

Testimony for Joint Public Hearing on Municipal Pensions
Senate Urban Affairs Committee / Senate Housing Committee
By Brian K. Jensen, Ph.D.
Monday, September 8, 2008

Good morning. Thank you for this opportunity to speak this morning regarding Pennsylvania's municipal pension situation. My name is Brian Jensen. I am a senior vice president with the Pennsylvania Economy League of Southwestern Pennsylvania where I manage the Local Government Function and Structure Program. The goal of that program is to make Pennsylvania local government, particularly that of southwestern Pennsylvania, Allegheny County and the City of Pittsburgh, less costly, more efficient, more effective, better focused, more coherently led, and more competitive economically.

The Economy League has promoted the value of better government for over seventy years. From the early-1950s, when our organization staffed a state commission that recommended a complete rationalization of functions and service delivery within Allegheny County local government to our extensive early-1990s program to promote functional consolidation between Allegheny County and the City of Pittsburgh, the Economy League has actively sought to foster intergovernmental cooperation to enhance effectiveness and cost efficiency.

It is in the light of the Economy League's tradition of researching and promoting good government management practices and structures that we undertook an analysis of Pennsylvania's municipal pension situation. This morning, I would like to convey to the committee some of the highlights of our research and offer some conclusions on what we think it means for the current discussion.

Pennsylvania is an extreme outlier among the fifty states with our radical decentralization of municipal pension plans. Our state has over four times as many public employee pension plans as any other state. Twenty-five percent of the nation's public employee pension plans belong to Pennsylvania's local governments and special districts. Our overly-fragmented municipal pension mishmash – it would be inaccurate to call it a “system” because there is nothing systematic about it – continues to grow with the number of local pension plans increasing steadily each year.

One consequence of having so many local government pension plans is that they tend to be very small. Two-thirds of our state's public pension plans have ten or fewer members and nearly half have five or fewer members. Only thirteen percent have more than twenty-five active members.

Small plans are more costly to administer than large plans. In 2005, the average per member administrative cost for Pennsylvania local pension plans with ten or fewer members was about \$1,400, compared to \$250 for the five municipal pension plans with over 1,000 members. Putting local government employees into larger pension plans would reduce administrative costs, generating about \$22 million in savings based on these figures.

On top of this, there is evidence that small plans tend to lag larger plans in returns on investment. Large, centralized pension systems have larger amounts available

for investment as well as the ability to employ more sophisticated investment instruments than is typically practiced by small, fragmented systems.

The high administrative costs and low returns that result from such radical fragmentation exacerbate the dire fiscal condition of many of our municipal pension plans. According to the Pennsylvania Public Employee Retirement Commission, in 2005, the unfunded accrued liability of our municipal pension plans was nearly \$5.1 billion.

As you can see from the map, the incidence of underfunded pension plans is distressingly widespread in Pennsylvania. While cities have the most acute problem, boroughs and rural townships are not immune from pension distress.

On the whole, public safety pension plans exhibit the worst incidence of underfunding. The binding arbitration provisions of Act 111 along with dozens of other state statutes make it very difficult for municipalities to manage their police and fire pension costs predictably and effectively.

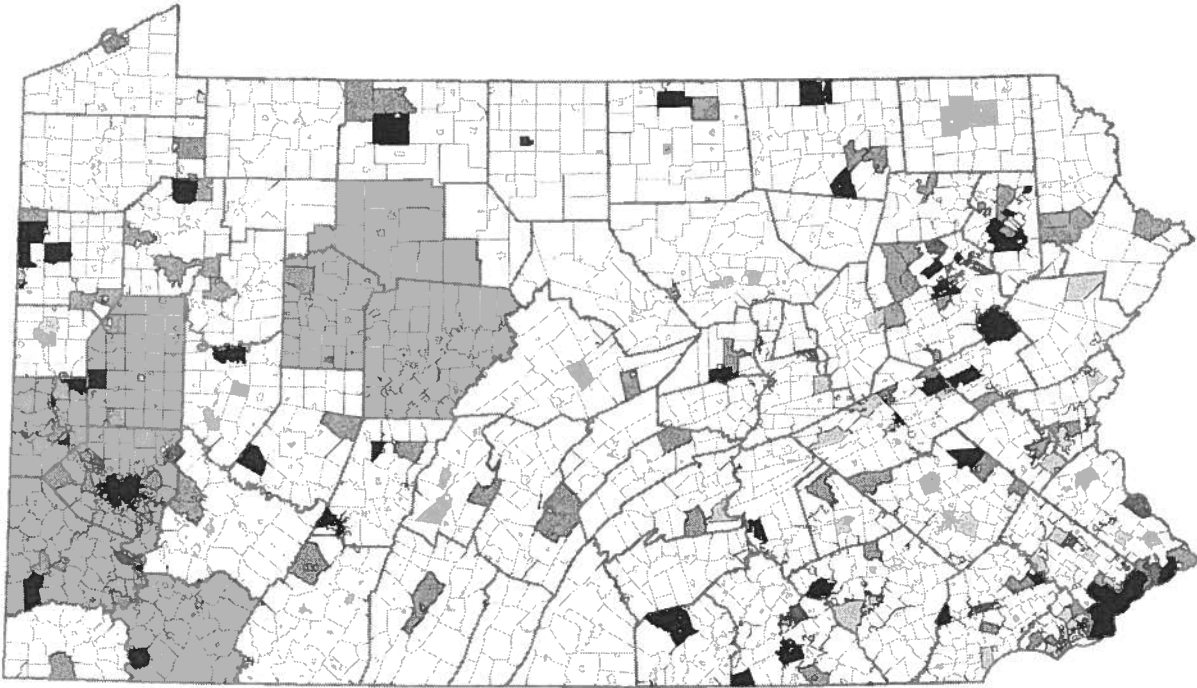
Pennsylvania needs to act soon to correct its mounting local government pension problems. Consolidating the administration of our numerous pension plans would be a good first step towards capturing the economies of scale and better investment returns necessary to guarantee livable retirement incomes for our municipal retirees and their families while at the same time protecting taxpayers from continually escalating tax burdens.

Taking it a step further, full consolidation of pension plans would make it easier to rationalize local government. One of the biggest obstacles to the consolidation of police departments and to broader municipal consolidation has been the challenge of resolving differing pension provisions. Fewer, better funded, better outfitted and better staffed police departments would be a happy consequence of a unified municipal pension system.

Another approach that should be considered is redesigning the formula for distribution of state aid for pension plans to provide greater support to truly needy and deserving municipalities. The current state aid allocation formula results in full funding of nearly half of all municipal plans, allowing those municipalities to increase benefits or reduce member contributions at no local cost. Such full-funding reduces the amount available to truly needy municipalities and has led to a substantial disparity in funding. Distribution amounts could be frozen at a particular point in time, and subsequent increases in the revenue base could be targeted to plans that continue to be underfunded despite demonstrated efforts to manage their problems through best practices.

Finally, in order to remove barriers to functional and structural consolidation, the Commonwealth should partner with willing municipalities by helping to defray cost increases that result from the leveling-up that typically accompanies such mergers. Such short term investments from the state will reap long-term fiscal benefits and improve municipal service levels.

Thank you Mr. Chairman, and Committee members. I would be happy to try to address any questions you may have.



Municipal Pension Distress Indicator (2005)

- Either no pension plans or no pension plans in distress
- ▨ Either Fund Ratio less than 70% or UAL/Payroll ratio exceeds 100% for at least one plan
- ▩ Both Fund Ratio less than 70% and UAL/Payroll ratio exceeds 100% for at least one plan
- Either Fund Ratio less than 70% or UAL/Payroll ratio exceeds 100% for all plans treated as a single unit
- Both Fund Ratio less than 70% and UAL/Payroll ratio exceeds 100% for all plans treated as a single unit

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