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PENNSYLVANIA STATE
EDUCATION ASSOCIATION

Testimony

of the

Pennsylvania State Education Association (PSEA)

Joint Hearing on PSERS

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House Republican Policy Committee

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By

James P. Testerman

PSEA President

Good morning, Chairman Erickson, Chairman Saylor, and members the Senate and House Republican Policy Committees. My name is James Testerman. I am a middle school science teacher currently on leave from Central York School District while I serve my elected term as President of the Pennsylvania State Education Association (PSEA). On behalf of PSEA's 191,000 members representing all aspects of education services throughout Pennsylvania, thank you for inviting me to share our views on the critical issue of the Commonwealth's pension system for public school employees.

In my decades of involvement with PSEA, I have never seen an issue motivate our members more than the issue of preserving retirement security now and into the future. I'll share with you four important truths that are motivating our members to speak out:

1) The current defined benefit pension plan is critical for recruiting and retaining quality public school employees, which benefits students, their families, and their communities.

2) The projected spike in employer payments has almost tripled from 2007 to today. This increase was not the result of any change in benefits. It is primarily the result of significant investment losses in 2008 and 2009, the continued lack of employer funding and a change in PSERS earnings assumption.
3) School employees have never stopped making their pension contributions. They have paid more than twice as much into the system as their employers over the last 10 years.

4) Many of the "solutions" being discussed make for good sound bites but will do nothing to lessen the projected payment increases. In fact, some of them would actually cause an increase in employer payments in the near future and hurt the ability to attract and retain quality education professionals over the long term.

The Pew Center on the States recently released a survey of state-administered pension plans. It appears that Pennsylvania is not alone in facing a funding challenge, and Pew has blamed a decade's worth of poor policy decisions for leaving pension plans short funded.

Pew deemed 16 states as solid performers in how they fund pensions and they are not in the situation we find ourselves today. Fifteen states, including Pennsylvania, were determined to need improvement, and 19 more states were considered to be facing serious concerns.

Ironically, the seeds of the problems confronting many of these states were sown during the best of economic times in the late 1990's.

During the late 1990's, PSERS investment earnings topped 15% each year, on average, over a 5-year period, and PSERS funded ratio increased to 123%.

As a result of these high funding levels and a lack of an employer contribution rate floor, one of the major line items in the state and school districts' budgets began to disappear. Employer pension contributions, which averaged 12.67 percent of payroll in the period between 1960 and 2001, suddenly fell to 0.

For one brief moment, it looked as though pension benefits could be funded totally through investment earnings. Then the economy went into a tailspin. Starting with the bursting of the dot.com bubble, PSERS incurred significant investment losses and the losses continued to mount over a two year period.

There was a need at this point to appropriately increase PSERS' employer pension rate to reflect the total costs of Act 9, which were amplified by the investment losses; however, it could not have come at a worse time for the Commonwealth. State revenues were falling due to the recession, and a large budget deficit was developing.

So the Legislature passed Act 38 in 2002 and then Act 40 in 2003, in both cases deferring payment of pension liabilities. As a result, the pension rate has remained artificially low, averaging 3.56% from 2001 to today.

PSERS funded ratio declined from 123% in 2000 to 104.8% in 2002, and today stands at 79.2%. This will continue to drop unless there is a substantial increase in employer contributions.

Meanwhile, employees have been making their contributions all along.

The problems developed when the employer rate was allowed to fall to such a low level that even getting it back up to normal levels became a huge challenge. This set the stage for the current problem. PSERS has been shortchanged for 10 years, and, effectively, they were not allowed to build up any reserves to help weather the next economic downturn when it came.

This problem has been apparent for many years.

PSEA has been concerned about the situation since talk of a pending crisis of underfunding for PSERS and SERS arose. In fact, members of the Committee who have been here for a few years might remember PSEA's previous testimony that pointed to two giant warning flags of the 2004 Joint State Government Commission report and a performance audit conducted by the Auditor General.

We all have known that legislation was necessary to adopt a proper funding strategy for PSERS as long as five years ago, but no steps have been taken to shore up finances or make adequate contributions.

So what are the options? They are exactly the same as they were back in 2006, except the problem has now gotten much larger due to delay.

As PSERS has indicated, the solutions fall into three categories:

1) Increasing the funding,
2) Deferring the payment of liabilities, or
3) Decrease costs/liabilities.

We expect that any final plan will probably include some changes in each area. PSEA is willing to work with you in coming up with a responsible solution that at the same time keeps alive the promise of a secure retirement for our members.

Where PSEA is most concerned is with some of the ideologically-based proposals that abandon the current system for a defined contribution plan with 401(k)-type accounts.

We see these as "silver bullet" solutions that may make for good sound bites, but would have absolutely no impact on the pension spike. Even if retirement benefits were totally eliminated for all new school employees – mind you not something I am advocating - the pension spike would still exist. These are costs that have been deferred by previous General Assemblies and they will still need to be paid regardless of what is done on the benefit side of the equation.

Any potential savings from a defined contribution plan only comes from a reduction in the level of benefits, not the move to a defined contribution plan itself. Defined contribution plans are actually more costly for the same level of benefits.

Even if the legislature would put all new employees in a defined contribution plan, with a greatly reduced level of benefits, any savings would be 30 years away. Meanwhile, the additional cost of running two separate plans would start immediately.

I also urge you to consider the unintended negative costs to the education profession and the Commonwealth, which would start immediately accruing. Defined benefit pension plans are not just better for the employees you represent, they are also better for employers. Investment returns in a defined benefit plan cover a large portion of retiree pension obligations. These plans also cost half as much to administer as defined contribution plans; reduce turnover, which contributes to a stable learning environment for children; and provide employee dollars for the Pennsylvania economy, business, and job creation.

Finally, I would like to challenge the argument that defined benefit pension plans are not sustainable.

Ten years ago, PSERS was 123% funded and the Governor's Office and the Legislature were operating from the premise that public pension funds could be sustained from investment earnings alone. There would be no need for employer contributions.

This was all based on a run of 5-years when PSERS earned more than 15% on average each year.

Perhaps we can borrow a phrase from Alan Greenspan and call this a period of "irrational exuberance."

Then PSERS suffered losses in 2001, 2002 and underperformed in 2003, and the irrational exuberance was shaken but not lost. It returned as PSERS earnings climbed to 19.67 percent in 2004, 12.87 percent in 2005, 15.26 percent in 2006, and 22.93 percent in 2007. Policymakers continued to assume that PSERS would generate enough money to allow them to continue on a payment holiday and avoid making proper contributions.

I think all of us here today will today agree that these assumptions were irrational and helped set the stage for the looming funding crisis.

PSERS has now had two years of losses, -2.82 in 2008 and -26.54 in 2009. The scale of the loss in 2009 was almost unprecedented; the largest since the Great Depression.

Again, borrowing from Alan Greenspan, we have entered a period of "irrational despair" and we hear from some that PSERS is unsustainable. We have swung from irrational exuberance the whole way to irrational despair, all with a 10-year period.

Sound policy decisions require a longer term perspective.

First, I want to remind the committees that PSERS was formed in 1917, and it has survived the Great Depression and all the ups and downs in the economy for a period of 93 years.

The current rate spike comes on the heels of a decade when the median annualized investment returns of public pension funds like PSERS have averaged 3.9%* as a result of two very severe recessions. It also comes on the heels of a decade in which Pennsylvania and many other states have shortchanged their pension funds.

Members of the committee should reflect on the fact that the median annualized investment returns of public pension funds over a twenty year period has been 8.1%*, even with the two recessions. They were actually even higher, 9.3%*, over a twenty-five year period. Both of these figures point to the sustainability of the fund.

Defined benefit plans benefit have long investment horizons. As long as cash is flowing into the plans, the pension funds can ride out a down market and stand ready to participate in the next recovery.

It is these long-term investment horizons that permit defined benefit pension plans don't just provide retirement security not only for participants, but also strength and stability to the U.S. economy as well.

With a sustained level of contributions by employees and their employers, and investment returns at nearer to these long term averages, defined benefit pension plans are sustainable.

PSEA urges the Senate and House Policy Committees to do some homework on all the proposed solutions, assess them, and examine the impact on the pension spike.

Our members trust that you will make informed and responsible decisions about the future of the fund into which they contributed to achieve the promise of a secure retirement. We stand ready to work with you to ensure that you fully consider the impact on school employees of any changes you adopt.

Thank you for the opportunity to testify on this important issue.
*March 2010 NASRA Issue Brief: Public Pension Plan Investment Return Assumptions