

Pennsylvania's Pension Systems: Joint Public Policy Hearing

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Testimony Provided by:

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Chairmen Saylor and Erickson, members of the House and Senate Republican Policy Committees, thank you for this opportunity to present our views and to offer some suggestions for resolving the very real and very serious funding problems with our Public School Employees' Retirement System (PSERS). My name is Richard Rowland and I am the Executive Director for the Pennsylvania Association of School Retirees, otherwise known as the PASR, and I have served in this capacity for nearly 22 years. Our organization is a volunteer membership organization, consisting of over 36,000 retired public school employees-- including retired teachers, administrators, and school support staff in every county and having past or present ties with all of the active employee unions and professional organizations. We are, though, an independent organization that is governed exclusively by school retirees elected by our members across the state.

Since our founding in 1937, PASR has served as a watchdog for PSERS and as a retirement security advocate for all persons retiring from the public schools of Pennsylvania. Our mission is to help ensure that PSERS is managed in the best interests of both the members and the taxpayers of this state, and to promote the changes necessary to ensure continued financial security in retirement for all persons who retire from the public schools of Pennsylvania.

I appear here today not to reiterate the funding problems or add any more facts and figures to what our very able PSERS administrators have presented. Nor am I here to point fingers of blame at any or all of the administration officials, legislators, employee/retiree organizations or individuals who may have played a role in bringing us to this point. I am here at the direction of my Board to offer you ideas for solving the problems we face, all of the retirement problems, and to urge you to take action now to pass a comprehensive pension reform measure that addresses the concerns and serves the needs of all Pennsylvanians, the members of the systems and the taxpayers of Pennsylvania who support our systems.

The funding problems of our retirement system and the causes are well known, if not entirely understood by everyone. They have been known for a very long time, harkening back to 2001 when the legislature enacted the infamous benefit changes in

ACT 9 of 2001 and the nation experienced its last economic recession. Those of you who served in the legislature at the time may recall what your colleague and representative on the PSERS Board in 2001, Representative Steve Nickol, stated publicly when he voted against the measure and declined the pension increases offered to legislators in the bill. He voiced concern for projections showing state and local costs rising dramatically in the next decade, saying *"Even if we have normal market conditions, there will be a price to pay at that point in time and the employers will have to pay it."* (*Patriot News, May 9, 2001*) In reality, the warnings began in 1993 when our Association held a rally on the Capitol steps with more than 3,000 members to protest a proposal by then Governor Bob Casey to balance the budget with actuarial manipulations and reductions in the employer contribution rates.

It is what it is, though. We can waste more time arguing amongst ourselves and between the various groups and organizations about whether our dilemma was caused by the market declines, the benefit increases enacted in 2001 and 2002, or the fact that the state and school districts have contributed less to the retirement systems than what the actuaries have said is necessary to pay for the benefits that employees were earning each year for twelve consecutive years. Or, we can accept the fact that all of these things contributed to cause the problems and take appropriate actions to fix the Systems.

In our view, there are three main areas that need to be addressed in a comprehensive pension reform measure and we wish to offer specific suggestions to resolve each. First, without question, we must take action to avert the dramatic increases in employer contribution rates set to occur in 2012 that would undoubtedly trigger massive state and local tax hikes. Second, we must address the public's concerns with the relatively high level of retirement benefits promised to public sector workers and work to bring down the costs of providing those benefits. And, third, we must enact a better, more cost efficient way to provide for annuitants' cost of living needs.

To avert the 2012 spike in employer contribution rates (which many are now rightly calling a rate plateau) there is no question in our minds that the state must direct a fresh-start refinancing of its retirement systems and impose constraints on the amounts that employer contribution rates can either increase or decrease over the next decade. We agree with the experts at our retirement systems that the funds can not earn their way out of this mess. We do not agree, though, that the taxpayers have to contribute all that the systems need to pay their existing unfunded accrued liabilities. What will fix the problem is a combination of higher employer contributions and higher than expected investment earnings that will occur as the national economy recovers from this recession.

Specifically, we recommend the following:

- **Direct a fresh-start refinancing of the retirement systems.**
- **Establish consistent 30 year amortization periods for recognition gains/losses and funding active member benefit obligations, i.e. reinstate proper actuarial funding methods.**
- **Reinstitute 20-year amortization periods for funding past and future ad hoc COLAs.**
- **Extend smoothing period to at least 10 years for recognition of annual investment gains/losses used in the calculation of actuarial value of assets.**
- **Increase minimum employer contribution rates to equal normal cost rate determined by the actuaries.**
- **Impose temporary collars on annual changes in the employer contribution rate (+/- 3% of payroll per year), to expire when systems fully implement new 10-year smoothing method--allowing the contribution rates to rise gradually if markets remain depressed and/or not decline dramatically if markets take off.**

Please note that some elements of this approach were recently advocated by Governor Rendell in his budget address, specifically the implementation of a fresh start refinancing and collaring of the employer contribution rates over the next 10 years. There are some significant differences, however, in that the Governor's proposal as we understand it would seek to prevent the employer contribution rates from rising more than 1% of payroll this year, and 3% of payroll in subsequent years. Nor do we believe that the Governor's proposal seeks to raise the minimum employer contribution rate to equal the systems' normal costs.

We urge your caucuses to oppose the Governor's refinancing plan as it will add to the existing funding problems. It would cause more havoc for school districts in their budget processes this year. And it will do nothing to prevent the state and school districts from underfunding the retirement systems again in subsequent years.

The PSERS Board of Trustees voted last December to increase the employer contribution rates to 8.22% of payroll for fiscal year 2010/2011, including 7.58% for pensions and .64% for the health insurance premium subsidies. School districts are in the process right now of constructing and adopting budgets containing the required increase in contribution rates, which is up from the 4.78% that the state and school districts are contributing this year. By the time the General Assembly might get around to passing legislation requiring PSERS to reduce the employer contribution rates for next year, as advocated by the Governor in his budget address, most if not all school

districts will have already adopted their budgets containing the higher, 8.22% rate set by the PSERS Board last December.

Everyone understands, we hope, that employer contribution rates need to be increased. We cannot continue contributing substantially less than what the actuaries calculate is needed to pay for the retirement benefits that employees earn with each additional year of service. The state and school districts need to contribute 8.08% just to pay for the benefits that active employees earn each year. That is what the actuaries refer to as the normal cost. The Governor's proposal will further delay getting the employer contribution rates up high enough to cover the normal cost each year, to stop the bleeding and adding to the systems' unfunded accrued liabilities each year that occurs from failing to contribute what is necessary to pay for the benefits earned each year.

As our retirement systems have reported, the markets have begun to turn around. Now is the time to give the systems more money to invest, when the values are low and the markets are rising, not a year from now when stock and bond prices will be much higher. Remember, the more the systems are able to generate from investment earnings, the less taxpayers will ultimately need to contribute to ensure that the benefit obligations are met. We need to give PSERS money to invest now, so they can do what prudent investors always do...buy low and sell high.

The employer contribution rate increase to 7.58% for pensions in 2010/11 will bring us close to the 8.08% stated by the actuaries as necessary to meet the system's normal cost obligations, and provide the opportunity to increase the minimum contribution rate prescribed in the Retirement Codes for subsequent years. We believe raising the minimum contribution rate to equal the normal cost is essential to prevent a recurrence of underfunding by the employers.

Employer contribution rates will need to continue increasing, to begin paying down the unfunded accrued liabilities, but not in the manner nor to the degree that the PSERS Board will be required to raise rates under the existing provisions of the Retirement Code. Much of the existing unfunded liability is attributable to the decline in investment asset values wrought by the recession. The markets will rebound as the economy recovers and the appreciation of investment values will eradicate much of the unfunded liability that appears today. Exactly when and/or how much PSERS' assets will increase to help pay off the unfunded liabilities is unknown. No one can predict the markets. But history has consistently shown that following economic recessions and periods of market declines the systems experience multiple years of higher than expected investment returns. We need time to determine how much of the unfunded liabilities will be eradicated by investment earnings as the economy rebounds.

Taxpayers should not be required to bear the entire burden of eradicating the systems debts at this time.

Our proposal, to extend what is called the “smoothing method” for calculating the actuarial value of assets, will promote greater stability in employer contribution rates. The present 5-year method is too short for today’s economy and the volatility of the markets. Our proposal is to move to a 10-year smoothing period and over the next 10 years, while the systems are working to fully implement the changes in actuarial methods, impose constraints on the total amounts that employer contribution rates can be raised or decreased in any one year. We agree with the Pennsylvania School Business Officials (PASBO) Association and the Governor that a provision limiting annual increases or decreases in the employer contribution rate to 3% of payroll is reasonable and appropriate.

There are some, perhaps in the media, who might want to characterize these suggestions as another attempt to avoid paying down the systems’ unfunded accrued liabilities and seeking to “kick the can down the road” another 10 years. That is absolutely not the case. A key difference and essential component of our proposal is to raise the employer contribution rate to equal the normal cost and allow the employer contribution rates to continue rising at a controlled rate each year, a rate that is within the ability of the state and school districts to plan for and incorporate in their budgets without having to raise taxes.

The actuarial method changes enacted by the legislature previously, in ACT 9 of 2001, ACT 38 of 2002, and in ACT 40 of 2003, all sought to constrain the increase in employer contribution rates and keep the rates below the normal cost. Those actions did indeed kick the can down the road and, in fact, grew the unfunded accrued liabilities for our systems. Our suggestions to set the minimum employer contribution rate to equal the normal cost and allowing the contribution rates to rise above the normal cost in subsequent years, in a controlled and affordable manner, would stop the bleeding—the adding to the unfunded accrued liabilities—and begin paying down the debt.

As I noted earlier, the normal cost for PSERS is now 8.08% of total pay. That is what the state and school districts need to contribute to ensure that the PSERS Fund will have enough to pay the retirement benefits earned each year when they ultimately retire and live out their lives in retirement. Many will argue that this is too high a cost burden on the taxpayers of Pennsylvania. It is well above that which most large scale employers contribute to retirement savings plans for their employees. We agree that the costs are too high and need to be reduced.

As you know, the Pennsylvania School Boards Association (PSBA) has advanced a proposal to establish a hybrid pension plan for all individuals hired to work in the public schools going forward. One of the things we find troubling about PSBA's advocacy of this proposal is that they and others so often preface discussion on the proposal with fear mongering about the projected employer contribution rate increases currently prescribed in the Retirement Code. We need everyone to be absolutely clear in their understandings that PSBA's hybrid proposal does nothing to eliminate or reduce the dramatic employer contribution rate increases, the so called rate spike or plateau that will devastate the budgets of the state and all school districts. It does nothing to avert the massive tax increases that would be required if the legislature fails to amend the actuarial funding methods currently prescribed in the Retirement Code.

The only thing PSBA's proposal would do about the spike is shift most of the responsibility for paying the contribution rate increases needed to fund the existing benefit promises onto the State. This is but taking the dollars out of the pocket from which Pennsylvanians pay state sales and income taxes, instead of the pocket from which we pay our local school taxes. In fact, as PSBA readily acknowledges, adoption of their proposal would impose higher costs on Pennsylvania's taxpayers in the short-term. The state would have to incur the additional and very significant expense of setting up and operating an entirely new retirement plan serving future employees, while continuing to operate the existing defined benefit plan for current employees and annuitants. They need also understand that adoption of their proposal would aggravate the funding problems of the existing system, robbing the current fund of contributions by and for new hires that could be invested and help retire the existing unfunded accrued liabilities.

It is difficult for people to recognize, looking at things at this moment in time, from the depths of this great recession, that PSERS historically has generated more than it has expected from its investments over extended periods of time. When we are looking at mature, defined benefit plans like we have with PSERS it is important to keep a long-term perspective. The current benefit obligations are not all due for payment today. The System is obligated to pay the pension benefits that have been earned to date over the next 50 or more years. Take any twenty year period in the System's history and you will find that PSERS has generated more than it expected from its investments. Look at the past 20 years. If I am not mistaken, from Jeff Clay's testimony to the Senate Finance Committee, I believe he reported that PSERS generated an average annual return of 10.6% over the past 20 years—well above the 8.5% annual earnings assumption it used during that period.

The PSBA proposal seeks to reduce costs over the long-term by capping the amounts that the state and school districts will contribute to provide retirement benefits to new

hires. The proposal, as I understand it, would continue to require that employers contribute a minimum of 4% of payroll for the defined benefit portion of the benefit, and up to 2% into individual savings accounts for the employees, for a total of at least 6%. Yes, 6% is significantly less the 8.08% normal cost to fund the existing benefit levels promised to current employees. But there is a simpler and more cost effective way to bring down employer contribution rates for new hires to the levels advocated by PSBA and that is to reduce the promised benefit levels for new hires that are currently prescribed in the Retirement Code.

We are advocating that a comprehensive pension reform proposal contain provisions to restore the 2% formula and revert to the 10-year vesting requirement that was in place prior to ACT 9 of 2001, for all new hires. We believe the 10-year vesting requirement that existed previously served well to promote longevity, to encourage teachers and other highly skilled professionals working in our schools to remain in education, and we believe that the previous 2% formula was sufficient to enable school employees to achieve their personal goal for retirement—the same goal we all have.

It is the goal and dream of all workers, public and private sector employee alike, to be able to retire with an income that enables them to maintain the standard of living they achieved for themselves at the end of their working careers. We want to stop working, yet have the ability to continue spending that which we have become accustomed to spending to serve our personal needs and interests. Financial planners and retirement experts will all tell you that individuals need incomes at retirement equal to between 80-90% of their pre-retirement income, with provisions to regularly adjust those retirement incomes upward to offset inflation, in order to maintain their standards of living throughout retirement.

The 2% formula in effect prior to the enactment of ACT 9 of 2001, coupled with the Social Security benefits that school employees are entitled to receive, was right on target in terms of providing career employees (those who spend 30-35 years in service to the Commonwealth and its school districts) with a retirement income equal to between 80 and 90% of their pre-retirement income. The 2.5% formula that exists today is overly generous and should be reduced for new hires.

In 2001, prior to the enactment of ACT 9, the employers normal cost rate was 5.63% of payroll—less than the amount that PSBA is advocating employers contribute for new hires in its hybrid proposal. We don't need to incur higher costs in the short term setting up a new system in order to produce long-term savings. We don't need to rob the current system of the means to generate higher than expected earnings over time to reduce the unfunded liabilities. And we don't need to run the risk that employees will fail

to contribute enough, or earn enough, in this new system to retire and maintain their standards of living in retirement. We need simply to reinstate the 2% formula for new hires.

The contributions required to pay for the benefits accrued by new hires will fall to around 6% or less, and will remain around that level consistently throughout their careers if our funding suggestions are adopted as part of a comprehensive pension reform measure. The setting of minimal contribution rates equal to the normal cost, and extending the smoothing method to 10 years will serve to stabilize annual employer contribution rates and keep them close to 6% for the new hires.

The Public Employees Retirement Commission (PERC) conducted an analysis and issued a report in 2003/04 of the benefits provided from ACT 9. It concluded that for individuals retiring with 35 years of service, when Social Security benefits kick in, their total income in retirement would range from 120-140% of their pre-retirement income. That is excessive and it is unnecessary to attract individuals to choose careers in public education.

What is often overlooked in that report and other reports issued by PERC are their discussions and analysis of cost-of-living adjustments (COLAs) and our state's unusual practice of enabling individuals to withdraw their contributions and a portion of the earnings generated from those contributions in lump sum at retirement. If you are to enact a comprehensive pension reform measure, and we believe it is vital that you do so, we urge you to address and resolve these issues as well.

Please understand, COLAs are a vital component of any retirement plan. Ask any financial planner. One must have the ability to receive periodic adjustments in their retirement income, to offset inflation experience; otherwise he/she will experience continuous declines in their standards of living. That is certainly not good for the individual and it is harmful for the economy. What happens when individuals on fixed incomes don't receive COLAs is that they are forced to curtail spending, first on discretionary things like taking their families to dinner, golfing, or whatever recreational activities they enjoy. That may sound trivial, unnecessary to some, but it is important to recognize that it is that discretionary spending that fuels so much of our economy.

It is simply not true that only retired public employees receive COLAs. All Social Security recipients receive COLAs. Social Security is also a defined benefit pension plan, albeit a very poorly constructed plan in terms of its funding and not at all like our pension plans. Social Security is essentially a pay as you go system, whereas our public employee systems are structured to provide that the full amount needed to pay

the promised benefits to the recipients for life is on reserve in the system on the dates the individuals retire.

The majority of private sector employees today, if they have any retirement savings plan at all provided by or through their employers, have defined contribution, 401-k type plans. In this kind of plan, the individual manages withdrawals from his/her account. If their costs of living increase, they can withdraw greater amounts from their retirement accounts to pay those costs at will. Prior to this current recession, when the markets were running strong, all retirees with private retirement accounts did just that—gave themselves COLAs. Pennsylvania's retired public school employees have not received any cost of living adjustments in their pensions for eight years now.

In a defined benefit plan, the funds are managed for the members of the plan by professionals and disbursements are governed by law. The Legislature has ultimate oversight responsibility and the decision making responsibility for benefit levels and distributions. In short, when retired public employees need cost of living adjustments, as all retired persons do, they must beg for their legislators to enact legislation authorizing additional disbursements from their collective retirement fund.

PERC has consistently pointed out in its reports over the years that Pennsylvania's state and public school employee retirement systems have a serious deficiency in that they are not authorized to provide COLAs. Moreover, the Boards are prohibited in their process of determining employer contribution rates from anticipating the enactment of COLAs and accumulating the reserves necessary to pay for the increases if and when the legislature authorizes one. When a COLA bill is passed, the funds to pay for the increases are borrowed from the assets accumulating in the Fund to pay for the pension benefits of the active employees who will be retiring in the future. The employer contribution rates for succeeding years are increased to repay the monies borrowed to pay for the COLA and reimburse the fund for the investment earnings that it expects to lose from having taken those monies out.

PERC has recommended for many years, as have we, that COLAs need to be anticipated and provisions made to prefund these benefit obligations. Few people recognize or understand that the pension benefits provided by these systems are not funded entirely by taxpayers (from the state and school district contributions), or by employees from their contributions, but primarily by investment earnings generated from those contributions. 70 cents of every dollar paid out in pension benefits was derived from investment earnings. The same principles applied in our System to fund the basic pension obligations should have been extended to fund COLAs... contribute relatively small amounts, invest those contributions over many years, and enable the investment earnings to pay most the costs of providing the benefits.

Unfortunately this was not done and the numbers of individuals expected to retire in the next several years will grow the annuitant population to the point where the Fund will simply not be able to provide COLAs that are paid for as they have been in the past. An alternative means of providing for the COLA needs of these future retirees needs to be enacted now.

We are advocating that all current and future employees be extended an option at retirement to secure the purchasing power of the annuities they earned from their years of service. Specifically, **we are recommending that employees be given the option of leaving their accumulated contributions in the Fund, instead of withdrawing the contributions in lump sum and receiving a reduced monthly annuity as they can elect to do now.** The system could then continue to invest those contributions for the members and, from the earnings generated from the members' contributions, adjust their monthly annuities each year in accordance with the rates of inflation they experience.

We have been told that the retirement systems have conducted some internal analyses and concluded that the accumulated contribution and interest amounts that employees withdraw today have risen to the point where they could, if left in the system, provide the employees annual COLAs with a 3% cap. Employees should now be given the option of securing their own retirements. If they want to continue taking their contributions out in lump sum, inform them that in doing so they will be assuming personal responsibility for investing those funds and providing for their own COLA needs. Or, give employees the option of letting PSERS continue to invest their contributions and returning the contributions and investment revenues generated from those contributions in the form of COLAs.

This change would address the COLA needs of future retirees, leaving us with the challenge of addressing the COLA needs of our current retirees. It is important to recognize and understand first that, prior to this point in time, the lump sum withdrawal amounts taken by employees at retirement were not large enough for them to invest and generate enough earnings to provide themselves COLAs. There are many retirees still with us who didn't even have the option of taking a lump-sum withdrawal when they retired. The great majority of today's retirees began and spent most of their careers working for very low salaries and, thus, did not contribute and receive back great amounts in lump sums at retirement—certainly not great enough to invest and totally provide for their own COLA needs.

The ad hoc COLAs enacted by the Commonwealth in the past have always sought to render partial assistance for retirees to maintain their standards of living, not provide adjustments to fully compensate for the inflation experience. All prior COLAs were

generally structured to provide the eligible annuitants with adjustments equal to one half the rate of inflation they experienced since the previous COLA was enacted and most employed graduated scales of percentage increases granting higher replacement amounts to longer term retirees. The COLA policies and practices started more than 40 years ago when the voters approved an amendment to the Constitution granting the General Assembly authority to increase pension amounts for annuitants.

The one-half inflation experience target with greater adjustments for the elder retirees recognizes the fact that public school retirees generally have three sources of income in retirement—their state pension, their Social Security benefits which are fully indexed to inflation, and their private savings and investments which should generate returns greater than inflation. In order to help retirees maintain their standards of living in retirement the amount of adjustment needed for their pensions is generally one-half the rate of inflation, because their private savings and investments are expected to produce returns greater than the rate of inflation. The private savings and investments, for public school retirees, consist mainly of the amounts they withdraw in lump sum at retirement. Again, the lump sums withdrawn many years ago by the elder retirees, if they were able to take a lump sum, were too small to generate much additional income. That is the principle reason why higher percentage adjustments have historically been provided to the relatively small groups of long-term retirees in most previous COLAs.

What we are suggesting, as part of a comprehensive pension reform measure, that you address the urgent needs of the existing retirees with a COLA similar to all those the General Assembly has enacted in the past, with one very important change. The data and study conducted by PERC in 2003/04 clearly indicates that the COLA needs of individuals who retired since 2001, with the higher benefit pension formula provided from ACT 9, are different than the needs of individuals who retired before then. They differ not though in terms of their need for COLAs, everyone needs COLAs in retirement to maintain their pre-retirement standards of living, but in terms of timing.

The study indicates, for at least the career employee with 30+ years of service, their pension and Social Security retirement incomes combined produce between 120-140% of their pre-retirement income. According to that study, these individuals, who were able to in effect raise their incomes by retiring, should not require a cost-of- living adjustment for ten years. At that point, inflation will have eroded their pension income to the point where adjustments will be needed to help them maintain their pre-retirement level of income/purchasing power.

We recommend the provisions of HB 1970 be incorporated in a comprehensive pension reform bill, with a restriction added to delay receipt of the proposed adjustments for beneficiaries of the ACT 9 pension formula change in accordance

with PERC's benefit study and recommendations. HB 1970 is the COLA bill advocated by all state and school employee organizations, and it is structured just as most previous COLAs were structured, with the inflation replacement targets discussed above. In short, we are suggesting you treat ACT 9 beneficiaries like you have treated early retirees in past COLAs. Early retirees, those who retired before achieving the superannuation or normal retirement age requirements, were not excluded in the COLAs passed previously, but they were restricted from receiving the increases until that point in time when they would have achieved superannuation had they continued working. Don't exclude ACT 9 beneficiaries, but don't give them the adjustments until they actually need them.

I hope you appreciate the risk we are taking, a volunteer membership organization, suggesting that some of our colleagues be subject to further delays in receiving an increase in their pensions. We would all like to receive more money. The present realities dictate, however, that we focus on providing not what people want but on what they need.

There is a tremendous need by school retirees for cost-of-living assistance. I could easily spend days providing you with real life examples of our members' suffering. As legislators, though, I suspect you have heard the cries for help from your constituents, first hand and many times over. The dilemma has been how do you provide for their needs with the funding challenges the retirement systems have now and the threat of massive tax increases these challenges pose for all of us taxpayers. The answer is to do it as part of a comprehensive pension reform proposal, like we are advocating here. A proposal to raise contribution rates gradually and sensibly, so as not to trigger tax hikes, and provide time to gauge the extent to which the systems' assets will recover with the market rebound that will follow this recession. A proposal that brings down the long term costs to state and local taxpayers, by returning to the basic purpose of a retirement plan—to provide just enough for a person to retire and maintain his pre-retirement standard of living, not raise his standard of living by retiring. A more sensible, economical proposal for dealing with the COLA needs of future retirees. That is what we are suggesting.

So much attention is focused on the costs of public employee pensions to the taxpayers who don't work for the state or local school districts. Scant attention is focused though on the benefits that these pension systems provide, not the benefits provided to the public retirees, but for the public at large. I think most people believe that retired public employees are living high on the hog with fat pension checks piling up under their mattresses. The reality is that the average annual pension for retired school employees is but \$22,000 per year—just a little more than half the medium household income for all citizens in this state.

The pension checks aren't piling up under their mattresses. School retirees are spending their pension incomes in their communities, using them to pay their school taxes, by goods and services from their local businesses, helping to create jobs. We need to recognize the huge economic engine that public employee pension disbursements provide to this state. There is more money poured every year into Pennsylvania's economy by public employee pension recipients than from the agriculture, mining, tourism, and recreation—our state's largest industries combined. It is the one constant source of funds into our economy that we have going for us in bad economic times like we are experiencing now.

Increasing the pension amounts for retired public employees with a modest COLA is also the fastest and most effective means you have of strengthening our economy. Every economist will tell you that what the economy needs now is increased consumer spending. Give tax breaks or otherwise find ways to get more money to people who are working will not guarantee that they will spend the additional money. They are likely to put it under their mattresses and save it for that day when they might lose their jobs and their regular paychecks. Give more money to retired public employees, who receive on average but \$22,000 per year and don't have to live in fear of losing their regular pension checks, and they will absolutely spend those additional dollars. They might then be able to take their families out to eat again, go golfing again, and otherwise provide those additional dollars to local businesses to help them stay in business, expand, and create more jobs.

If not for the retirees own benefit, you need to give the retirees a COLA so that they can spend the money to benefit the businesses and non-public sector employees in your legislative districts. It is no accident that most COLAs enacted by the General Assembly in the past were passed during an economic recession, including the last COLA in 2002. They were approved in large part to help stimulate the economy and it worked! The economy is in very dire straits now and the need for a COLA has never been greater.

We have heard the question so often put to you by your non-public employee constituents, "Why should we be forced to pay more to pay for public employee retirement benefits when we do not have retirement benefits ourselves?" This proposal, we believe, is an answer to the first part of that question. They should not have to pay more in taxes. Not if the reforms we suggest here are adopted in total.

It is the second part of their question we urge you to provide greater attention to, once you have fixed the problems with the public employee retirement systems. Most workers in the private sector are not receiving pension benefits from their employers any longer. Those that have are provided defined contribution, 401-k plans, that every

study I have read clearly shows are not working in terms of enabling individuals to accumulate sufficient savings to sustain their standards of living in retirement. The statistics are startling. Before this recession hit, individuals within ten years of retirement accumulated an average of but \$50,000 in their 401 (k) accounts. Of course, the recession and market collapses declined their savings balances to an even greater degree than the losses experienced by our retirement systems.

The much greater retirement crises looming in Pennsylvania is posed by the millions of private-sector employees nearing retirement with insufficient savings to provide them income in retirement. The question needs to become why don't private sector employees have adequate retirement plans and what can we do to help them, not why do public employees have an adequate retirement plan and what can we do to hurt them?

Our Association urges this General Assembly to consider the retirement needs of all Pennsylvanians, public and private sector employees alike. Direct a study of the retirement savings plans and opportunities available today in the private sector and give strong consideration to creating a means for all citizens to earn more from their retirement savings investments, at less cost, and with greater security. Essentially, these are the strengths of the public employee retirement systems. Our systems have achieved tremendous success by pooling the contributions of hundreds of thousands of individuals, diversifying the investment of those contributions in all investment vehicles all over the world, sharing the costs of investing among such large numbers of participants, and pooling risks of individuals outliving their retirement savings.

Our systems have generated higher returns, at less cost and over a longer period of time than any 401 (k) plan in existence and made available to workers in the private sector. And in more than 90 years of existence, PSERS has never found itself unable to pay the promised benefits to its retired members. We must seek to create a means of sharing these positive experiences and providing similar retirement security for all Pennsylvanians.

Thank you again, Chairmen Erickson and Saylor and members of the Policy Committees, for this opportunity to present our ideas for reforming the public employee retirement systems and for rendering retirement security to all Pennsylvanians.

Eliminate the Projected Contribution Rate Spike/Plateau

- Direct a fresh-start refinancing of the retirement systems.
- Establish consistent 30 year amortization periods for recognition gains/losses and funding active member benefit obligations, i.e. reinstate proper actuarial funding methods.
- Reinstigate 20-year amortization periods for funding past and future ad hoc COLAs.
- Extend smoothing period to at least 10 years for recognition of annual investment gains/losses used in the calculation of actuarial value of assets.
- Increase minimum employer contribution rates to equal normal cost rate determined by the actuaries.
- Impose temporary collars on annual changes in the employer contribution rate (+/- 3% of payroll per year), to expire when systems fully implement new 10-year smoothing method--allowing the contribution rates to rise gradually if markets remain depressed and/or not decline dramatically if markets take off.

Reduce Long-Term Costs and Address Public's Concern with Private/Public Sector Retirement Benefit Disparity

- Revert to Pre ACT 9 of 2001 formula for new hires (2% multiplier).
- Revert to 10 year vesting period for new hires, perhaps not state employees.
- Direct a comprehensive study of the pension/retirement savings plans available to employees in the private sector, including a long-term economic impact analysis for the Commonwealth.

Address Long and Short Term COLA Needs of Annuitants

- Establish new option for all future annuitants to forego lump-sum withdrawals, electing to receive the reduced annuity that would have occurred with the withdrawal and accepting annual COLAs tied to inflation with a 3% cap on the annual adjustments.
- Provide ad-hoc COLA for all current annuitants, as provided in HB 1970, but add restriction on receipt of increases by beneficiaries of ACT 9 in accordance with the benefit analysis conducted in 2003/04 by the Public Employees' Retirement Commission (PERC).