INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS

Statement of

Harold A. Schaitberger
General President
International Association of Fire Fighters

Hearing on "Transparency and Funding of State and Local Pension Plans"

Before the

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Introduction

Chairman Boustany, Ranking Member Lewis, and all the distinguished members of the House Ways and Means Subcommittee on Oversight, I welcome the opportunity to provide this statement for today's hearing on "Transparency and Funding of State and Local Pension Plans." As the General President of the International Association of Fire Fighters (IAFF), I speak today on behalf of the nearly 300,000 men and women who risk their lives to provide fire rescue and emergency medical services protection to over 85 percent of our nation's population.

In addition to having the honor of representing these courageous Americans, I also speak as someone who has spent the better part of his professional life focusing on retirement security issues for first responders and other public employees. After serving as a Lieutenant in the Fairfax County Fire Department, I served as a public member of the County pension board. Upon my arrival in Washington, DC, I served as Counsel to both the National Conference on Public Employee Retirement Systems and the National Association of Government Deferred Compensation Administrators. And as President of the IAFF, I have greatly expanded our organization's emphasis on retirement issues, creating a new Pension Department. In total, I have spent four decades championing public pension transparency and accountability.

Fire fighters know firsthand the true meaning of the word "sacrifice." Indeed, we were again reminded of the ultimate sacrifice that 343 of our brothers made on September 11 when we learned of the demise of Osama Bin Laden. Although the death of this murderer can help bring closure to the surviving widows and children of the 9/11 victims, it gives me no great comfort to know that the next disaster, the next fire, the next attack, could force our brothers and sisters to once again make that ultimate sacrifice.

For the IAFF, shared sacrifice does not end there. Our members are sharing in the sacrifice that far too many Americans are making at their kitchen tables when confronted with difficult choices over their budgets. In state capitols and city halls all across our great country, our members are making voluntary budget concessions to help balance state and municipal budgets. We make these hard choices because we know that to fully recover from the worst recession since the Great Depression, all Americans must carry this great load. "A house divided cannot stand," said Lincoln, and as fire fighters, we know the wisdom of this phrase all too well.

But there are limits to what the IAFF can endure. When politicians attack our pension plans, they attack our pension safety-net, which has evolved to meet the specific needs of fire fighters. That is why this hearing and the underlying legislation, H.R. 567, the "Public Employee Pension Transparency Act," give the IAFF great alarm.

H.R. 567 should really be renamed the Public Employee Pension **Elimination** Act because that is what the bill will ultimately do. Reporting a pension's financial status based on the "riskless rate" would dramatically exaggerate the plan's unfunded liabilities. This would give the false impression that pension plans are going bankrupt and lead to calls to eliminate defined benefit pension plans altogether in favor of 401(k)-style defined contribution plans. In the end, fire fighters would be left without the critical safety-net that makes our current pension system irreplaceable.

Is There A Public Pension Crisis?

This distinguished subcommittee is not the first in the 112th Congress to explore the issue of public pension plans. Both the House Oversight and Government Reform Committee and the House Judiciary Committee have held hearings with prominent scholars that explored public pensions and their impact on state budgets. Most recently, the American Action Forum hosted a Capitol Hill briefing that explored the question, "Are Employee Pensions the Cause of the Financial Crisis in the States?" that featured prominent conservative scholars from the American Enterprise Institute, the Heartland Institute, and the Manhattan Institute.

At every instance, conservative and liberal scholars alike all agreed that public pensions are not to blame for the current fiscal crisis in the states. That's because only 3% of state expenditures are related to paying employee pensions. The budget deficits facing states throughout the nation are the result of decreased revenue and increases in spending on health care and education. Pensions have nothing to do with the shortfalls, and pension reforms will not solve the problem.

It is also misleading to say that public pension plans are in a liquidity crisis that requires immediate federal intervention, or worse, a bailout. The highly-respected Center for Retirement Research at Boston College issued a report in March 2011 that examined this issue. They concluded, "Most state and local plans had made great strides in improving their funding discipline and management in recent decades, so they had a relatively solid foundation in place before the two financial crises hit. For that reason, even after the worst market crash in decades, state and local plans do not face an immediate liquidity crisis."[1]

It cannot be stressed enough that the vast majority of public pension plans are on sound financial footing with an overall funded status of 77.4%.[2] While the downturn in the stock market has posed challenges, most plans will be able to recoup their losses. Those plans that need to make changes are already doing so. In the past few years, nearly two-thirds of states have made changes to benefit levels, contribution rate structures, or both; many local governments have made similar reforms.

It is true some public pensions, such as plans in Illinois and New Jersey, are seriously underfunded, but they are the exceptions, not the rule. The reason they are dangerously underfunded is because the state refused to make their required annual contributions during good times and now are paying the price. In no way should these few bad apples be considered the norm.

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[1] Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby. "Can State and Local Pensions Muddle Through?" Center for Retirement Research at Boston College, March 2011, 3.
[2] 2011 NCPERS Public Fund Study Preliminary Results, 2.

Of course, the tried and true does not make for good news. That's why titles like "The Public Pension Time Bomb" and the "Trillion Dollar Gap" make for good headlines. It's easy to examine public pension plans during the worst economic recession since the Great Depression and conclude that public pensions will need a federal bailout.

But that's like going to Texas, which is enduring a severe drought, and concluding that the state will soon become one giant desert. Such limited snapshots in time fail to incorporate decades of past performance and the historic circumstances of the present moment. Clearly, it will rain again in Texas, just as investment assets in public pension plans will rebound.

According to a recent survey by the National Conference on Public Employee Retirement Systems, investment returns (and not taxpayer dollars) constitute about 66 percent of fund revenue; the rest is made up by employee (10%) and employer (24%) contributions. As the markets improve, so too will the funding levels of public pension plans.

Given time, along with targeted reforms to benefit and contribution levels for plans requiring it, public pension plans will be able to pay their obligations. No plan is anticipating the need for a federal bailout, and the unprecedented federal intrusion into state and local governments that H.R. 567 embodies is simply unwarranted.

The Public Employee Pension <u>Elimination</u> Act

The IAFF is strongly opposed to H.R. 567. Contrary to what its supporters have said, the bill is not a benign attempt to shed sunlight on the books of public pension plans. If that were all it truly did, the IAFF would be ardent supporters. Fire fighters clearly benefit by having access to information about our pension plans, and the IAFF has been the nation's leading proponent of public pension transparency over the past several decades. These efforts have led to the reporting and disclosure requirements in place in every state that ensure that information about our pension funds is publicly and readily available.

Moreover, the Government Accounting Standards Board (GASB) is in the process of updating their new standards on how public pension plans report their finances. As you may know, GASB is a private, non-governmental organization that establishes accounting principles for State and local governments. While GASB's recommendations don't carry the force of law, the financial markets closely follow GASB and will penalize those plans that don't adhere to GASB's standards. The new rules GASB is expected to announce this year will be written by financial experts who are far better equipped than politicians to decide the most appropriate rates that plans should report. H.R. 567 would impose an unnecessary and duplicative reporting requirement.

H.R. 567, however, is not about providing better transparency. It's about providing bad numbers that will make public pensions look bankrupt. At its heart is an attempt to force public pension plans to value the discount rate at a "riskless" rate of return that would be equal to the Treasury bond rate of about 4%. The problem is the “riskless rate” isn’t grounded in reality. The simple fact is public pension plans don’t invest solely in Treasury bonds. They have a diversified portfolio of investments that include stocks and bonds that historically have produced a much higher rate of return than Treasury bonds.

Requiring reporting of the unfunded liabilities based on the riskless rate is simply a naked attempt to scare the public into believing that public pension plans are going bankrupt. The point is to create the political will to convert them into defined contribution plans to the benefit of Wall Street.

Overall, defined benefit plans are superior to defined contribution plans in many ways. Defined benefit plans have much greater return on investments than defined contribution plans and have lower administrative costs. Defined benefit plans also weather the ups and downs of the stock market better than defined contribution plans, and do not penalize workers who reach retirement age during a market downturn.

Fire fighters and their families would be especially hard hit if our defined benefit plans were dismantled. As a matter of public policy, state and local governments have determined to provide earlier retirement ages for public safety officers than other occupations. Many jurisdictions have mandatory retirement ages which require a person to leave their job at a certain age.

We have helped structure defined benefit pension plans that allow for the earlier retirement ages of fire fighters and law enforcement officers. Defined contribution plans, which are dependent solely on the amount of money contributed rather than a benefit formula, undermine the policy goal of having a younger, more physically fit, public safety workforce. We do not believe it is wise public policy to force a fire fighter to remain on the job after they are no longer capable of performing their duties solely because a market downturn robbed their DC plan of the funds they needed to retire.

Our DB plans also address the high rates of disability in public safety occupations. Working with our employers, we have designed our pensions to protect the retirement security of those who lose their ability to earn a living because they placed themselves in harm’s way to protect their neighbors. 401(k)-style defined contribution plans provide no such protections and jeopardize the financial security of those who serve in dangerous occupations.

Finally, I want to touch on the myth of the overly generous pension. While DB plans have proven to be essential for the retirement security for our members, their pensions are by no means lavish. While there have been a few widely reported cases of people unfairly gaming the system, the typical pension received by a fire fighter who works a full career is less than $35,000 a year. Moreover, most fire fighters are not covered by Social Security, so this modest benefit may be all they have to live on.

The image of lavish pensions being paid to retirees living high on the hog is both false and deeply offensive to the men and women who put their lives on the line to earn their retirement.

Conclusion

For several generations, defined benefit plans have provided the nation's fire fighters with a fair retirement in exchange for risking their lives to keep the public safe. Attempts to undermine these plans and force fire fighters into DC plans so that Wall Street can reap larger profits are unacceptable. For this reason, we strongly oppose HR 567.

But if you don't want to take my word for it, then I would implore you to heed the advice of a prominent conservative public policy advocate. Eli Lehrer, Vice President of the conservative Heartland Institute, recently wrote a defense of public pensions in the *Weekly Standard*. I will reserve the last word for Mr. Lehrer:

> Given that pension systems are not all that expensive, very difficult to change, and in better shape than some assume, there's a strong practical case for directing budget cutting attention elsewhere. State and local governments also have a strong comparative advantage relative to private industry in offering pension benefits: State governments never go out of business and can count on rising gross revenues so long as their populations grow … In principle, therefore, state governments are much better positioned to offer pensions than the typical private corporation and can offer them more cost effectively. Since many of the most common government jobs—firefighter, police officer, corrections officer, regulatory overseer—have no direct private sector analog, the lifetime-with-one employer career path scorned by many in the private sector makes a lot of sense for government employees.[3]

[3] Eli Lehrer, "Pensions Aren't the Problem," *The Weekly Standard*, March 28, 2011, http://www.weeklystandard.com/articles/pensions-aren-t-problem_554833.html