Commonwealth Foundation
for PUBLIC POLICY ALTERNATIVES

Myths AND Facts

PENNSYLVANIA'S PENSION CRISIS

Pennsylvania's two main government worker pension systems, the Public School Employee Retirement System (PSERS) and the State Employee Retirement System (SERS), are dramatically underfunded. Together these funds owe more than $47 billion in unfunded liabilities, and paying for this debt is draining public school resources and threatening to skyrocket local property taxes.

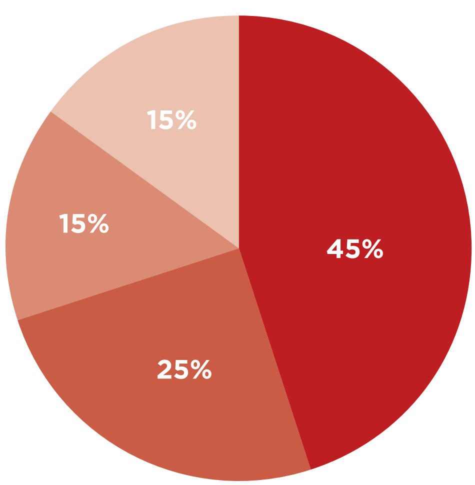
MYTH #1

The 2008 stock market collapse is the sole culprit of Pennsylvania's public sector pension crisis.

Fact: The stock market collapse and other investment losses account for only about half of today's pension crisis. The rest of the problem stems from the following political factors unique to Pennsylvania's pension plans:

- Legislators retroactively increased pension benefits in 2001, followed by a cost-of-living adjustment in 2002, which added nearly $10 billion in debt instantly;
- Legislation in 2003 and 2010 delayed pension contributions, which led to higher future taxpayer payments; and
- PSERS and SERS officials reduced their assumed stock market returns from 8% to 7.5%; these simple adjustments added $5.5 billion to the state's pension shortfall.

PSERS analyzed the causes of its unfunded pension plan in 2010:



PSERS $27 Billion Unfunded Pension Liability Causes:

- Investment Losses
- Underfunding
- Benefit Improvements
- Lowered Asset Expectations

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MYTH #2

Act 120 of 2010 solved the growing debt problem for teacher and state worker pensions.

Fact: The Pennsylvania State Education Association, for example, claims Act 120 fixed our pension crisis by lowering upcoming pension costs. This claim ignores a dramatically underfunded system. We're already more than $47 billion in debt, which will require higher taxes to pay off.

Projections regarding Act 120 were based on an unrealistic 8% return on investment. These assumptions have already been lowered. Without consistent, unrealistically high investment returns, the current pension system is beyond hope of becoming self-sustaining.

MYTH #3

Pension obligation bonds are a risk-free investment to finance pension plans.

Fact: Issuing a pension obligation bond is like taking out a second mortgage on your house, investing the money in the stock market and hoping for a great investment return. It's a risky bet that requires investment returns to consistently exceed interest payments on bonds.

Moody's Investor Service has warned state and local governments on such borrowing to finance underfunded pension systems. Their report stated:

"[P]ension bonds are often a red flag associated with greater rigidity of long term obligations, failure to find sustainable solutions to pension funding and a pattern of pushing costs off into the future."

Under Mayor Ed Rendell in 1999, Philadelphia issued $1.29 billion in pension bonds to balance the city's budget. But officials continued to underfund the city's pensions, leaving Philadelphia in the same predicament as before the bonds were issued, only now with more than $1 billion in additional debt.

What does genuine pension reform look like?

Pension costs are ballooning so quickly, they threaten to consume funds for education, public safety and welfare. Without changes, school districts will likely be forced to compensate for pension obligations by laying off more teachers and cutting programs.

Public retirement plans should be affordable for taxpayers, have costs that are predictable for state and local governments and be paid while workers are currently working—not pushed off onto future generations. Lawmakers should:

- Establish a new defined contribution, 401(k)-type type plan for new state and local government workers, school employees, judges and legislators.
- Prohibit new borrowing schemes to finance pensions.
- Fund pensions consistent with accounting rules.
- Consider modifying unearned benefits and eliminating loopholes that allow people to game the pension system.
- Fund pensions without increasing taxes or borrowing.

By adopting proven, comprehensive pension reforms now, Pennsylvania can save current and future generations from an unbearable and unfair fiscal burden.

For more on the Pension Crisis, visit **www.commonwealthfoundation.org**

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