House Legislative Analysis Section

Olds Plaza Building, 10th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

PSERS, SERS AMENDMENTS

House Bill 4938 as enrolled
Public Act 272 of 1994
Sponsor: Rep. Barbara Dobb

House Bill 4939 as enrolled
Public Act 273 of 1994
Sponsor: Rep. Kim Rhead

House Committee: Appropriations
Senate Committee: Appropriations

First Analysis (1-24-95)

THE APPARENT PROBLEM:

Efforts to balance the budget in recent years have taken many forms. At least two strategies have been used to ease budget difficulties related to the public school employees retirement system (PSERS) as well as the state employees retirement system (SERS).

One approach has dealt with a statutory requirement for an annual comparison and reconciliation of actual retirement system needs with budgeted amounts. The PSERS act requires retirement system officials to annually certify to the state superintendent of public instruction and the director of the Department of Management and Budget (DMB) the actual aggregate compensation paid to public school employees during the preceding fiscal year. It used to be that the executive budget for the following fiscal year had to contain an amount that adjusted the state contribution to the system to reconcile the estimated and actual aggregate compensation. Starting with fiscal year 1990-91, however, payments of the additional contributions were to be paid over five years, with interest. This approach, called "smoothing" the contributions, was adopted in the budgets for fiscal years 1990-91 and 1991-92, and was made a part of the PSERS act by Public Act 158 of 1992, and similar provisions were added last year to the SERS act. However, the legislature added a sunset clause to the five-year smoothing provisions in both acts so that it would have to revisit the issue annually before the end of each fiscal year.

A second, more controversial, approach also was made a part of the PSERS act by the 1992 amendatory language after having been effected through executive orders for preceding fiscal years. That approach changed the method of funding the costs of health benefits for retirees and their beneficiaries under the act. Prior to 1990, state contributions for health benefits were pre-funded as required by Public Act 91 of 1985, which expanded health benefits and replaced cash funding (that is, funding on a year-to-year basis) with prefunding (meaning, basically, that the benefits earned in a given year were to be funded for the future in that year). While prefunding costs less in the long run, it costs more in the short term; thus, budget negotiators and the legislature opted for a return to cash funding of PSERS health benefits, but, again, placed a September 30, 1994, sunset on the provision that needs to be extended if this funding method is to continue.

In a related matter, the question of who should be responsible for paying for PSERS members' retirement and Social Security benefits has been debated for some time. Even though the state historically has been able to cover these costs, this ability has been diminished in recent years due to chronic fiscal problems. Before the changes in the school aid distribution system prompted by the passage of Proposal A, local and intermediate school districts, and other PSERS member employers, contributed five percent of the aggregate annual compensation of their employees toward the costs of these benefits, while the state picked up the remainder (appropriated annually via the school aid fund). But after voters approved Proposal A by a wide margin last year, which among other things increased the per-pupil state aid that most school districts receive, some people feel the time has come to absolve the state of this financial burden. In fact, the new minimum per-pupil state aid grant amount for which school districts are eligible was formulated on the assumption that school districts would assume entire responsibility for paying the costs of Social Security and retirement benefits for PSERS members. With this in mind, legislation has been proposed that would shift responsibility for paying this obligation from the state to employers of PSERS members.

THE CONTENT OF THE BILLS:

House Bill 4938 would amend the Public School Employees Retirement Act (MCL 38.1341) to specify that, beginning with the 1994-95 fiscal year, an employer of PSERS members would be directly responsible for paying the employer's retirement and Social Security contributions for members. The bill also would extend the sunset on five-year "smoothing" provisions from September 30, 1994, to September 30, 1996; thus, local and intermediate school districts and other employers of PSERS members would have to pay (for purposes of reconciling differences between actual and budgeted amounts for retirement system needs) amounts still owed, including interest on the deferred amounts, over a five-year period rather than all in the first year. The bill's provisions would apply to all employers of qualifying PSERS "members" (generally, employees of public schools and certain state public universities as well as employees of certain public school academies--i.e., "charter schools"). However, the bill would exempt from membership in PSERS employees of a charter school operated by a state public university or a charter school corporation formed by a state public university which was not subject to the Optional Retirement Act.

The bill also would do the following:

* Replace a reference to the 1993-94 fiscal year with a reference to the 1994-95 fiscal year in the provision mandating cash funding (as opposed to prefunding) of retirees' health benefits.

* Relete all language that currently provides for state appropriations to be made annually (out of the school aid fund) to fund contributions to the PSERS retirement system and Social Security. Instead, the bill would require the official of each reporting unit to forward each month the entire employer contribution required to be paid to the retirement system. The bill also would delete language that requires higher education institutions with PSERS members to forward contributions to the retirement system on a quarterly basis.

* Revise the process in which reconciliation amounts for school districts are certified. (The bill would remove the superintendent of public instruction from the certification process, expand the role of the retirement board's executive secretary in the process, and require amounts to be certified to, and paid by, specific "reporting units"--that is, local and intermediate school districts and other employers of PSERS members--rather than to and by the state treasurer.)

* Delete obsolete language pertaining to retirement contributions paid by the Michigan High School Athletic Association and contributions for employees working on federally-funded programs.

House Bill 4939 would amend the State Employees Retirement Act (MCL 38.38) to provide for the contribution rate for dental and vision benefits to be computed using a cash disbursement method. Under the bill, unfunded actuarial accrued liability would be equal to the actuarial present value of benefits, excluding dental and vision benefits, reduced by the actuarial present value of future normal cost contributions and the actuarial value of assets on the valuation date.

The act currently requires, no later than 60 days after the end of a fiscal year, the Bureau of Retirement Systems to certify to the director of the Department of Management and Budget the actual aggregate compensation paid to active members during the preceding fiscal year. The bill, instead, would require the executive secretary of the retirement board to certify this information to the DMB director.

The bill also would postpone until September 30, 1995, the sunset for the five-year "smoothing" of annual adjustments in the state contributions to the retirement system. The act currently specifies a September 30, 1994, sunset date. (Under the act, an adjustment in the state contribution to the SERS due to any difference in the estimated and actual aggregate compensation must be included in the following year's executive budget; with five-year smoothing, the payments for additional contributions to the retirement system are spread out over a five-year period, with interest being paid on the deferred amounts.)

FISCAL IMPLICATIONS:

According to the Department of Management and Budget, extending the cash disbursement method of funding health insurance benefits for PSERS members (House Bill 4938) would save the school aid fund approximately $173 million in fiscal year 1994-95. Also, extending cash disbursement for SERS members dental/vision benefits (House Bill 4939) would save about $1.3 million in fiscal year 1994-95; extension of the "smoothing" provisions for reconciliation (both bills) would save about $12.4 million in fiscal year 1994-95. Under House Bill 4938, as the burden of paying the entire amount of retirement and Social Security costs would be transferred to employers of PSERS members (primarily, local and intermediate school districts), they would have additional costs related to funding these contributions. Costs to pay these obligations, however, would vary from district to district and could not be determined. (It should be noted that this additional cost for school districts was considered in calculating the new basic per pupil state aid grant that districts receive--which, for most districts, was increased--under school financing reform measures adopted last year.) (1-20-95)

ARGUMENTS:

For:

House Bill 4938 is essential to help balance the budget for the 1994-95 fiscal year. Without it, there would be a major "hole" in the school aid budget. While cash funding of PSERS health insurance may prompt complaints from some, the DMB has noted that the bill would be consistent with the state retirees' health plan, which has always been funded on a cash basis. Moreover, there are only seven states (including Michigan) that prefund retirees' health benefits. Cash funding for health benefits and five-year reconciliation smoothing have been in effect for several years, without adverse effect. The bill would have no effect on retirees' benefits; it merely would ease cash flow problems.

For:

House Bill 4939 is important to help balance the budget in fiscal year 1994-95. Without it, money would have to be found elsewhere to support the state employees retirement system, to the detriment of other important programs. Use of the dental-vision reserve fund and five-year reconciliation smoothing would have no effect on retirees' benefits; the strategies merely would ease cash flow problems.

Against:

The more the state uses cash funding now, the more expenses it will face in the long term. By setting aside a little now, rather than a lot later on, prefunding of health care benefits saves money in the end; cash funding means that the opportunity to offset costs with investment income is lost. (Unfortunately, rapidly escalating health care costs mean that the sum believed necessary to adequately prefund is more than the sum just to pay today's premium.) Future state costs also rise with interest payments on amounts deferred under five-year smoothing. In essence, the bill proposes to borrow from the future to solve the budget problems of today.

For:

Adoption last year of the school finance reform measure known as "Proposal A" moved the state from a K-12 funding system that relied heavily on local property values and the taxes generated from them, to a system whose funding derives primarily from the dedication of revenues generated from an increase in the state sales and use tax from four to six cents. Under the new system, the per-pupil state aid that school districts may receive was increased for all but the wealthiest districts. However, in agreeing to adjust upward the minimum amount of state aid school districts could receive, proponents of the measure argued that school districts should have to assume entire responsibility for the costs of contributing toward Social Security and retirement benefits of members of the Public School Employees Retirement System (PSERS). (Before Proposal A, employers of PSER members were required to pay only five percent of employee compensation toward these costs.) The basic per-pupil state aid grant under the new funding system, in fact, was derived partly from the assumption that school districts would pick up the entire cost of school employees' Social Security and retirement benefits. It is argued that by subsidizing this expense for school districts, the state unwittingly encourages the escalation of costs at the local level (for such things as employee salaries, benefits, and the like). If, on the other hand, school districts have to pay this expense themselves, they may be less likely to go along with demands from employees and their unions for annual salary increases which, in many cases, exceed the rate of inflation. By transferring this responsibility to employers of PSERS members, House Bill 4938 merely fulfills one aspect of the school finance measure.

Against:

Even though most school districts saw their per-pupil state aid grant increase under Proposal A, the funding increase was supposed to be used for "improving schools and the quality of education received by students." Transferring responsibility for paying such things as PSERS members' Social Security and retirement costs from the state to local school districts would merely require districts to spend the increase on purposes other than that for which it was intended. Further, the ranks of retiring school teachers are expected to grow significantly over the next decade or so, which will put even more strain on local school districts' budgets. And finally, the efficacy of the school finance reform measure depends largely on how strong Michigan's economy remains; due to its historical dependence on manufacturing and the auto industry, the state's economy no doubt will contract eventually, which will only force schools to cut their budgets further.