



The Research Bureau

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Mr. Chairman, members of the Committee, thank you for the opportunity to present this testimony.

The Research Bureau undertook a study of public employee pensions because of all the abuses and scandals resulting from the current system and because of the severe losses public pension funds have sustained during the current recession which must be compensated by taxpayers.

As a result of our study, we have made several recommendations for reforming some of the problems and egregious abuses with the current system. Most of these, including the enforcement of fitness standards during employment, reform of the cancer presumption law so that it is based on demonstrated medical evidence, and establishing a separate retirement system for employees in hazardous occupations are controversial. They can be found in appendix A of this testimony and in the text of The Research Bureau's report. But these reforms, significant though they may be, are merely tinkering at the margins because defined-benefit pension plans are fundamentally flawed. "Meaningful pension reform," as Governor Patrick has called for, requires transitioning from a defined-benefit plan to a defined-contribution plan. In doing this, Massachusetts would not be breaking new ground. Michigan and Alaska, in 1997 and 2006, respectively, closed their defined-benefit plans to all new state employees, instead enrolling them in a defined-contribution plan. Such a plan has the following advantages:

- A defined-contribution system is better for **budget discipline**. With a defined-benefit system, the employer (ultimately the taxpayer) is always making promises that it cannot know if it can fulfill, or at least not without great expense. A defined-contribution plan is therefore more honest, and its cost to the employer is much more predictable. With a defined-contribution system, the employer would

never get caught in the situation Worcester and all other cities and states across the nation will be faced with in FY10, of having to raise new revenues or cut services in order to continue to fund promised benefits amidst an environment of fiscal crisis. There is no such thing as an “unfunded liability” for a defined-contribution system, since a defined-contribution system is, by definition, always fully funded.

- A defined-contribution system would provide **equity with workers in the private sector**. While a defined-benefit system is not necessarily more generous than a defined-contribution system, there is no question that during a recession, individuals in the private sector with a defined-contribution plan (especially if they are at retirement age) fare much worse than public employees. Not only does a defined-benefit system for public employees provide a safety net most taxpaying citizens do not have access to, it also asks those taxpaying citizens to compensate for the system’s market losses. It is inherently **unfair** to require private-sector workers who bear the investment risk for their own retirement to also bear all the investment risk for public employees.¹
- The traditional argument for a defined-benefit plan was that, because public employees were paid less than private-sector employees, their retirement and health benefits needed to be more generous in order to attract a qualified workforce. But with many Worcester employees making over \$100,000 per year, this argument lacks credibility.² In 2007, the average salary for a City worker was \$47,464, which was actually greater than the average salary for Worcester and the surrounding area, \$43,440, according to Bureau of Labor Statistics.³ (Average *total* compensation, taking into account retirement and health benefits, is, of course, still greater.) Simply put, a defined-benefit retirement plan is **not necessary to attract a qualified workforce and has outlived its purpose**. A defined-contribution plan could be more attractive to certain employees such as younger employees or anyone not planning to spend his whole professional career in the public sector. Meanwhile, having a defined-benefit plan provides a disincentive for public employees to leave the public sector. Once the employee is vested, and given limited years of service required to receive full benefits, public employees have little incentive to pursue other opportunities.
- A **defined-contribution system** is a simpler system which **offers virtually no potential for abuse**. Salary spiking through temporary promotions or cashing in vacation days, double-dipping, and the numerous other forms of “gaming the system” are possible only in a defined-benefit system, which relies on a benefit

¹ According to data analyzed by The Center for Retirement Research at Boston College (CRRBC), between 1980 and 2006, the number of private-sector workers covered by a defined-benefit pension plan declined from 60.2% to 10.4%, and the number covered by a defined-contribution plan rose from 17.1% to 65.4%. (“Private Sector Workers with Pension Coverage, By Pension Type, 1980-2006,” CRRBC, http://crr.bc.edu/frequently_requested_data/frequently_requested_data.html).

² Not including compensation for police details, 180 public employees in Worcester made over \$100,000 in 2007. If detail work is included, the number increases to well over 250. According to the *Boston Herald*, 2,516 Boston city and school public employees earned more than \$100,000 in 2008. (Source: Worcester Regional Research Bureau calculation based on “Your Tax Dollars at Work: 2009 Boston Payroll,” <http://www.bostonherald.com/projects/payroll/boston/total.DESC///1/>.)

³ “May 2007 Metropolitan and Nonmetropolitan Area Occupational Employment and Wage Estimates, Worcester, MA-CT,” http://www.bls.gov/oes/2007/may/oes_79600.htm#b00-0000.

formula that can be manipulated in numerous ways. In a defined-contribution system, one's retirement benefits are determined simply by whatever sums employee and employer have contributed throughout the employee's career, plus the investment return.

- Based on past experience, **the liability of a defined-benefit plan is unlikely to ever be funded.** To presume that there will be no unfunded benefit increases over the next 20-30 years is not only speculative but contrary to past experience. The state Legislature is likely to make further concessions to the unions regarding benefit increases. New employees, who contribute at the highest, post-1996 rate, may object to receiving the same benefits as those who contribute much less. Thus, their contribution rate might be lowered eventually. The House is currently considering legislation to do just that. Can we be sure that investment returns will be as steady as had been expected? Our current financial crisis indicates otherwise. Any early retirement programs will increase the unfunded liability. (The Worcester City Manager's current proposal for early retirement benefits for 100 employees is expected to increase the City's annual contribution to the Worcester Retirement System by \$1.6 million per year.) Any pension holiday, such as Governor Patrick has proposed in his "Municipal Partnership Act," will lead to an increase in the unfunded liability. What if, due to breakthroughs in medical science, the average life span increases further, as has been happening gradually over the past century? An increase of only one or two years could have a dramatic impact on the unfunded liability.

There is much uncertainty about the long-term costs of the current defined-benefit pension system. The best way to eliminate that uncertainty as well as provide more equity with private-sector taxpayers and eliminate the numerous opportunities for abuse, would be to close the system and enroll all new employees in a defined-contribution plan. This would be truly "meaningful pension reform."

Appendix A

Based on our research and discussions with pension experts, The Research Bureau offers the following recommendations for reforming the current public employee pension system:

The Worcester Retirement Board and City Manager adopt the City Auditor's plan of smoothing plus pushing back the amortization date to the latest allowable date under state law.

To reduce the impact of 2008's market losses on the FY10 budget, the state should grant the Home Rule petition sought by the Worcester City Manager to extend the funding schedule ten more years, to 2038. Many vital services stand to be cut if the WRS stays on its current funding schedule. Moreover, if some relief is inevitable, extending the funding schedule is preferable to the sort of pension holiday being proposed by the Governor in his Municipal Partnership Act. The Governor is proposing not only to ignore the experience of 2008 and the need to somehow compensate for recent losses, but to *reduce* the annual pension appropriation from that made in FY09, all the way up through FY12.

Compensating for market losses is painful, but responsible. A defined-benefit plan requires a government to bear the burdens associated with it, rather than pass them on to future taxpayers, as former generations did. The City Manager's proposal would provide a more systematic, honest way of addressing fund losses, and would transfer less of the cost to future taxpayers than the Governor's proposal would.

The state Legislature should make fitness standards for police and fire personnel a condition of continued employment, not just initial employment.

To be hired as a firefighter or police officer, a candidate must meet certain fitness standards. All applicants must pass a physical fitness test and go through pre-employment physical screening. However, once a candidate is hired, and throughout his career, he is not required to meet any fitness standards as a condition of continued employment. This should be changed: basic fitness standards (regular medical examinations and fitness tests, similar to what applicants undergo when seeking initial employment) should be implemented on a regular basis or at least at the time of promotion. Meeting these standards should not be another compensation "perk" or matter of voluntary compliance, but a *requirement* for continued employment. It can be expected that those police officers and firefighters who do maintain proper fitness so as to be prepared for the rigors of their job will support the introduction of regular fitness testing. Knowing that their peers are fit will prevent them from having to undertake excessive burdens themselves.

Past attempts at strengthening fitness standards in Massachusetts have been allowed to languish and voluntary programs, such as installing fitness equipment at firehouses, have

failed to curb high rates of accidental disabilities.⁴ The difficulty involved in instituting standards is that public employee unions view them as a change in the conditions of employment and therefore a matter for collective bargaining. What this means in effect is that fitness standards could only be instituted in exchange for a concession by the City regarding wages or benefits.⁵

In order to avoid the inevitable tradeoffs that would occur from bargaining collectively for fitness standards, there must be legislation at the state level. This also means there will have to be an appropriation at the state level, additional local aid to enforce these standards. Otherwise, the standards would be considered an unfunded mandate that would not be implemented, as has happened in the past.

The Research Bureau recognizes the difficulty involved in calling for increased local aid for fitness standards at a time of fiscal crisis. However, there are considerable savings to be gained in reducing the rate of accidental disabilities.

The foregoing recommendation is intended to address accidental disabilities which are not cases of outright abuse. However, the numerous journalistic accounts of accidental disability abuse indicate a need for closer scrutiny of all such claims. In order to prevent such abuse, or at least reign in the costs, the state should authorize the following:

The City should be made formal party to Retirement Board hearings.

Retirement Board hearings are currently conducted more like an investigation by an independent commission than a standard legal proceeding. The Retirement Board decides if a benefit is deserved based on the information at its disposal. Although the City ultimately bears the cost of all pensions granted, an especially high cost in the case of accidental disability, it possesses no formal right to contest the proceeding or even to express its position. With the exception of the Human Resources Department, which compiles and presents the petitioner's employment history (including medical records) to the Board, the City's role in Retirement Board hearings is very limited. Benefits hearings should be structured more like standard legal proceedings, where both parties involved (the individual petitioning for the retirement benefit, and the City, who will have to pay for it) possess a right to state their case in front of the neutral third party, the judge or jury, or in this case the Retirement Board.

⁴ A number of reports about the Boston Fire Department have recommended instituting fitness standards. See, most recently, "Boston Fire Department Independent Review Panel," November 30, 2007, p. 8-9, and "The Challenge: Managing Diversity, Tradition, and Change," Boston Fire Department Review Commission, January 2000, Section 6.6.4. See also Donovan Slack, "Studies of Boston Fire Department Going Unheeded," *Boston Globe*, October 22, 2007, http://www.boston.com/news/local/massachusetts/articles/2007/10/22/studies_of_fire_dept_going_unheeded/.

⁵ The issue is similar to the controversy surrounding instituting drug testing for Boston firefighters. See the Boston Municipal Research Bureau's "Time for Drug Testing for Firefighters," January 16, 2008, <http://www.bmr.org/content/upload/Fire081.pdf>.

The state should set employee contribution rates by group classification, not by date of hire.

The current system of employee contributions is the result of raising contribution rates over several decades among new employees in order to fund benefits promised to current retirees. The rates have no connection to an employee's specific job or to the value of the retirement benefits he will receive. A more rational arrangement would be to link employee contribution rates to group classification. This could apply only to new employees, since current employees' contribution rates are protected as part of an employees' constitutional right to contract.⁶

A similar recommendation was made in the 2006 "Report of the Blue Ribbon Panel on Massachusetts Public Employees' Pension Classification System," although this report did not specify, as The Research Bureau does, that this should mean higher employee contribution rates: "Earlier ages for full pensions should be reflected in higher contribution rates. An explicit decision should be made of how those higher contribution rates should be divided between employee and employer. Thus, employee contributions should no longer be based on date of hire as under current law (p. 3)." The employer contribution rates are already, in effect, determined by group classification, because group classification determines generosity of benefits. In a defined-benefit system for public employees, the employer contributes whatever costs are not covered by the employees' contributions. If two groups of employees contribute at the same rate but one group enjoys more generous benefits than the other, as is the case with Group 1 (most public employees) and Group 4 (public safety) employees, then the employer has to contribute more for one group than another.

As noted above, a main reason for the greater expense associated with police and fire retirees is the higher rates at which they retire on accidental disability pensions. Disability pensions for firefighters and police officers function like an insurance policy. Because these occupations are sometimes hazardous and physically demanding, provision must be made for the occurrence of job-related injuries. However, the entire pension system is designed like a health insurance policy: lower-risk employees subsidize higher-risk ones. In other words, police officers and firefighters pay the same "premium" of 9% plus 2% over \$30,000 as janitors, office workers, and city councilmen, despite the much higher rates of disability of public safety personnel. The disability system should resemble the auto insurance industry: higher risk drivers (teenagers, drivers with a bad record) pay higher premiums.

The state should maintain a separate, statewide retirement system for employees in hazardous occupations.

It is common practice in many other states to maintain separate systems for hazardous and non-hazardous occupations. This has the advantage of making transparent the greater costliness of retirement benefits for hazardous employees. In Massachusetts, the greater costliness of providing retirement benefits to police and fire personnel is in fact masked by their being, on both the municipal and state level, part of the same system as other

⁶ In 1973, the Massachusetts Supreme Judicial Court ruled that employee contribution rates could only be raised for new employees. (*Opinion of the Justices*, 364 Mass. 847 (1973).) See also Karen Steffen, "State Employee Pension Plans," *Pensions in the Public Sector*, pp. 41-65.

employees. Transferring all hazardous-occupation employees would not only make clearer the greater burden on taxpayer money for providing pensions to hazardous occupations employees, but might provide a disincentive to disability abuse. If new public safety employees have to pay higher rates which would increase with increases of the high number of accidental disability pensions, these employees might have the incentive to police one another to ensure that abuses were minimized.

The state should reform the cancer presumption law.

According to the International Association of Fire Fighters, 27 states have cancer presumption laws for firefighters.⁷ These laws come in two varieties: about half list specific cancers which, if they have been contracted, are presumed to be related to firefighting. The other half are non-specific, but presume any cancer is related to firefighting if an individual can show he has been exposed to a known carcinogen. Of the ones that do list specific cancers, not all include those listed in Massachusetts' law. Alaska, Arizona, Maryland, Virginia and Washington do not include liver cancer. Arizona, Virginia, and Maryland do not presume a correlation between kidney cancer and firefighting. And of course, the 23 states that don't have a cancer presumption law don't recognize any correlation. There is no reason why medical evidence should differ from one state to the next. An exhaustive review of the medical evidence linking firefighting and cancer should be done to examine the validity of this presumption. This law should be based on medical evidence, not politics.

A recent survey of 32 previous studies of the link between firefighting and certain types of cancer may be found in "Cancer risk among firefighters: a review and meta-analysis of 32 studies," published in the *Journal of Occupational and Environmental Medicine*.⁸ The results are included in **Table 10**. Based on the best evidence available to them, the researchers determined that only three types of cancer are "probably" linked to firefighting: multiple myeloma, non-Hodgkin's lymphoma, and prostate cancer.

If this is the case, then the Massachusetts law should be reformed so as to eliminate the presumption that the kinds of cancer that have no demonstrated link to the professional activities of firefighters are job-related.

⁷ <http://www.iaff.org/hs/phi/disease/cancer.asp>.

⁸ Grace K. LeMasters, et al., "Cancer risk among firefighters: a review and meta-analysis of 32 studies," *Journal of Occupational and Environmental Medicine*, 48.11, November 2006.

Table 10: Cancers in MGL ch. 32 s. 94B

Type of Cancer	Correlation with firefighting
Bladder	Unlikely
Brain and Other Nervous System	Possible
Colon & Rectum	Possible
Esophagus	Unlikely
Kidney	Unlikely
Larynx	Unlikely
Leukemia	Possible
Liver & Bile Duct	Unlikely
Lung	Unlikely
Melanoma of the Skin	Possible
Multiple Myeloma	Probable
Non-Hodgkin's Lymphoma	Probable
Oral Cavity and Pharynx	Possible
Pancreas	Unlikely
Prostate	Probable
Stomach	Possible

The state Legislature should amend Ch. 32 s. 3(8)(c).

There is no justification for “receiver” retirement systems in Massachusetts benefiting at the expense of “sender” systems like Worcester. Under current law, the costs of the pension is split between the two systems based on years of service and is calculated at the time of retirement. Instead, an assessment should be made at the time of transfer to determine the amount of retirement benefits the individual accrued in the first system. Assets equal to this amount could then be transferred to the receiver system, with no further liability to the sender retirement system. Moreover, the amendment to 3(8)(c) should apply retroactively: an assessment for all employees who have transferred should be performed, and all imbalances between sender and receiver systems immediately restored.

The process by which the state Legislature grants benefit increases should be more transparent and deliberate.

Other states, such as Georgia, have adopted “cooling-off” periods between proposing a retirement benefit increase and passing it. A similar measure adopted in Massachusetts would allow for PERAC to perform an actuarial study to precisely estimate the cost of the increase to the system before the Legislature votes it into law. It would also allow the Legislature time to identify a funding source to pay for the prospective increase. No new benefit increases should be granted without identifying a new funding source.

Another way of reforming the benefit-increase process would be to require any and all increases to be approved by popular referendum. In November 2008, Orange County, CA voters approved, by a 75% margin, “Measure J,” which will subject all prospective

pension increases for public employees to a popular vote.⁹ County supervisors will have to request the approval of voters in a referendum, after having presented them with an actuarial report of the expected increase in future costs. San Diego voters adopted popular approval for pension increases in 2006 and San Francisco has required popular approval for benefit increases for retirees for its entire history.

Adopting a similar process for benefit increases would bring absolute transparency and clarity as to who is paying for benefit increases.

Either of these measures, the “cooling off” period, or a referendum vote, would do much to prevent the Legislature from approving benefit increases just because there is a temporary surplus (not, of course, that that will be an issue anytime soon).

The Governor should appoint a blue-ribbon commission to draw up a plan for moving all or some Massachusetts retirement systems to a defined-contribution system.

The most fundamental reform to the Massachusetts public pension system would be to change the system from a defined-benefit to a defined-contribution system. The former Lieutenant Governor Kerry Healey, in her 2006 gubernatorial campaign, proposed such a change.¹⁰ Healey proposed closing all 106 retirement systems in the Commonwealth to new employees, and enrolling them into one large defined-contribution system. (The only exception was police and fire personnel, whose defined-benefit systems Healey proposed maintaining.) Michigan and Alaska, in 1997 and 2006, respectively, closed their defined-benefit plans to all new state employees, instead enrolling them in a defined-contribution plan. Eight other states (Washington, Vermont, North Dakota, Montana, Florida, South Carolina, Ohio, Colorado) offer employees the choice of enrolling in a defined-contribution plan or a traditional defined-benefit plan. And two states, Oregon and Indiana, enroll all new state employees into “combined” plans, where employees must participate in both a defined-contribution and defined-benefit plan.¹¹

⁹ Girard Miller, “A Cap on Pension Benefits,” *Governing*, November 19, 2008, <http://www.governing.com/articles/0811gmillerd.htm>.

¹⁰ “A Modern Touch for the Pension System,” *Boston Globe*, June 13, 2006, http://www.boston.com/news/globe/editorial_opinion/oped/articles/2006/06/13/a_modern_touch_for_the_pension_system/

¹¹ Alicia H. Munnell, et al., SLP #3, “Why Have Some States Introduced Defined Contribution Plans?,” CRRBC, January 2008, http://crr.bc.edu/images/stories/Briefs/slp_3b.pdf?phpMyAdmin=43ac483c4de9t51d9eb41.