TEXAS PUBLIC POLICY FOUNDATION
Testimony

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Changing Public Pensions from Defined Benefit to Defined Contribution

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Thank you, Honorable Members, for allowing this testimony.

Arduin, Laffer & Moore Econometrics and the Texas Public Policy Foundation studied a unique opportunity Texas government has to take the uncertainty out of state employee pension funds, and in doing so, provide employment flexibility and individual ownership for government employees.

Texas, unlike other states, has fully funded pension systems. You have been very fiscally responsible, thus providing the opportunity to convert your system to an annuity and/or a defined contribution program going forward. Such a conversion would take risk out of the system—risk of actuarial assumptions such as investment returns, demographics, and employee behavior.

As you know, fully funded status can be fleeting, as evidenced by other states' experience. Even Illinois had actuarially sound pension systems just 10 years ago, and today they have a $100 billion hole that is impossible to fill, leaving employees, pensioners, and taxpayers at significant risk. Defined contribution systems, are by definition, fully funded.

Moreover, defined contribution—or individual account—plans can allow employees to move in and out of the state workforce, allowing them flexibility and perhaps the opportunity to gain valuable experience in the private or not-for-profit sectors that will be useful in their future public service. The average public employee stays 7.2 years on the job these days—more than three years longer than their private sector colleagues—perhaps because of the "golden handcuffs" that bind state workers to their jobs.

In addition, defined benefit systems function like entitlement programs, and redistribute funds among workers. In some systems, depending on design, they function like pyramid schemes. Entitlement programs are always more expensive than consumer-directed government programs and are prone to abuses, like "spiking" pensions.

We looked into the history of private pension systems. In 1975, one-third of private sector pension plans, and 71 percent of covered employees were in defined benefit plans. Why? Federal tax laws, regulations, and guarantees provided employers the incentive to do so. But as government changed those laws, including ERISA requirements, PBG premium increases, and excise taxes, private employers opted to migrate their systems to individual accounts. Today, less than 10 percent of private sector employee plans are defined benefit plans.

Ironically, if governments had to live under ERISA, most of them would be breaking the law, and perhaps would have already made the conversion.

I know you are facing difficult budget choices due to the national great recession, but Texas has always been a leader, and has the opportunity to lead by protecting its pension systems for current and future workers and taxpayers. Thank you. ✩