 9 bankruptcy. Since Act 47 only deals with municipalities, school districts and authorities are not allowed to file.

Obviously, legislative language changing Act 47, or making municipal bankruptcy in Pennsylvania more accessible, must be very careful to avoid permitting capricious misuse of the bankruptcy provisions. Once in Chapter 9, state law—including the Pennsylvania Constitution’s language in Article I, Section 17 about not abrogating contracts and treating public sector benefits as sacrosanct—must yield to the Federal code. A memorandum from a U.S. Bankruptcy court involved in a case dealing with a Chapter 9 filing in California stated “when a state authorizes its municipalities to file a Chapter 9 petition it declares that the benefits of Chapter 9 are more important than state control over its municipalities”.

It is important to note that in private sector bankruptcy the Federal bankruptcy code supersedes the Article I, Section 17 language regarding abrogation of contracts. Thus it seems reasonable that in a municipal bankruptcy the Federal code would also take precedence.

Employees and retirees deserve to be and must be protected to the greatest extent possible consistent with the level of financial distress of a community filing for bankruptcy. At the same time there must be recognition of responsibility. Cities that have made overly generous commitments and now cannot meet their obligations cannot reasonably expect taxpayers in other municipalities who have been more prudent to provide the funds necessary to solve the legacy cost problems of irresponsible communities. Retirees enjoying handsome pension and other benefits in a city that cannot afford to pay for current basic services have no ethical or moral claim on taxpayers in other communities.

Obviously, many hearings and debates will be necessary before these dramatic proposals can move toward legislative language and bill enactment. Still, the very process of entertaining the possibility of forceful steps could engender some meaningful, voluntary compromise that would help ease the crisis substantially.

At the very least, Chapter 9 bankruptcy in Pennsylvania should offer municipalities or school districts an opportunity to renegotiate the terms of pension plans for future retirees such as increasing the number of years needed to be eligible for full benefits; limiting the use of overtime or other non-standard pay in the calculation of retirement benefits; and reducing the percentage of annual pay received for each year of service.

Along with a new municipal bankruptcy statute, the Legislature must reform Act 111 to force arbitrators to take local financial conditions into account in their contract awards. The right to strike of public sector employees, including teachers and transit workers, must be repealed. By restoring balance in contract negotiations these actions would help prevent some of the more egregious situations that have developed around the state. Taxpayers and residents needing core government services deserve no less.

When dire situations such as the pension crisis arrive, it is necessary to confront the real causes of the problem and not kick the problem down the road for someone else to deal with later when it will surely be much worse. Adequate provision of core government services without wrecking the economy with exorbitant taxes must not be held hostage to earlier decisions made by governing bodies to award excessively generous benefits to public employees.

We wish all Veterans a very happy day as we celebrate your service.

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