

Testimony Regarding SB596
By Brian K. Jensen, Ph.D.
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Good morning. My name is Brian Jensen. I am a senior vice president with the Allegheny Conference on Community Development and the Pennsylvania Economy League of Southwestern Pennsylvania where I manage the Local Government Function and Structure Program. Thank you for this opportunity to speak today regarding Senate Bill 596 and the potential benefits to Pennsylvanians of consolidating municipal police pension plans at the state level.

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 \$21.7 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. The municipalities highlighted in bright red meet two criteria of pension distress across the spectrum of their pension plans: low fund ratios and high unfunded accrued liabilities. The municipalities highlighted in pink meet one or the other of those two criteria across the spectrum of their pension plans. The municipalities shaded in dark gray meet both of the criteria for at least one of their pension plans, while the municipalities shaded in

light gray meet one or the other of the criteria for at least one of their pension plans. While cities have the most acute problem, boroughs and townships are not immune from pension distress.

On the whole, police 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 pension costs predictably and effectively.

The central concepts in SB 596 are a good step towards correcting our vexing local government pension problems. Consolidating our numerous pension plans will provide 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.

No less important is that consolidation of pension plans will make it easier to rationalize local government. One of the greatest 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.

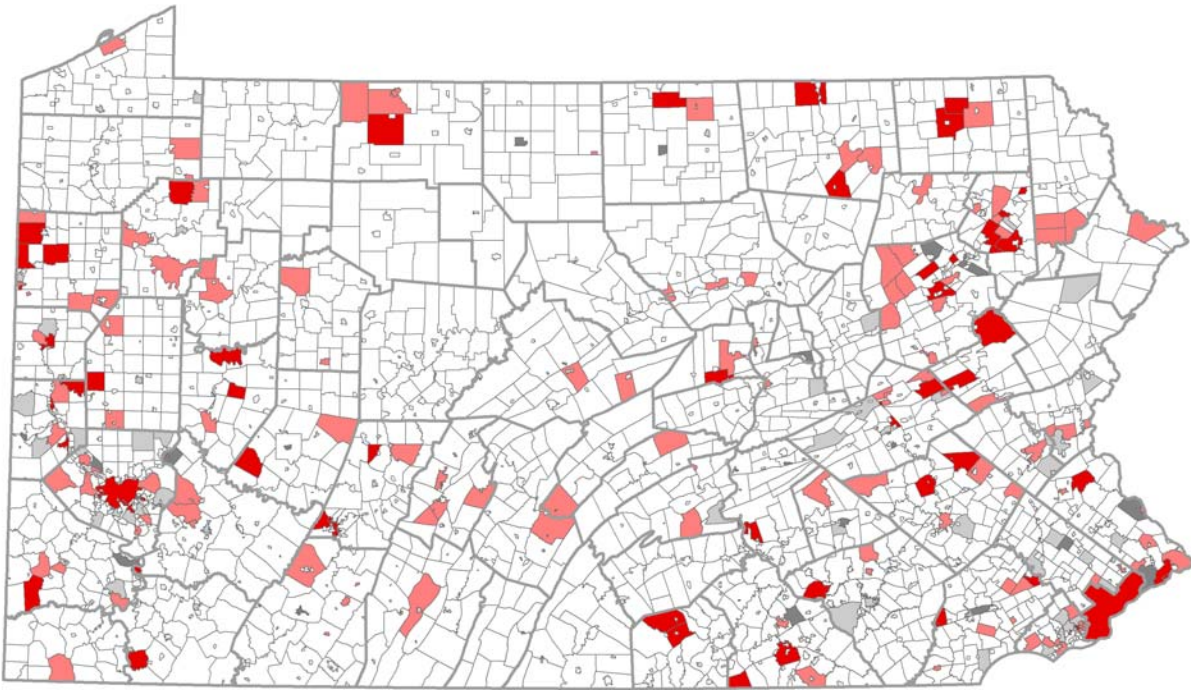
While the proposal has important merits, it applies only to plans that are fully funded. Solutions need to be developed at the state level that will help

municipalities to address their unfunded pension liabilities so they too can garner the benefits of a unified pension system.

One 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. Reducing the maximum allocation cap would provide cost control incentives and result in more aid to municipal plans most in need. Alternatively, 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 members of this Committee. 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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