TEXAS PUBLIC POLICY FOUNDATION
Testimony

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Reforming Texas' Public Pension Systems

Testimony before the Committee on Pensions, Investments, and Financial Services

by The Honorable Talmadge Heflin, Director of the Center for Fiscal Policy

Chairman Truitt and Members of the committee,

My name is Talmadge Heflin and I am the director of the Center for Fiscal Policy at the Texas Public Policy Foundation. Thank you for the opportunity to testify today and share our thoughts on the importance of reforming Texas' pension systems.

Pension reform is as broad an issue as the state is big; however, my comments today will focus in on answering three basic questions: 1) Why do we need pension reform?; 2) What are the consequences of inaction?; and 3) How do we best solve the problem?

Why do we need pension reform?

Typically, when the issue of pension reform is brought up, the first questions I am asked are: "Why do we need reform? After all, unlike other states, doesn't Texas have fully-funded pension systems?" To which I respond:

- ***A fully-funded pension system is fleeting.*** There is a short-lived nature to having a fully-funded pension system—Illinois is a perfect example of this.

  According to the Pew Center, Illinois' pension system was 73 percent funded in 1999—slightly below the level considered adequately funded. However, between 1999 and 2008, the average annual growth in contributions from employees and the government was 4.5 percent in Illinois, much less than what was called for. As a result, by 2008 Illinois' pension system was an even bleaker 54 percent funded. And these figures do not even include the liabilities from retirement health care obligations or other retirement obligations promised by the state.*

- ***The defined benefit plan is a failed model.*** Consider that defined benefit plans were once a sizable minority of all the benefit plans in the U.S. However, over the last 30 years or so, the private sector has moved away from this model—due in large part to ERISA regulations, which were supposed to ensure that no company ever allowed their defined benefit plan to be underfunded and thereby leave employees' pensions vulnerable to not being paid. Ironically, the public sector is not subject to these same requirements.

  The model that the private sector has chosen over the defined benefit plan is the defined contribution plan.

- ***The current system discourages workforce innovation, encourages risk-averse behavior, and creates a culture that locks workers into their current career path.***

** In an update released today by the Pew Center on the States, the funding level for Texas' pension systems dropped from 90.7 percent in 2008 to 84 percent in 2009, and 83 percent in 2010. Additionally, health benefits are only 1 percent funded, according to the same study.*

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What are the consequences of inaction?

Failure to address the consistent underfunding of the state's pension obligations can have dire consequences for taxpayers and the state in general. Consider that if Texas' pension systems are not reformed, then the state could potentially face:

- ***Ongoing budget problems.*** The entitlement nature of the defined benefit plan creates an unknown and heavy burden that, when coupled with an uncertain economic environment and stagnating revenues, has the potential to create fiscal conflict.

- ***Less funding available to other vital programs and services due to crowd-out.*** Since the defined benefit plan is similar to an entitlement, appropriators have no choice but to allocate fewer resources to other areas, leaving other vital programs and services at risk of diminished funding.

- ***Higher taxes.*** With more resources directed at funding the state's pension systems and less funding available for education, health and human services, transportation, and the like, it is a safe bet that Texas taxpayers could be on the hook to support the state's growing obligations.

How do we best solve the problem?

Thorough research and analysis of the state's pension issue has led me to believe that the system could be best reformed by:

- ***Moving away from defined benefit plans toward defined contribution plans.***
- ***Freezing the defined benefit plan for all new and unvested public sector employees.***
- ***Transferring all new or current unvested employees into a defined contribution plan.***
- ***Implementing either a hard freeze or a soft freeze of the system for current vested employees.***
- ***Using Health Savings Accounts to address the unfunded medical costs.***

In the Foundation's view, the bill that best accomplishes the goals outlined above is House Bill 2506. This bill would create defined contribution plans for newly hired state employees and teachers, and give current employees the option of joining the new plans by transferring the current value of their benefits. It is important to note that, if this bill were passed, every employee currently vested in the Employees Retirement System and the Teacher Retirement System would be able to keep their pension, if they so choose.

We acknowledge that this bill needs some work and we stand ready to work with Representative Chisum, pension actuaries, and this committee.

Madam Chair, noting the passage of HJR 99 today, we stand ready to work with you and your committee in the interim to help define the best sustainable public pension systems for Texas.

Thank you for your time and I look forward to answering any questions you may have. ✮

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