TESTIMONY

OF

RICHARD BLOOMINGDALE, PRESIDENT

THE PENNSYLVANIA AFL-CIO

ON

SENATE BILL 1

BEFORE THE

HOUSE STATE GOVERNMENT COMMITTEE

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Good morning Chairman Metcalfe, Chairman Cohen, and members of the House State Government Committee. My name is Rick Bloomingdale. I am the President of the Pennsylvania AFL-CIO, and I am here today on behalf of the affiliated labor organizations representing over 800,000 hardworking women and men.

Thank you for the opportunity to present testimony regarding Senate Bill 1.

For fourteen years, the Commonwealth has borrowed from the workers. That is, employees have paid their fair share into their pension systems while, the state and school districts have not. A study by the Arnold Foundation and the Pew Center on the States found that the number one reason our two state pension funds are in debt is that Pennsylvania ranked 48th out of 50 states since 2003 in terms of paying the Actuarial Recommended Contribution. This is the standard measure of pension payment discipline. Instead of making proper payments into the pension funds, the state spent the money on other priorities. The money essentially was borrowed from the pension funds, and catch-up payments must now be made. There were also other contributing factors to the current $50 billion in debt, including investment losses in 2008-2009, but missed employer payments are by far the largest factor. Public servants should not have to pay for the mistakes made in Harrisburg while taking even more out of the taxpayers' pockets. Switching our employees to a 401(k)-style retirement plan would be fiscally irresponsible and

unfair to workers who have spent years paying into the pension system. What is more is that, over the last few years, actuaries have drawn attention to the significant transition costs involved in shutting down the defined-benefit plans.

The Wall Street Journal had an article about how 401 (k)s were never meant to be a sole source of retirement income. *While we have seen problems with 401(k)s, Senate Bill 1 does nothing to solve these problems.* The Pennsylvania AFL-CIO opposes Senate Bill 1. Any responsible pension reform plan has to do two things: be constitutional and pay down the debt. Senate Bill 1 does neither.

Article I, Section 17 of the Pennsylvania Constitution reads: "No ex post facto law, nor any law impairing the obligation of contracts, or making irrevocable any grant of special privileges or immunities, shall be passed." In light of this provision, Senate Bill 1's benefit rollbacks for current employees will probably be challenged in court as an unconstitutional impairment of the obligation of contracts. Upwards of 75% of the so-called savings under Senate Bill 1 are generated by way of reducing the benefits of *current* employees. For this reason, if the courts rule the legislation unconstitutional, the Commonwealth will be confronting mounting fiscal budgetary pressures with which to reckon.

As far as paying down the debt is concerned, the proponents of changing the pension systems persist in having as a priority preventing new employees from participating in the current system. They imply that so doing will somehow lessen

the debt. In reality, it is just the *short-term* budget relief that is the motivation behind lowering the Employer Contribution Rate over the next few years. Payments are simply being deferred. The facts of the matter are that, when the population of a retirement system is an open group, with a continuous influx of new active members, payroll generally increases, which could lead to a decrease in the actuarially required contribution from the Commonwealth. In a closed group, however, the payroll will begin shrinking in the future and the level-dollar payments will represent an increasingly larger percentage of payroll. The fixed-dollar cost of paying down these liabilities will result in increased amortization payments as a percentage of payrolls and may become excessively burdensome for the remaining active member employers.

Consequently, the transition costs incurred when closing off large defined-benefit pension plans saddled with substantial amounts of debt are estimated by actuaries for Pennsylvania's two pension funds as *in*creasing the debt, not *de*creasing it. Just ask the West Virginia, Alaska, and Michigan legislatures how well similar innovations in their pension systems fared for them. West Virginia, for example, moved to 401(k) style pensions for its employees in 1991 only to face such dauntingly increasing unfunded liabilities that they opted to revert to a defined-benefit plan.

Act 120 was a pension reform plan passed in 2010 and supported by many members of this committee. It should be given a chance to work before any further changes in legislation are made. Act 120 substantially reduced the benefits of new employees and cut the cost of benefits for employers. Act 120 is the most appropriate guideline to use here. There has been mutual sacrifice—employees pay more money for fewer benefits, must work ten years instead of five to be vested, and retirement age has increased from 62 to 65. New school employees are paying from 7.5 percent to 10.3 percent of salary into the pension fund and covering more than 70 percent of the cost of their own retirement benefits. In addition, they are subject to paying an additional risk-sharing contribution rate if the pension fund does not meet its investment earnings assumption. As a result of these changes, the normal cost of pension benefits for school employees is projected to fall each year eventually to about 3 percent of payroll as these new hires replace existing employees.

To put things in perspective, the problem is not the structure of Pennsylvania's defined-benefit pensions nor overly generous benefits—benefits that average $25,000 per year. Defined-benefit pension plans are not inherently problematic. PSERS was created in 1917. SERS was created in 1923. They both survived through the Great Depression. Problems arise when legislators

consistently fail to pay the state's required contribution into the system. This is precisely what happened in Pennsylvania.

We appreciate this Committee's willingness to hear from all sides unlike the Senate, which passed this bill without a single hearing on it. Here, right before us, we have an issue that affects over 250,000 current public employees and billions of dollars of taxpayer money; however, the Senate did not hold a single hearing on this massive bill. What is more is that the actuarial report issued by the Pennsylvania Employee Retirement Commission (PERC) on May 12 candidly concedes that, due to time constraints, Senate Bill 1 wasn't even read. PERC also admitted that, if the bill is ruled unconstitutional, the current employees would end up actually costing more to taxpayers than under current law.

Also, it should not go unnoticed that, amid the morass of minutiae in Senate Bill 1, there is a provision on page 268 repealing the Act 44 of 2010 bans on investments in Iran and Sudan by failing to expressly prohibit either pension board from indirect or pooled investments that invest in either terror sponsored nation. It should be noted that federal law does not limit investments in pensions. We are not sure of the Senate's motives behind abandoning the legislator's role of overseeing investments in terrorist states. This is one of the problems with four-hundred page bills that are passed without giving legislators adequate time to vet them. We hope this repeal of Act 44's bans was inadvertent.

Employees have played by the rules, paying their full share into their pension systems. Should Senate Bill 1 be deemed unconstitutional, the Commonwealth will be confronting even more formidably increasing fiscal budgetary pressures. We ought to let Act 120 run its course prior to enacting anything legislatively. Senate Bill 1 is just plain bad policy. All the while, a solution is ready at hand: the General Assembly mustering the fiscal discipline to make the necessary payments into the state's pension systems. Provided legislators do as much, they can preserve retirement security for generations to come. The working men and women of the Pennsylvania AFL-CIO support defined-benefit pension plans and reject efforts to expand defined-contribution plans within our state and the nation.

Thank you.