POLICY BRIEF

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State Throws Cold Water on City Pension Aid Request

Members of Pittsburgh's City Council visited state officials on February 6th to make a simple request: please help us with our pension costs, preferably by letting the City fold its three municipal plans (one for police, one for fire, and one for non-uniformed employees) into the state's pension system the way it is done in Florida. The answer from administration officials and legislators was that it would not be fair, or politically realistic, to ask the rest of the state to take over the obligations resulting from Pittsburgh's past excessively generous promises and poor management. At least that's what they are saying for public consumption. A cynic might wonder if a wink-wink, nod-nod signal that help might be coming later has been sent to City officials.

A little background on Pennsylvania's pension systems is in order to fully appreciate and understand the issues involved here. The state itself administers two pension funds—one for state employees and one for school employees. Municipalities administer their own plans subject to state regulations. The municipal plans obtain significant funding from a tax on premiums paid to out-of-state fire and casualty insurance companies. In 2005, the tax raised $190 million to be distributed to the state's municipality plans on a formula based on each plan's financial status and number of participants.

Most large authorities also have pension plans but neither they nor county pension plans receive funds from the fire and casualty tax revenues.

The Allegheny Institute will release a full report in the near future on the financial condition of municipal plans, with special attention given to the 294 plans in Allegheny County. Not surprisingly, there is a great variety in the levels of assets, liabilities (funded or unfunded), the number of employees covered, and the type of benefits offered.

Statewide many plans have been added over the last three decades. Amazingly, the current 3,129 local government plans represent one-fourth of all public pension plans in the U.S. The majority (71%) of Pennsylvania's plans are self-insured, defined benefit plans for which the taxpayers are required to cover any shortfall.

We have previously documented the status of Pittsburgh's pension funds and the attempts to fix the associated problems. As of January 2005, the combined assets of Pittsburgh's three plans were $371 million with combined liabilities of $842 million, leaving $470 million in unfunded liabilities. The ratio of assets to liabilities was a quite low 45 percent. Pittsburgh's fire employee plan at 57 percent funded was the best of the City plans in terms of funded liabilities.

In one attempt to remedy shortfalls, the City sold bonds and invested the proceeds in the stock market to reduce unfunded pension liabilities. Our 2002 report on Pittsburgh's pensions detailed these bond issues and noted that "largely as a result of declines in stock prices and continued increases in pension benefits, the percentage of funded pension liabilities has fallen from a high of 67% at the beginning of 2000 to just over 50% in 2002 - and will probably be under 45% in January 2003". That prediction came true.

The state's recovery plan/oversight agencies have yet to produce any substantial or meaningful solution for the pension problem. Apparently, City Council members are counting on other municipalities in similar straits to work with the City to lobby for state help. One council member seems to feel that "all older communities" are facing major pension difficulties. However, that is not a correct assessment of the situation.

In Allegheny County it will be tough to find a lot of other municipalities needing a state bailout. Recent data for the 288 non-Pittsburgh related plans show that as of January 2005, only 7.6 percent (22) of pension plans (municipal or municipal authority) had a fund ratio (assets/liabilities) of 69 percent or lower. The majority of plans in the County are well funded, with close to 60 percent of them fully funded or better. Statewide, the situation is similar with only about 270 plans (8%) having a funded level of 69 percent or lower. If there is another municipality that Pittsburgh can commiserate with, it would be the City of Philadelphia whose unfunded liabilities for its three pension plans totaled $3.2 billion. In fact, Pittsburgh and Philadelphia pension shortfalls combined account for 75 percent of the total unfunded liabilities for all local pension plans in the state.

The fact that the vast majority of pension plans are adequately funded is major reason the state is reluctant to allow Pittsburgh to join the state pension system. Another is that limited past attempts to merge plans have failed. Then there is the fact that, thanks to the misguided and overly generous promises of previous administrations and legislatures, the state and its 501 school districts are looking at significant increases in their pension contributions in a few short years that will have major negative impacts on Pennsylvania taxpayers. Thus, the state will likely be scrambling for solutions to problems of its own making and is unlikely to be interested in taking on the massive unfunded liabilities of Pittsburgh and Philadelphia.

So what could Pittsburgh—and the state—do to get the pension problem under control? There are several solutions, some longer term in nature than others. One would be to get new employees into a defined contribution (401K) system instead of a defined benefit program. Second, a new agency should be created along the lines of the Federal Pension Benefit Guaranty Corporation. This agency would be empowered to assume the assets and liabilities of pension plans for seriously distressed communities and authorities. The agency would manage the assets and pay out guaranteed benefits on a reduced fractional basis to retirees in order to preserve the plan's long term viability. Third, the state should take a page from its planned turnpike privatization and finally get out of the liquor business by selling off stores to the private sector and setting aside the proceeds to cover future shortfalls in state pension funds.

Above all, the state and its municipalities need to move to a pension system that is more in line with the private sector and what taxpayers can afford. Taxpayers must not be treated as a perpetual unlimited source of funding for the reckless and imprudent promises made by public officials. Failure to deal with the problem in a way that protects taxpayers will have enormous deleterious consequences for the economies of Pennsylvania and its large problem ridden cities.

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