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Pennsylvania's Lesson for Illinois

A bipartisan reform begins to address the state's funding abyss.

State and local governments owe at least a trillion dollars to public employee pensions. So it is welcome news that some politicians are noticing, and this week Pennsylvania took a step toward sanity in worker benefits.

On Monday Pennsylvania's Democratic Governor Tom Wolf signed a bill that would enroll new state employees in "hybrid" retirement plans that feature defined-contributions from employees, much like 401(k)s offered by private businesses. The government would put up a smaller defined benefit. Employees could also choose a plan with only the 401(k), though it isn't clear how many would. Teachers and other current workers would have the option to switch into the new plans. The legislation passed the Republican legislature by wide margins.

Pennsylvania's pension system is among the most broke in the country, with up to \$70 billion in liabilities by some estimates. The state like so many others tries to conceal the damage with dubious assumptions—predicting 7% returns that never materialize while chasing yield in risky instruments. Pennsylvania ran a pension surplus as recently as the early 2000s, but that was blown up by expanding benefits and reducing payments.

The legislature has for a decade considered reforms, including borrowing money and dumping it into the stock market, as if that's never ended poorly. Meantime, the burden increased: Nathan Benefield at the Commonwealth Foundation notes that Pennsylvania school districts spent \$2.3 billion on pensions in 2014-15, a 252% increase since 2008-09. School district revenues increased \$3.9 billion from 2009 to 2015, but nearly half of the increase went to pensions. Many districts are strapped for cash as a result.

Thus the plan to enroll new employees in hybrid plans, effective 2019. This would eliminate the taxpayer risk for new hires. Another benefit is portability: A teacher who would like to work five years but not three decades can bring savings with her when she leaves. Perhaps some younger workers who doubt they'll ever see the promised pension will elect to join the hybrid plans.

Note also that the bill enjoys bipartisan support in a state with often dysfunctional politics, and Gov. Wolf deserves credit for signing the measure after vetoing a hybrid pension bill in 2015. Government unions didn't fight the legislation in a heretofore unseen display of restraint, and perhaps they think this will stave off more invasive changes for current workers or retirees. It's also instructive that former Republican Governor Tom Corbett couldn't pass his similar plan in 2013.

The new plans are still much more generous than private alternatives: A career employee could retire with benefits of up to 95% of his final earnings, which the American Enterprise Institute's Andrew Biggs says is much higher than the 70% replacement rate most financial advisers say is sufficient.

The law also can't erase government liabilities, and pension woes won't be fixed until governments are honest about what they owe and how to pay for it. But the Pennsylvania improvements are at least a start. Are you paying attention, Illinois and Connecticut?

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