Oregon Public Employees Retirement System: The PERS Crisis & 2003 Legislative Reforms

Oregon Business Council
Prepared with data from ECONorthwest
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One of the most important contributions of the Oregon Business Plan was to help focus policy attention on Oregon's most serious fiscal challenge, PERS. After a decade of dithering, Governor Kulongoski and the Legislature made reform a top priority – and took extraordinary steps to address the challenge.

The success can partly be credited to a coalition of public employers groups and business associations standing together in favor of reform. But the greatest credit must go to the political leaders who stood up against scathing attacks from the public employees across the state.

The PERS Crisis

During the 2003 Legislature, OBC hired ECONorthwest to provide a long-term (25-year) cost analysis of the Oregon Public Employees Retirement System (PERS) and to review the cost of various proposals to fix PERS. ECONorthwest found:

1. If the PERS system remained unchanged, employer rates would average 24 percent of payroll over the next 25 years—a rate more than twice the historic average of 10.74 percent (Fig. 1). This does *not* include the additional 6 percent employee contribution picked up for most public employees.

2. If the PERS system remained unchanged, peak employer rates could approach 30 percent (Fig. 1), not including the member contribution "pick up."

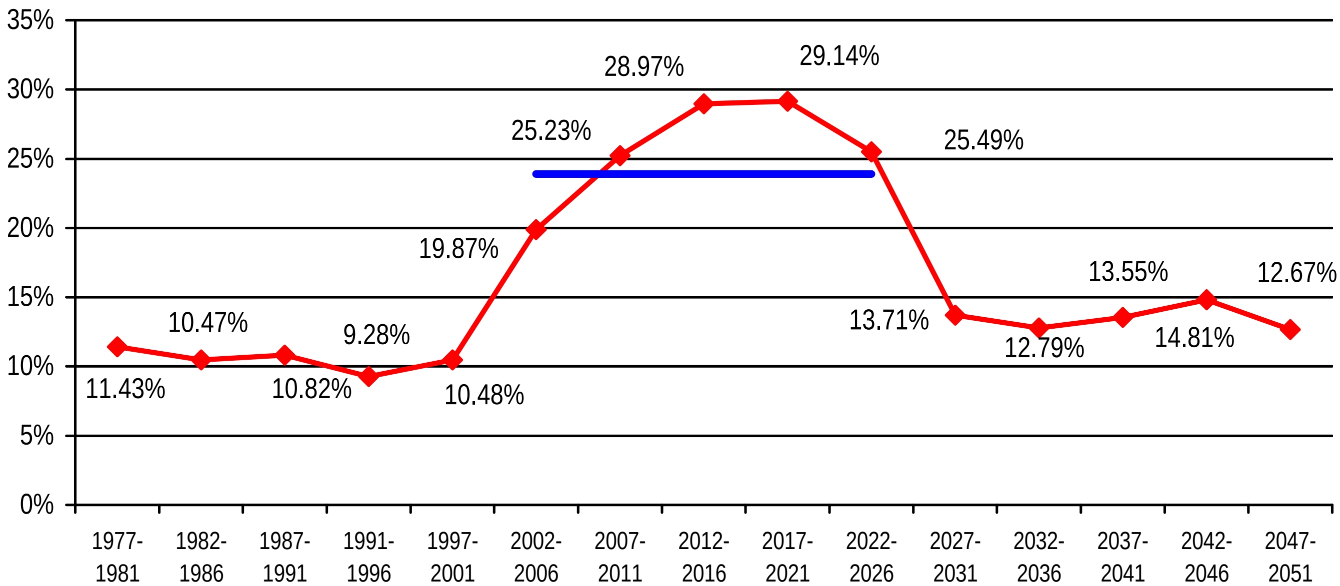

Figure 1 – PERS Employer Rates: Historic and Projected (Before 2003 Reforms)

3. Each percentage point increase in employer rates added roughly $60 million to the State's General Fund per biennium (and even more when other non-General Fund public services were included). For perspective, an additional 4 point increase in employer rates—which was the increase the Department of Administrative Services predicted for the 03-05 biennium—would have required $250 million in additional General Fund spending—two-thirds related to the State School Fund.

The ECONorthwest data was the only long-term (25-year) cost analysis of PERS conducted by any group that took into account stock market fluctuations each year—a technique known as "levelizing." In mid-April 2003, this data was provided to the House PERS Committee and Governor's office.

The Legislative Solution

A week after this data was provided, Governor Kulongoski proposed significant amendments to House Bill 2003 that ECONorthwest estimated would cut employer costs to less than 12 percent of payroll (levelized over 25 years—Figure 2).

Reform	Estimated Employer Rate
PERS System (before passage of HB 2003)	23.9%
No new members and Defined Benefit (8% normal cost)	23.2%
No new members and Defined Contribution (6% normal cost)	22.3%
HB 2003 (Before Governor's Amendments)	15.3%
Full formula only	13.8%
Plan Termination and DB (8% normal cost)	13.1%
HB 2003 (With Governor's Amendments)	Less than 12%
Plan Termination and DC (6% normal cost)	11.1%

Figure 2 – 25-Year Levelized Employer Rates Under the Policy Alternatives

With the Governor's amendments, HB 2003 passed both the House and Senate and was signed into law on May 9, 2003. Specifically HB 2003 will:

- Eliminate, going forward, the 6 percent annual employee contribution to member accounts. Instead the 6 percent employee contribution will be directed to a 401(k) plan. This slows the growth of existing member accounts, and over time, reduces the value of the Money Match option.

- Suspend the 8 percent earnings crediting for Tier 1 members while there is a Deficit Account balance. Tier 1 members still will be guaranteed the assumed rate—compounded over their term of service—upon retirement, but not during individual years. Crediting of between zero and the assumed rate also is allowed when crediting the full assumed rate would result in new deficits.

- Suspend cost of living (COLA) increases for retired members whose benefits are determined to be too high by the court (in the City of Eugene et a. v. State of Oregon). Increases will be suspended until they match what they should have been absent the over-crediting.

PERS Successor Plan

On August 26, 2003, the Legislature approved House Bill 2020, a PERS successor plan blending a traditional defined benefit plan with a 401(k)-style investment plan. Under HB 2020, all new public employees will earn a pension benefit equal to 45 percent of their final salary after working for 30 years. In addition, new hires will also get a 401(k)-style account funded by the 6 percent employee contribution (which is picked-up by most employers). The new law also increases the retirement age from 60 to 65 for general workers and from 55 to 60 for police and firemen.

PERS Governance Changes

On May 9, 2003, Governor Kulongoski signed House Bill 2005 into law. The bill immediately reduced the number of PERS board members from 12 to 5 and mandated that three of the members must be from the private sector (and *cannot* be PERS beneficiaries).

Total Savings of PERS Reforms

<u>Taken together, the PERS reform bill (HB 2003), the PERS successor plan (HB 2020), and the governance changes (HB 2005) are expected to cut at least $9 billion from the $17 billion unfunded liability—and possibly much more.</u>

The business community, public employers, and Oregon taxpayers will need to stay alert to PERS issues, and we will need to regroup entirely should the court throw out the reforms. Assuming the reforms stand, this is an item we check off as a huge success. It is very important that the business community recognizes the courageous work of our political leaders in making these changes. **Governor Kulongoski, Representative Tim Knopp, Representative Greg Macpherson, Senator Tony Corcoran, and all the Legislators who voted in favor of these reforms deserve enormous credit.**