Testimony of Tim Nesbitt
Bipartisan PERS Solutions Work Group
September 21, 2016

My name is Tim Nesbitt. I am appearing today at the request of the Oregon Business Council as the lead author of a report presented to the Oregon Business Summit last December on the need and the ways to moderate scheduled increases in the costs of the Public Employees Retirement System.

As you know, the scheduled PERS rate increases represent a large and growing claim on state, school and local government budgets that will require a diversion of resources from the services those jurisdictions provide.

Whether you believe those costs arise from overpromising or underfunding, they are nonetheless real costs which, under the PERS financing scheme, will have to be borne in full by public employers. This means they will have to be paid in full by Oregon taxpayers. Further, if and when those payments are made, their effects will be borne by citizens, in the form of fewer services, and by public employees, in the form of heavier workloads. In our schools, that means fewer teachers, larger class sizes and/or shorter school years than would otherwise be the case if these pension cost increases could be moderated or averted.

This is why I have called the prospect of rising PERS costs an inconvenient truth for those of us who believe in government as a force for good, for educating our children, keeping us safe, creating opportunity, combatting inequality and promoting prosperity...and who believe just as strongly in the principle of fair compensation for the employees whose service enables us to achieve these purposes. What's inconvenient is that we have to reconcile this conflict of purposes and values.

I and the Council appreciate the forum you have created here to begin to respond to this challenge, thoughtfully and fairly. To begin, I'd like to put recent events in perspective.

We are now coming off of a honeymoon period for maintaining our PERS benefit system. During the honeymoon period, reforms enacted in 2013 kept payroll costs for PERS relatively flat over the past three years, which enabled you to direct more of the revenue dividends from an expanding economy into education budgets that did more with more. The "more" in this instance included the hiring of more classroom teachers and counselors in K-12, the expansion of kindergarten to full-day schedules statewide and the enactment of a new program that promises nearly tuition-free community college for qualified high school graduates this year.

But, thanks to the Supreme Court's Moro decision, the honeymoon has ended; there is a large bill to pay; and it looks like you will not be able to do much "more with more" for years to come. The court's decision and continued underperformance of PERS' investment funds will force you and your colleagues on school boards and city councils to direct most of the revenue dividends from an expanding economy to meet the higher costs of PERS and, at best, to maintain current budgets -- or worse, to cut services, when tax receipts will be at record levels in the next biennium.

Then, even if you manage to absorb these costs in the next budget, the fiscal challenge you face will double and triple in subsequent biennia, as PERS pension costs rise from an average of 18% of payroll currently to something close to 30% -- or more -- within six years.

This is a tough issue, for which there are no easy or perfectly fair solutions. We're dealing with legacy costs now, by which the consequences of prior failures and mistakes are shifted from one generation to another. That was the practical effect of the Court's decision in Moro, when it ruled unanimously that what is done cannot be undone for those already retired and for those still working who have earned certain benefits to date. But, the court also made clear that what happens hereafter is up to Oregon lawmakers, who can reduce benefits prospectively or require new forms of cost-sharing from PERS-covered employees in the future. Those kinds of solutions may not feel fair to public employees, but the legacy cost problem is itself unfair -- to younger employees, to school kids, to working families – if we continue to treat it as unsolvable.

I would like to offer several observations from years of viewing this problem from the union side and the management side in bargaining sessions and in legislative sessions during the past two decades.

- The PERS pension plan is a promise that must be kept, at least in regard to benefits earned to date. The court made that clear.
- But PERS is more than a defined benefit plan. It also includes a mandated defined contribution savings plan, known as the IAP, which is disconnected from the pension plan.
- The pension plan is underfunded. The IAP is by definition fully funded, since its obligations consist of no more than individual retirement savings.
- The pension plan is non-contributory – the only major public employee pension plan in the U.S. in which employees do not contribute to their benefits. The IAP is contributory, directly or indirectly, depending on employee bargaining agreements or compensation plans. But none of the contributions to the IAP support the pension plan.
- We have promises to keep in the pension plan, the costs of which will have dire consequences for school kids, for those who rely on public services and for our economy. In effect, we have a pension plan that has become unaffordable. So why are we continuing to support a second retirement savings plan with funds that are not helping to support the pension plan?

This is the question that focused our deliberations in preparing the report for the OBC.

There are other questions to consider about the best design of retirement plans for the future – the pension plan versus the 401K model.

There are practical issues to address, beginning with the recognition that the cost of retirement benefits cannot be separated from the total compensation of employees, and that managing the growth of total compensation going forward may be justifiable and feasible, while reducing compensation for current employees may be neither.

Finally, there are equity issues to keep in mind, including the fact that only a minor portion of the system's unfunded liabilities is attributable to those now working. Most are attributable to those already retired. But the benefits accrued by Tier 1 and Tier 2 employees have contributed more to PERS' unfunded liabilities than those accrued by OPSRP members. To the extent that current employees are involved in controlling and apportioning PERS costs going forward, fairness demands that there be some proportional relationship to the magnitude of benefits accrued and the unfunded liabilities that are attributable to those benefits for each of these employee groups. The same principle applies to inactive employees, those who have separated from PERS-covered employment but are not yet retired.

Our conclusion was that the most productive, feasible and least unfair approach to this problem is to look at it as a matter of moderating future pension cost increases as a percent of payroll and as a claim on public budgets. You may choose to go further and to undertake an overhaul of the system for future employees. But that is not the most urgent problem to be solved. The challenge is to manage a retirement program whose costs system-wide have never exceeded 20% of payroll and keep it from consuming larger and larger shares of public resources, to as much as 30% of payroll or higher, that would otherwise go into expanding and improving services for Oregonians.

To this end, our major recommendation reflected that of the Portland City Club in 2011 – to find ways to direct future contributions to the supplemental retirement savings plan – the IAP -- to help offset the costs of keeping the promise of the larger PERS pension plan. Since the City Club adopted its report in 2011, we have seen more examples of other states boosting both employer and employee contribution rates to shore up their pension plans. Treating the IAP as a source of employee support for the pension plan and as a way to mitigate increases for employers is, to our thinking, the most feasible way to do this, especially if it can be done without reducing take-home pay for low and middle-paid employees. Focusing on the IAP will make this possible. And keeping an eye on total compensation – involving salary, health benefits and retirement benefits – is, we think, the best approach to balancing the interests of public employees and the citizens that depend on their services.

My participation at the Business Summit last December ended with a workshop in which representatives of school boards and universities begged for a solution to the PERS problem that many of my former colleagues continue to resist. But, in the reception that followed, I was reminded of how some of our private sector unions have dealt with an identical issue. John Mohlis, who at that time led the Oregon State Building and Construction Trades Council, told me that members of the Bricklayer's Union opted to defer their pension accruals for three years during the Great Recession in order to replenish funding for benefits previously earned and maintain the viability of the union's retirement plan. I was later contacted by a member of a Carpenters union local, who told me that his members had voted to do something similar to restore the funding for their pension benefits. These are examples of a shared sacrifice, by which union members who held on to their jobs during the recession made concessions that helped to preserve benefits for those who would come after them.

That's known as solidarity, the inter-generational kind. And it's a useful principle to apply to the problem that now confounds our hopes for a better Oregon.