



# Pennsylvania's Pension Bomb About To Explode

Two Years Before Economic Armageddon?

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By Michael Brand

Pennsylvania is about to be hit with a megaton bomb, a fiscal bomb that will slam taxpayers, limit investment in education and heighten the growing tension between the public and its government. The threat is the Public Employees Pension Bomb, a problem with causes similar to the mortgage banking meltdown: unrealistic economic projections, privatized benefits, socialized losses, politically connected interests topped off with a helping of naked greed.

Between 1980 and 2000 the Dow Jones went from 785 to 11,500. Private 401(k) retirement accounts soared. Teachers and other public employees with old style defined benefit programs felt they were falling behind. Using a healthy dose of political contributions their lobbyists induced then Governor Ridge and the legislature to structurally change the system. It was a windfall: payouts increased 25% , vesting lowered from ten years to five; individual benefit levels calculated according an retirees top three earning years, rather than lifetime salary history (as social security will to calculate your benefit).

Politically, the changes were easy because the stock market boom swelled reserves held by the Pennsylvania's Public School Employees' Retirement System (PSERS) and the State Employees Retirement System (SERS). Saving for a rainy day is not strength of government. The new formula assumed 8% growth in stocks forever. Fantasy thinking similar to mortgage bankers making sub-prime loans assuming housing prices would always rise.

When the economy stalled in 2002 both retirement funds immediately ran into trouble. Rather than step back and rethink the increased payouts, Governor Rendell and the legislature kicked the can down the road.. Full payments into the system were delayed till 2012 in the hope that a revived economy would generate the revenue to patch the problem. Thus was planted an economic time bomb that will explode in taxpayer's faces in the next few years.

The numbers are staggering. According to Ken Bean, Director of Fiscal Affairs at the Bellefonte School District, current annual pension contributions by

taxpayers within that district of \$430,000 climb to \$2.6 million by 2012, \$5 million in 2013 and \$6 million the year after that. In State College, this year's \$1.4 million payment will shoot to \$12 million in four years. All the area school districts except for Bald Eagle are raising taxes incrementally now and banking that cash in order to soften the whopping increases coming in 2012.

Here's the kicker. Those figures represent just 50% of each school district's obligations. The other 50% comes from Harrisburg out of the General Fund. The Legislature is currently staring into its own fiscal black hole.

But even small initial tax increases locally have met resistance. When the State College School Board earlier this year considered a nominal increase, member Jim Pawelczyk balked; "Asking for \$145 tax increase (in this economy) for an average taxpayer remains unacceptable,"

...the average household in Pennsylvania presently kicks in \$212 a year to the teachers and state employees retirement systems. In 2012 that climbs to \$516, skyrockets to \$1500 in 2013 and balloons to \$1900 by 2016.

That refrain is likely to be heard statewide. Using data supplied by the state, the Commonwealth Foundation tallied the personal impact of the Pension Bomb. Through taxes, the average household in Pennsylvania presently kicks in \$212 a year to the teachers and state employees retirement systems. In 2012 that climbs to \$516, skyrockets to \$1500 in 2013 and balloons to \$1900 by 2016.

Increases of this magnitude threaten to turn the fledgling Tea Party activism into the dominant political movement of the age. The median working family in Centre County makes \$47,000. What will be the political fallout of 30-40-50% tax increases in order to pay 55 year old retirees up to \$80,000 a year?

Any solution will leave a significant portion of Pennsylvania seething. The most frequently mentioned proposal is bond refinancing, which is borrowing to pay off current debts. It's the easiest answer politically, but the most reckless fiscally. It's another version of kicking the can down the road and is similar to the Debt Consolidation commercials one sees on late night TV.

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To address its own Pension Bomb, the State of Illinois took the bond route. The bond market responded by extracting significantly higher interest rates from the state. Pension bond holders understand the higher risk. These bonds neither build infrastructure nor place Illinois in a healthier economic position.

Existing tax rates, climate and aging infrastructure already put Pennsylvania at a competitive disadvantage against other states and other countries. What

companies are likely to locate here and which ones will chose to stay here knowing Pennsylvania has enormous pension bond obligations?

Can Washington help? Recent comments by the PSERS Executive Director Jeffrey Clay indicate he's betting on a federal bailout. This strategy depends upon Congress and the White House continuing historic levels of borrowing, an unlikely prospect. Besides, there could be significant fallout for the Obama administration if money intended to help educate our children is instead funneled to pay for retirement condos on the Outer Banks.

The most politically challenging possibility is to go back and rescind the pension increases. President Obama has called for Wall Street Executives to return excessive payments, so the moral case can be made for public employees in Pennsylvania to do the same. No less than FDR slashed pension payments to retirees during a similar economic crisis. So this solution has precedent. In addition, renegotiated union benefit contracts saved a number of US companies in the 80s (think Ford and GM). Could a new governor in Harrisburg rally public employees to give back excessive gains for the common good?

We are well into the Pennsylvania political season, but avid followers of the gubernatorial candidates report hearing little honest adult conversation about the painful choices we face. Afraid of offending large and well financed constituencies, the candidates have offered up nothing more than vague platitudes.

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Five years from now things will look very different in Pennsylvania, but different in what way is still to be seen. We could see a hollowed out education system as staff are cut and programs slashed to meet pensions obligations. We could see chaos in Harrisburg as unions fight tooth and nail to retain payouts. We could see economic decline as business relocates to more friendly areas. Or we could bite the bullet and impose yearly double digit tax increase upon the public. In that case we might see President Palin.

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**Michael Brand operates *Accelerate Now*, a private practice enhancing Pennsylvania nonprofit organizations ability to do what they do Bigger, Better Faster Cheaper. He resides in Bellefonte. He can be reached at [michael@michaelbrand.org](mailto:michael@michaelbrand.org)**