A Framework for Reform

How might the General Assembly draw on elements of the existing pension proposals and other ideas to build on Act 120 and better meet the five criteria above? There is no escaping the difficulty of this challenge, which suggests that surmounting it depends in part on the process leading to pension changes. That process should involve negotiation – give and take among all pension stakeholders – and enough time and technical support to evaluate all the impacts of alternative proposals. That process should not involve a rushed legislative process designed to avoid scrutiny of complex pension proposals so that they can be passed before stakeholders and the public know what hit them.

Based on the analysis here, the following elements could offer a framework for building on Act 120.

- **First, the judicious use of pension bonds as proposed by Representative Grell and Senate Democrats could help buy down the state's pension debt** and partially compensate for employers' failures to make adequate pension contributions in the past. Bond purchases should be spaced out over time and made only if there is a reasonable spread (e.g., at least 1.5 percentage points) between the bond interest rate and the 7.5% projected investment returns of the state pension plans.

- **Second, the state should consider dedicating specific additional tax revenue to making pension contributions and paying off pension bonds.** This revenue could be a portion of revenue generated by closing corporate tax loopholes, increasing the tax rate on high-end income, or enacting a real natural gas drilling tax.

- **Third, the state could explore a trade with employees that lowers near-term employer contributions – and raises near-term employee contributions – but then does the reverse down the road.** By maintaining total contributions this does not repeat the mistakes of past employer contribution holidays. Instead, this idea recognizes that employer contributions are extremely unbalanced currently over time – very high near term because of the unfunded liability (20% to 33%) but very low long term (as low as 3.5%) because of the deep Act 120 pension benefit cuts. This idea thus asks employees to share an additional funding burden when total contributions peak but only in exchange for lower contributions down the road.

- **Fourth, the state could try to capture some of the savings in the Grell and Senate Democratic proposals.** Specifically, in the context of a negotiated solution, the state could explore whether employees subject to the Act 9 pension rules would accept some modest modifications to pension benefits such as those proposed by Representative Grell, in exchange for a sufficient infusions of funds into the pension plans and potentially lower employee (and higher employer) contributions down the road. The state should also end the pension double dip by charter schools as proposed by the Senate Democrats.

- **Fifth, the state could explore caps on high-end pensions** such as a New Jersey change that made the maximum pension the Social Security wage going forward. This would not save a great deal of money because, despite media reports to the contrary, the vast majority of pension payments go to middle-class retirees, but it would save some.

- **Finally, with a sufficient infusion of new revenues from bonds and dedicated taxes, the state may be able to buy down the total pension contribution sufficient to explore an Arizona and Missouri pension plan practice of dividing annual required contributions (ARC) payments between employees and employers.** In these two states, splitting the ARC resulted in both employer and employee contributions rising quickly and automatically when financial markets declined in the dot.com bust, and then rising further after the financial meltdown that triggered and deepened in the great recession.[27] As a result of the quick and shared increase in contributions, employer contributions in both states are now peaking at about 12%-14%, a manageable level under half the projected peak for the PSERS employer contribution currently.

Institutionalizing the sharing of ARC contributions – even if only possible some years down the road – would help ensure against future contribution holidays that lead to underfunded pensions. It would also make more transparent to the public sharing of financial market risk between taxpayers and employees. Ultimately, such sharing might allow Pennsylvania to stabilize for the long term a "best of both worlds" retirement system that safeguards retirement security for public employees and is cost-effective for taxpayers (even if that has been forgotten in the wake of financial market meltdowns and ill-advised employer contribution holidays). Lastly, stabilizing Pennsylvania's pensions for the long term would allow lawmakers to focus on a much more important retirement crisis – the collapse of retirement security in the private sector.

[27] On the Arizona example, see Dave Wells and Stephen Herzenberg, *On Track to Financial Sustainability with Retirement Security*, Grand Canyon Institute; online at http://grandcanyoninstitute.org/research/arizona%E2%80%99s-pensions-track-financial-sustainability-retirement-security; on the Missouri example, see Stephen Herzenberg, forthcoming Missouri pension brief.