FOR IMMEDIATE RELEASE
June 3, 2015

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KRC report online at http://keystoneresearch.org/pensionprimer12
NIRS report online at http://goo.gl/Ne4yuY

New Keystone Research Pension Primer Finds Switching Pa.’s Public Pensions Primarily to 401(k)-Style Plans Would Be Harmful to Public Employees, Unconstitutional & Hurt Taxpayers in the Long Run

National study shows 401(k)-type plan switch increased costs in other states

(HARRISBURG, Pa.) -- A new pension primer released today by the Keystone Research Center finds that Senate Bill 1, under consideration in the General Assembly, would cut the pension benefits of current teachers, firefighters, nurses and other early career public servants in Pennsylvania by 24-28 percent and reduce benefits for their future colleagues by as much as 70 percent.

Unfortunately, Pennsylvania taxpayers won’t see meaningful cost savings from these benefit cuts and employee sacrifices but rather will see higher costs long term.

“This misguided, 410-page proposal rushed through the Senate will cost taxpayers money in the long run by shifting future workers to less efficient retirement plans and requiring wage increases to offset the benefit cuts,” said Dr. Stephen Herzenberg, author of the report and executive director of KRC. “It also could potentially reduce the investment returns of the existing pension plans, which would mean taxpayers have to contribute more.”

Additionally, the benefit cuts for current workers present constitutional problems that make them likely to be thrown out in court, the report predicted, meaning that not only will there be no cost savings, but there could be long drawn-out legal challenges that would leave Pennsylvania with even more pension debt in a few years.

Excluding savings from cuts to current employees, the actuary for PSERS estimates savings of only $614 million in today’s (present-value) dollars and $3.2 billion on a cash-flow basis. Savings for SERS are estimated at only $2 billion (on a cash-flow basis) including the savings from likely-unconstitutional cuts (which are not broken out separately).
In Pennsylvania, Senate Bill 1 will likely cost taxpayers more in the long run because it primarily switches new employees to inefficient 401(k)-style individual accounts which typically have low returns and high fees, and can require twice as much in contributions to achieve the same retirement benefit. The potential erosion of investment returns in the existing pensions – highlighted by the PSERS actuary but not modelled because of the rushed evaluation of SB 1 – could also increase taxpayer costs. Any future increases in wages required to maintain competitive compensation with radically reduced benefits will also increase taxpayer costs.

The new report adds to a body of research that shows switching public employees to 401(k)-style plans has failed in other states. In a KRC press call with reporters today, Diane Oakley, executive director of the National Institute on Retirement Security (NIRS) shared recent NIRS analysis of three states – West Virginia, Michigan and Alaska – that switched new employees to DC plans (online at http://goo.gl/Ne4yuY). The report found that switching from defined benefit plans to defined contribution plans did not address the real funding problems in those states, and they ended up with significantly more pension debt.

- In Alaska, a 2005 DC switch was sold as a way to contain an unfunded liability but pension debt doubled to $12.4 billion by 2014. Legislation has been introduced to move back to a DB pension plan.
- In Michigan, the DB pension plan was overfunded when it closed in 1997 but funded status dropped to about 60% in 2012 with $6.2 billion in unfunded liabilities.
- In West Virginia, the state closed the teacher retirement system in 1991 to new employees but the system’s funded status continued to deteriorate and retirement insecurity increased for teachers with the new DC accounts. The state switched back to its DB pension plan by 2008.

Instead of advancing Senate Bill 1, today’s KRC pension primer recommends building on the pension reforms in Act 120 of 2010. “With additional reforms that have bipartisan support, state and school district pension contributions could level off as soon as next year. But Senate Bill 1 would only take Pennsylvania backwards on pensions,” Herzenberg said.

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