Dave Adkisson
Kentucky Chamber of Commerce
Kentucky Public Pension Task Force Comments
August 21, 2012

- The Chamber has been talking about the state's pension problems since 2007, when we began highlighting Kentucky's growing public pension and health insurance costs.

- The problems of Kentucky's public pension system have been well documented by the Pew Center on the States and other researchers, which we have cited in our reports. We are very pleased that the Pew Center is working with the task force and are optimistic these experts can help the Task Force come up with meaningful recommendations.

- As you are aware, the Chamber has highlighted our public employee benefit problems in our Leaky Bucket reports on trends in state spending. We found the cost of public employee health insurance was growing faster than any area of the state budget—about five times faster than overall budget growth since 2000, and our pension system is among the most poorly funded in the country.

- Just last week, a presentation by the Director of Research of the Federal Reserve Bank of St. Louis identified Kentucky as having the largest combined debt burden (Pension, state and local debt) in the region, with combined debt obligations of 42.5% of our Gross State Product. In fact, he referred to Kentucky as the Greece of our surrounding states – a sobering reference to our state's debt obligations.

- You have invited us here today to discuss our recommendations for addressing Kentucky's pension problems, so we will not rehash information that has been previously presented by the experts working with the task force. Our recommendations and concerns are based on three key points:

    1. Kentucky's business community contributes about 40% of state revenue in income, corporate and sales taxes, and we are deeply concerned about the unsustainable trends in public employee benefits.
    2. Increased spending on benefits is taking needed funding away from education at all levels. This is particularly disturbing, as the Chamber believes that increasing education attainment is the key to growing our economy.
    3. While we are not pension experts, from our vantage point the benefits provided to public employees outpace those available in the private sector.

- We recognize and commend the General Assembly for taking action in 2008 to address state retirement benefits. But as the reports from the experts on the current condition of the system indicate, we believe more aggressive action is required.

Recommendations

Reduce Health Insurance Costs: Health insurance costs, which have increased about 200% since 2000, constitute just over half of the required pension contribution. As health benefits are set by the Personnel Cabinet each year, and are changed frequently, the state has significant latitude to control costs by adjusting benefits. Therefore, Kentucky can significantly lower its unfunded liability by meaningful changes to health benefits for active employees. While some progress has been made in slowing the growth in health insurance costs, and one-time federal funds were used to lower costs in the past fiscal year, we believe public health benefits are generally out of line with the private sector:

- The Kaiser Family Foundation reports that the average annual premium for employer-provided single health coverage in Kentucky is $4,683, with employers paying an average of 81% of premium costs.
- By comparison, the Kentucky Employee Health Plan reports that state government paid more than $7,000 per year for single coverage in 2011 or 91% of premium costs. This cost is 50% higher than in the private sector.

The Chamber remains concerned that these benefit levels are having a significant impact on Kentucky's unfunded pension liability and has advocated that state employees be required to pay at least $50 per month for health insurance benefits. We also recommend that more aggressive wellness activities be instituted for public employees. Participation in wellness programs is voluntary for Kentucky employees. (You might want to use the Chamber is an example of how private employers use wellness.) However, some states, such as Alabama, now require employees to pay more for health insurance unless they participate in health screenings and wellness programs. Actions to control health insurance costs will not only have a positive impact on the pension system, but it will also reduce costs for active employees as well.

Freeze COLA: KRS 61.691 (2) provides for a 1.5% annual cost of living increase for retirees, unless suspended by the legislature. The General Assembly has suspended this provision in the current budget. The Chamber recommends that no COLAs should be provided until the system is more adequately funded. It makes no sense to increase the costs to the system while it is underfunded. <u>If you're in a hole, stop digging.</u>

Defined Contribution Plan: The Chamber also recommends that new employees be placed in a defined contribution plan and use a portion of the employer share of the contribution to fund a bond issue to help finance the transition from the current defined benefit program. Defined contribution or 401k plans have been the standard in the private sector for some time now, as the older-style defined benefit plans have largely been phased out. We believe Kentucky should move toward a defined contribution plan for new hire and provide incentives for current employees to convert to the new plan as another way to limit the unfunded liability. We are not here as experts in crafting such a system, but believe the Pew Center could provide invaluable assistance in helping Kentucky create such a system.

Board Member Duties: We also believe the duties of the Board of Trustees of the Kentucky Retirement Systems, as set forth in KRS 61.650, should be amended to require the board to consider the impact on the state budget of any changes to retirement benefits they recommend or support. A board solely focused on increasing benefits to employees tends to function more as an advocate than as a steward of public funds. We do believe the board should be required to consider the public funds necessary to operate the retirement system.

Stop Double Dipping: Public employees should be prohibited from retiring and then returning to full-time work in a similar job at the same agency. The 2008 pension legislation does not allow employees returning to work after retirement to earn a second pension, but the employer still makes a contribution to the retirement system for them for the financial benefit of the system. Even more significant is the fact that the employee is now drawing two state checks—a paycheck and a pension check. If double dipping were not allowed, many employees would not retire in the first place and would save the retirement system the cost of the benefits they are now paying to people still working full-time for the state. This practice compounds our pension problems and is simply not allowed in the private sector. Employees who retire should stop working and only be allowed to return to work on a limited, consulting basis to take advantage of their expertise if needed temporarily.

Action is Needed Now: The nature of the pension system, in which costs are constantly accruing, requires that action be taken now to put the system on a sustainable track. Every year that passes without significant changes simply kicks the can down the road and increases the cost of any eventual solution. Failure to take action also continues the current spending trend of less funding for education and more for benefits—leading to lower investments in training and education that Kentuckians require to be competitive in our economy harder to afford. And in terms of state employees, failure to bring benefits in line will make it that much more difficult for the state to afford annual raises that have been suspended for a number of years.

The Kentucky Chamber stands ready to work with the Task Force and support meaningful changes to our pension system. We challenge you to be bold in your approach to solving this very difficult fiscal challenge and to offer specific recommendations for action in the 2013 General Assembly.