Pennsylvanians have learned a great deal about pensions over the past 18 months. With policymakers, the media, and members of the public now digesting Governor Tom Corbett’s budget address, the Keystone Research Center presents a summary of the facts that have emerged from the pension policy debate so far.

- **The biggest cause of Pennsylvania’s pension debt is the employers’ failure to make annual required contribution (ARC) payments** to ensure long-term financial sustainability. Pennsylvania ranks 48th out of the 50 states since 2003 in making its ARC payment, with contribution shortfalls accounting for nearly half of Pennsylvania’s pension debt. If Pennsylvania employers had made adequate contributions, the state’s pension funds would now be well above the 80% funded level considered financially healthy.

- **Pennsylvania’s pension debt is not the responsibility of Pennsylvania employees, who have contributed about 7% on average of every single paycheck to their own pensions.** In the difficult decade of the 2000s, Pennsylvania employees contributed nearly twice as much to their own pensions as did their employers. Nationally, that ratio is flipped: state pension plan employers in other states pay nearly twice as much as employees in pension contributions. Consequently, state pension plan employees in Pennsylvania contribute three-and-a-half times as much to their pensions, relative to employers, as employees in other states’ pension plans. Under Act 120 of 2010, Pennsylvania state employees will continue to contribute roughly 7% of every paycheck, on average, to their pensions, while employers will contribute – once the unfunded liability is paid off – 3% of salaries on average. Thus, employees hired after 2010 will pay more than twice as much for their own pensions as their employers contribute under Act 120.

- **Pennsylvania does not have a “pension” problem – public pensions cost taxpayers little going forward. Instead, Pennsylvania has a pension debt problem due to employers’ failure to make adequate contributions.** As noted, Act 120 already lowered the employers’ cost of pensions for employees hired after 2010 to only 3% of salaries. Given that employee wages plus benefits already trail the private sector for comparable employees (see below), it is unlikely that the state can save money by cutting the employer cost of future pensions even more. If pensions for teachers, nurses, first responders, and other public servants erode further, public employers would likely have to make offsetting increases in salaries.

- **Both major proposals to redesign Pennsylvania’s public retirement plans – Governor Corbett’s proposal to shift to 401(k)-type retirement accounts and legislative proposals to shift to a cash balance pension – would dig a deeper pension hole,** increasing Pennsylvania’s pension debt and leaving taxpayers to pick up the tab. Last May and June, three actuaries confirmed what the Keystone Research Center had noted in February 2013: that shifting new employees to defined contribution pensions would increase Pennsylvania’s pension debt by an estimated $40 billion. A cash balance proposal could also increase the state’s pension debt if fund managers invest more.
conservatively once a significant proportion of public employees participate in the cash balance plan rather than the traditional pension.iv

- **Adopting either a defined contribution or cash balance approach would shift Pennsylvania’s pensions towards a less cost-effective pension plan,** costing taxpayers and employees more to achieve any given level of retirement security. Long-term, guaranteed pension such as Pennsylvania’s current plans have a better investment return track record than 401(k)-type retirement security plans, and they also have lower fees and save money by pooling “longevity risk.”v If cash balance plans have lower investment returns (see previous bullet), they too will cost more to deliver any level of retirement security.

- **Both proposals to redesign Pennsylvania’s current pensions would jeopardize retirement security.** 401(k)-style pensions have proved wholly inadequate at providing retirement security in the private sector.xi Representative Grell’s cash balance proposal would reduce pensions across a sample of career trajectories by about 20% on average, and by as much as two-thirds for career employees.vii

- **Pennsylvania’s public-sector pensions are modest, averaging less than $25,000.**viii Even with good benefits, Pennsylvania public workers earn wages plus benefits per hour that are 3.7% less than equivalent private workers.ix Additional cuts in pension benefits would increase the compensation penalty for teachers and others with a college degree who choose a career in public service – a group that accounts for more than half the Pennsylvania public-sector workforce.

- **Corporate tax breaks have a bigger impact on the state budget than pensions.** The annual taxpayer cost of funding the retirement benefits of current Pennsylvania employees is only 36% of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.x Similarly, the annual (normal) cost of pensions is less than half the annual cost of tax cuts and tax credits enacted under Governors Rendell and Corbett.xi

- **The transfer of income to Pennsylvania’s top 1% dwarfs the state’s unfunded pension liability.** Since the second half of the 1970s, the share of Pennsylvania income received by the top 1% has increased from 8-9% to 17-19%. This shift costs the broad middle class (the “99%”) an amount every single year roughly equal to the state’s pension debt (which can be paid off over several decades).xii

In light of the facts, the best way for Pennsylvania to build on Act 120 would be to address employer-contribution problem that led to the current pension debt. One way to start would be to embrace Representative Grell’s proposal for a pension bond that would help the state make up for low employer contributions over the past decade. This might allow for some pension relief for school districts in the near term. A permanent fix would ensure that the state pays its full ARC every year.xiii What Pennsylvania should not do is repeat the mistakes of the past by cutting pension contributions and increasing the state’s pension debt.

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**REFERENCES**

i Greg Mennis, Pew Charitable Trusts, and Josh McGee, Laura and John Arnold Foundation, “Letter to Senators Brubaker and Blake,” January 24, 2014, p. 1. The Pew/Arnold estimate is similar to a Keystone Research Center estimate made last April of how much lower Pennsylvania’s pension debt would be if employers had made
sufficient contributions to bring the PSERS and SERS employee/employer contribution ratio up to the national average. See the source in the next end note, pp. 4-5.


v Stephen Herzenberg, *Less Bang for Pa.’s Buck: Governor’s Pension Proposal Would Force Taxpayers (and Employees) to Foot the Bill for Retirement Plans with High Fees, Low Returns*, June 18, 2013, online at http://keystoneresearch.org/publications/research/pension-primer-6-less-bang-PA-buck


vii Herzenberg, *Cash Balance Plan Could Hurt Public Employees and Taxpayers*, pp. 6-10.


xii Keystone Research Center, forthcoming.

xiii One novel approach to paying the full ARC exists in Arizona, where employees in two pension plans split the cost of the ARC 50-50 with employers and employees in a third pension plan pay one third of the ARC while employers pay two thirds. An even more fiscally responsible approach than paying the ARC would be to pay either the full ARC or normal cost, whichever is higher. A transition to splitting the ARC – or the higher of the ARC or normal cost – would not be possible in Pennsylvania without first buying the ARC down with a pension bond. For details on the Arizona experience, see Wells and Herzenberg, *Arizona’s Pensions*.