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PHILADELPHIA NEEDS TO REVISE ITS MUNICIPAL RETIREMENT PROGRAM

Recommendations for the
Mayor and the City Council
of the City of Philadelphia

Pennsylvania Economy League (Eastern Division)
Philadelphia, PA 19107
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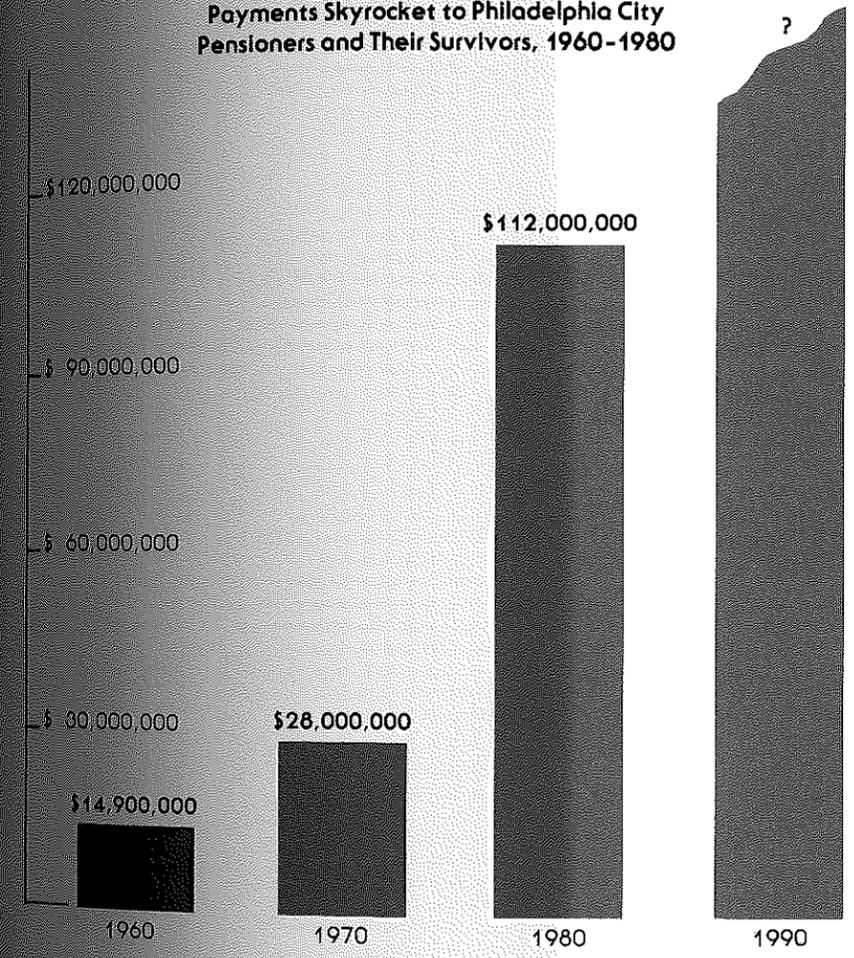
PHILADELPHIA NEEDS TO REVISE ITS MUNICIPAL RETIREMENT PROGRAM

Philadelphia's pension program is **out of hand**.
The following figures show the alarming growth of the city's annual benefit payments to pensioners and their survivors:

1960	\$ 14,900,000
1970	28,000,000
1980	112,000,000

If the current trend continues, the total in 1990 could be as much as \$200,000,000. Too much.

Payments Skyrocket to Philadelphia City Pensioners and Their Survivors, 1960-1980



The city's pension program is financed primarily from city taxes and supplemented by employee contributions, state subsidies and interest on assets. Look at how the tax bite has grown:

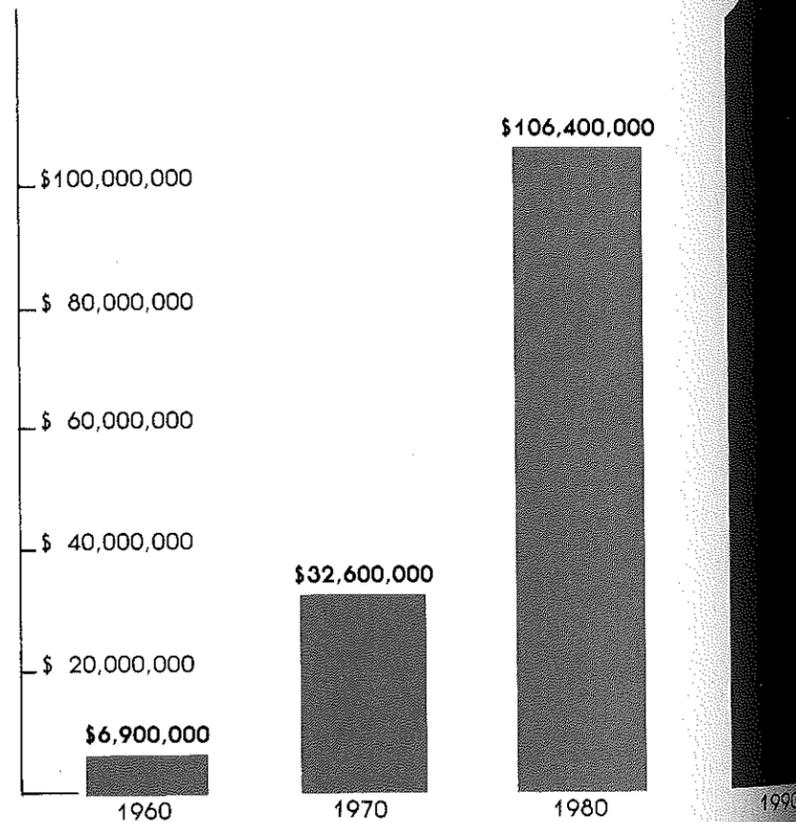
1960	\$ 6,900,000
1970	32,600,000
1980	106,400,000

The 1980 amount was equal to **one-half of the city's property taxes**.

The pension program, as specified in the retirement system ordinance, must be revised. It must be brought into line without taking benefits away from present employees and with fair treatment for the city's future employees and the taxpayers.

How was this situation allowed to develop and what, exactly, can be done about it?

City Taxes Skyrocket to Help Finance Philadelphia City Pensioners and Their Survivors, 1960-1980



HOW IT CAME ABOUT

Public officials are justifiably wary of proposals for expensive new programs. Such caution has been frequently missing, however, in the case of proposals to increase public employee pensions. This is, in part, because the government can put off the day of final reckoning—buy now, pay later.

Back in 1957, Philadelphia city government decided to tackle the emerging pension problem. With the help of the Pennsylvania Economy League, city officials developed new pension plans for new employees. All employees entering service after January 1, 1957, automatically came under these new pension provisions, which could be administered at reasonable cost to the taxpayers.

But the new plans were undermined by a series of ordinances that were enacted in subsequent years. In 1967, for example, retirement benefits were substantially increased. The result of that and similar increases is that the city's benefits are now among the most generous of the nation's **public and private** pension plans. And the cost to the city's taxpayers has increased accordingly.

The fiscal liability of these pension increases is reflected in the city's actuarial deficit. ("Actuarial deficit" is the difference between what the actuaries say the city **should have deposited** into the pension system and the amounts the city **actually has deposited**.)

In 1953, Philadelphia's actuarial deficit was \$240 million. **Today it is \$1.3 billion.**

This huge sum is no fiscal fantasy. It is a real debt that must be paid. It will not just go away. It is every bit as real as the \$503 million of city debt that must be paid from taxes; and it will have to be paid with interest.

BENEFITS

For pension plans, Philadelphia city employees are divided into two major categories: UNIFORMED employees of the Police and Fire Departments, including investigators; and all other employees, known as GENERAL employees. (Almost all general employees are covered by Social Security but uniformed employees are not.)

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There are three principal types of benefits:

- Service Pensions—payable after a member has reached a certain age;
- Disability Pensions—payable to disabled employees unable to perform their duties;
- Death Benefits—payable to employees' survivors.

Minimum retirement age for general employees is 55; for uniformed employees it is 45. No employees are required to retire at the minimum retirement age. Benefits are based on years of service and average compensation. If an employee does not retire at the minimum age, he/she continues to accumulate credits for additional years of employment until he/she reaches the maximum benefit.

The following compares the service pension benefits of the two groups.

Uniformed employees at retirement receive 2.5% of average final compensation for each year of credited service up to a maximum of 100% for 40 years of service. Average final compensation is defined in this case as the final rate of pay less longevity payments (bonus payments to employees with long service). There is also an alternative, which is based on the highest salary earned over an uninterrupted 12-month period and including longevity.

EXAMPLE: A uniformed employee is covered by Police Plan D or Plan X. His average final compensation is \$20,000 and he retires at age 55 after 35 years of service. His annual pension is \$17,500.

General employees at retirement receive 2.5% of average final compensation for each year of service up to and including 20 years. For this group average final compensation is defined as the average earned during three consecutive years of highest salary.

When a general employee retires after more than 20 years of service he receives payments equal to 50% of his average final compensation for the first 20 years and 2% for each year over 20. The maximum pension is 80% of final compensation after 35 years of service.

EXAMPLE: A general employee is covered by Municipal Plan J. His final compensation is \$20,000 and he retires at age 55 after 35 years of service. His annual pension is \$16,000.

It should be noted again that most general employees receive Social Security benefits in addition to their city pension.

EVEN MORE GENEROUS THAN PRIVATE PLANS

Pension plans in the private sector generally range from 1.5 to 2.0% of final pay for each year of service. This is misleading, however, since many private firms reduce benefits when the pensioner begins receiving Social Security payments. The reduction is usually half the Social Security benefit, reflecting the company's contribution to Social Security during the pensioner's work life.

When the benefit rate is adjusted to reflect this reduction, **the private rate falls to 1.0 to 1.1% of final pay for each year of service, or less than half of the city rate of 2.5%.**

Most private sector employees do not contribute to their pension plans; city employees pay dues of 3.75 to 6% of pay. But even considering employee dues, retirement benefits of city employees are much higher than those in private industry. What's more, most private sector pension plans do not allow full rate benefits until age 60 or higher, compared to age 45 to 55 in the city's plan.

While the pension benefits paid to police and firefighters in Philadelphia seem high in relation to the benefits of private industry, they are in line with police and firefighter pension benefits in other major cities, the higher rate reflecting the special responsibilities of those workers. Tailoring a new plan that is fair to police and firefighters and to the taxpayers, therefore, presents somewhat of a problem.

The pension benefits plan for general employees, however, presents no such problem because their responsibilities are similar to those of private industry employees; their pension benefits should also be similar.

The time to act is now. The longer the current benefits package continues to be committed to new employees, the deeper the fiscal hole becomes for the city.

Philadelphia must honor its commitments to present and retired employees, of course. But new employees should enter city service under a new pension plan—one more closely in line with the reasonable pension benefits paid in the private sector.

Simply adopting a new plan is not enough. There must also be proper and reliable safeguards so that this situation does not recur.

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WHAT SHOULD BE DONE

Pension reform must include a new plan for new city employees. Workers on the city payroll prior to the effective date of the new plan should have the option of continuing under the present program or of joining the new plan.

Recommendation: The city should enact a new pension plan for new employees.

* * *

Because of the basic differences between pension benefits and other forms of employee compensation, all proposed substantive changes in the city pension ordinance should be subject to voter approval. Unlike wages, for example, once increased pension benefits are approved they become vested and cannot be reduced by the city. Moreover, their true cost, even under sound financing, has a delayed impact on the city budget.

Recommendation: The Home Rule Charter should be amended to require that any changes in the Philadelphia pension ordinance be subject to voter approval

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In addition to bringing pension benefits into line, there must also be a provision for the financing of future benefits.

Recommendation: Voter approval of liberalized pension benefits for city employees should automatically be accompanied by a special tax to meet the increased costs.

FOR FURTHER READING

If this publication stirs your interest, here are some of our other publications on the subject.

See these issues of our newsletter, "Citizens' Business":

- 2,369 Extravagant Pensions Would Set Unfortunate Precedent
- 2,370 Philadelphia Service-connected Disability Benefits Are Overly Generous; Need to Be Revised Downward
- 2,372 Philadelphia City Government Spends More Than One-Third of Payroll for Employee Benefits
- 2,414 Charter Should Be Amended to Require Voter Approval of Proposed Changes in Philadelphia's Pension System
- 2,443 A Rueful Look at Philadelphia's Municipal Pensions, and a Few Proposed Remedial Steps
- 2,463 Excessive Pensions for Public Officials Would Set Costly Example
- 2,509 Costly Employee-benefits Package Burdens Philadelphia's City Budget

Economy League reports included the following (report number, title, and date of publication):

- E-361 Philadelphia Municipal Employee Benefits Compared with Employees of Private Companies in the Area (February 1972)
- E-362 Pension Primer for Philadelphians (October 1972)
- E-372 PEL Comments on Proposals of the Philadelphia Charter Revision Commission (February 1974)
- E-394 Philadelphia's Experience Under the Pennsylvania Police and Fire Arbitration Law (October 1977)
- E-414 Benefits of City of Philadelphia Employees Compared with Benefits in Private Industry (April 1980)

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Edwin Rothman
Director

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