D.C. RETIREMENT SYSTEM—COPING WITH UNFUNDED LIABILITIES

HEARING

BEFORE THE

SUBCOMMITTEE ON THE CIVIL SERVICE

OF THE

COMMITTEE ON
GOVERNMENT REFORM
AND OVERSIGHT
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

APRIL 29, 1997

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D.C. RETIREMENT SYSTEM—COPING WITH UNFUNDED LIABILITIES

TUESDAY, APRIl 29, 1997

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE CIVIL SERVICE,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 2154, Rayburn House Office Building, Hon. John L. Mica (chairman of the subcommittee) presiding.

Present: Representatives Mica, Morella, Cummings, Norton, and Ford.

Staff present: George Nesterczuk, staff director; Caroline Fiel, clerk; Ned Lynch, professional staff member; and Cedric Hendricks, minority counsel.

Mr. MICA. Good afternoon. I would like to call this meeting of the House Civil Service Subcommittee to order.

Today the subcommittee will be holding a hearing on the D.C. retirement system. The title of it is, "Coping With Unfunded Liabilities." This hearing is at the request of one of our Members, the Delegate from the District of Columbia, Ms. Norton, and also due to my interest in this topic and the administration's proposal for making dramatic changes in the D.C. retirement system.

I would also like to announce, for those who were interested in the markup that was to take place immediately following this hearing, that the markup will be postponed, and hopefully we will have an opportunity to announce that it will be held at some near future date, but it will not be this afternoon.

I would like to start this afternoon's hearing on the D.C. retirement pension changes with my opening statement, then yield to our members.

Ladies and gentlemen, my colleagues, from the moment that I accepted responsibility as Chair of this subcommittee, I have always emphasized my concern and my commitment that we adequately fund retirement systems for our public employees, particularly our Federal employees.

Today's hearing will review the proposal by the administration to dramatically alter the District's employee pension fund. The proposal that has been made has been reviewed by several of our oversight agencies, and today we will have an opportunity for the subcommittee to understand the consequences of alternatives currently being considered.

For most of its employees, the District of Columbia provides a defined contribution retirement plan. With a defined contribution

plan, Government provides funds for future pensions from current expenses. Therefore, it has no unfunded future obligation, and pensions earned by today's employees are not vulnerable to future fiscal anxieties. More important, future taxpayers are protected from potential fiscal time bombs in their Governments' accounts.

Defined benefit retirement plans often promise more generous benefits but are rarely funded by dedicated revenues. Instead, future payments are promised from the "full faith and credit" of the Government that, in fact, owes the pensions.

As the Congressional Budget Office described this process in a March 27 memorandum, it is the equivalent of saving for your children's college education by sticking IOUs in a cookie jar. They used this analogy, and I will refer to it today. When the tuition comes due, somebody will have to redeem the IOUs.

Again today, CBO illustrates the problem very well: nonmarketable Treasury securities that make up the assets of Federal pension funds are nothing more, in fact, than IOUs. In CBO's words, and I quote, "Those Federal securities are merely the promise of the Federal Government to itself, the left pocket owes the right pocket, but the combined trouser assets are exactly zero." As CBO describes the results of this fiscal charade, "From the perspective of the Federal Government as a whole, none of the $1.5 trillion in promised annuities is funded." That's not what I said; that's what CBO said. "None of the $1.5 trillion in promised annuities is funded."

When Congress established home rule for the District, it selected a different option to fund the future benefits of its police, firefighters, and teachers. The District's Retirement Board manages investments that earn revenues rather than IOUs. These accounts now hold about $4.2 billion in real assets to provide for future pensions. Even with that investment success, the District's future obligations are still only 44 percent funded.

For fiscal year 1998, the cost of redeeming the IOUs in the District's "full faith and credit" cookie jar amounts to $307 million. The District, however, cannot easily raise taxes to fund this obligation. The District's need to borrow restricts its ability to provide current services and increases its need to tax current residents. The District's high tax rates tend to reduce its potential for attracting business, investments, and an expanded resident population.

Clearly, the District needs relief from this vicious fiscal cycle. The administration and the District government set an arbitrary target for an annual retirement payment of $60 million. Over the next 10 years, they also plan to spend more than $3 billion of the District retirement fund's assets to pay the benefits that the President has described as being assumed by the Federal Government.

This plan, unfortunately, has two major flaws: First, the plan allows the Federal Government to raid the hard assets of the District retirement fund. This provides the appearance of establishing a balanced budget or working toward a balanced budget, while the administration continues to increase domestic spending within the 5-year budget window that we've been talking about here.

Rather than reduce spending to pay for the District's recovery, the administration plans to raid the retirement fund of the District's police, firefighters, and teachers. This potential fiscal fiasco

will not erase these obligations. Instead, what will happen is, they will be transferred into the budgetary so-called "out years." In the year 2010, the assets raided from the District retirement fund will have been depleted. Tomorrow's taxpayers will be left holding the bag, a pretty sizable one, too.

With their real funds expended, District employees will join our current Federal employees and retirees in an annual raid on the U.S. Treasury just to survive. Unfortunately, there will be nothing but IOUs in the Federal cookie jar. Where the District's unfunded liability is a mere $4.8 billion—I say that "mere," because the Federal retirement system is now $540 billion—the unfunded liability that we are going to combine this with, is over a half trillion dollars.

Where the District each year must raise more than $300 million to fund its obligations, the Civil Service Retirement and Disability Fund needs to tap current taxpayers for about $30 billion to cover this year's shortfall. In this year's budget analysis provided by Chairman Kasich, I think we rank about third or fourth in obligations tapping the general treasury. I think first is Social Security and Medicare and Medicaid, and then this $30-billion shortfall to cover our Federal retirees' benefits.

Within 20 years, in 2016, the annual cost of paying for funds raided from the Federal cookie jar will exceed $100 billion. By 2041, OPM has forecasted that the annual shortfall for Federal pensions will amount to $221 billion that year.

With recurrent shortfalls facing future Congresses each year, pressures will inevitably increase to reduce the future benefits authorized by current law for present employees. Federal employees' pensions, therefore, will become more vulnerable in the future, unless we devise measures to fund them adequately, and fund the pensions for which Congress has made promises to our Federal employees.

The second major flaw in this proposal is that it would establish a precedent that would give deep concern to every Federal employee with a nickel in the Thrift Savings Plan. We saw last year, during the dispute over the extension of the debt ceiling, that the Treasury was willing to raid the G Fund to extend the Government's borrowing ability. Now the administration is willing to raid the District's retirement fund to meet short-term pension obligations.

If not rejected, this rationale might prove a precedent for future raids on the Thrift Savings Plan's stock or bond funds. We must establish firmly the principle that, when Federal retirement funds are set aside in trust, they are, in fact, off limits for any other purposes.

It is my hope today that we can accomplish two objectives in this hearing: First, I want everyone involved to leave this room with a clear understanding that the proposal that the administration has put on the table is an unacceptable solution for the future of the District and the future of taxpayers.

It's a bad deal for the police. It's a bad deal for the firefighters. It's a bad deal for the teachers and other employees, because it exceeds the fiscal capacity of the governments making the deal. Most of all, it is a future albatross that will only compound challenges

that future Congresses and the District of Columbia will face in attempting to redeem the IOUs in the empty Federal cookie jar.

Finally, I want everyone to recognize that we have reached the "out years" of earlier reforms. We are here. We do not need to add to the explosive power of the fiscal time bomb that has already been created. We do need to work together to develop a solution that will protect the hard assets of the District's retirement fund and begin to restore the retirement fund's assets for future retirees and current employees.

Those are my opening comments, and I yield now to the ranking member, the distinguished gentleman from Maryland, Mr. Cummings.

[The prepared statement of Hon. John L. Mica follows:]

DAN BURTON, INDIANA
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
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ONE HUNDRED FIFTH CONGRESS

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Opening Statement of the Honorable John L. Mica
Chairman, Civil Service Subcommittee
Unfunded Liabilities: Do They Really Matter?
Washington, DC
April 29, 1997

From the moment that I accepted responsibility as Chairman of this Subcommittee, I have emphasized my concern about adequately funding retirement systems for public employees. Today's hearing will review the proposal by the Administration to alter the District's employee pension fund. This will enable the Subcommittee to understand the consequences of the options currently on the table.

For most of its employees, the District of Columbia provides a defined contribution retirement plan. With a defined contribution plan, government provides funds for future pensions from current expenses. Therefore it has no unfunded future obligation, and pensions earned by today's employees are not vulnerable to future fiscal anxieties. More important, future taxpayers are protected from potential fiscal time bombs in their governments' accounts.

Defined benefit retirement plans often promise more generous benefits, but are rarely funded by dedicated revenues. Instead, future payments are promised from the "full faith and credit" of the government that owes the pensions. As the Congressional Budget Office described this process in a March 27 memorandum, it is the equivalent of saving for your children's college education by sticking IOUs in a cookie jar. When the tuition comes due, somebody will have to redeem the IOUs.

Again today, CBO illustrates the problem very well. The "nonmarketable Treasury securities" that make up the "assets" of federal pension funds are nothing more than IOUs. In CBO's words, " . . . those federal securities are merely the promise of the federal government to itself. The left pocket owes the right pocket, but the combined trouser assets are exactly zero." As CBO describes the results of this fiscal charade, "From the perspective of the federal government as a whole, none of the $1.5 trillion in promised annuities is funded."

When Congress established home rule for the District, it selected a different option to fund the future benefits of its police, firefighters, and teachers. The District's Retirement Board manages investments that earn revenues rather than IOUs. These accounts now hold about $4.2 billion in real assets to provide for future pensions.

Even with that investment success, the District's future obligations are only 44 percent funded. For FY-1998, the cost of redeeming the IOU's in the District's "full faith and credit" cookie jar amounts to $307 million. The District, however, cannot easily raise taxes to fund this obligation. The District's need to borrow restricts its ability to provide current services, and increases its need to tax current residents. The District's high tax rates tend to reduce its potential for attracting businesses, investments, and resident population. Clearly, the District needs relief from this vicious fiscal cycle.

The Administration and the District Government set an arbitrary target for an annual retirement payment of $60 million. Over the next ten years, they plan to spend more than $3 billion of the District retirement fund's assets to pay the benefits that the President has described as being assumed by the

federal government.

This plan has two major flaws. First, the plan allows the Federal government to raid the hard assets in the Retirement Fund. This provides the appearance of a balanced budget while the Administration continues to increase domestic spending within the five-year budget window. Rather than reduce spending to pay for the District's recovery, the Administration plans to raid the retirement funds of the District's police, fire fighters, and teachers.

This potential fiscal fiasco will not erase the obligations. Instead, they will be transferred into the budgetary "out years." In 2010, the assets raided from the D.C. Retirement Fund will have been depleted. Tomorrow's taxpayers will be left holding the bag.

With their real funds expended, District employees will join our current federal employees and retirees in an annual raid on the U.S. Treasury just to survive. Unfortunately, there is nothing but IOUs in the federal cookie jar. Where the District's unfunded liability is a mere $4.8 billion, the unfunded liability for federal pensions now exceeds $540 billion. Where the District each year must raise more than $300 million to fund its obligations, the Civil Service Retirement and Disability Fund needs to tap current taxpayers for about $30 billion to cover this year's shortfall. Within 20 years, in 2016, the annual cost of paying for funds raided from the federal cookie jar will exceed $100 billion. By 2041, OPM has forecast that the annual shortfall for federal pensions will amount to more than $221 billion.

With recurrent shortfalls facing future Congresses each year, pressures will inevitably increase to reduce the future benefits authorized by current law for present employees. Federal employees' pensions, therefore, will become more vulnerable in the future unless we devise measures to fund adequately the pension promises that Congress has made.

The second major flaw in this proposal is that it would establish a precedent that should give every federal employee with a nickel in the Thrift Savings Plan deep concern. We saw last year, during the dispute over the extension of the debt ceiling, that the Treasury was willing to raid the G-Fund to extend the government's borrowing ability. Now, the Administration is willing to raid the District Retirement Fund to meet short term pension obligations. If not rejected, this rationale might provide precedent for future raids on the TSP's stock or bond funds. We must establish firmly the principle that when retirement funds are set aside in trust, they are "off limits" for any other purposes.

It is my hope that today we can accomplish two objectives in this hearing.

First, I want everyone involved to leave this room with a clear understanding that the proposal that the Administration has put on the table is an unacceptable solution for the future of the District and for future taxpayers. It is a bad deal for the police, fire fighters and teachers because it exceeds the fiscal capacity of the governments making the deal. Most of all, it is a future albatross that will only compound challenges that future Congresses -- and the District of Columbia -- will face in attempting to redeem the IOUs in the empty federal cookie jar.

Second, I want everyone to recognize that we have reached the "out years" of earlier reforms. We do not need to add to the explosive power of the fiscal time bomb that has already been created. We do need to work together to develop a solution that will protect the hard assets of the District's Retirement Fund and begin to restore the retirement assets of our federal retirees and employees.

###

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. Chairman, the issue of how best to resolve the problems caused by the District of Columbia's unfunded pension liabilities for police, firefighters, teachers, and judges has been under the consideration of the District of Columbia Subcommittee for some time. I must say that I was surprised to see it come up on our agenda. I recognize, however, that your own interest in the Civil Service Retirement System's unfunded liability is what draws you to an examination of the District's situation.

Having said that, Mr. Chairman, my focus today will likely be the same as yours, to determine whether or not there are lessons to be learned from the District's experience that can guide the administration and perhaps the reform of our retirement system.

I must say, at the outset, that I see more differences than similarities, which leaves me uncertain as to just what this exercise will accomplish. Nonetheless, I look forward to the testimony of each of the scheduled witnesses and to whatever recommendations they care to make concerning the Civil Service Retirement System.

We currently have in place two retirement systems serving our workforce: the Civil Service Retirement System and the Federal Employees Retirement System. Both appear to be functioning just the way Congress intended. The unfunded liability that has been incurred was expected. Those who earn benefits can still reasonably expect to be paid them.

But we will hear from the Congressional Budget Office today that current Federal fiscal policies are creating some risks that our future pension benefit will not be paid in full. I believe that our pensions can be secured without necessarily imposing further cuts on Federal and Postal employees and retirees.

In contrast, the District's present pension system for police, firefighters, teachers, and judges is not secure, but this is not the District's fault. The system was designed not by the District but by the Congress, primarily to serve the Federal Government's own economic self-interest.

This system and a $2 billion unfunded liability were imposed on the District by the Congress in 1979. The District was not given the ability to control its growing costs, either by changing the funding formula or by reducing the generosity of benefits. This was surely a recipe for disaster. That is just what it has wrought.

Today, the District's initial unfunded pension liability has grown to nearly $5 billion due to the accrual of interest, which Federal law did not require to be paid. As a result, the District has made payments to the system's retirement fund far in excess of what it should have. Now, nearly an insolvent District lacks the capacity to further carry or pay off this liability. It should no longer be made to carry the burden of a debt of this magnitude which is not its own.

Our distinguished colleague, Congresswoman Norton, has introduced legislation addressing the problem of this unfunded pension liability during each of the past two Congresses. One of her bills received a hearing back in June 1994. While they have not received any further legislative action, these bills nonetheless have served to keep a sharp focus on the inequity of this situation.

Her efforts, no doubt, paved the way for the Clinton administration to come forward in January of this year with its own proposal to relieve the District of this obligation as part of its National Capital Revitalization and Self-Government Improvement Plan.

Mr. Chairman, I believe that what ought to be the subject of some immediate attention here on Capitol Hill is the relative merit of the Congresswoman's plan, the President's plan, or any other serious plan to address the District's unfunded pension liability. That undertaking, however, should be handled by the District of Columbia Subcommittee, with those of our members having time and expertise to contribute being free to do so.

Thank you very much.

Mr. MICA. Thank you.

I would like to recognize now the gentlelady from Maryland, Mrs. Morella.

Mrs. MORELLA. Thanks, Mr. Chairman.

Mr. Chairman, as a member of both this subcommittee and the Subcommittee on the District of Columbia, I am pleased to have this opportunity to explore ways in which to address the District of Columbia's growing unfunded liability for the pension plans for police, firefighters, teachers, and judges.

Congress first authorized funding for pension plans for police, firefighters, teachers, and judges during the early part of the century. At the time, the Federal Government instituted a pay-as-you-go method to fund D.C. pensions, failing to put aside enough money each year to make sure that funds would be available to meet future obligations. It is my understanding that, during these early years, the District made contributions to the Federal Government that went into the Federal Treasury and not into a separate fund.

In 1979, when the Congress passed the Home Rule Act, the total unfunded liability was $2.6 billion. Under this home rule legislation, the Federal Government assumed responsibility for only $646 million. The remainder of the unfunded liability, $2 billion, was transferred to the District of Columbia. Since home rule was established, the District has contributed far more than the normal costs of these plans, placing a tremendous burden on its operating budget.

In 1995, the District spent $291 million for retirement for police, firefighters, and teachers. In Baltimore, the retirement cost for these same employees was $85 million, $206 million less than in the District of Columbia. This year the District will pay $321 million, and in 2007, when the District will assume full responsibility for this unfunded pension liability, the city will be required to pay $640 million.

The unfunded pension liability of $2 billion in 1979 is now, in 1997, estimated to be $4.8 billion, and it threatens to grow to $6 billion by 2004. So unless we resolve this unfunded pension liability issue, the District will never achieve financial recovery and stability.

I firmly believe that we owe a pension system that does offer security and stability to our police, firefighters, teachers, and judges. So, Mr. Chairman, I look forward to hearing from our expert witnesses today, so that we can look to this challenge and arrive at a resolution that will be appropriate.

Thank you.

Mr. MICA. I thank the gentlelady and now recognize the gentlelady from the District, who has great interest in this topic. We appreciate her leadership, and we are also trying to honor her request to look into this matter.

Thank you. You are recognized.

Ms. NORTON. Thank you very much, Mr. Chairman.

May I thank you for your interest in the complicated District pension liability problem and for your generous courtesy in postponing this hearing when I had an unavoidable conflict.

Few would disagree with the claim that the most important part of the President's plan is the proposed pension relief. There are four reasons: First, the unfunded pension liability was a principal reason for the District's insolvency.

Second, this problem must be resolved before 2004, when the meager Federal contribution disappears and the District's annual outlay escalates to an amount that, in and of itself, would destroy the city.

Third, the unfunded pension liability is entirely congressionally accrued.

Fourth, the Congressional Budget Office has made a set of findings concerning serious additional harm to the District, directly traceable to the liability: that the unfunded liability reduces the District's bond rating, thus raising the city's borrowing cost; lowers property values; and requires the city to pay a premium to hire and retain employees.

At a time when there is rationing of resources and continuous cuts in vital services in the city, it is worth noting that the District has been overfunding these plans since they were turned over in 1979. These plans for firefighters, police, teachers, and judges were handed over to the District with an unfunded liability totaling approximately $2 billion. Today, almost entirely as a function of interest on the congressional liability amount, that liability has grown to over $5 billion.

Designing suitable pension relief that fits the District's needs, as well as Federal budget constraints, is unusually difficult. The major reason for the difficulty is not the drawing of the new pension plan itself. The primary reason this task is so hard lies with the congressional commitment to deficit reduction.

I do not envy Mr. Raines and Mr. DeSeve and other members of the administration as they tackle the thankless task of trying to eliminate billions of dollars of congressionally accumulated pension liability without adding to the deficit. Any awkwardness in the administration's proposal is due primarily to this problem.

Yet Chairman Mica has additional concerns. His concerns include what these pension programs would add to the Federal liability, although the District's liability, in this case is and always has been Federal liability. The chairman is also attracted to the investment strategy used by State and local pension boards and would like to retain it.

With difficult problems already on the table, however, the pension proposal is fraught with more hurdles than any other section of the bill. That is a dangerous posture for an indispensable provision. Yet I have no doubt that, if the deep problem-solving talent

of OMB and the committee is applied to this provision, we will be able to handle the complexity.

The administration has the special gratitude of the District for proposing to remove entirely this liability. I want to express my appreciation again to Chairman Mica for his attention to this issue. I welcome today's witnesses and look forward to their testimony.

Thank you again, Mr. Chairman.

[The prepared statement of Hon. Eleanor Holmes Norton follows:]

ELEANOR HOLMES NORTON
DISTRICT OF COLUMBIA

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE

SUBCOMMITTEES
PUBLIC BUILDINGS AND
ECONOMIC DEVELOPMENT
WATER RESOURCES AND
ENVIRONMENT

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON
GOVERNMENT REFORM AND
OVERSIGHT

SUBCOMMITTEE
RANKING MINORITY MEMBER,
DISTRICT OF COLUMBIA

STATEMENT OF CONGRESSWOMAN ELEANOR HOLMES NORTON ON THE CIVIL SERVICE SUBCOMMITTEE HEARING ON THE DISTRICT'S UNFUNDED PENSION LIABILITY

April 29, 1997

May I thank Chairman John Mica for his interest in the complicated District pension liability problem and for his generous courtesy in postponing this hearing when I had an unavoidable conflict.

Few would disagree with the claim that the most important part of the President's plan is the proposed pension relief. There are four major reasons. First, the unfunded pension liability was a principal reason for the District's insolvency. Second, this problem must be resolved before 2004 when the meager federal contribution disappears and the District's annual outlay escalates to an amount that in and of itself would destroy the city. Third, the unfunded pension liability is entirely congressionally accrued. Fourth, the Congressional Budget Office (CBO) has made a set of findings concerning serious additional harm to the District directly traceable to the liability -- that the unfunded liability reduces the District's bond rating thus raising the city's borrowing costs; lowers property values; and requires the city to pay a premium to hire and retain employees.

At a time when there is rationing of resources and continuous cuts in vital services in the city, it is worth noting that the District has been overfunding the plans since they were turned over in 1979. These plans for firefighters, police, teachers and judges were handed over to the District with unfunded liability totaling approximately $2 billion. Today, almost entirely as a function of interest on the congressional liability amount, that liability has grown to over $5 billion.

Designing suitable pension relief that fits the District's needs as well as federal budget constraints is unusually difficult. The major reason for the difficulty is not the drawing of the new pension plan itself. The primary reason this task is so hard lies with the congressional commitment to deficit reduction. I do not envy Mr. Raines and Mr. DeSeve and other members of the administration as they tackle the thankless task of trying to eliminate billions of dollars of congressionally accumulated pension liability without adding to the deficit. Any awkwardness in the administration proposal is due primarily to this problem.

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Yet, Chairman Mica has additional concerns. His concerns include what these pension programs would add to federal liability -- although the District's liability in this case is and always has been federal liability. The Chairman is also attracted to the investment strategy used by state and local pension boards and would like to retain it. With difficult problems already on the table, however, the pension proposal is fraught with more hurdles than any other section of the bill. That is a dangerous posture on an indispensable provision. Yet I have no doubt that if the deep problem-solving talent of OMB and the committee is applied to this provision, we will be able to handle the complexity.

The administration has the special gratitude of the District for proposing to remove this liability. I want to express my appreciation again to Chairman Mica for his attention to this issue. I welcome today's witnesses and look forward to their testimony.

Mr. MICA. I thank you.

I would now like to recognize our newest member of the panel, Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Let me thank Congresswoman Norton for her leadership on this issue, and the other committee members, and, of course, the panelists for being here today.

I don't really have a lengthy opening statement. It is really more of a comment and a question. I apologize, I have a group of students from my district here who have come up specifically to sing to their young Congressman on the other side of the Capitol steps, so I will have to leave early. I do hope you do excuse my having to leave early.

Although the focus of the hearing is on retirement, I think the ramifications of this issue have much broader ramifications, and perhaps repercussions, for all of the District residents. In human terms, as you all know, and all of us on this committee know, we are talking about hard-working police persons, firefighters, judges, and our hard-working teachers. But the District's ability to meet the most essential needs of its young people is also in jeopardy here, as well.

All of us probably saw this morning's paper, as it said 11 D.C. schools to be closed, 5 others spared. At least part of the reason these schools were forced to shut down is because the District does not have the financial resources necessary to keep them alive and well.

Addressing the issue of unfunded liabilities will not solve all of the District's financial woes, as I realize, but I cannot help but believe that, if the District had an additional $136 million in its budget, the amount of savings that would be generated by Congresswoman Norton's budget in the first year, at least some of these schools would have been able to remain open.

I guess what I would like the panel to address—and I look forward to reading or at least hearing some of the testimony—is that by confronting and resolving some of the issues related to unfunded liabilities, will this enable the District to better direct its limited resources toward some of the other pressing problems it faces, particularly schools and some of the public services?

Again, I thank the panelists, and I thank Congresswoman Norton for her leadership, and our chairman, as well.

Mr. MICA. Thank you, Mr. Ford.

We have completed our opening statements, and I would like to welcome our panel this afternoon. We have three witnesses: The first witness is Ed DeSeve, who is the Comptroller of the Office of Management and Budget; we have Anthony Williams, chief financial officer of the District of Columbia government; and James Blum, who is Deputy Director of the Congressional Budget Office.

Since this panel is investigation and oversight, and within the purview of Government Reform and Oversight, we do swear in our witnesses.

Gentlemen, if you would stand and raise your right hands.

[Witnesses sworn.]

Mr. MICA. Thank you.

I would like to welcome you. We will hear first from the Comptroller in the Office of Management and Budget, Mr. DeSeve.

You are recognized, sir.

If you would like to, as those of you who have been here before know, you can summarize. We like to have your statements limited to 5 minutes, and you are free to submit any additional testimony for the record.

Thank you.

STATEMENTS OF G. EDWARD DeSEVE, COMPTROLLER, OFFICE OF MANAGEMENT AND BUDGET; ANTHONY WILLIAMS, CHIEF FINANCIAL OFFICER, DISTRICT OF COLUMBIA GOVERNMENT; AND JAMES BLUM, DEPUTY DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. DESEVE. Thank you very much, Mr. Chairman, members of the committee, for the chance to discuss the President's plan to have the Federal Government assume the great majority of the estimated $8.5 billion of actuarial liability for the pension programs of the District's teachers, firefighters, police, and judges. This proposal is a key element of the President's plan to revitalize the District of Columbia and strengthen home rule.

I would like to begin by summarizing the National Capital Revitalization and Self-Government Improvement Plan. I will then touch upon what the pension proposal is intended to do and what the District will have to do to make the proposal work.

As Franklin D. Raines, the Director of the Office of Management and Budget, stated during his February 20th testimony before the District of Columbia Subcommittee, the current relationship between the District and the Federal Government is broken. Our Nation's Capital faces not only structural financial problems, but even serious obstacles to providing the most basic services to its residents.

The President has presented a plan to reorder that relationship, putting our capital city on firmer financial ground and improving home rule's prospects for success. The plan is not a panacea. The District government and financial authority will have to continue to do the hard work necessary to create a city where the streets are safe, where the children enjoy the quality education they deserve, where every resident has a chance to make the most of his or her own life, and where the city government spends within its means.

I want, parenthetically, to applaud the City Council today as they go through the very difficult budget negotiations to find the last $45 million in balance. It is a tough problem, and they are taking it on very, very responsibly, a year earlier than the Financial Responsibility Act would have required.

Through the plan, the Federal Government will assume a significant and growing share of the District's operating costs over the next 5 years, in the areas of Medicaid, prisons, and criminal justice. Beyond providing relief to the city's operating budget, the Federal Government will also invest heavily in the Nation's Capital over the next 5 years, in the areas of economic development, transportation, criminal justice improvement, and tax collection.

Why should the Federal Government assume the District's pension liability? In 1979, the District of Columbia Retirement Act required the District to assume liability for the pensions of teachers, police, firefighters, and judges. The act authorized a Federal payment to the District's retirement system of $52 million a year for 25 years, a stream of payment with a discounted present value of $646 million in 1979 dollars.

However, the act also transferred a $2.65-billion unfunded liability to the District retirement system. This left the District with more than $2 billion in anticipated future payments that were unfunded. From 1979 to the present, contributions by the District government and employees to the retirement system, along with earnings, have more than covered the cost of benefits paid out annually. But these payments have not stopped the unfunded liability from growing.

As of October 1, 1996, the District's actuary certified that the present value of future benefits for the retirement plan is $10.5 billion. The accrued actuarial liability sat at about $8.5 billion. While accumulated assets of the retirement plan are valued at $3.7 billion, the net unfunded liability has grown since 1979 to about $4.8 billion, net accrued unfunded liability. This obligation is the District's largest liability. Meeting this liability will consume an increasing share of the city's budget if the President's pension proposal is not enacted.

Beginning in fiscal year 1998, the Federal Government proposes to assume both financial and administrative responsibility for the major share of the benefits payable under the District's retirement program for police and fire and teachers. Because the President's plan will make the Federal Government responsible for financing but not administering the District's courts, the Federal Government will also assume all liabilities and benefits associated with the plan for judges.

Legislation will provide for transfer of assets and liabilities to the Federal Government. The Federal Government will be responsible for nearly all pension benefits accrued under the plan for all active and retired employees. Most of the assets of the retirement plan will be transferred to the Federal Government. The Federal Government will pledge its full faith and credit to meet its responsibilities to these beneficiaries. These assets will be used only to pay benefits to these beneficiaries.

The precise parameters of the assumption of liability and distribution of assets is still being discussed with the District financial authority and the District's pension board, based on figures generated by the District's actuaries.

The Federal Government will make full benefit payments to current retirees and beneficiaries, and it will pay the vast majority of benefits for current employees. Benefits payable to current employees will be "frozen," based on service earned as of the date the legislation is introduced. The Federal Government will pay retirement, death, and some of their disability benefits to the extent they are earned based on frozen service.

Active employees will be able to count on future service with the District toward vesting and eligibility for retirement benefits but not for the amount of the benefits, so that, as additional years of

service are earned, those will be under a new plan. Active employees, however, will get the benefit of subsequent pay increases and the cost that the Federal Government will be bearing.

The District government will agree to put in place a new retirement program for current active teachers, police, and firefighters for future benefits, as well as for employees hired after the date the current retirement programs are frozen. The District will also maintain responsibility for those employees, other than teachers, police, firefighters, and judges, hired after October 1, 1997.

The market value of the accumulated pension assets, as of October 1, 1996, was $3.75 billion. Most, if not all, of these assets will be transferred to the Federal Government. The Federal Government will appoint a third-party trustee to administer the plan and manage these assets, which will be liquidated as needed to make payments to beneficiaries.

Therefore, there will be no increase in Federal outlays until after the existing assets are exhausted, which is not estimated to occur until well into the next decade. A trustee will act as a fiduciary, because the Federal Government typically does not hold private assets to fund pension obligations that are its direct responsibility.

As with the other aspects of the President's plan, Federal assistance will be conditioned on the District's taking specific steps outlined in a Memorandum of Understanding between the District and the Federal Government.

Our engagement with the District's pension concern is nothing new. The administration has previously worked with D.C. stakeholders to consider various proposals, including the President's fiscal year 1997 budget proposal to provide an additional $52 million toward its unfunded liability and growing this stream in future years.

The administration has reviewed the proposal put forward by District Delegate Eleanor Holmes Norton. It has also assessed the recommendations of the D.C. Appleseed Foundation to have the Federal Government assume the assets and liabilities associated with the pension system.

As with other elements of the President's plan, we are working with the District government, the financial authority, and Congress to use common actuarial and budget numbers, based on an analysis by the District actuary, to finalize cost savings, liability, and cash-flow associated with the pension proposal. We will be happy to share these final figures and resulting analysis with the committee, as we have done in the past, as they become available.

That concludes my testimony, Mr. Chairman. Thank you very much.

[The prepared statement of Mr. DeSeve follows:]

TESTIMONY OF THE HON. G. EDWARD DESEVE
CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET

ON THE PRESIDENT'S PROPOSAL FOR CHANGES IN
THE RETIREMENT PROGRAM OF THE DISTRICT OF COLUMBIA

4. 29. 1997

Introduction.

Mr. Chairman and Members of the Committee, thank you for the chance to discuss the President's plan to have the Federal government assume the great majority of the estimated $8.5 billion of actuarial liability for the pension programs of the District's teachers, firefighters and police, and judges. This proposal is a key element of the President's plan to revitalize the District of Columbia and strengthen Home Rule.

I would like to begin by summarizing the President's *National Capital Revitalization and Self-Government Improvement Plan*. I will then touch upon what the pension proposal is intended to do and what the District will have to do to make the proposal work. After I conclude my remarks, I would be happy to take any questions that you have.

Overview of the President's Plan.

As Franklin D. Raines, the Director of the Office of Management and Budget, stated during his February 20th testimony before the District of Columbia Subcommittee, the current relationship between the District and Federal governments is broken. Our Nation's capital faces not only structural financial problems, but even serious obstacles to providing the most basic services to its residents. The President has presented a Plan to re-order that relationship, putting our capital city on firmer financial ground and improving Home Rule's prospects for success.

The Plan is not a panacea. The District government and Financial Authority will have to continue to do the hard work necessary to create a City where the streets are safe, where children enjoy the quality education they deserve, where every resident has the chance to make the most of his or her own life -- and where the City government spends within its means.

Through the Plan, the Federal government will assume a significant and growing share of the District's operating costs over the next five years in

the areas of Medicaid, pensions, and criminal justice.

Beyond providing relief to the City's operating budget, the Federal government will also invest heavily in the Nation's Capital over the next five years in the areas of economic development, transportation, criminal justice improvements, and tax collection.

Why the Federal Government Should Assume the District's Pension Liability.

The 1979 District of Columbia Retirement Act required the District to assume liability for the pensions of teachers, police and firefighters, and judges. The Act authorized a Federal payment to the District's retirement system of $52 million a year for 25 years -- a stream of payments with a discounted present value of $646 million in 1979 dollars. However, the Act also transferred a $2.65 billion unfunded liability to the District retirement system. Less the Federal share of $646 million, the District was left having to shoulder a present value of $2 billion more in anticipated payments than scheduled future payments, earnings, and assets would cover.

From 1979 to the present, contributions by the District government and employees to the retirement system, along with earnings, have more than covered the costs of the benefits paid out annually. But these payments have not stopped the unfunded liability from growing.

As of October 1st, 1996, the District's Actuary certified that the present value of future benefits for the retirement plans is $10.5 billion. The accrued actuarial liability sits at about $8.5 billion. And while accumulated assets of the retirement program are valued at over $3.7 billion, the net unfunded liability has more than doubled since 1979, growing to about $4.8 billion. This obligation is the District's largest liability. Meeting this liability will consume an increasing share of the City's budget if the President's pension proposal is not enacted.

What the President's Pension Proposal will Do.

Beginning in FY1998, the Federal government will assume both financial and administrative responsibility for a major share of the benefits payable under the District's retirement programs for police and firefighters, and teachers. Because the President's plan will make the

Federal government responsible for financing -- but not administering -- the District's courts, the Federal government will assume *all* liabilities and benefits associated with judges.

Legislation will provide for the transfer of assets and liabilities to the Federal government. The Federal government will be responsible for nearly all pension benefits accrued under the plans for all active and retired employees. Most assets of the retirement plans will be transferred to the Federal government. The Federal government will pledge its full faith and credit to meet its responsibilities to these beneficiaries. The precise parameters of the assumption of liability and distribution of assets is still being discussed with the District and the Financial Authority, based on figures generated by the District's actuaries.

Coverage. The Federal government will make full benefit payments to current retirees and beneficiaries, and it will pay the vast majority of benefits of current employees. Benefits payable to current employees will be "frozen" based on service earned as of the date the legislation is introduced. The Federal government will pay future retirement, death and some of their disability benefits to the extent they are earned based on

the frozen service. Active employees will be able to count future service with the District toward vesting and eligibility for retirement benefits, but not for the amount of the benefits. However, active employees will get the benefit of subsequent pay increases on the frozen benefits.

The District government will agree to put new retirement programs in place for currently active teachers, police and firefighters for future benefits, as well as for employees hired after the date the current retirement programs are "frozen."

Employees hired after the freeze date will belong to new District plans, not to the plans taken over by the Federal government. Both the plan for new hires and the plan for active employees will be fully funded. Employee contributions will be paid into the District, not Federal, plans.

The District will also maintain responsibility for those employees -- other than teachers, police & firefighters, and judges -- hired after October 1, 1987. (These employees are covered by Social Security and a defined contribution plan.) In addition, D.C. will continue to pay a share of the costs for the remaining 15,000+ employees hired before October 1, 1987,

who are covered by the Federal Civil Service Retirement System.

Transfer and Management of the Assets. The market value of the accumulated pension assets, as of October 1, 1996, was $3.75 billion. Most, if not all, of these assets will be transferred to the Federal government. The Federal government will appoint a third-party Trustee to administer the plan and manage these assets, which will be liquidated as needed and used to make payments to beneficiaries. Therefore, there will be no increase in Federal outlays until after the existing assets are exhausted, which is not estimated to occur until well into the next decade. A Trustee will act as Fiduciary because the Federal government typically does not hold private assets to fund pension obligations that are its direct responsibility.

Conditions.

As with the other elements of the President's Plan, Federal assistance will be conditioned on the District taking specific steps outlined in a Memorandum of Understanding between the District and Federal governments and D.C. Financial Responsibility and Management Assistance

Authority. These include the establishment of replacement retirement plans; the transfer of copies of all books and records to the Federal government or its Trustee; and that the costs of replacement plans not exceed those approved in the District of Columbia Budget and Financial Plan.

How the Proposal has been Developed.

Our engagement with the District's pension concerns is nothing new. The Administration has previously worked with D.C. stakeholders to consider various proposals regarding the City's pension system. The President's FY1997 Budget proposed to provide the District an additional $52 million toward its unfunded pension liability in 1997, and a growing stream of payments in subsequent years (with a present value of about $3 billion) -- a proposal that was not enacted into law.

The Administration has reviewed the proposal put forward by District Delegate Eleanor Holmes Norton. It has also assessed the recommendations of D.C. Appleseed to have the Federal government assume the assets and liabilities associated with the pension systems of

teachers, police and firefighters, and judges.

As with the other elements of the President's Plan, we are working with the District government and Financial Authority to use common actuarial and budget numbers -- based on analysis by the D.C. Actuary -- to finalize costs, savings, liability, and cash flows associated with the pension proposal. We will be happy to share these final figures and resulting analysis with the Committee when that becomes available.

This concludes my testimony, Mr. Chairman, and I will be glad to answer any questions that you might have.

Mr. MICA. Thank you. We will reserve questions until we finish all the panelists.

I next recognize Mr. Anthony Williams, the chief financial officer of the District of Columbia.

Welcome. You are recognized, sir.

Mr. WILLIAMS. Mr. Chairman and members of the committee, thank you for the opportunity to testify on the President's plan for addressing the District's retirement dilemma, as part of its overall economic recovery. I applaud you, Mr. Chairman, for your interest in this matter, and, of course, Mrs. Norton, for her longstanding interest in addressing this important issue.

I think all of the different plans before us and all the discussion about the District's financial recovery have focused on three essential components: Obviously, one component, improving management and bringing cost efficiencies to the District; a second component, improving our economy and needed revenue; and a third component, bringing needed investment, and that needed investment in the form of the Federal Government stepping forward and playing its proper role in the District's opportunity and destiny.

I mention these three components because the President's plan, we believe, in addressing the retirement problem, this unfunded liability, is essential for us proceeding through this recovery. Without this plan—I've likened it, to basically turning the lights off on the Titanic to achieve better energy efficiency, when we still know, without addressing this unfunded liability, we're going to hit this iceberg. This is a major issue before us, and I applaud the President for his commitment to solving it.

Just some of the impacts, Mr. Chairman, very, very briefly. I think Congresswoman Morella mentioned the impact on our credit rating, and this is, I think, a big factor. Over the years, if you talk to the rating agencies, you talk to the investment bankers, an overall cloud over our opportunities in the public financial markets has been this unfunded liability.

We have, above and beyond that, the contributions we have made in excess of the full, normal costs that we are paying into this plan. All these contributions are made out of our cash resources available to us, and I can tell you that, as we operate day-by-day, this is a major burden.

Finally, there is the aspect—the President's plan addresses this in terms of investment for economic recovery and the Economic Development Corporation, a number of plans have addressed this in terms of tax incentives, all this to bring much needed investment into the District. I think there have been a number of studies.

There has been a range of discussion about the reluctance of investors to come to the District when there is this overarching cloud over our ability to meet our obligations and to make needed investments in public safety, streets, and other improvements in the future, when we know that, in the year 2005, essentially, our obligations year by year are going to double.

So, for all those reasons, I applaud the commitment of the President in shouldering the burden and addressing our unfunded pension liability. I, as others, would point out that the plan is not a perfect plan, but I think, for just those reasons—the plan bumps up against these issues over the kind of retirement system the Fed-

eral Government wants to have—I think, for just these reasons, I have reason to applaud the ingenuity of the OMB and the President in crafting it in a very, very difficult operating environment.

I guess what I'm saying, Mr. Chairman, is that an imperfect environment will often result in imperfect results. But however imperfect those results, I applaud those results and look forward to working with the OMB and the Congress as we fashion an ultimate plan for the District's recovery.

I thank you.

[The prepared statement of Mr. Williams follows:]

Good afternoon Chairman Mica and members of the Civil Service Subcommittee. Thank you for inviting me to appear before you to comment on the District of Columbia's unfunded pension liability. After my initial remarks, I will be happy to answer any questions you have.

First, let me say that I am pleased that the Subcommittee has chosen to examine the origin and impact of the District's unfunded pension liability. This is an extraordinary moment in the history of the District – a time when many people say that something must be done to alleviate the financial constraints under which the District operates and move the District toward long-term financial stability. Nothing constrains the District's finances or threatens its financial stability more than its massive unfunded pension liability.

Origin of the District's Unfunded Pension Liability

The origin of the District's unfunded pension liability lies in the transfer of certain pension plans from the Federal Government to the District Government with the advent of Home Rule.

Congress created pension plans for District police officers and firefighters in 1916, for teachers in 1920, and for judges in 1970. Through the years, the District Government and the plans' participants contributed to the plans. These contributions were deposited into the general fund of the U.S. Treasury, and applied toward the Federal Government's general operating expenses. The Federal Government had immediate, unrestricted use of plan contributions, promising to pay retirement benefits to plan participants when they retired. The Federal Government financed the plans on a pay-as-you-go basis: annual appropriations equaled annual retirement benefits, and no assets were accumulated to fund future plan payouts.

In 1975, under the District's Home Rule Charter, Congress transferred its pension responsibilities and liabilities for the District's police, firefighters, teachers and judges to the District Government. The retirement benefits that employees had accrued before the transfer had a then present value of $2.7 billion. In 1979, under the D.C. Retirement Reform Act, the Federal Government committed to pay toward the pension liability a stream of payments which had a then present value of $646 million. Thus, the District was confronted with more than $2 billion in original unfunded pension liability.

This $2 billion liability is a retrospective estimate, using sound actuarial assumptions, of the amount of assets that should have been transferred to the plans in 1979 to ensure that the plans could produce sufficient income to pay projected future retirement benefits. Because the $2 billion was not provided in 1979, the associated investment income has been foregone. This lost investment income, often referred to as "interest on the unfunded liability," increases yearly, adding to the unfunded liability. Even though the District Government and plan participants have made substantial contributions to the retirement

plans, the unfunded liability has grown to $5 billion—an amount which exceeds the District's annual general fund budget.

It is important to note that the District has fully funded all benefits earned by plan participants since the 1979 transfer of liability. The unfunded pension liability facing the District today is attributable solely to the original liability of $2 billion plus accumulated interest.

In fact, the District's required payments into the Retirement Fund have been greater than the normal cost of the pension plans. The excess payments, which total $1.8 billion, have reduced the rate of growth in the inherited unfunded pension liability. If not for the District's contributions, the unfunded pension liability would be even larger than it is today.

Prospects for the District's Unfunded Pension Liability

The unfunded liability is projected to grow to more than $6 billion by the year 2004. Beginning in 2005, the D.C. Retirement Reform Act requires the District to pay, each year, the net normal cost of the additional benefits accrued and to begin paying interest on the unfunded liability. For FY 2005 this payment is projected at $640 million, which is double the District's FY 1997 payment of $321 million.

Financial Impact of the District's Unfunded Pension Liability

The unfunded pension liability imposes a heavy financial burden on the District. The most serious impact is on the District's financial stability.

Payments to the pension plans required by the D.C. Retirement Reform Act constitute an increasing share of the District's expenditures. The payments absorb funding which could be used to eliminate the operating deficit and pay for capital improvements or other vital programs. Because the District's pension payments are in cash, they exacerbate the District's already significant cash flow difficulties.

For FY 1997, the required District payment to the pension plans is $321 million. The payment formula for FY 2005 and beyond is even more onerous. The projected growth in the District's pension payments far exceeds the projected growth in the District's revenues. For example, the required pension payment is expected to double by 2005, while District revenues are projected to grow by only 13%. It is unlikely that the District will be able to afford the future annual payments.

While the unfunded liability does not count directly against the District's debt ceiling, the bond rating analysts and the investment community give it serious consideration in assessing the District's financial health. They are concerned about the District's capacity to afford the pension liability along with the District's future borrowing needs and fixed costs.

An unfunded pension liability is a red flag in any municipal credit analysis. The magnitude of the District's unfunded pension liability creates downward pressure on the District's credit rating, and inhibits the chances for a ratings upgrade. As a contributing factor in the District's below-investment-grade bond rating, the unfunded pension liability increases the likelihood that the District will have only limited access to external capital, and raises the cost of funds when borrowings are undertaken. By limiting the District's ability to borrow, the unfunded pension liability reduces the options available to the District in managing its cash flow, addressing its accumulated deficit, and otherwise working to resolve its financial crisis.

Credit analysts view the pension obligation as an ongoing, contractually-required operating cost. The credit markets are particularly concerned about the severe pension funding requirements that apply in the year 2005 and beyond. Revenues in these years which would otherwise be available to fund normal operating and capital expenditures are seen as being earmarked for pension payments. As such, the unfunded pension obligation imperils the District's financial viability and its future capacity to deliver services.

The credit markets will continue to penalize the District as long as the problem of the unfunded pension liability remains unresolved.

Human Dimension of the District's Unfunded Pension Liability

The District's unfunded pension liability exacts a human cost not apparent in the District's financial statements or credit ratings.

By calling into question the retirement benefits that plan participants counted on when they made their employee contributions, the unfunded liability clouds the retirement future of thousands of current and former District employees. While they have legal and contractual rights, participants can take little comfort in knowing that their claims are against the District--an entity that may not have the means to pay them.

The unfunded pension liability serves to restrict employment opportunities for District residents. Among the factors that corporations review when deciding where to expand or relocate their operations is the financial health of the various localities under consideration. Other things being equal, corporations want to do business in locations where municipal finances are sound and municipal services are assured. To the extent that the unfunded pension liability threatens the District Government's financial health, it helps dissuade businesses from expanding or relocating to the District. The human impact is felt in forfeited employment opportunities for District residents, and in diminished hopes for a better future.

Conclusion

While the unfunded pension liability has not caused the District's financial crisis, it has exacerbated it. The financial burden it imposes is heavy, and its growing impact has the potential to offset the gains I and my staff are working toward in the areas of financial efficiency and budgetary balance.

The President's National Capital Revitalization and Self-Government Improvement Plan recognizes that resolving the problem of the unfunded pension liability is a necessary step in the revitalization of Washington, D.C. as the nation's capital. It further recognizes that the District itself does not have the financial resources to address the unfunded pension liability.

Under the President's Plan, the Federal Government would assume the major portion of the unfunded liability, while receiving a significant share of current plan assets. In so doing, the Federal Government would correct the imbalance that originated in the transfer of pension obligations to the District at the beginning of Home Rule--the imbalance between plan obligations and the District's capacity to meet them.

Of course, sufficient plan assets must remain with the District to allow the District to pay any future District costs associated with the existing unfunded liability. In other words, under the President's Plan, the Federal government should take out only those assets necessary to fund the liabilities assumed by the Federal government.

I strongly urge the Subcommittee to support the Federal Government's assumption of responsibility for the District's retirement plans for teachers, judges, police, and firefighters.

Mr. Chairman, that concludes my testimony. I would be pleased to answer any questions that you or the Subcommittee members have.

Mr. MICA. Thank you for your testimony. I'll have some comments on the Titanic a little bit later.

I, right now, recognize Mr. Blum, Deputy Director of the Congressional Budget Office.

You are recognized, sir.

Mr. BLUM. Thank you, Mr. Chairman and members of the subcommittee.

I appreciate the opportunity to discuss the President's proposal for the District of Columbia's pension plan. My statement, which I will submit for the record, assesses the consequences of the administration's approach for beneficiaries and taxpayers, compares the President's proposal with alternative forms of assistance, and discusses some of the implications for the Federal pension system.

Mr. MICA. Without objection, we are going to put the whole report into the record. Thank you.

Mr. BLUM. Excellent.

I think there are four major points that I would like to draw from that prepared statement this afternoon. The first is that the administration's proposal takes advantage of the cash-based Federal budgetary accounting system to delay recognition of the Federal assumption of the District's unfunded pension liabilities.

Under cash-based accounting, the benefit payments to District annuitants would be financed by selling the pension plan's assets, which would be accounted for as an offsetting receipt in the Federal budget. Thus, the administration's proposal would have no effect on net Federal outlays or the deficit for at least 10 years. After the assets are exhausted, annual Federal outlays for District annuitants would initially amount to between $700 million and $800 million.

If the budget were on an accrual basis, conversely, the assumption of the unfunded liabilities would be recognized immediately as a Federal expense. Now, the same effect could be had in a cash-based budget by simply making a lump-sum payment to the District to cover the amount of the unfunded liabilities. Obviously, in a situation where we are trying to reduce the Federal budget, a payment of that size all a one time is a very large pill to swallow.

The second point is, the administration's proposal would probably enhance the longer term security of District plan benefits, but it would subject, as the chairman pointed out, the District annuitants to the same political risk faced by Federal employees under their own retirement system. Earned benefits under the District plan are currently at substantial risk, as we have heard, because of the unfunded liability and the inability of the District to finance that burden.

While the long-term projected cash outlays for Federal retirement benefits are unlikely to impose a heavy burden on future taxpayers—projections in my statement show that the Federal outlays for retirement benefits would actually fall as a percentage of gross domestic product, the total size of the economy, after 2015. Nonetheless, when you look at the overall fiscal situation facing the Federal Government, our long-term projections saw Government spending increasing rather significantly after 2010, as a result of the retirement of the baby boom generation, and continued expansion in the use of federally financed health care expenditures.

That is shown in the second table in my statement that projects out the long-term budgetary pressures that the Federal Government is facing, and they were explained in some detail in a report that we just issued last month, entitled "Long-Term Budgetary Pressures and Policy Options."

The projected fiscal stress confronting the Federal Government leaves retired Federal workers exposed to the political risk that their earned benefits would not be paid in full, in the face of unrelenting downward pressures on Federal spending that we think is going to happen, under current policies, in the long-term.

The third point, an alternative approach to the administration's proposal that would also recognize the Federal responsibility for the District's unfunded pension liability but would retain the current pension system, would be to simply increase and extend the current Federal annual payment to the District pension plan, as recommended last year, for example, by Delegate Eleanor Holmes Norton.

This alternative approach would avoid the cost of setting up a new retirement plan to fund future earned benefits for District employees, retain the independent retirement board and its sound funding policies, and also provide fiscal relief to the District. One disadvantage of amortizing the unfunded liability over the next 30 years or so is that the future Federal payments would not be certain, as the Federal Government grapples with the unsustainability of its own fiscal problems.

The fourth and final point, improving the Federal Government's long-term fiscal condition would increase the security of the current system of Federal employee benefits. If we were able to solve, in the next several years, this long-term problem facing us, then I don't think, Mr. Chairman, we would be concerned about the security of the Federal Employees Retirement System.

But the pressures on the budget which emanate from the commitments to the elderly, through our Social Security system, and the Medicare system, and the Medicaid system, do impose very strong and forceful pressures on the Federal budget. If those problems or those pressures can be relieved, then I think the Federal Employees Retirement System would not be subject to the same political risk that it is currently.

Fully funding current plans could contribute to this difficult process of improving the fiscal condition, but only—only—if it affected congressional behavior to act sooner rather than later, in terms of reducing spending or increasing taxes.

Alternatively, the Congress could switch the Federal retirement system to a defined contribution basis. Such a change does entail some risk, in terms of the vulnerability of the funds for the beneficiaries, in terms of investment risk, but it certainly reduce the political risk that would be involved.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Blum follows:]

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to discuss the President's proposal for the District of Columbia's pension plan for teachers, judges, police, and firefighters. My statement assesses the consequences of the Administration's approach for beneficiaries and taxpayers, compares the President's proposal with alternative forms of assistance, and discusses some implications for the federal pension system.

CONSEQUENCES OF THE PRESIDENT'S PROPOSAL

As part of its plan to provide fiscal relief to the District of Columbia, the President's proposal would convert the District of Columbia's pension plan for teachers, judges, police, and firefighters into a federal retirement system. Under that proposal, the District would terminate the plan and transfer to the federal government all assets currently held by that plan and most of its liabilities. (As initially proposed, the District would retain responsibility for about $1 billion of pension liabilities.) If the District plan's assets matched its liabilities, the proposed transfer would be of little consequence to federal taxpayers. However, assets are $4.75 billion less than liabilities, and the long-term cost to taxpayers will be determined by the amount of that unfunded liability that is assumed by the federal government. That cost cannot be changed by juggling the budgetary accounting of the transfer.

The proposal takes advantage of cash-based budgetary accounting to delay recognition of the assumption of the District's unfunded pension liabilities. The proposal would have no effect on the budget deficit for at least 10 years. Assets would begin being consumed immediately in order to pay annuities to beneficiaries. The liquidation and drawdown of plan assets would continue for 10 years or until the transferred portfolio was completely exhausted. At that time, the federal government would begin to pay the remaining pension obligations out of general federal revenues. After the assets were exhausted, annual federal outlays for the assumed plan would initially amount to between $700 million and $800 million.

The President's plan would shift most of the cost of the $4.75 billion unfunded liability to future federal taxpayers and change the nature of risk to beneficiaries of District pensions. Those effects can be seen by comparing the financial characteristics of the current District plan with those of the federal retirement system and by examining the economic consequences of the President's plan.

Differences Between the District and Federal Pension Plans

The current District pension plan differs from the federal system in several major respects: the quantity and kind of assets held and the independence of plans from the sponsoring employer.

Plan Assets. A major difference between the District and federal pension plans lies in asset holdings. The District pension plan holds a diversified portfolio of prime-quality securities issued by private entities. The plan holds no debt obligations of the District of Columbia. Avoiding debt issued by the plan sponsor is consistent with the aim of reducing the plan's exposure to risk from deterioration in the financial condition of the District. The District plan also avoids investments in obligations issued by firms in Maryland and Virginia to minimize the concentration of regional economic risks.

By contrast, the federal government's defined benefit pension plans hold only nonmarketable debt securities issued by the government itself. The federal system makes no attempt to acquire claims on third parties or to diversify its assets. Instead, pension obligations are backed by the power of the national government to raise money through taxes and borrow when payments fall due. Federal practice in that regard can be justified by the fiscal capacity of the U.S. government and by the diversification of tax revenues among all taxpayers. Nonetheless, the use of

nonmarketable Treasury debt securities, which creates the appearance of funding, can be compared to a housekeeper who in anticipation of future bills deposits his or her own IOUs into a cookie jar each week. Although the cookie jar deposits can help remind the housekeeper of looming obligations and thereby restrain current spending, they provide no direct, independent assistance in paying off the bills.

Plan Funding. Another difference between the District and federal plans is in their respective funding levels. Currently, the District pension plan for teachers, judges, police, and firefighters has about $3.75 billion in assets and about $8.5 billion in actuarial liabilities. Thus, about 56 percent ($4.75 billion) of the plan's liabilities to present and former employees is not funded. The federal defined benefits pension systems for civilian and military employees holds about $500 billion in Treasury IOUs and owes about $1.5 trillion in benefits. Accordingly, about two-thirds ($1 trillion) of federal liabilities to beneficiaries appear to be unfunded. But those federal securities are merely the promise of the federal government to itself. The left pocket owes the right pocket, but combined trouser assets are exactly zero. By increasing the volume of IOUs to $1.5 trillion, the federal government could pretend to "fully fund" its retirement system. Such funding would cost current taxpayers nothing. Nor would it directly reduce the burden on future taxpayers. From the perspective of the federal government as a whole, none of the $1.5 trillion in promised annuities is funded.

Independence. The District and federal pension systems also differ significantly in the extent to which the plans are independent of the employer. The District plan is under the direction of a Retirement Board, whereas the federal pension systems are administered by executive branch agencies—the Office of Personnel and Management (OPM) and the Department of Defense (DoD). The District's Retirement Board manages fund assets for the exclusive benefit of employees. The District Board has demonstrated its fiduciary responsibility and commitment to plan beneficiaries by obtaining court orders to require the District to make payments to the pension fund. By contrast, neither OPM nor DoD can be expected to place the interests of employees above those of the government.

Meaning of Differences in Plan Funding

The significance of the Administration's proposed changes in the District's plan stems from its effects on the security of pension promises to current and former employees and on who bears the burden of paying the costs of the retirement benefits. The level of pension plan funding, however, is not a reliable guide to either pension security or the incidence of pension costs on current or future taxpayers.

False Assurances of Plan Funding. The security of benefits and the distribution of financing costs for a public pension plan cannot be determined solely on the basis of

its financial condition. Rather, the size of the total fiscal burden being shifted by government to future taxpayers—in relation to their ability to bear it—is critical to that determination.

The equivocal significance of a plan's funding level can be demonstrated by a hypothetical public plan that holds a diversified portfolio of blue chip assets in excess of the current actuarial value of plan liabilities. From all appearances, annuity payments are secure. Past and current taxpayers also appear to have paid taxes or forgone other spending to acquire the assets held by the plan. But the financial condition of the plan itself reveals nothing about the other assets and liabilities of the government. For example, the government may have an outstanding public debt equal to the full amount of its pension obligations, precisely because it acquired those pension assets with money borrowed through the issue of general obligation bonds. In that case, current and past generations of taxpayers have paid for none of the accumulated pension benefits. Instead, they have left future taxpayers with the full burden of paying for pensions.

Funding pension liabilities with marketable assets may also fail to protect the security of benefits. If the total tax burden shifted to future citizens is so heavy as to be intolerable, it will not be borne, and the government will not be able to meet all its promises. When a government is subject to severe fiscal pressures, assets in its defined benefit pension plans are unlikely to be regarded as untouchable. Accord-

ingly, a government forced to scale back some of its obligations can offer no assurances to creditors, including its retired employees, that they will be paid in full.

Usefulness of Plan Funding. Even though the level of plan funding is an unreliable guide to cost incidence and benefit security, the act of funding a pension plan can facilitate a rational allocation of pension costs among taxpayers and enhance the security of benefits. That is true because the process of funding a pension plan affects the fiscal decisions that determine the overall financial condition of the government.

To fund a pension plan is to recognize the cost of benefits in the budget as those benefits are being earned. This recognition takes place as the sponsoring government makes periodic payments to the plan. If they are included in the budget, those payments must be financed. Policymakers and citizens are forced by the arithmetic of the budget to acknowledge that pensions are consuming fiscal resources.

Recognition of costs in the budget does not necessarily mean that the burden rests on current taxpayers. Financing retirement costs with higher deficits would shift some of the burden to the future. But without budget recognition and full disclosure, policymakers have little opportunity to weigh the appropriate division of costs among present and future generations. Failure to recognize all future net costs increases the chances that amounts shifted to the future will be greater than intended,

that the shifted burden will be intolerable, and that current policies will be unsustainable over the long term.

Effects of the President's Proposal on Beneficiary Security

Earned benefits provided under the District pension plan are currently at substantial risk. More than half are unfunded. Although the District has paid the plan for all benefits earned since 1979 and made additional payments for the unfunded liability, the District's current fiscal policies cannot be sustained.

The Administration's proposal for transferring the District's plan to the federal government would use current assets to pay pension benefits. That policy change would not affect the security of annuity payments for the next 10 years or so, because accumulated plan assets provide sufficient financing to pay all obligations coming due over that period even if the District retained responsibility. After the plan's assets have been consumed, the superior financial condition of the federal government compared with that of the District could enhance the longer-term security of District plan benefits.

In order to determine the effect of the Administration's proposal on the longer-term security of benefits, the Congressional Budget Office (CBO) looked first

at the long-term projected cash outlays to federal annuitants (see Table 1). That projection showed federal disbursements to be manageable under current policy. Federal pension payments to annuitants will constitute a declining share of national income after 2015 because of downsizing in the federal workforce and armed services. Also contributing to this downward trend is the shift from defined benefits to Social Security and defined contributions enacted with the Federal Employees' Retirement System (FERS) in 1983. Although the projection does not include outlays for District annuitants under the Administration's proposal, this share of the District's pension payments (about $800 million in 2010) is too small in relation to federal pension outlays ($126 billion) to affect significantly the conclusion that federal outlays for pensions are unlikely to impose a heavy burden in the future. From this perspective, projections suggest that federalizing District pension obligations could increase the long-term security of benefits to annuitants.

The next step in the assessment is to consider the entire burden being shifted to the future by current federal policies. CBO projects that government spending under current policy will rise significantly after 2010 (see Table 2). The retirement of the baby-boom generation and continued expansion in the use of federally financed health care services will drive up outlays for Social Security, Medicare, and Medicaid. If policies are not changed, that surge in spending, unless accompanied by a corresponding increase in tax receipts, will cause federal borrowing to rise to unsustainable levels. The projected fiscal stress confronting the federal government

TABLE 1. LONG-RANGE PROJECTIONS OF FEDERAL CIVILIAN AND MILITARY RETIREMENT PAYMENTS (In billions of current dollars)

	1996	2000	2005	2010	2015	2020	2030	2040	2050
Civilian	40	48	62	81	103	124	171	225	296
Military	29	33	39	45	51	57	74	104	151
Total	69	81	101	126	153	181	245	329	447
Memorandum:									
Percentage of GDP	0.9	0.9	0.9	0.9	0.9	0.8	0.7	0.6	0.6

SOURCE: Congressional Budget Office estimates based on projections by the Office of Personnel Management and the Department of Defense.

NOTES: Projections do not include spending for retiree health care. They assume that discretionary spending grows with the economy after 2007.

GDP = gross domestic product.

ABLE 2. LONG-RANGE PROJECTIONS OF FEDERAL RECEIPTS AND EXPENDITURES, CALENDAR YEARS 1996-2050 (As a percentage of GDP)

	1996	2000	2005	2010	2015	2020	2025	2030	2035	2040	2050
NIPA Receipts	21	20	20	20	20	20	20	20	20	20	20
NIPA Expenditures											
Federal consumption expenditures	6	5	5	5	5	5	5	5	5	5	5
Transfers, grants, and subsidies											
Social Security	5	5	5	5	5	6	6	6	6	6	6
Medicare	2	3	4	4	5	6	7	7	8	8	8
Medicaid	1	1	2	2	2	2	2	3	3	3	3
Other[a]	5	5	4	4	4	4	4	4	4	4	4
Net interest	3	3	3	3	3	4	5	6	8	9	12
Total	22	22	22	23	25	27	29	31	33	35	39
NIPA Deficit	2	2	2	3	5	7	9	11	13	15	18
Debt Held by the Public	50	48	48	50	59	75	97	125	158	193	267
Memorandum:											
Gross Domestic Product (Trillions of dollars)	7.6	9.1	11.4	14.4	18.0	22.4	27.7	34.3	42.6	52.8	80.5

SOURCE: Congressional Budget Office.

NOTES: Simulations without economic feedbacks assume that deficits do not affect either interest rates or economic growth. Discretionary spending is assumed to grow with the economy after 2007.

GDP = gross domestic product; NIPA = national income and product accounts.

a. Includes federal retirement spending.

leaves retired government employees exposed to the risk that their earned benefits will not be paid in full in the face of unrelenting downward pressures on all federal spending.

Over the longer term, the Administration's proposal would expose District annuitants to the same fiscal risks that federal employees are facing. Those beneficiaries face risk now, however, and the net effect on their well-being is probably improved.

Effects of the President's Proposal on Tax Burdens

The Administration's proposal would shift the burden of most of the accumulated shortfall in the District plan to future federal taxpayers and provide immediate relief to District citizens. Inasmuch as the entire unfunded liability in the District's pension plan is attributable to the failure of the federal government to fund retirement benefits before home rule, this shift may be appropriate. However, the proposal avoids burdening federal taxpayers for the next 10 years or so. Use of accumulated assets to pay benefits for that period enables the federal government to avoid making payments from its own revenues. The President's proposal requires no net increase in federal outlays or the deficit except in years that are outside the 10-year budget planning outlook.

ALTERNATIVE APPROACHES TO THE DISTRICT PENSION PLAN

The President's proposal would provide immediate financial relief to the District of Columbia. A federal takeover of the pension plan would initially reduce the District's pension contributions by $176 million a year. Relieving the District of the obligation to make up the plan's unfunded liability could also raise the credit quality of the city's bonds and reduce its financing costs. The primary disadvantages of the Administration's proposal are that it terminates the District's independent plan for funding earned benefits and delays budgetary recognition of the cost that is shifted to federal taxpayers. As you suggested in your letter of invitation, Mr. Chairman, alternative approaches to resolving the District's unfunded liability could preserve the current plan structure, result in earlier recognition of the cost of federal assistance in the budget, and do so without increasing total federal cost.

Preserving the District Plan

Retaining the current plan, with its independent board and its policies of funding liabilities with first-quality, marketable financial assets could have several advantages. It would avoid the cost of setting up a new retirement plan to fund future earned benefits for District employees. More important, the current system—if fully

funded now—might afford District beneficiaries more long-term security than they could obtain under a federal plan. That security might result from the ability of the autonomous pension board to defend earned benefits from cuts. A fully funded District plan might also insulate District annuitants from fiscal pressures that may threaten earned benefits under the federal system.

Two options—a lump-sum payment and 30-year amortization—would preserve the District's plan (see Table 3). Those plans, which cost the federal government the same amount in present value, differ only in the rate that federal funds are paid into the District pension plan. Under the lump-sum approach, the federal government would make a single payment to the District in 1998 to cover the estimated unfunded termination liability of $3.9 billion. Operationally, this is the simplest way of providing immediate relief to the city while preserving the current plan. The lump-sum option would require an immediate budget outlay for the full amount of the federal contribution.

The hole in the District pension plan does not have to be filled immediately, however. The sustainablility of the existing plan could be restored by increasing the current federal annual payment to the District plan of $52 million through 2004 to the District plan to $318 million a year for the next 30 years. That is the general approach recommended by Delegate Eleanor Holmes Norton. The 30-year amortization plan would add up to $1.6 billion in federal outlays over the 1998-2002 period

TABLE 3. FEDERAL BUDGETARY COSTS OF ALTERNATIVE PLANS TO ASSUME MOST OF THE DISTRICT'S UNFUNDED PENSION LIABILITY
(In millions of dollars)

	1998	1999	2000	2001	2002	Five-Year Total	Present Value[a]
Administration's Proposal	0	0	0	0	0	0	3,856
Lump-Sum Payment	3,856	0	0	0	0	3,856	3,856
30-Year Amortization[a]	318	318	318	318	318	1,593	3,856
Pro-Rata Federalization[b]	208	220	233	247	261	1,169	3,856

SOURCE: Congressional Budget Office estimates based on data from Milliman & Robertson, Inc., *District of Columbia Retirement Board Valuation as of October 1, 1996 for Fiscal Year 1998* (Washington, D.C., February 1997).

NOTE: "Unfunded pension liability" refers to the "unfunded present value of accrued benefits" or the unfunded termination liability. The Administration proposed that the federal government assume responsibility for the unfunded termination liability.

a. The present value expresses the flow of current and future payments in terms of an equivalent lump sum paid today. The calculation assumes a 7.25 percent interest rate, as do the other calculations in this table.

b. Assumes that 49.3 percent (the current funding ratio of the termination liability) of benefit payments are made by drawing down trust fund assets and that 50.7 percent of benefit payments come from general federal revenues.

(see Table 3). From the District's perspective, one disadvantage of amortizing the unfunded liability over 30 years is that receipt of future payments would not be certain, especially as the federal government begins to come to terms with the unsustainability of its own current fiscal policies.

The last option, the pro-rata approach, would terminate the District's plan but disclose federal acceptance of the cost of the District pension plan more prominently. Under this alternative, the federal government would use plan assets to pay benefits, but only in proportion to the ratio of current assets to current liabilities. Because plan assets constitute about one-half the termination value of accrued federal liabilities, the federal government would pay one-half the annual cost of annuities from liquidating plan assets and pay the rest from general federal revenues. The estimated five-year cost of this approach would be about $1.2 billion.

Reporting Federal Costs

Recognizing the full federal cost of taking over the District's pension plan in the budget when it is enacted is consistent with several objectives of budgeting, including accountability, fiscal control, and the provision of full information. Accountability requires that costs be matched in time and place with the actions that give rise to those costs. Recognizing the full cost of a decision also supports the

objective of fiscal control. Furthermore, decisions are not fully informed unless all information about cost is available.

The District plan's unfunded liability is attributable to the failure of the federal government to fund retirement benefits before the plan was turned over to the District under home rule. Under any option that returns the District plan to the federal government, the cost of earned benefits is "sunk" or possibly fixed beyond the ability of the federal government to control. Inasmuch as the federal government incurred but did not recognize that cost in the past, the timing of its recognition appears to be arbitrary. However, a broader, governmentwide perspective suggests a decisive basis for preferring earlier to later recognition of pension costs—even those that are sunk. The essential fact about the financial condition of the federal government is that its current policies cannot be sustained over the long term. Current long-term commitments cannot be honored indefinitely with current tax rates.

Significant policy changes will be required to restore long-term balance, and those changes will considerably affect the ability of citizens to realize their long-term financial plans for economic security. The unavoidable increases in taxes or cuts in spending will require adjustments in personal behavior and plans. Policy changes will be more manageable and less disruptive if they happen gradually rather than suddenly. That is especially true for changes in retirement programs, on the

basis of which citizens are making plans and taking action over a lifetime. To wait until beneficiaries are nearing retirement to change policy is to leave annuitants without opportunities to minimize their losses by adjusting long-term consumption and savings. The sooner the necessary changes in policy and expectations are adopted, the more gradual they can be and the lower their social cost. The need to ease the adjustment to a sustainable set of policies argues for recognizing all costs sooner rather than later.

IMPLICATIONS FOR FEDERAL PENSIONS

The disadvantages of the President's proposal to convert a District pension fund into a federal plan highlight some weaknesses of the federal pension system. One weakness is that the security of earned federal retirement benefits is not assured. Another is that in a cash-basis budget, cost recognition for federal pensions is deferred until benefits are paid out. The Congress has a variety of options for addressing these shortcomings. Of course, each remedy has its own disadvantages.

The Security of Earned Federal Benefits

Few observers feel that a doomsday scenario, which is inherent in the unsustainability of current federal policy, is a realistic forecast. The government is expected to modify current policy to avoid that outcome. The process of adjusting current policy to a sustainable path, however, will expose all federal spending programs to intense downward pressure. Spending for federal retirement benefits is unlikely to escape those pressures entirely.

The insecurity of benefits is obviously a disadvantage to beneficiaries. But it may also be inconsistent with the interests of taxpayers and the public at large. The uncertainty of benefits can reduce the value that current employees assign to future benefits. That discounting for risk raises the total compensation that must be offered to attract employees to government. Thus, taxpayers would benefit from increasing the certainty of retirement benefits in terms of a lower cost of total compensation for federal employees.

Recognizing the Deferred Cost of Federal Retirement Benefits

The federal government gives only incomplete recognition to the cost of employee retirement benefits as they are earned. Current costs are recognized through internal

bookkeeping entries rather than cash payments, which are the unit of account for most other activities. In addition, the accounting entries understate the costs of earned benefits for many employees.

Trust funds for defined benefit pension plans for civilian and military personnel have been established on the books of the government in order to tally and report those costs. Employee contributions to defined benefit plans are credited to the trust fund. Similarly, intragovernmental transfers from employing agencies are credited to the trust funds as benefits are earned. For employees covered by FERS or the Military Retirement System, agency transfers of credits cover the present value of the normal cost of earned benefits. For civilian employees covered by the older Civil Service Retirement System (CSRS), agency transfers cover about one-third of the present value of the government's expected outlays for pensions. Agencies make no transfers to the trust funds for the cost of retiree health care benefits. Those costs are paid out of the general fund of the Treasury.

The excess of employee and agency contributions over benefits paid in any period is "invested" in special-issue Treasury debt, on which the Treasury pays interest. But because of the underfunding of CSRS benefits and an inherited deficit in the Military Retirement System, the trust funds have a gap between Treasury promissory notes and pension liabilities (health care costs are not booked) of about $1 trillion. Consequently, Treasury's interest payments to the trust funds are only

about one-third of the amount required to convert the present value of earned pension benefits into the amounts to be paid. That underpayment increases the gap between Treasury IOUs and pension obligations, despite a series of Treasury payments intended to amortize the trust fund deficit. Therefore, the funds' reported unfunded liability tends to grow.

Options for Improving Federal Pension Security

Alternative structures for federal pension plans could accelerate recognition of pension costs in the federal budget and contribute to an increase in the security of earned benefits. Options that inform legislators and citizens more quickly of the fiscal consequences of current policies could facilitate the adjustment to a sustainable policy path, reduce future financial stress, and add to the security of earned benefits. Those alternatives would require some trade-off of other objectives, however. Two options are outlined here: a fully funded, defined benefit plan and a pure defined contribution plan.

Funding the Federal Defined Benefit Plans. The federal government could adopt a fully funded version of the District of Columbia's defined benefit pension plan. Doing so would mean creating an independent board of trustees charged with the fiduciary responsibility of overseeing the operation of each plan for the sole benefit

of plan participants. An autonomous board might provide some protection of earned benefits by monitoring and reporting periodically the financial condition of the plan and actions of the federal government that could threaten benefits.

That option would also require the government to acquire a large portfolio of high-grade investments. Purchasing those assets would accelerate the recognition of federal pension costs by raising budget outlays and the deficit now. One way in which funding the plan would increase the security of federal pension promises is through an improvement in the general, long-term financial condition of the government. The short-term increase in the deficit is the key to obtaining that improvement. If the size of the current budget deficit affects the willingness of the Congress to spend or tax now, raising the deficit now rather than later will cause some cuts in spending or increases in taxes now. Depending on the specific policies, that adjustment could shift some of the burden slated to be borne by future taxpayers to the current generation and guide fiscal policy toward a more sustainable course. If policymakers do not adjust current policy in response to higher current deficits, all the assets acquired to fund pension liabilities will be matched by an equal increase in federal debt and the future tax consequences of current policy will remain unchanged.

Because the critical link between the funding of pension benefits and increased pension security occurs through the effect on the budget deficit, it is worth

noting that the advantages of funding could also be obtained through changes in the federal budgetary treatment of pension benefits. For example, by simply filling the shortfall in the federal trust funds with Treasury IOUs, requiring agencies to pay the full cost of CSRS benefits, and designating the trust funds as nonbudgetary, the annual federal deficit would be increased by the annual change in the value of earned pension benefits. Funding the cost of retiree health benefits in the same way would add further to the deficit. Fully funding federal defined benefits with either Treasury IOUs or private securities would also require that projected increases in the federal debt ceiling take place now rather than later.

Funding a federal defined benefit plan with a portfolio of securities would also raise some potential difficulties. First, the trustees might be subject to political pressure to invest the retirement funds according to the objectives of the sponsoring government and to exercise some control over the firms in which it invested. That is the same issue that arises in proposals to invest the Social Security trust funds in private securities. Second, a funded defined benefit plan might provide new opportunities for budget gimmickry. It is not a simple matter to evaluate the assets and liabilities of such a plan to determine its actual funding level. Where there is room for doubt, there is room to fudge. Indeed, many private, state, and local sponsors do not fully fund their defined benefit plans.

Defined Contribution Plan. The difficulties inherent in a defined benefit pension plan have prompted a number of private and public employers to move to defined contribution plans, such as the federal Thrift Savings Plan (TSP). Defined contribution plans have all the cost recognition features of a fully funded defined benefit plan combined with the further advantages of greater ease of administration, security and portability of earned benefits, and limited scope for budgetary sleights of hand.

Under a defined contribution plan, an employer pays benefits as earned to a pension fund in which accounts are maintained for individual beneficiaries, who exercise some control over fund investments. The government's cost of providing pensions is recognized as outlays as the benefits are earned and paid. Once paid into employee accounts, contributions belong to employees. For public employees in particular, there is less risk that the government will succumb to future budget pressures and renege on earned benefit promises. Moreover, defined contribution plans are always fully funded by definition. If the employer defaults on the agreement to make contributions, that breach is immediately apparent, rather than being discovered when retirement benefits are due for payment.

Experience to date with the Thrift Savings Plan suggests that a possible win-win situation might exist—savings for the government and higher-valued retirement benefits for federal employees—if the government were to switch to the defined

contribution approach. Because of the potential for high returns on TSP investments and the plan's other positive attributes, the average employee might be better off if the government made the switch away from defined benefit plans. For example, employees might find a $90 contribution to the TSP more attractive than a $100 contribution to the defined benefit plan.

Defined contribution plans have some disadvantages, however. First, the value of the benefit at retirement depends on the financial performance of plan investments. Although employees can reap rewards from holding marketable securities, they also bear the risk of fluctuations in value. Inevitably, some employees will be unlucky or make poor investment choices and will end up with a lower benefit at retirement than expected. Second, a defined contribution plan does not penalize employees who change employers, as a defined benefit plan does. Some employees and employers may regard that as an advantage, but for other employers it may mean reduced worker loyalty and greater employee turnover. As a result, the employer may have a weaker incentive to invest in employee training. Third, defined contribution plans do not include a disability benefit that is often rolled into a defined benefit plan. To fill that gap, disability insurance has to be added to the compensation package.

CONCLUSION

The President's proposal for addressing the unfunded liability in the District's pension plan exploits federal budgetary accounting practices to prevent any of the cost from appearing in the budget outlook for the next 10 years. That delayed cost recognition sends policymakers and the public the wrong signals about the commitment of scarce resources and shifts fiscal burdens to the future. Alternatives to the Administration's proposal could increase the chances that a larger share of the cost would be borne now and increase the long-term security of benefits.

Although the cost of federal pensions is projected to decline as a share of national income, overall federal fiscal policies are unsustainable over the long run. Federal pension benefits, which are backed solely by the ability of the federal government to finance payments when they come due in the future, are thus subject to some risk that they will not be paid in full. Improving the federal government's long-run fiscal condition would increase the security of the current system of federal employee benefits. Fully funding current plans could contribute to the difficult process of improving the fiscal condition of the federal government if doing so affected Congressional behavior to act sooner to reduce other spending or increase taxes. Alternatively, the Congress could switch federal retirement benefits to a defined contribution basis, but such a change would increase the vulnerability of beneficiaries to investment risks at the same time as it reduced political risks.

Biographical Sketch for James L. Blum

James L. Blum has been with the Congressional Budget Office since it was established in 1975. He is currently the Deputy Director of CBO, appointed to that position by Director Robert D. Reischauer in December 1991. Previously, Blum was the Assistant Director for Budget Analysis for 16 years, and he also served as Acting Director of CBO from December 1987 to March 1989.

Prior to joining CBO, Blum held a variety of positions in the federal government, including the Council on Wage and Price Stability, the Department of Labor, and the Office of Management and Budget. He has also worked for the Organisation of Economic Co-operation and Development in Paris. Blum studied economics at the University of Michigan, satisfying all requirements except completion of a dissertation for a Ph.D.

Blum serves as the CBO representative to the Federal Accounting Standards Advisory Board. He also is a member of the National Academy of Public Administration, and he was the 1990 recipient of the Roger W. Jones Award for Executive Leadership.

Mr. MICA. I thank each of our panelists.

Mr. Blum, is there a precedent for raiding trust funds in this fashion?

Mr. BLUM. An analogy might be drawn—I don't know if I would call this a precedent—but an analogy might be drawn to what happens with private sector defined benefit plans where companies terminate these plans. They go out of business. The Federal Government, in fact, has an insurance program. The Pension Benefit Guarantee Corporation, does provide insurance for those plans.

And, in effect, what happens when that occurs is that the corporation takes over the assets of the terminated plans, and the Federal Government is committed to paying the benefits that have been earned under those plans, up to a limit, in terms of the amount of the benefits that can be paid.

Actually, the way that this shows up in the Federal budget is quite similar to what the administration has proposed here for the District, in the sense that the assets in those privately terminated plans are drawn down as needed and to help finance the Federal benefit payments that go to the beneficiaries. The budgetary treatment turns out to be essentially the same, and I think one could say that there is a similar situation going on here with the administration's proposal.

Mr. MICA. Well, I think you also testified that, while there is some short-term gain in this plan—it does relieve the District, I think initially, of about a quarter of a billion, I guess, initial payment, and then that comes down—what is the pitfall in the long-term? Are we just adding to this already massive unfunded liability that the feds have in their own system?

Mr. BLUM. Well, the Federal Government would be taking over the unfunded liability of $4.8 billion, as it stands now, and that would be added to, as you pointed out, our essentially unfunded liability of $1.5 trillion.

Mr. MICA. Did you calculate what that would be, like when we run out of funds, the $4.8 current?

Mr. BLUM. Well, we think that that would last, assuming the remaining—the assets would be drawn down only as needed each year, and therefore they would continue to have earnings. We think that this would last for about 10 years.

Mr. MICA. What would the unfunded liability be in 10 years, the same?

Mr. BLUM. No, I assume that would grow.

Mr. MICA. To how much?

Mr. BLUM. I haven't done the calculation for that, but we could do that.

[The information referred to follows:]

In the Administration's proposal, the unfunded liability of $4.75 billion would grow by the assumed actuarial interest rate of 7.25 percent. After 10 years, it would total $9.6 billion.

Mr. MICA. So, as we are drawing down the asset, the unfunded liability is increasing, and in 10 years—if you could provide the subcommittee, I would like to know what kind of an obligation we are inheriting.

Does the Federal Government have this inherent responsibility anyway, since the financial arrangement of the District is so closely

intertwined with Federal finances? Would that be a fair assumption, or do we truly have an independent pension fund, as has been termed in some of these documents, and that's presenting kind of a firewall, or is there just an obligation we're going to have to meet anyway?

Mr. BLUM. Well, I think, as Congresswoman Morella pointed out, and also Mrs. Norton, under home rule and with that District Retirement Act of 1979—up to then what we had was essentially a Federal retirement system for these District employees that was on a pay-as-you-go basis. There was no real funding of the plan.

In 1979, in effect, that plan was then shifted to the District, to become the responsibility of the District, and the Federal Government opted only to pay for 25 percent of the unfunded liability that existed at that time. I think what the administration has recognized is that the Federal Government was responsible perhaps for all or almost all of that initial unfunded liability that was passed to the District.

Mr. MICA. You heard the calculations, and I think we got that, those figures from OPM, as far as the out-of-pocket expenditures from the general treasury to pay current benefits, it grows pretty dramatically. In 10 years, it's up close to $100 billion a year, I believe, somewhere in that range.

So this unfunded liability, and then that general obligation would kick in—at some point, I guess after 10 years, somebody is paying the difference between the premiums coming in and the payments going out; is that correct?

Mr. BLUM. That's the nature of a pay-as-you-go financing system.

Mr. MICA. Right. But the pay-as-you-go, the new payer will the Federal Government. How much will that add to the—I guess we will be up around $100 billion a year, and this will just be, what, another quarter of a billion? Is it $700 million?

Mr. BLUM. Our calculation is, after the assets have been exhausted, the Federal annual payment will be somewhere between $700 million and $800 million a year. That, I suppose, could be considered a drop in the bucket compared with the actual.

Mr. MICA. Let's see. I'm 54. When can I start drawing? I want to calculate this so I get out just in time, when all this crashes. So it's about three-quarters of a billion at that point.

Mr. BLUM. That's true. For example, in table 1 of my prepared statement.

Mr. MICA. That's equal to the entire subsidy I think we did last year, or fairly recently, isn't it, to the District? What is the District's biggest shortfall; $660 million? Oh, OK. Well, it's right in that range. And in 10 years we would need that just to meet the shortfall for pension.

Mr. BLUM. Well, I might comment on the use of the word "shortfall."

Mr. MICA. Money coming in versus money going out.

Mr. BLUM. Well, that's true, that difference. But that is the nature of the pay-as-you-go financing system for the Federal retirement system, which is a common way of financing retirement benefits for central governments worldwide. Essentially, it's drawing upon the entire financial resources of the country, simply because the Federal Government enjoys a taxing power that reaches nation-

wide, as opposed to something like the District which can only tax its own citizens.

Now, in the year 2005, according to the estimates in table 1, our projection is that the total Federal, civilian, and military retirement payments will amount to $100 billion. So adding $700 million or $800 million is adding less than 1 percent to the total that the Federal Government will be expending less than 10 years from now.

Mr. MICA. I thank you.

I yield to our ranking member now.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. Blum, back in June 1995, you testified before this subcommittee that the Civil Service Retirement fund does not face a financial crisis. Is that still your opinion?

Mr. BLUM. Yes, it is, and it's drawn from, essentially, the numbers that are presented in table 1 of my statement today. Two years ago, we made the same point, looking in terms of what the cost of these annual retirement benefits would be in constant dollars. We were saying that, after 2015, in constant dollar terms, those payments would actually diminish.

What I've done today is give a different kind of measure. Here we're looking at the projected cash outlays as a percentage of the total economy, the gross domestic product. It's a typical way of measuring what the burden will be on taxpayers in the future. There it shows that the total civilian and military retirement benefits will remain constant at about nine-tenths of a percent of GDP through 2015, and then begin to decline. So, in that sense, the burden will be reduced over the longer term, on current taxpayers.

Now, as my statement goes on to explain, looking at just the retirement plans does not give you a complete picture of what the fiscal situation will be for the Federal Government as a whole. That was provided in table 2 in my prepared statement and discussed in more detail in this report that we issued last month.

Looking down the road, we can see that, while we're in a relatively benign period, in terms of the Federal deficit coming down—last year it was only 1.4 percent of GDP—the long-term projections over the next 10 years, it doesn't rise all that much under the current policies.

But after the retirement of the baby boom generation, in the year 2010, then the picture changes. We're getting an aging population, and with the commitments that the Federal Government has made to pay Social Security benefits to retired people, to finance health care expenditures under Medicare and, to a growing extent, under Medicaid, it will add a considerable burden, considerable pressure to the overall fiscal picture for the Federal Government.

Unless taxes were raised, the deficit would begin to mount rather seriously, and after a period of time, the debt that the Federal Government would have would have serious economic consequences.

Mr. CUMMINGS. At that same hearing, you testified that, "The projected cash-flow benefits of the retirement fund appear to be manageable under the current pay-as-you-go policy." I take it that your position is still accurate.

Mr. BLUM. Yes, sir.

Mr. CUMMINGS. Finally, you testified that, "The efforts to reduce the cost of the system should weigh the effects of such actions on hiring and retaining employees on the credibility of the government as an employer." I take it that that is still your position, also.

Mr. BLUM. That's clearly the picture for Federal retirement benefits. It is part of the overall compensation package that the Federal Government offers to its employees.

Mr. CUMMINGS. Mr. DeSeve, we all know that the unfunded liabilities of the District pension plans are a direct result of the Federal Government's not having funded those plans before home rule, when it was responsible for establishing pension funding policies.

The nearly $5 billion in unfunded liabilities that exist today were in no way caused by the government of the District of Columbia. That is why I think it only fair that the Federal Government step up to the financial responsibilities that were incurred on its watch, and I commend the administration for acknowledging this responsibility.

Could you explain to us how much of the current unfunded pension liability the President's plan would transfer to the Federal Government and how much would be left with the District?

Mr. DESEVE. Yes, sir, I will. The only element to be left of the unfunded liability with the District is the disability pay portion of a retiree who becomes disabled. We will be taking everything else except that portion. We want to have the District continue to administer that benefit for its employees because we think its an important thing.

Congress, in fact, has recognized and has capped the amount of disability that is available. We would like to see the Congress continue to have oversight and the District to continue to manage that aspect of its workforce. So everything else—and if I could give you an absolute number, I would—but everything else will be the Federal Government's responsibility going forward, as far as the accrued unfunded liability is concerned.

Mr. CUMMINGS. Now, the President's plan appears to include very complicated accounting requirements for dividing, between the Federal and District governments, responsibilities for the cost of benefits to workers who retire, become disabled, or die after the Federal Government takes over the current plans.

I would think that a clearer, simpler approach would be to do what we did in the mid-1980's, when the Federal Government converted from the CSRS to the Federal Employees Retirement System, which was to close the CSRS to new entrants, but allow enrolled workers to remain in that plan throughout the remainder of their careers and retirement.

Could you explain your plan and comment on the simpler approach that I just stated?

Mr. DESEVE. Yes, sir, I will. We believe that the longevity of the employee going forward, that policeman, fireman, teacher, should be the responsibility of the District; that is, they should continue to pay for that individual's accumulating years of service. That's how we've made our division.

You might argue that it's an arbitrary division and the division that you had is a better way to do it. What we're trying to say is, if we clean up the problems of the past for the District, that, going

forward, the District should decide under what system their existing employees and their new employees would continue to accrue benefits. That's how we divide the costs.

We do want to try to find an administrative way so that an individual will get a single check. We believe that the individual getting a single check is certainly something that we and the District can figure out a way to do.

Mr. CUMMINGS. Just one other question. Under the administration's proposal, the District would be required to establish and administer a new plan for current and future teachers, police officer, and firefighters. Would the District immediately be faced with an unfunded liability for those plans, and how much would those plans cost the District each year?

Mr. DESEVE. No, there would be no unfunded liability for those plans, because they are starting new, and they would have to be funded each year, incrementally, according to the precise cost. I don't have the actuarial number for the cost of the new plan. In fact, the District has to decide what benefit levels that it wants within the new plan.

We have based our assumptions on the continuation of the old plan. That's a question that the District and its employees will have to negotiate.

Mr. CUMMINGS. Mr. Williams.

Mr. WILLIAMS. Yes, sir. Paying the full cost, as Mr. DeSeve is saying, I think we're estimating an order of magnitude of around $55 million to $60 million per year. That's a number I just got a few minutes ago.

Mr. DESEVE. That would be a net cost, because we leave all employee contributions, which is about 7 percent of payroll, with the District. The Federal Government doesn't take those. So there's about $35 million a year, in addition to the District contribution, to make those payments.

Mr. CUMMINGS. So, Mr. Williams, I take it that the Control Board feels comfortable with this plan, the President's plan.

I mean, if you can't speak for them, I understand, but I'm just curious.

Mr. WILLIAMS. I cannot speak for the Control Board, but I can observe. I have observed a consensus in the District, among all the decisionmakers, that certainly this component of the President's plan is a worthy component that we all applaud and salute.

Mr. CUMMINGS. Thank you very much.

Mr. MICA. I thank the gentleman and yield now to the lady from Maryland, Mrs. Morella.

Mrs. MORELLA. Thanks, Mr. Chairman.

Thanks, gentlemen, for your statements on this very important issue. I was looking over the actual President's bill that I think had been circulated among various agencies and departments for their responses, and I noticed that there's a section that would establish a third-party trustee. As I understand it, it would be to manage the assets and make the payments, as necessary.

These are functions that are currently performed by the Retirement Board. I thought the Retirement Board—and you know more than I do—was doing a very capable job. If it appears to be work-

ing well, then why would we eliminate it? Would you just elucidate that whole concept of the third-party trustee?

Mr. DESEVE. We would be happy to. The President's plan is to take on the liabilities, the entire liability of the plan, with the reservation that I spoke of, of disability, and to take the assets and use the assets to directly pay beneficiaries over time, to liquidate the assets over time.

The Secretary of the Treasury would have the responsibility for making payments, and we want to be very clear that that responsibility is one that rests with the Federal Government from the time at which the statute is passed. The trustee is an agent of the Secretary of the Treasury who acts on behalf of the beneficiaries.

The Pension Board will still have remaining assets and remaining responsibilities for the individuals who are still employees of the District. They will be receiving, for example, the employee contributions every month. We believe it will be necessary to leave some assets behind to make sure that all of the liabilities of the District are covered. We've been talking to them about that.

So they will still be in place, but we would like a clean separation between those liabilities and assets that we're taking over, and the payment for those, and those where the Pension Board acts as a fiduciary for other District employees. That's why we've set it up that way.

Mrs. MORELLA. This is something that you approve of. What is it going to demonstrate? You're trying to show a clarity of division?

Mr. DESEVE. Yes, we are. We're trying to say that it's our liability, and we're going to use the assets that come forth to make payments to the beneficiaries.

Mrs. MORELLA. Does it enhance the trust that should always have been there, anyway?

Mr. DESEVE. We certainly hope so. That line has never been drawn before. That line of the Federal Government assuming the liabilities and using the assets to pay beneficiaries has never been established before.

Mrs. MORELLA. Very interesting. Didn't the Council meet today?

Mr. DESEVE. Yes, they did. I spent most of the morning with the Council, and we had a very good exchange of views on the memorandum of understanding.

Mrs. MORELLA. I was just going to ask. Can you shed any light on whether they signed it?

Mr. DESEVE. I can't. And I don't think that today is necessarily definitive. Today is a day on which they could act, but I believe that we made a lot of progress this morning in our conversations. They may, in fact, choose to act today. They may have more information that they need.

It's a fairly complicated document. We tried to make it simple, but like everything else in Government, somehow it grows on it. They had some very good questions that we're getting them the answers to.

Mrs. MORELLA. The other day there seemed to be the feeling that they might well be voting on it today, and I guess that's what's needed to kind of push this whole issue into more activity.

I'm going to be going over to the floor, Mr. Chairman, and so I leave it back in your trusty hands and hope to return. Thank you very much.

Mr. MICA. I thank the gentlelady.

I wanted to state, too, that it looks like Ms. Norton will not be able to join us. She is introducing someone in the Senate, but if she doesn't get back before I ask a few more questions, we will submit written questions to the panelists. We were trying to accommodate her, but this went a little bit faster than we thought.

I heard you respond, Mr. Blum, to Mr. Cummings' comment about your comments that were made in previous testimony, that there wasn't any immediate financial problem to the retirement system. In the first part of your response, you did indicate that in the years when some of this obligation comes due, 2010, that we face some very serious potential problems with funding some of these obligations.

Is that correct? Did I hear that correctly?

Mr. BLUM. Yes, that's correct, Mr. Chairman.

Mr. MICA. So, in the short term, we're fairly sound in meeting our obligations. In the long term is where we could expect some problems, probably about 2010 would be a particularly difficult time.

Mr. BLUM. That's when the difficulty begins to mount rather severely.

Mr. MICA. I read the last page, in your conclusions it said, "Overall Federal fiscal policies are unsustainable over the long run. Federal pension benefits, which are backed solely by the ability of the Federal Government to finance payments when they come due in the future, are thus subject to some risk that they will not be paid in full."

Now, somebody has got to make a choice between making those payments in the form of benefits or raising taxes. The last estimate I saw showed that if we continue spending the way we have been in order to meet the benefits that we're also paying out at a current rate our tax rate will be up in the 75- to 80-cent range when we get to 2010. There are going to be some tough choices then, unfortunately, it appears.

Mr. BLUM. That's one way of characterizing what this longer term fiscal problem is. There are others, which is what—the one that we would prefer is table 2 in my prepared statement which shows what that pressure looks like over time.

Mr. MICA. I wanted to ask a question. We should all acknowledge that the issue isn't whether or not we're going to address the District's unfunded liability. The question is how we meet that obligation and how we best protect any hard assets that we've put into these funds, and then how we get to a point where someone looks back and says, "Hey, they really goofed up in 1997. When they had a chance to do things right, they ignored it." I've heard a lot of that in the history of this panel and this Congress.

You've got, on page 15, table 3, a couple of choices there. Could you comment? If you were going to pick one of these, why would you pick it as a solution? The administration's proposal you don't carry out to where the impact really hits. You only go to 2002, I guess it is. I don't want to get into that. If we were going to take

something other than the administration's proposal, which of these would you pick and why?

Mr. BLUM. Well, I think the lump-sum payment and the 30-year amortization are essentially the same, in the sense of leaving the pension plan in the District's hands, but recognizing the Federal responsibility for the unfunded liability and paying the District for that.

That could be done either in a lump sum payment, all at once which, in fact, is the equivalent—if we were on an accrual budgeting system, when we're taking over an unfunded liability of $4.8 billion, how you would recognize that in your balance sheet would be an increase in your liabilities of that amount, and that would also show up in that year's expense statement, as well.

But you don't have to pay it all at once. You could spread it over time. This third line in table 3 is just, simply, if you were to amortize this over a 30-year period, this would require a string of payments from the Federal Government. The Federal Government, as we know, has already been making payments for that share of the unfunded liability that it was willing to assume in 1979. The problem is that that string of payments will come to an end after 2004.

The administration's proposal last year is a variant of this same theme, which was, increase the Federal payment by another $52 billion and let that grow over time. That has the advantage of leaving the pension plan in the District's hands, leaving the Retirement Board to administer it. It leaves the chances that the Retirement Board will get greater than actuarially expected benefits by its investments in private securities, and so forth.

This last option is just a different way of doing what the administration has, in fact, proposed, which is taking over all the liabilities as well as the assets, but instead of offsetting completely all of the annuity payments that will be due over the next 10 years or so, only draw down the assets to the extent that the assets represent the total actuarial liability, which is a little under 50 percent. So that ends up with the numbers that are presented in the fourth line.

The problem with either lump-sum payment or any of these amortizations or even the pro rata Federalization is, it goes to the point that Mrs. Norton observed, that in a time when the budget negotiators are trying to reach agreement on balancing the budget, reducing the deficit, these all go in the opposite direction of increasing Federal spending. So that's the attractiveness of the administration's proposal, and I dare say that was the prime motivating factor for its submission.

Mr. MICA. A couple of quick questions. I think Mr. Williams said they inherited a $2.6 billion unfunded liability.

Mr. WILLIAMS. $2 billion, approximately.

Mr. MICA. Is it $2 billion in, was that, 1979, 1980? So the unfunded liability is now $4.8 billion. Where did the other $2.8 billion come from? Was that just accumulated from that original amount?

Mr. BLUM. Well, it's from the failure to, essentially, pay the interest on that debt.

Mr. MICA. So some of that is the District's responsibility, or whose responsibility?

Mr. BLUM. I think it's arguable as to whose responsibility it was. I mean, one case that can be made is that the Federal Government had responsibility for all of the unfunded liability, because it was running these pension plans before home rule. It was making all the decisions on what the benefits would be.

Mr. MICA. But $2.8 billion—was it 1980 when they converted?

Mr. BLUM. Yes, as a result of the act of 1979.

Mr. MICA. So there is some culpability on the District's part or the Pension Board? No?

Mr. BLUM. Well, there may be some.

Mr. MICA. Some responsibility.

Mr. BLUM. Some, but I think it's arguable.

Mr. MICA. Well, I just heard that it was the Federal Government's fault that we got into this situation. Well, we didn't do much better for the Federal Employees Retirement System, from CSRS to FERS, because we inherited quite a—well, I should take that back, because the unfunded liability is only $2 billion, isn't it, in that? And $538 billion since 1985, so we have done better. Somebody goofed up on the District.

Mr. BLUM. Well, we've done better.

Mr. MICA. The District's unfunded liability has grown to $2.8 billion, while FERS grew, in a little bit different timeframe, but $2 billion.

Mr. BLUM. It's really an entirely different situation. I mean, the Federal plan does recognize the accrued costs of the earned benefits as they are earned under FERS and under the military retirement system, since it was reformed. But these are recognized, essentially, as intragovernmental budgetary transactions. There is no funding in private assets, or private securities, or what not, as you observed in your opening statement, Mr. Chairman. Essentially, these are IOUs that are placed in the cookie jar.

Mr. MICA. But somehow, in the District's scheme, when they revised things, they did manage to get some hard assets which are up—well, you're proposing to take $3.7 billion; is that right?

Mr. DESEVE. That's what the number was in October, yes.

Mr. MICA. Except for some disability payments. So we're going to draw those down and eliminate all but a half billion, or somewhere in that range, $1.2 billion.

Mr. DESEVE. We will make payments to the beneficiaries out of that pool, except for probably about $1.2 billion, at this point is our best calculation, that will be left with the Pension Board to meet the District's liabilities and provide financial relief for the District over time.

Mr. MICA. I yield to the ranking member.

Thank you.

Mr. CUMMINGS. Mr. Blum, I take it, just from your statements, that, if we were able to fix the Social Security, Medicare, and Medicaid, we would not have a problem with this whole situation.

Mr. BLUM. You would not have the same concern or the same pressure that would be brought to bear on these retirement benefits. The kind of pressure I'm talking about is the kind that you have been subjected to over the last couple of years in the way of proposals for deferring the cost-of-living adjustments, increasing employee contributions, other changes that might be made in the

Federal Government's defined benefit portion for both FERS and the CSRS.

Mr. CUMMINGS. Mr. DeSeve, let me go back to something that I'm sure a number of the unions are concerned about and I'm just wondering about. How would your plan ensure that the future benefits of current workers would not be reduced, if the current plans in which they are enrolled are ended? I mean, how would that be assured, if at all?

Mr. DESEVE. Yes. I think Mr. Blum has testified to it himself, that the assurance is the same assurance we give other Federal workers. It's Mr. Mica's point. They would have the same "full faith and credit" pledge of the United States that other workers in the Federal Government who have a defined benefit plan have.

Mr. CUMMINGS. I yield to Ms. Norton.

Ms. NORTON. Thank you very much, Mr. Chairman. I thank you for your indulgence. I have not mastered the art of cloning yet.

Mr. MICA. Ms. Norton, you can have the balance of his time plus your time.

Ms. NORTON. Plus my own?

Mr. MICA. Yes.

Ms. NORTON. Well, I'm sure that much of what I would have covered has already been covered. I just want to clarify why we're in this spot.

I have tried more than one approach in introducing bills to conquer the unfunded liability. An earlier approach I used, to get away from the complications of it, essentially required the Federal Government to pay 5 percent per year of the remaining amount, and the District was capped at an amount.

My most recent bill settled on another approach altogether, and it came, in part, out of my own study of the GAO study of possible approaches. Essentially, it settled on a flat amount that the Government would pay, and for very good reason, if you're looking to save the Government money over the long haul, and this is a long-haul proposition.

So, essentially, what it did is to say, you're going to pay what looks like a large amount, but it's going to be smaller and smaller and smaller, because it's going to be the same amount over 40 years. So you come out ahead, because you're paying the same amount.

And behold, that's essentially what the Federal Government is doing now. It's paying $52 million every year and $52 million every year. The difference is, it's an amount that doesn't leave the District carrying the disproportionate share of the burden.

Now, in a real sense, the administration is caught in the same problem I was caught in when I was doing my 5 percent bills. It looked good in the short term, but in the long term the Federal Government was going to end up paying more money.

Now, the administration has not chosen a different, but at the same time similar, approach because it prefers that approach. Essentially, the approach the administration has chosen leans in the direction of saving the Government money now, when the pressure is on to save the Government money now.

And I really don't think the administration had any other choice, unless we can find some sensible choice around the problem. I

think they did the very best they can, and we have really forced them to jump through all kinds of hoops. It's a very complicated plan.

I want to congratulate Mr. DeSeve, in particular, because when you consider how many land mines there were out, and every time you ran into one, you would have to figure your way out of that one, and then there was another one there.

I really think this is a question for Mr. Blum. What do you think, given what I'm sure you know, about the approach that has been forced on the administration and the approach that saves the Government money over 40 years? Is there a way, consistent with deficit reduction, to solve this problem without engaging in a charade which costs the Government more money because of the way it has chosen to go at deficit reduction and the timeframe that it is using to go at that problem?

I mean, is there a better way to do it, in your judgment, given all the constraints? Given all the constraints, is there a way out of this that you would suggest that the administration can take, recognizing, as I'm sure you do, why the administration has chosen the path it has chosen, which is ultimately going to cost the taxpayers more money?

Mr. BLUM. Well, as I observed earlier, the administration did propose an alternative approach a year ago that was not unlike what you yourself had proposed. A year ago, the administration proposed to increase its annual payment to the District pension plan, now at $52 million, and that was going to grow over time.

Your latest proposal was simply a variant of that, in the sense of amortizing the unfunded liability over a longer period of time, for a constant payment. That example is illustrated in table 3 of my prepared statement, of a 30-year amortization. The numbers aren't magic. I mean, it could be any length period, but it was just to illustrate that there is this alternative approach, which you had recommended.

The advantage of that approach is that it would retain the District's pension system with the District. It would retain the Retirement Board and its sound investment policies, which have been earning more than 7 percent, the actuarial assumption, on its investments. And the District would not have to go through the process of creating a new pension plan. So, there are advantages with that approach.

But as you are acutely aware, the disadvantage of it is that, on the Federal budget, it shows up as an increase in Federal expenditures. It also shows up as an increase in Federal expenditures in the so-called discretionary spending pool, which Congress has set limits on, and which budget planners like to write down very restrictive limits on in the future. So it runs up against that hurdle, which is a major problem.

Now, as you have observed, the administration has gotten around that by simply adopting a process similar to what we do with terminated private pension plans under the responsibility of the Pension Benefit Guarantee Corporation, where the Federal Government takes over the assets from the terminated plans and uses those assets to help pay the promised benefits to the beneficiaries of those plans.

The effect on the budget is zero in terms of the deficit. The actual outlay of the payments is offset by essentially selling off or liquidating the assets in the plan. So it avoids that problem for 10 years, then it shows up in the Federal budget 10 years from now as a $700-million to $800-million increase in spending.

Ms. NORTON. Well, I understand how it works, Mr. Blum. Look, the daily mantra, indeed sermon, on why we have to go at cutting this deficit in 5 years, goes as follows: It's because we are bankrupting our children. Now, what we have here is an instance where we are forcing our children, according to who you talk to, to pay, I don't know, twice as much, maybe three times as much, because of what I can only call a fiction which is 5 years, in which we say it's got to look like it's balanced.

At some point, I guess, I'm trying to break through at the commonsense level and at the level that the Congress says deficit reduction is, in fact, concerned with, that we're supposed to save money for our grandchildren. Well, we are guaranteeing that our grandchildren are going to pay more than we ourselves could pay.

Let me just ask you straightaway: In light of the underlying rationale of deficit reduction, which is to save others from having to pay our debt, is there any kind of commonsense exception to the deficit reduction fiction that you know of or that you think might be recommended to take care of this perversion, frankly?

Mr. MICA. I'm sorry. The gentlelady is out of order. She's injecting common sense in this discussion. That's totally out of place. [Laughter.]

Ms. NORTON. Strike that from the record.

It's very hard to keep walking ahead against the very philosophy and the very rationale that the Congress is operating under.

So I'm really asking, since we all understand what the problem is, since we understand why the administration has broken its neck and many pencils in order to get here, do you know of any device existing under law, or can you recommend one that we might use in order to solve this problem within the President's plan and in keeping with deficit reduction, without increasing the deficit in a very serious fashion in the out years, that you, yourself, have said was about $700 million?

Is there something you can recommend that would help us get around this hurdle, recognizing that this is not the District's liability, that we're talking about congressional liability? If it had done what this administration is trying to do now, 20 years ago, then this problem wouldn't be here. So it's here for this Congress because the Congress in 1979 didn't do it, and now we are forcing ourselves into a crucible not of our own making.

The question is, since we know this must be dealt with, since we know 2004 is coming, since we know the District blows up in that year, is there a way that we can—a commonsense way—excuse me, Mr. Chairman—that we can find our way around this dilemma?

Given your own considerable knowledge and talent, and I'm sure your allegiance to saving the Government money in the long run, can you recommend either a waiver or some other way around a problem which is going to, one way or the other, cost the Federal Government more money? The only question is, how much, is it greater or is it less?

Mr. BLUM. Well, I think you've put your finger on it, Ms. Norton. This is going to cost the Government money, either now or in the long run. The most straightforward way is to recognize that liability now and to pay for it now. It doesn't necessarily have to be done all at once. It can be done, as you have suggested, over a period of time.

In effect, what the administration's proposal has done, though, is to deny recognizing or recording that cost in the budget in the short run, for short-term budgetary considerations.

Ms. NORTON. Not at their preference. They didn't start out trying to do that. They are just trying to conform to what the Congress is doing.

Mr. BLUM. But the net result of that could well be to increase the burden on future taxpayers more than otherwise would be necessary.

Ms. NORTON. Mr. Blum, can't you just see it? At some point, let's say it's 2003, somebody is going to come up with a bill—if I'm here, it's likely to be me—to say, at that point, let's change what we did in 1997 so that the Government's expense won't be $700 million, but we would have made it in 1997, if we could have made it that.

I mean, wouldn't the responsible thing, for anybody sitting here, then, at least at that point, be to come forward to try to reduce the Government's expense to the far smaller figure that is possible here, even now?

Mr. BLUM. I think you give me more credit than I deserve. I cannot think of a solution along the lines that you're seeking.

Ms. NORTON. You can't think of a way to get around the deficit reduction problem?

Mr. BLUM. No.

Ms. NORTON. On the other hand, you would agree, I take it, that after the strictures are over with, that the logical thing is to try to come forward to reduce the Government's expenses from the $700 million to something closer to the amount in my bill.

Mr. BLUM. Well, at that time, when we've exhausted all the assets, essentially the $700 million to $800 million is just the annual payment that's due to the District annuitants at that time.

Ms. NORTON. Well, they won't all be exhausted in 5 years. There will be some of them left.

Mr. BLUM. No, I'm talking after it is exhausted, so about 10 years.

Ms. NORTON. OK.

Mr. BLUM. When that time comes, the $700 million to $800 million a year is simply the annual cash benefits that will be owed to the District annuitants, unless, for example, the Congress changes what those defined benefits will be, cuts back the amount of benefits.

Now, there's no property right in those benefits. The benefits are statutorily determined.

Ms. NORTON. Are you suggesting that, at that point, the way in which to proceed would be to cut back the benefits rather than reduce the Government's cost?

Mr. BLUM. That's the only way you can do it. If you don't want to bear the cost of the $700 million to $800 million a year, that means cutting back the benefits.

Ms. NORTON. Or, in fact, redesigning the plan so that it costs less, in a way not unlike the original bill I offered. I mean, as you say, you can do anything you want to do, you're the Congress.

Mr. BLUM. Yes.

Ms. NORTON. At that point, there is an alternative to cutting back benefits. I mean, I'm sure that if retirees hear that what may happen at the point we get to $700 million—you couldn't cut back benefits enough to deal with that kind of problem.

Mr. BLUM. Exactly.

Ms. NORTON. Mr. Blum, I wish you would think hard about this. I know you sit where you cannot advise us to get around deficit reduction, but you also sit where you might advise the Congress that it is countermanding its own stricture that we should not raise the costs for future generations.

Could I ask about the disability figure? Mr. DeSeve, you have a concern that disability payments be left with the District. Would you explain that, please?

Mr. DESEVE. Yes, Ms. Norton. When someone retires on disability, there actually are two actuarial calculations that cause them to get their retirement benefits: One is the normal pension they would have gotten at their normal retirement age; the second is the extra benefit that has to be paid for as a result of retiring early or having additional years of service, in a sense, imputed to you.

We want the District to continue to manage its relationship with its workforce; that is, to continue, rather than having the Federal Government conduct health examinations for District employees and decide whether Mary or Harry happen to be disabled, to have the District continue to do that, and make decisions about the disability of their employees, subject to the congressional strictures that are currently in place, rather than having the Federal Government make that decision.

In order to fund that, we will leave behind some assets, so the District's liability in that regard is covered by the assets that are left behind.

Ms. NORTON. How much would you leave behind?

Mr. DESEVE. I want to ask that we get back to you with the precise answer to that. We use the calculations that Milliman & Robertson does, and I don't have those with me today. I don't have those numbers with me today.

Ms. NORTON. Are you certain that that would cover? Suppose it didn't cover the real cost and we were left where we are now, paying for unfunded liability?

Mr. DESEVE. The best I can do is get all the parties to agree: the District, the Pension Board, the actuaries. We have our friends at the PBGC helping us. We will all sit down and agree and come up with a number, and that's the amount that will be left behind.

Ms. NORTON. Mr. Williams, do you have any idea? Could you tell me what disability, in some proportions, or with some figure, is costing the District now?

Mr. WILLIAMS. I could get that figure for you, Ms. Norton.

Ms. NORTON. It's very important to get that figure.

Mr. WILLIAMS. And I would echo what Mr. DeSeve has said. We would work closely with the OMB in agreeing on all the numbers,

and look forward to agreeing on these actuarial numbers and the asset issues, as well.

Ms. NORTON. We certainly need to have this be more than a guesstimate. And I don't know what the District intends to do about disability, what plans you are making. In fact, I suppose I should ask you. Is the District considering any changes in its disability policies?

Mr. WILLIAMS. I think one of the overarching issues, and we've talked about this with the District, is how we set up this new plan, what the policies are going to be in this new plan, related to a number of other human resources issues and how we deal with disability. I think the Council has talked about this. No conclusions have been reached, but this is an issue.

Ms. NORTON. We have a disability problem still left over here from last year that wasn't dealt with in the appropriation, which I hope we will deal with.

One final question. Obviously, with changes like this, Mr. DeSeve, employees must wonder where they will end up. Does your plan ensure that the future benefits of current workers would not be reduced, if the current plans in which they were enrolled were ended?

Mr. DESEVE. Yes.

Ms. NORTON. Would you elaborate?

Mr. DESEVE. Certainly. What the Federal Government is saying is, an individual who currently has X years of service—first of all, for the retirees, all of their benefits are guaranteed by the Federal Government because they are already on retirement. They get the entire amount.

Ms. NORTON. That's right. That's why I said "current employees."

Mr. DESEVE. With the current employees, if you're an individual who has a particular number of years of service, we agree to pay for the number of years of service times whatever your formula is—there are different formulas—whatever your formula is, and we will pay the increase, over time, of the pay.

So if today you're making $30,000 a year and you have 10 years of service, and in the future you're making $40,000 a year, we will pay on the basis of your high years of service at 40 years. So you will get the increase in your pay. You will get the number of years of service you currently earned, paid for by the Federal Government.

If you stay with the District another 10 years, the District will be responsible for those going forward years from today, put a new plan in place. We've always, in our calculation, used a mirror image plan, one that had identical terms and conditions. That's up to the District.

Ms. NORTON. Did you consider the FERS approach, where we ended our one plan and simply started another? And it was much simpler. It seemed to offer a simpler approach than what you've been forced to do.

Mr. DESEVE. It's simpler. The difference is that, in FERS, we weren't really worried about who was sharing cost. What we're saying is, the District, going forward, should bear the pension cost of its employees. We will take care of the past. We will take care of the sins of the past. And they should make a decision under home

rule and a judgment as to how they want to handle those going forward costs. So FERS didn't have a cost-sharing element to it.

Ms. NORTON. So you really see this as a continuum. It's just a different party who does the payout.

Mr. DESEVE. That's correct. And what I testified earlier is, we will figure out a way between us to solve a two-check problem. Is it going to be one check or two checks? We will solve that problem.

Ms. NORTON. I'm sure employees wouldn't mind if there were two checks, if somehow they added up to—if one and one added up to more than two.

Thank you very much, Mr. Chairman.

Mr. MICA. I thank the gentlelady.

Just a couple of quick points. Maybe you're familiar with the administration's proposal for Federal employees, but it's to increase employee contributions to the retirement system. Are you familiar with that? That came to us in the Congress. And they also proposed delaying COLAs for Federal retirees for 3 months.

Has there been any proposal by the District to change any of the employee contribution, to have some additional revenue coming into this? I see in the audience an affirmative nod. Can anybody confirm that? Is there anything that makes a proposal similar to what we're doing for Federal employees, to meet our shortfall or our obligation?

Mr. WILLIAMS. I think the District has made some changes over the last couple of years to reduce its burden, in terms of retirement benefits.

Mr. MICA. But the employees are still paying 7 percent.

Mr. WILLIAMS. Right.

Mr. MICA. There's no proposal for increasing that?

Mr. WILLIAMS. No, but I think there is, though, speaking next, a representative from the Retirement Board who can speak to that point.

Mr. BLUM. Mr. Chairman, if I may, I would just point out that Ms. Norton's bill last year proposed just that for the District plan.

Mr. MICA. Right.

Ms. NORTON. Would the gentleman yield for a second?

Mr. MICA. Yes.

Ms. NORTON. I'll make a deal with you, Mr. Blum. I'll bet the employees would accept my change, because that had been negotiated, if you will accept my bill and advise the chairman that it is the better approach.

Mr. MICA. Looking awfully good.

Mr. WILLIAMS. If I could say, Mr. Chairman, though, among all the things in the District, I think the way the District has handled its retirement responsibilities has been commendable, because, by our calculation, the District has put in $1.7 billion above and beyond paying the full cost, normal cost, you called it, of beneficiaries from the inception of the program in 1980 on. I think it's been very, very responsible.

Mr. MICA. Mr. Williams, I get to oversee some dozens of Federal pension plans and observe what's going on in others. Sir, to have $4.2 billion in assets for the District of Columbia, someone should get—last week I gave a veteran a purple heart—we should have a special medal coined when your unfunded liabilities are $4.8 billion

and you have $4.2 billion. If I had that in just the Federal retirement system, employees' system, I'd be doing a dance with Ms. Norton down at one of these pubs downtown.

Ms. NORTON. Is that an offer, Mr. Chairman? [Laughter.]

Mr. MICA. If we could keep some of that cash. It just dismays me no end to see this one little bit of cash left and the one thing the District has done semi-right, and their employees have these assets, to have it drained off. And then, because of some CBO scoring thing, and because of the lack of some common sense to get out here, when we're going to be hard-pressed to meet obligations and be in a more difficult situation, and then to have blown the money.

I don't mind participating in rearranging the deck chairs on the Titanic, but I don't want to raid the passengers' safety deposit boxes just before the ship goes down. So we're looking for some alternative here to do this in as positive a fashion, retain and protect as much of the hard assets as we can.

Now, it may also require some of the components that the gentlelady has proposed before. So we're willing to work with you all to come out with some solution that does resolve this in a satisfactory manner and as painless as possible.

Did you want me to yield?

Ms. NORTON. Thank you very much, Mr. Chairman, because you made a point that I think is very important to followup on.

First, let me say that I do support the administration's proposal, and I support it because I believe I don't have any choice. I think that they have done what they had to do. They said, "What are the rules of the game?" And instead of screaming and hollering that they want new rules and that it was, you know, congressional liability, so they deserve new rules, they have jumped through hoops to come up and play the rules of the game. And I admire you for doing it, even though I think it is very tortured, and I know what you must have gone through to do it.

But I would like to ask all three of you, given your backgrounds in these affairs, perhaps not always in pensions, although Mr. DeSeve has a long pension background, but when the Congress gave the District this, it didn't say just fund it, in essence, the Congress has made the District overfund this pension liability. That's what the $1.7 billion, or whatever, that Mr. Williams was talking about is.

I really have to ask you, in light of what you know about pension funds, and in light of what you know about the institution we're talking about, the city, and may I also add, in light of what you know about people going into pension funds these days—the good Governor of New Jersey—where people are really saying, "Do we really want to lay away all that much cash, when we have pressing needs?"

Just for my edification, recognizing that it will not affect directly the remedy to this bill, was it a wise decision to make the District not only fund but overfund, when one considers what it has done to the credit rating of the city, to the very stability of the city? Was this the best way to do it, or would it have been better to have had, even with the unfunded pension liability, to have had the District pay less over time and end up a stronger mechanism than it is?

You would still have had a lot of unfunded liability, but looking at it in a kind of costbenefit way, was it wise of Congress to, in fact, extract this much in unfunded pension liability from the District of Columbia?

Mr. DESEVE. The executive branch is never allowed to criticize the wisdom of Congress, certainly in public, certainly in this committee.

But I think, if we had had a system in which the same treatment had been given to these employees as was given to other Federal employees, if their pension fund had been, in essence, Federalized, with the continuing costs—Mr. Mica mentioned earlier the liabilities associated with that—so that it wasn't a District burden, but it remained for these employees a Federal burden, it certainly would have imposed a significantly lesser cost on the District of Columbia.

It's always nice to have hindsight. It's 2020 hindsight. But if they had been treated as other Federal employees.

Ms. NORTON. Would the Federal Government have made itself overfund these?

Mr. DESEVE. No, I'm agreeing with you that, in 1979, if these employees had been transferred to a Federal defined benefit plan, as some other employees, I understand, were, that would have a lesser cost implication for the District as they made payments over time. So it's easy in hindsight to say it probably would have been better to have done it that way.

Ms. NORTON. Mr. Williams.

Mr. WILLIAMS. Ms. Norton, I would agree with Mr. DeSeve. One of the key principles in the President's plan, that isn't often talked about, is the alignment of authority and accountability in the plan.

Let's take expenditures. Don't hold the District accountable for expenditures, if it doesn't have the authority and resources, really, to manage them well. Don't hold us accountable, for example, in managing of our budget, if we really don't have ultimate authority to manage it well. Don't hold us accountable for managing a good retirement plan and system, if the lines of accountability are murky and blurred.

I think that's what happened in 1979. That's what I think, commendably, the President is hoping and attempting to correct in this plan. So I would definitely not have done it the way it was done in 1979.

Ms. NORTON. But to the credit of the Congress, the Congress, in fact, tried to give a formal, balanced apportionment, as between the Federal Government, and it was President Jimmy Carter who vetoed that bill. What was left, though, was that the Congress required of the District of Columbia what it has never required of itself, in terms of funding these plans, far weaker mechanism that we are.

In essence, look what has happened. Funding these plans wrecked the city without insuring the pensions. So we got the worst of both worlds. The liability puts the pensions in jeopardy, because if we don't do something by 2004, everything is going to go down the tube. And in the process, Mr. Mica's point about seeing this $4 billion, this amount of cash here, in the process, we put

some money beyond our reach and wrecked the city, which is responsible for continuing to add to that fund.

I hope we can correct this. I don't think it is all hindsight. I think this was perfectly predictable. Once President Carter vetoed that bill, everybody knew how those amounts would go up each year until we got to the point where next year we're over $300 million, and the Federal Government is still at $52 million. Everybody understood that. The District should have come forward sooner for a remedy, and the Federal Government should have recognized that the city itself was being sacrificed.

Thank you very much, Mr. Chairman.

Mr. MICA. Thank you.

When they read the record of this hearing 10 years from now, we foresee it will be $700 million a year. I'm not sure if we're making progress, Ms. Norton.

I would like to thank our panelists for their testimony. We may have some additional questions, and we're working with the D.C. Subcommittee to help resolve this issue. We appreciate your being with us today. Thank you.

I would like to call our second panel this afternoon. We have Jeanna Cullins, executive director of the District of Columbia Retirement Board. We have Ron Robertson, chairman of the Metropolitan Police Labor Committee; Thomas N. Tippett, chairman of the Pension Committee of the Fire Fighters Association of the District of Columbia; and Mr. James Baxter, treasurer of the Washington Teachers Union.

I'm sorry, we have a change. Betty Ann Kane, will be testifying instead of Jeanna Cullins for the District of Columbia Retirement Board.

As I mentioned to the first panel, this is an oversight and investigation subcommittee. If you would stand, please, and be sworn in.

[Witnesses sworn.]

Mr. MICA. The witnesses responded in the affirmative.

We would like to welcome you to our panel. Thank you for waiting patiently. As I mentioned to our first panel, if you have a lengthy statement or additional information you would like submitted for the record, we would be glad to do that by unanimous consent.

We will recognize first Betty Ann Kane.

You are recognized.

STATEMENTS OF BETTY ANN KANE, CHAIRMAN, LEGISLATIVE COMMITTEE AND TRUSTEE, DISTRICT OF COLUMBIA RETIREMENT BOARD; RON ROBERTSON, CHAIRMAN, METROPOLITAN POLICE LABOR COMMITTEE, FRATERNAL ORDER OF POLICE; THOMAS N. TIPPETT, CHAIRMAN, PENSION COMMITTEE, FIRE FIGHTERS ASSOCIATION OF THE DISTRICT OF COLUMBIA; AND JAMES BAXTER, TREASURER, WASHINGTON TEACHERS UNION

Ms. KANE. Thank you very much, Mr. Chairman, and committee.

I am the chairman of the Legislative Committee for the D.C. Retirement Board, a trustee of the Retirement Board, a 12-year former member of the Council of the District of Columbia, where I chaired the Council's Government Operations Committee, with

oversight for the Retirement Board, among other things, and also served 4 years on the Board of Education. I had responsibility and concern for teachers' pensions there.

I do have a written statement I will put in the record and briefly summarize.

Mr. MICA. Without objection, your full statement will be made part of the record.

Ms. KANE. Thank you, Mr. Chairman.

As you know, the Retirement Board, just by way of background, was established by Congress in 1979. The legislation establishing it gave us exclusive authority and discretion to manage the pension funds for the District's police officers, firefighters, teachers, and judges.

The Retirement Act passed by Congress, to which we've had many references here today, sets up the board's structure, authority, and legal responsibilities. There has been some change in the structure due to Council legislation, in terms of adding some additional representatives, but, basically, it has remained the same.

Mr. Chairman, it is very important for us to clarify, at the outset, that as fiduciaries of the funds, the board members are statutorily and equitably bound to act solely and exclusively in the best interest of the beneficiaries and the participants in the fund. So, accordingly, the comments and the views expressed in my statement, on behalf of the Retirement Board before this committee, are tempered and reflective of this overriding obligation of the trustees.

As was said, we invest the funds. We do not make benefit determinations or calculations. We do not maintain benefit records. We do not process payments to the beneficiaries, at least under the current setup. These noninvestment administrative duties are shared among several agencies of the District of Columbia government, including personnel, pay, and retirement, et cetera.

Our management of the funds, as has been referred to here today, has been reviewed, scrutinized, and analyzed by many proponents and critics alike, including Congress, CBO, the D.C. City Council. Most all of these, including Ms. Norton's task force that was set up and issued its report in April 1994, have basically concluded that the funds are well managed.

The Bear Stearns report, which the Congress required in the 1995 Appropriations Act be undertaken, was submitted. Their report was submitted in May 1995 to Congress. They concluded that the board's operations were well run. Its investment performance was in the top quartile of public pension funds for the period examined. Our costs were found to fall within a reasonable level. Our asset allocation and procedures were determined to be "well documented, thorough, and effectuated by the board in a prudent and deliberate manner."

And the most recent report was a March 1997 report from the Congressional Budget Office, which again analyzed our policies and performance, and concluded that the funds were professionally managed, that they meet fiduciary standards, and that our performance has been consistent with other large public employee funds.

I was a member of the City Council in 1979, a new member, when the legislation was passed by Congress transferring responsi-

bility for the pension funds to the District. We have come a long way since 1979. We are very proud of the accomplishments of the board and its staff. As has been mentioned, we now have $4.2 billion in assets. We are 44 percent funded.

We started, essentially, from zero. There were some small amounts of money in the teachers' pension fund. They had them in Treasury bonds, making about 3 percent. There was, I think, $100 million or $150 million. Our funding level has increased almost 20 percent since 1991. In 1991, we were 25 percent funded, had gone from 1979 to 1991, from zero to 25, and from 1991 to date, have gone to 44 percent funded.

At the conclusion of calendar year 1996, we have exceeded our performance objectives, which is a 7 percent rate of return on all investments, 14.1 percent. Not only did the board outperform the actuarial assumption rate of 7.5 percent, we outperformed our target total benchmark, which was 12.6 percent. I might add that we have exceeded our target, exceeded that actuarial assumption in 11 of the last 14 years, and as a result of that performance, have $1.1 billion in net assets to the fund.

Mr. Chairman, as a practical matter, a retirement program is part of an employee's compensation. It is designed to attract and retain the employee. The employer who, in the public sector, is the taxpayer, the District taxpayer, receives the benefit of the employee's service when they are active, not when they are retired.

We believe that the liabilities of and contributions to a retirement program, therefore, should be related to the period in which the benefits are earned rather than the period in which the benefits are paid. During the period before enactment of the D.C. Retirement Reform Act of 1979, of course, this principle of funding was not followed by the Federal Government.

Let me summarize. The act which created the board 17 years ago specifically acknowledged that the police and firefighters', teachers' and judges' retirement funds were not being maintained on an actuarially sound basis. It's in the report; it's in the findings. Congress determined at that time that the net pay-as-you-go method was unsound and that the fund should be maintained on an actuarially sound basis. Therefore, the trust was created for the three funds, requiring that the assets be invested to provide for the retirement security of these employees.

I might mention, because we had some questions previously about new systems created by the District. The D.C. Council, in the fall of 1996, took exactly the same action that the Congress had taken in 1979. It has created, Mr. Chairman, a new fund for new hires. All police, all firefighters, all teachers who have been hired on and after October 1, 1996, the beginning of the current fiscal year, are in a third tier, a new fund, a new program.

I know Mr. Tippett, in his testimony, will talk more about the details of that fund. That is a defined benefit fund, but it is starting from ground zero, starting from scratch, and it will be fully funded from day one.

The Council looked, and worked with us and our actuaries, at that versus a defined contribution plan, and determined that actually, in the long run, it was more economical for the District, particularly dealing with public safety employees, as well as better for

the beneficiaries, to do a defined benefit plan. If you started from zero, started from day one, and funded it, it would work. So that's been taken care of for everybody from October 1, 1996, on.

As I said, an unfunded liability in an employee retirement system presents many problems. The beneficiaries have less security. An employee, a retiree really only feels assured that they are going to receive their benefit if there is money already set aside to pay that benefit.

Second, the burden with an unfunded liability is shifted to future generations of taxpayers. Because contribution have not been paid in the past, future taxpayers will have to make up the difference. And, most important, investment earnings potential is lost because there is no money in the fund.

A cash infusion of $2.6 billion in 1979 would have solved the entire problem. Today, it would require $4.8 billion. Under the President's plan, which I want to finally address in the summary of our testimony, the absence of a funding mechanism is estimated to cost over $30 billion in future taxpayer dollars.

With regard to the President's plan, let me say that the board of trustees of the retirement system applauds the President for his vision and for his administration in recognizing that the unfunded liability is a Federal creation and is, therefore, a Federal responsibility. We favor the Federal Government's assumption of that liability.

However, unfortunately, we still don't have specific details of the President's plan, and we are not able to totally evaluate and comment on its limitations, but we know that it has inherent, very significant limitations. I don't need to describe this but to say that the President's plan would have the retirement funds revert back to the very funding method that Congress found in 1979 was unsound.

The President's plan does not propose to fund the unfunded liability. Rather, it proposes to terminate the current retirement system, take all or at least the majority—and we go back and forth in hearing whether it's some, all, most—of the current trust assets, and transfer them to a third-party trustee appointed by the Federal Government.

Those assets would be then used to pay the beneficiaries until the assets are depleted, which we estimate would be in about 10 years, the Federal Government would be responsible for annually allocating future benefits payments. Our actuarial firm, Milliman & Robertson, estimates that the Federal annual payments, once the assets have been depleted, will average over $700 million a year for over at least 20 years.

So the President's plan would take the funds from 44 percent funding, which they currently are, back to zero percent funded within about 10 years. Those payments would be scheduled, that is, the Federal payment, then, of $700 million would be scheduled to begin at about the same time as the first wave of baby boomers would begin to move into retirement, forcing Congress to address the Social Security crisis at the same time.

We find the uncertainty surrounding the retirement security of the beneficiaries and the participants in the D.C. retirement system, under this scenario, very, very troubling. As fiduciaries of the

funds, it is the board's view that it is in the best interest of the beneficiaries and the participants to fund the unfunded liability and not defer action for another 10 years, for another Congress that may or may not be supportive of the major annual capital outlay called for under this plan.

These employees will still be District employees; they will not be Federal employees. We do question—we have seen the payment proposed going from $52 million to $104 million last year. That was not approved by Congress. So we do have a doubt and a concern, as fiduciaries, that if there is not a willingness to go from $52 million to $104 million, where will there be some guarantee there would be a willingness to from zero to $800 million?

Alternatives: Congressman Norton offered an excellent piece of legislation during the last Congress which would have provided an equitable method of amortizing over a number of years the unfunded liability. In our view, this kind of approach that directly addressing the unfunded liability issue, provides greater security for the beneficiaries and the participants than a plan that leaves the unfunded liability unsolved.

We find no comfort in the argument that Social Security, Civil Service, and military personnel benefits are handled in the pay-as-you-go manner and that, therefore, it is acceptable to place the District's police officers, firefighters, teachers, and judges in the same tenuous position. We must endeavor to safeguard their retirement security, not to weaken it.

Mr. Chairman, let me reiterate that we have to have more detail to carefully consider and comment on the President's plan. The board needs to know precisely what our beneficiaries and participants would be receiving, what they are giving up, before we could support the proposal. We have to have these details demonstrated to protect the retirement security of our beneficiaries and participants.

Thank you, Mr. Chairman, for giving us the opportunity to share the board's views and observations. That concludes my statement. I would be happy to answer any questions.

[The prepared statement of Ms. Kane follows:]

Statement of
Jeanna M. Cullins
Executive Director
D.C. Retirement Board
before the
U.S. House of Representatives
Committee on Government Reform And Oversight
Subcommittee on Civil Service

April 29, 1997

Good morning Chairman Mica, Members of the Committee, my name is Jeanna M. Cullins, I am Executive Director of the D.C. Retirement Board (the "Board"). I am pleased to appear before you today to provide an overview of the Board's operations, management of the current assets and liabilities of the program supporting the pensions of the District of Columbia's Police Officers and Fire Fighters, Teachers, and Judges, and general observations about the President's plan to assume certain pension obligations of these programs, in response to your letter of invitation.

The Board was established by the U.S. Congress in 1979, as an independent agency of the D.C. government, pursuant to the District of Columbia Retirement Reform Act (the "Act"), Public Law 96-122, (codified at D.C. Code § 1-701, et. seq.). This legislation gave exclusive authority and discretion to the Board to manage the pension funds of the D.C. Police Officers' and Firefighters', Teachers' and Judges' Retirement Fund, (collectively the "Funds"). The Act also sets forth the Board's structure and specific authority and legal responsibilities.

Mr. Chairman, it is very important to clarify for the record that as fiduciaries of the Funds, the Board is statutorily and equitably bound to act solely and exclusively in the best interest of the beneficiaries and participants of the Funds. This mandate is singular in many respects and may in fact be in conflict with the current objective of establishing financial stability for the District of Columbia. Accordingly, the comments and views expressed in my statement before the Committee are by necessity tempered and reflective of this basic obligation.

Operations of the Board

In addition to the statutory framework provided by the Act regarding the Board's creation and operation, the District of Columbia Municipal Regulations ("DCMR") contain an extensive set of rules and regulations (published in Title 7, Chapter 15) that address various structural and operating characteristics of the Board. The DCMR, for example, delineates the various Officers of the Board and their responsibilities, staff positions and their respective functions, the Committees structure, functions and procedures, and the rules under which the Board conducts its meetings.

Composition of the Board of Trustees

The Board is currently composed of thirteen (13) members and one (1) alternate (i.e., Alternate Judicial Appointee), which reflects recent amendments to the Act. There are six (6) members elected by the active or retired participants of the retirement system. Thus, the active D.C. Police Officers, Firefighters and Teachers elect one of their members to the Board as do the retired Police Officers, Firefighters and Teachers. Rather than being elected, the Judicial representative (and the alternate) is appointed by the Joint Committee on Judicial Administration and must be a retired Judge. In addition to these seven members and the alternate, three members are appointed by the D.C. Mayor and three are appointed by the D.C. City Council. One of the appointees of the City Council and to two of the Mayoral appointees must have professional work experience in banking, insurance, or the investment industry.

Once elected or appointed, each Board member serves a four-year term. The Act limits all Board members to a maximum of two terms. Terms are staggered to provide the Board continuity and experience. The Chairman of the Board is elected annually by the members and is limited by Board rules to two consecutive terms.

Staff

The Board has thirteen (13) authorized staff positions of which eleven (11) are filled. The Board has very detailed job descriptions for the various staff positions. The Executive Director's position description is approved by the Board's Search and Selection Committee. Additionally, the duties and responsibilities of that position are addressed throughout the D.C. Municipal Regulations (see e.g., §§1503.1 and 1503.2; §1508.1, §1510.4, §1510.6, §1510.7, etc.). The Board's senior staff is composed of the following four positions:

(1) **The Executive Director** manages all day-to-day operations of the Board and is effectively the liaison between the policy making functions of the Board and the implementation and execution of those policies by the staff. Reporting to the Executive Director are the other three senior staff positions.

(2) **The Deputy Director for Finance** serves as chief financial officer and chief investment officer for the Funds. The Deputy Director for Finance has three positions reporting to her who are assigned various support duties (e.g., accounting, investment analysis and staff support).

(3) **The Deputy Director for Operations and Benefits** is responsible for consideration of actuarial studies, reporting and disclosure by the Trustees, communications with participants and beneficiaries, assisting the Executive Director in the management of the operations and other duties as the Executive Director may assign.

(4) **The General Counsel** is the fourth senior staff position. In addition to serving as chief legal advisor to the Board and staff providing day-to-day legal analysis and advice, this person is also designated as the Board's Chief Compliance Officer.

In addition to the four senior staff positions, the Board has seven (7) other staff employees which include: Controller, Investment Analyst, Accountant, Office Manager, Executive Assistant, Secretary and Receptionist.

It should be noted that the Board is primarily responsible for the investment of the assets of the Funds. Unlike governing bodies of many other public employee retirement systems, the Board does not make benefit determinations or calculations, maintain benefit records, or process payments to beneficiaries. The responsibility for administration of non-investment related components of the Funds is vested with several agencies of the District of Columbia government. The Board transfers funds from a short-term investment account on a monthly basis to the District, based upon a certification letter, to cover benefit payments.

Eligibility Determinations

Eligibility for the Police Officers and Firefighters' retirement benefits is determined by an adjudicating board under the D.C. Office of Personnel (the Police and Firefighters Retirement and Relief Board; the "Relief Board"). The Relief Board is responsible for establishing eligibility for regular and disability pensions, including the determination of degree of impairment and the percentage of disability of each applicant. Similarly, authority for eligibility determinations for the Teachers' retirement benefits are vested with the Board of Education. Finally, retired Judges, in consultation with the Court System's Office of Personnel and/or the Payroll and Retirement Office, determine eligibility for the Judges' retirement benefits.

Once eligibility has been established by the applicable adjudicating authority, the Payroll and Retirement Office, under the D.C. Controller's office, calculates the retirement benefits amount, adds the annuitant to the retirement rolls, maintains the appropriate records, and thereafter makes monthly payments regularly from assets transferred monthly by the Board until the beneficiary becomes ineligible or dies.

Allocation and Disposition of Benefit Payments

The Act defines numerous liability figures for purposes of disclosure and determining funding requirements (contributions) for the District of Columbia and the Federal Government. While each of the liability figures are difficult to understand, they collectively form a unique pattern of future funding requirements for the District and the Federal government. It is important to note that the statutory funding requirements provides three (3) components to determine the District payment, while the Federal payment, which is subject to appropriation, is flat at $52.07 million annually.

According to the annual valuation (*Valuation as of October 1, 1996 for Fiscal Year 1998)* issued by the Board's actuarial firm Milliman & Robertson, Inc., "asset returns throughout the 1990s have been excellent resulting in the assets increasing over 80% since 1992." This trend has kept the unfunded liability from growing despite Federal contributions (as prescribed by statute) which are not enough to prevent the unfunded liability from increasing."

In accordance with the Act's mandate, which is virtually identical to the Employee Retirement Income Security Act (ERISA), the Board must exercise its responsibilities with respect to the Funds with the care, skill, prudence, and diligence as would a prudent individual acting in a like capacity and familiar with such matters under like circumstances. By diversifying the investments of the Funds so as to minimize the risk of large losses, the Board seeks long-term investment returns in excess of the actuarial assumption of 7 percent (raised in the fiscal year 1998 actuarial valuation to 7.25%) at a level of risk commensurate with the levels of returns and consistent with sound and responsible investment practices.

At the conclusion of *calendar year* 1996, the Board had achieved its performance objectives (the actuarial assumption rate and the target total fund benchmark) by earning a rate of return on all investments of 14.1 percent. Not only did the Board significantly outperform the actuarial assumption rate of return of 7 percent, but it also outperformed the target total fund benchmark of 12.6 percent. Over longer time horizons, the Board has consistently outperformed the actuarial assumption. For example, for the two years ended December 31, 1996, the Board earned 18.4 percent; for the three years, the Board earned 11.6 percent and for the five years, the investment portfolio earned 11.3 percent.

Attainment of the investment performance objective is often attributable to the construction of a broadly diversified portfolio that maximizes return for a given risk level. The Board has exceeded the 7 percent actuarial investment return assumption eleven (11) times since 1982 adding an additional $1.1 billion to the Funds.

Difficulties Encountered

All of the Board's expenses are paid out of the investment earnings of the Funds. Funds are periodically transferred from the Board's Master Custodian Bank to the District of Columbia General Fund for availability to cover Board related expenditures. Access to these funds, however, is often delayed and/or frustrated by newly established budgetary cost containment procedures which do not differentiate between District agencies that are totally self-funded and those who are dependent upon and obtain their revenues from the District's General Fund. We believe that it is imperative that a process be established to make such a distinction. Without such procedures, the Board's ability to continue operating efficiently and effectively is impeded. Although sufficient funds are available, the Board can not always make required payments in a timely manner. The Board is all too often required to explain late payments to its service providers in spite of the fact that funds are available. The Board has also from time to time experienced difficulties in obtaining timely payments from the District.

Investment Portfolio Management

Mr. Chairman, we have come a long way from our genesis in 1979, and I am very proud of the accomplishments of the Board and its Staff. The Funds currently have approximately $4.2 billion in assets and are 44 percent funded.

The following table represents the Funds current asset allocation.

Total Fund Target Asset Allocation

Asset Class	Allocation (%)
Domestic Equities	45.0
International Equities	20.0
Domestic Fixed Income	22.5
Global Fixed Income	7.5
Opportunistic*	5.0

* The "Opportunistic" classification is comprised of alternative investments and real estate.

Although the Board has sufficient assets available to meet all investment and administrative expenses, it nonetheless monitors all expenses very carefully. Fund expenditures as a percent of the market value of the Fund have experienced a downward trend since *fiscal year* 1990. At *fiscal year end* 1988, expenses as a percent of Fund assets were .42% (under one-half of one percent). The Board utilizes a number of cost-reduction measures, such as: (1) aggressively negotiating contract terms with investment managers (e.g., inclusion of a *most-favored client clause)*[1]; (2) imposition of a management fee reduction penalty for investment managers who under perform for a specific period of time[2]; (3) renegotiation of management fees before increases in asset allocations; and (4) renegotiation of domestic and global custodial rates. At the conclusion of *fiscal year* 1996, total Fund expenses represented .32% of the funds under management.

[1] The Board's "*most favored client clause*" requires all investment managers to provide the Board an equivalent fee if they negotiate a lower fee with a comparable Fund.

[2] The fee reduction penalty is part of the Board's "*Watch List*" policy that affords the investment manager the opportunity to correct its under performance, if possible, before being terminated thus avoiding expensive transaction costs.

Management Record

Mr. Chairman, over the past four (4) years the operations and management of the Funds and the attendant investment performance has been thoroughly reviewed, scrutinized and analyzed by a multitude of proponents and critics alike including the U.S. Congress, the Congressional Budget Office, the D.C. City Council, various independent task force groups and various local and national news reporting services. In addition to the tremendous responsibility involved in managing and investing the assets of the Funds, the Board and its staff have been inundated by the volumes of questions regarding the Board's performance and activities. Suffice it to say, the record is replete with analysis of every facet of the Boards operations and activities.

Some of the more extensive and noteworthy reviews conducted over the past several years include a report filed on January 13, 1994 by the D.C. Council Committee on Government Operations, which has oversight over the Board's operations. A second comprehensive review was conducted by a "blue ribbon" task force established by Delegate Eleanor Homes Norton, and Chaired by current OMB Director Franklin D. Raines (the "Task Force"), focused on the structure, operations, management policies and practices of the Board, including its fiduciary obligations, legal structure, investment policies, staff functions, and general rules of conduct. It's Report was issued in April 1994 [3].

Report language accompanying the 1995 District of Columbia Appropriations Act (Public Law 103-334) acknowledged the useful contribution and efforts of the Norton Task Force and the Council, however, it noted that those prior reviews were "limited in scope and in expertise". Accordingly, Congress decreed a third definitive analysis of the Board's fiduciary, management and investment practices and procedures to provide some assurance to the Congress that investment opportunities were being maximized. Congress not only required another review, but it incorporated language in the bill describing specific qualifications for the firm conducting the evaluation. The selected firm had to demonstrate expertise in the areas of investment and investment consulting including:

"(1) the review and analysis of the investment portfolios of large public pension funds;

(2) the investment practices of the managers of such funds;

(3) the relationship of such practices to the fiduciary responsibilities of the managers of such funds; and

(4) the analysis of the investment returns achieved by such funds on both an absolute and risk-adjusted basis."

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[3] *"Report of the Task Force on the District of Columbia Retirement Board"*, April 1994.

Bear Stearns Report

Bear Stearns Fiduciary Services, Inc., (now "Independent Fiduciary Services, Inc.") a nationally recognized firm which specializes in evaluating complex investment portfolios with extensive expertise regarding fiduciary responsibility in investment decision making, was selected as the firm best suited to meet the criteria set forth by the Congress. Their comprehensive report[4] was submitted to Congress on May 2, 1995 and set forth specific conclusions regarding the Board's investment performance, the current Board and staff structure, the Board's investment policy, and the investment managers selection and monitoring process. In sum, the Bear Stearns Report concluded that the Board's operations were well run and its investment performance was in the top quartile of public pension funds for the period examined. Management fees were found to fall within a reasonable level and the Board's overall asset allocation and procedures were determined to be "well documented, thorough, and effectuated by the Board in a prudent and deliberate manner ...."

CBO Report

Most recently, the Congressional Budget Office ("CBO") issued a report (March, 1997) which analyzed the investment policies and performance of the Board. Authors of the CBO Report concluded that the Funds are professionally managed and meet fiduciary standards, and the performance of the Funds has been consistent with other large public employee funds. The Report also noted that investments earned 14 percent last *calendar year*, and the 10-year average return was 11 percent.

Retirement Programs and Funding Issues

As a practical matter, a retirement program is part of an employee's compensation and is designed to attract and retain the employee. The employer (and the taxpayer, in the public sector) receive the benefit of the employee's service while the employee is active, not retired. The liabilities of and contributions to a retirement program therefore, should be related to the period in which benefits are earned, rather than the period in which benefits are paid.

During the period before enactment of the D.C. Retirement Reform Act of 1979, this principle of pre-funding the program throughout the careers of participating workers was not followed by the Federal government. The annual contribution was simply the net pay-as-you-go cost -- benefit payments to retirees less current employee contributions. In other words, the contributions were NOT related to the period in which benefits were earned as described above, but rather to the period when benefits were paid. As a result, an unfunded liability of over $2.6 billion existed in 1979, when the retirement funds of the Police Officers, Firefighters, Teachers and Judges where transferred to the District government by P.L. 96-122.

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[4] *"Report of Findings and Recommendations Regarding District of Columbia Retirement Board"*, April 4, 1995

Our actuaries tell us that the entry age normal funding method is the most common method used by the public sector employers to attribute the retirement benefit over active service. It is also the method specified in the 1979 Act. Under this method, the normal cost rate is determined which represents a level percentage of pay contribution that would be sufficient to fund the plan benefits if it were paid from each member's entry into the program until termination or retirement. The actuarial liability is determined as the portion of the value of projected benefits that will not be paid by future normal costs or by member contributions. The unfunded actuarial liability is the difference between the actuarial liability and the assets of the system. It represents missed normal cost payments, plus the lost investment earnings on those missed payments.

Unfunded Liabilities

Generally speaking, an unfunded liability presents many problems. First, participants have less benefit security. An employee or retiree can feel assured he or she will receive his/her retirement benefit only if there is money already set aside to pay that benefit. An unfunded liability means that the benefit comes from future tax dollars, which future taxpayers may not be willing to pay. Secondly, the burden is shifted to future generations of taxpayers. Because contributions have not been paid in the past, future taxpayers will have to make up the difference *plus* the lost investment earnings. As evidence, a cash infusion of $2.6 billion would have solved the entire problem for the D.C. retirement system in 1979. Today however, it would require $4.8 billion plus the nearly $1 billion in Federal contributions and $2 billion in excess District contributions that have been paid since 1979.

Under the President's plan for the District, which I will address in subsequent paragraphs, our actuaries have estimated that the failure to fund will cost over $30 billion in future taxpayer dollars. Finally, contributions to a system with an unfunded liability are not stable as a percentage of payroll. In a funded system, the contributions to a pension plan will equal the normal cost (plus/minus a small percentage to reflect deviations between the actual experience and the assumptions). The District's contribution to a fully funded system would have been 25% of payroll or less. However, under current circumstances, the District's contributions in FY 1980 began at approximately 35% of payroll and are currently nearly 60% of payroll.

While the Board cannot comment on other public sector pension systems, we do know that the D.C. Retirement System is unique in its history with the Federal government. Furthermore, we know that of those other public sector retirement systems with an unfunded liability, most have an actuarially sound method for amortizing any unfunded liability within a definite time frame. The current statutory funding method for the D.C. Retirement System provides no mechanism for amortizing the unfunded liability.

Observations of the President's Plan

Mr. Chairman, with regard to the President's Plan for the District, let me state at the outset that the Board applauds the President for his vision and for his Administration being the first to recognize the unfunded liability of the Police Officers and Firefighters', Teachers', and Judges' Retirement Systems as a Federal creation and thus a Federal responsibility. Let me also say that

we are unequivocally in favor of the Federal government's assumption of the unfunded liability. Unfortunately, we do not have specific details of the President's implementation plan. As you know, the devil is in the detail and we have no detail. Accordingly, our ability to properly evaluate and comment on the pension plan component of the President's plan has inherent limitations. However, based upon what we have read and heard, and the information we have received from OMB, we are currently unable to embrace the methodology underlying the assumption of the pension funds.

Addressing the Unfunded Liability

There is no doubt the President's Plan does not propose to fund the unfunded liability. Rather, it proposes to terminate the current retirement system (terminate the funding to the plans), take all of the current Trust assets (although there has been discussion about leaving some assets) and transfer them to a third-party trustee appointed by the Federal government. The District would be responsible for setting up replacement plans for current and future employees (except for Judges), and the assets transferred to the Federal government from the existing Funds would be used to pay benefits to the beneficiaries until the assets are depleted. Once depleted, the Federal government would be responsible for annually allocating benefit payments from general revenues. OMB has indicated that it (the Federal government) will take full responsibility for the Judges' retirement plan.

Federal Payments

The President's plan would cease the current funding of $52 million by the Federal government to the retirement Funds. No additional appropriations will be required by the Federal government until all the assets are depleted, ten to twelve years from now. The Board's actuarial firm (Milliman & Robertson) estimates that Federal annual payments, once the assets have been depleted, will average over $700 million per year for over twenty years. As mentioned above, our actuaries estimate that failure to fund will likely cost over $30 billion in future taxpayer dollars. These payments would be scheduled to begin at about the same time as the first wave of baby boomers will begin to move into retirement forcing Congress to address the Social Security crisis. The uncertainty surrounding the retirement security of the beneficiaries and participants of the D.C. Retirement System under this scenario is very troubling.

As fiduciaries of the Funds, it is the Board's view that it is in the best interest of the beneficiaries and participants to fund the unfunded liability, and not defer action for another ten years for another Congress that may, or may not, be supportive of the major annual capital outlay called for under this plan. Again, this large outlay would be particularly problematic in light of the hard decisions that will have to be made with respect to Social Security.

District Payments and Responsibility

As mentioned, the plan calls for the District Government to establish a new replacement pension system for current employees. The new pension system will establish the benefits which

would be accrued after the freeze date. Will this new plan maintain benefits for employees at the current level? What amount will the District be required to pay for this new plan? Will the District begin the new plan with an inherent unfunded liability and what would be the amount of the liability? There are a myriad of unanswered questions and the answers will require thorough examination before the proper evaluation can be made of the financial impact on the beneficiaries and participants of the Funds.

Since 1979, the Federal Government has contributed approximately $935.2 million in actual cash outlays to the Funds. This contribution has been invested in the Permanent Fund. The District has made approximately $3.2 billion in actual cash outlays to cover benefits, as required by the formula contained in the 1979 legislation that transferred the unfunded liability to the District. This $3.2 billion represents approximately $1.5 billion (without interest) above the amount that would have been required of the District had the pension system been fully funded by the Federal Government at the time of transfer in 1979. For this reason alone, one can reasonably argue that the District should not be required to turn over all the assets that have accumulated over the past 17 years. It is precisely this type of financial burden (i.e., the unfunded liability) which has been unfairly shifted by the Federal government to the District that has resulted in the financial crisis that the city is currently confronting.

The impact of funding a pension system cannot be overstated as illustrated by the current situation confronting the District. The lack of funding has cost the District over $1.5 billion over 17 years. Had this amount been available for investment during that period, it would have yielded in excess of an estimated $2.4 billion. Notwithstanding the foregone revenue, the Funds are currently 44% funded which represents an increase in funding of almost 20% since 1991 when we were only 25% funded. The Funds have grown from $150 million in assets when the Board took control of the Funds to $4.2 billion today. Again, it is important to remember that the Federal government has only contributed approximately $935.2 million, and the current unfunded liability of $4.8 billion is entirely attributable to the initial (1979) $2.6 billion unfunded liability that the Federal government created as a result of the net pay-as-you-go system. The excellent investment performance of the Funds, combined with no salary increases for employees, has in recent years kept the unfunded liability relatively flat.

The President's budget calls for an annual retirement payment of $400 million starting in FY 98 and a $22 million fee for the Trustee. Actuaries have certified that the payment required in 1998 is $307.4 million. Further, the Funds current budget including investment manager fees, salaries, rent and other administrative costs is $16 million. This discrepancy highlights the need for greater detail and suggests that this transfer to the Federal Government (to be managed by a third party trustee) may result in unexplained inefficiencies.

Alternatives

Congresswoman Norton proffered an excellent piece of legislation during the last Congress which would have provided an equitable method of amortizing over a number of years the unfunded liability. This type of approach, that addresses the unfunded liability issue in our view,

would provide more security for the beneficiaries and participants and would be more prudent financially for the Federal government.

Sound Actuarial Management

The Act which created the Board seventeen years ago acknowledged that the Police and Firefighters', Teachers', and Judges' Retirement Funds were not maintained on an actuarially sound basis. Like other pensions administered by the Federal government (i.e., Civil Service Retirement System, Military Retirement, and the Social Security System), the Funds were maintained on a net-pay-as-you go basis, which means current employee withholdings were used to pay for current retirees, rather than being invested to provide for their own retirement. As indicated earlier, a pay-as-you- go structure is simply an inter-generational transfer from younger workers to older retirees. Congress determined that this net-pay-as-you go method was unsound and that the Funds should be maintained on an actuarially sound basis. Thus a Trust for the three Funds was created requiring that the assets be invested to provide for the retirement security of these employees. Are the Funds beneficiaries and participants now expected sit idly by as their retirement funds revert back to the very funding method that Congress found in 1979 to be unsound? The very method that has resulted in a Social Security System in crisis.

As fiduciaries, we find no comfort in the argument that Social Security benefits are handled in this manner, thus it is acceptable to also place the District's police officers, firefighters, teachers and judges in the same tenuous position. We must endeavor to safeguard their retirement security -- not weaken it.

Conclusion

Mr. Chairman, allow me to reiterate that we must have more detail to carefully consider and comment on the President's Plan for the District government. The Board must know precisely what the beneficiaries and participants are receiving and what they are relinquishing before we are in a position to support this proposal. We must have the details and those details must be demonstrated to protect the retirement security of our beneficiaries and participants.

Mr. Chairman, thank you again for giving me the opportunity to share the Board's views and observations on these issues. This concludes my statement.

Mr. MICA. I thank you, Ms. Kane, for your testimony. We will defer questions till we have finished all the panelists.

I recognize now Ron Robertson, chairman of the Metropolitan Police Labor Committee, and offer my condolences on the tragic death of another officer this past weekend.

Welcome. You are recognized, sir.

Mr. ROBERTSON. Thank you, Mr. Chairman, Congresswoman Norton.

Thank you for the opportunity to testify before you regarding President Clinton's proposal to relieve the District government of the unfunded pension liability attached to the retirement programs for its police officers, firefighters, and teachers.

The pension plan enjoyed by police officers and others covered under the program is the result of congressional action. I and my fellow officers who are already retired or still working came to work for the District of Columbia under an agreement which included these benefits as part of our employment contract.

The plans recognize the special nature of law enforcement. It is an undeniable fact of our professional lives that we place ourselves in harm's way while serving this community each and every day. Unfortunately, not a year goes by that my fellow officers are not assaulted. Scores of us are injured and hospitalized every year.

We are on the front lines of a never-ending war on crime every day. We face a deadly enemy who wears no uniform and nearly always strikes without warning. No other Government employee faces such unending danger. Even our military enjoys years of peaceful duty between wars.

A memorial for fallen law enforcement officers stands blocks from here. It contains more than 12,000 names, and more are being added as this hearing is progressing. I have attended too many funerals for those among the ranks of the Metropolitan Police Department who have their lives savagely taken.

I am proud to be a police officer. I know that we save lives every day. We serve and protect without consideration of time or place. Where we see criminal activity, it is our unrelenting duty to act. We arrest those who prey on our honest citizens and work very hard to remove them from the streets. The dangers and difficulties we face come with the oath and duties of our office.

The retirement plan which I and others qualify for is underfunded and the subject of this committee's hearing today. The retirement plan reflects one quantitative recognition of the special hazards and duties I have just described. It is a promise made by the District of Columbia and the Congress to those of us who have served and continue to serve this community.

Our side of this promise is to perform our duty and to be prepared to make the ultimate sacrifice while doing it. We are keeping our side of the contract. I urge you to move to ensure that the benefits promised become the benefits delivered. President's plan provides for full protection of the benefits contained in the program as it currently exists. The Fraternal Order of Police wholeheartedly endorses that preservation of existing benefits without reduction.

Our members' duties under the employment contract containing the retirement benefits have not been diminished. In fact, they have been expanding and made more dangerous than ever before.

I urge this Congress to affirm the President's commitment to those of us behind the badge here. It is the right thing to do.

While I support the preservation of our existing benefits and their assumption by the Federal Government, as of the date of introduction of this plan, I do question the wisdom of the funding method chosen to secure them. I am no actuary or public accountant, but what I have read from those who are qualified to make financial assessments leads me to believe that the proposal to spend down the money currently contained in the retirement plan is not a good one.

According to the projections completed by Milliman & Robertson, Inc., for the D.C. Retirement Board in January, the President's plan would cost American taxpayers more than $24 billion by the time the last expected survivors or participants are deceased. But if a decision was made to more fully fund the retirement plan by obligating the Federal Government to a flat rate of $295 million annually over the next 40 years, the cost would be cut in half, to about $12 billion.

The Fraternal Order of Police urges you to adopt this type of funding strategy. I understand that the Congress and the administration are under significant pressure to reduce the Federal spending in order to balance the budget, but I am deeply concerned that a decision to avoid immediate expense will result in a future obligation which may not be honored because it will come due at the same moment in time when Social Security and other entitlements are making tremendous demands on the treasury.

I hope that people of honor will keep the promise made to me and other Metropolitan Police officers, but I am very concerned about the temptation of putting off until tomorrow what should be resolved today, especially when tomorrow's price tag is twice what timely action today would cost.

I conclude by urging you to take the difficult immediate steps necessary to protect those who serve and protect you. Please pass legislation which will begin funding our retirement plan at a level which will provide for all of its current and future annuitants on an actuarially sound basis.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Robertson follows:]

Testimony
of
Ron Robertson, Chairman
Fraternal Order of Police Labor Committee/
Metropolitan Police Department
before the
Committee on Government Reform & Oversight
Subcommittee on Civil Service
April 29, 1997

Thank you for the opportunity to testify before you regarding President Clinton's proposal to relieve the District Government of the unfunded pension liability attached to the retirement programs for its Police Officers, Firefighters and Teachers.

The pension plans enjoyed by police officers and the others covered under the program are the result of Congressional action. I and my fellow officers who are already retired, or still working came to work for the District of Columbia under an agreement which included these benefits as part of our employment contract.

The plans recognize the very special nature of law enforcement. It is an undeniable fact of our professional lives that we place ourselves in harms way while serving this community each and every day. Unfortunately, a year does not pass when my fellow officers are not assaulted. Scores of us are injured and hospitalized every year. We are on the front lines of the never ending war on crime every day. We face a deadly enemy who wears no uniform and nearly always strikes without warning. No other government employee must face such unending danger. Even our military enjoys years of peaceful duty between wars. A memorial for fallen law enforcement officers stands just blocks from here. It contains more than 12,000 names and more are being added as this hearing is progressing. I have attended too many funerals for those among the ranks of the Metropolitan Police Department who have had their lives savagely taken.

I am proud to be police officer. I know that we save lives every day. We serve and protect without consideration of the time or place. Where we see criminal activity it is our unrelenting duty to act. We arrest those who prey on our honest citizens and work very hard to remove them from our streets. The danger and difficulties we face come with the oath and the duties of our office.

The retirement plan which I and others qualify for is under funded and the subject of this Subcommittee's hearing today. The retirement plan reflects one quantitative recognition of the special hazards and duties I have just described. It is a promise made by the District of Columbia and the Congress to those of us who have served and continue to serve this community. Our side of that promise is to perform our duty and to be prepared to make the ultimate sacrifice while doing it. We are keeping our side of the contract. I now urge you to move to ensure that the benefits promised become benefits delivered.

The President's Plan provides for the full protection of the benefits contained in the program as it currently exists. The Fraternal Order of Police wholeheartedly endorses that preservation of existing benefits, without reduction. Our members' duties under the employment contract containing the retirement benefits have not been diminished. In fact, they have been expanded and made more dangerous than ever before. I urge this Congress to affirm the President's commitment to those of us behind the badge here. It is the right thing to do.

While I support the preservation of our existing benefits and their assumption by the Federal government as of the date of introduction of this plan, I do question the wisdom of the funding method chosen to secure them. I am no actuary or public accountant, but what I have read from those who are qualified to make financial assessments leads me to believe that the proposal to spend down the money currently contained in the retirement plan is not a good one.

According to a projection completed by Milliman & Robertson, Inc. for the D.C. Retirement Board in January, the President's plan would cost American taxpayers more than $24 billion by the time the last expected survivors and participants are deceased. But, if a decision was made to more fully fund the Retirement Plan by obligating the federal government to a flat rate of $295 million annually over the next 40 years the cost would be cut in half to about $12 billion. The Fraternal Order of Police urges you to adopt this type of funding strategy.

I understand that the Congress and the Administration are under significant pressure to reduce federal spending in order to balance the budget, but I am deeply concerned that a decision to avoid immediate expense will result in a future obligation which may not be honored because it will come due at the same moment in time when Social Security and other entitlements are making tremendous demands on the Treasury.

I hope that people of honor will keep the promises made to me and other Metropolitan Police Officers but I am very concerned about the temptation of putting off until tomorrow what should be resolved today. Especially, when tomorrow's price tag is twice what timely action today would cost.

I conclude by urging you to take the difficult immediate steps necessary to protect those who serve and protect you. Please, pass legislation which will begin funding our Retirement Plan at a level which will provide for all of its current and future annuitants on an actuarially sound basis. Thank you.

Mr. MICA. Thank you for your testimony.

I will turn now to Mr. Thomas Tippett, chairman of the Pension Committee of the Fire Fighters Association of the District.

Welcome, and you are recognized, sir.

Mr. TIPPETT. Thank you, Mr. Chairman.

I also have a statement I would like to submit—it's rather lengthy—and then try to summarize.

Mr. MICA. Without objection, that will be made part of the record. Thank you.

Mr. TIPPETT. Thank you, Mr. Chairman, members of the committee and staff.

I am Thomas Tippett, chairman of the Pension Committee of the D.C. Fire Fighters Association. I am a 29-year veteran of the D.C. Fire Department and have served as president of the Fire Fighters Association for 12 years. Presently, I am serving as the active firefighter representative on the D.C. Retirement Board.

In my capacity as president of the Fire Fighters over the years, I have served on numerous pension task forces, work groups, mayoral pension transition teams, and have testified before the House and Senate committees many times, the subject matter always being the same as it is today: How do we address the unfunded pension liability?

Mr. Chairman, we do believe that the administration's plan is a bad deal for the firefighters, but I believe also that it is vital, as we discuss the proposed legislation dealing with the unfunded liability, that we don't forget or overlook the past legislative history that has brought us to this point.

I have laid out a history of that in my testimony, but specifically, in 1976, legislation was passed to address the unfunded liability, in the Congress, and OMB voiced strong opposition to the bill. In 1978, Representative Mazzoli introduced the same bill, and it was amended in subcommittee and further during conference. It was passed by the House and Senate and sent to the White House, and President Carter vetoed that bill. At the time, the budget director was Bert Lance, and a staffer working at OMB was Franklin Raines, ironically.

In 1979, President Carter signed our current legislation, 96–122, the D.C. Pension Reform Act, but it was not at the time, and we all knew at the time, enough to fund the pension system. So we knew, and I plead guilty. Having been involved back then in the pension legislation, we knew at that time that there was a shortfall. And I don't want to see that happen again, Mr. Chairman. I think it needs to be addressed and addressed in its entirety this time, not put off for another 5, 6, 10 years, where it surfaces again.

At that time, there were major changes made to the pension system for police officers and firefighters. All those hired after 1980 are under an entirely different system. The age requirement was added, 50 years of age; 25 years of service was required to retire. The annuity was then changed to be based on your high three instead of your salary at your date of retirement.

We eliminated a major provision for disability retirement, called the "aggravation claus." Disability retirement for those after 1980 is based on a percentage of impairment instead of two-thirds salary, it could be a minimum of 40 percent of salary. There were re-

strictive earnings placed on disability retirees. One COLA is now in effect for those retirees hired after 1980.

The D.C. Retirement Board was established under that legislative act. And we have had a new system that has been put in place for employees hired after October 1996. So we actually have a three-tiered system for police officers and firefighters in the District today. Under that new system, employees pay 8 percent of salary, as opposed to the 7 percent for pre-1986 employees. And those employees, post-1996 employees, have their COLAs capped at 3 percent.

So, again, there have been two instances where there have been major reductions in benefits for public safety employees, since 1978 when this issue really surfaced and was addressed by the Congress.

Now, the D.C. Fire Fighters Association has supported, in testimony before the Congress, the elimination of the twice a year COLA replaced by a single COLA. We have supported the elimination of the equalization clause, which gives members who retired prior to 1980 the same salary increases as active members. This would be replaced by providing retirees with a single COLA, and this would serve to stabilize the actuaries' assumption and prohibit the Mayor from adding to future liabilities. We have also supported the increase in all employee contributions from 7 percent to 8 percent.

The plan that is being discussed today, Mr. Chairman, was an outline to us until a meeting April 9 at the White House, at which time the staff of OMB gave a more descriptive analysis of what the President's plan would entail and how it would impact on current employees and current retirees.

In our opinion, the Clinton administration committed a great injustice to the active and retired members of the public safety family, particularly our elderly retired members and their widows, by prematurely announcing a plan that had the potential to adversely impact their monthly annuity but offered no specifics.

Again, it wasn't until the April 9 meeting that the White House acknowledged in a handout that, for employees already retired as of the freeze date, the Federal Government would be responsible for paying all future retirement benefits, and that these benefits would remain unchanged under the proposal.

They also stated that they would assume responsibility for the District's existing pension plans for law enforcement officer, firefighters, teachers, and judges. Mr. Chairman, the key word in the press release is "assume." We believe that the word should be "fund," that they should fund the existing plans.

It appears that the folks at 1600 Pennsylvania Avenue don't get it. They still haven't learned from past mistakes. Had the Carter administration properly addressed the unfunded liability, as Congress wanted them to do, we wouldn't be having this hearing today. Instead, they are requesting you to approve the transfer of the board's assets, now approximately $4 billion, to a third-party trustee who will use the assets to pay benefits to the beneficiaries until the assets are gone. We believe this is sheer folly.

I support your statement of February 15, when you said, "At a time when we need to be looking for ways to infuse real cash into

our pension system, Social Security, as well as Civil Service, the D.C. proposal appears headed in the wrong direction."

It appears that the administration is proposing to raid the current assets to pay for short-term annuity obligations. The firefighters respectfully suggest that the third-party trustee be mandated to invest the approximately $4 billion in assets for maximum return, and that a payment formula be designed by the Congress that would finally recognize the Federal obligation, as well as the city's responsibility to the police officers and firefighters hired prior to home rule.

Mr. Chairman, one other point that is very disturbing is the impact that this proposal is having on the current workforce. There is a great fear out here among the senior staff of the Police and Fire Departments that there will be a major change in their level of benefits once the District has to come up with a plan that will be implemented after the so-called "freeze date," a date that has changed three different times.

Because of that fear, because of that concern, there are over 200 firefighters, top-level, senior people, and I believe well over 600 police officers, who are anxiously awaiting September 30 of this year, as sort of a date certain to retire by. I think it would be certainly devastating to public safety in the city if that large a number of police officers and firefighters were to retire because of the fear of the unknown; they cannot be given any certainty as to their level of benefits.

Unfortunately, there is no one here from the city today to address that issue. All the President's plan calls for is the city to, within 12 months, come up with a new plan for current and future employees. Well, we are current employees, going back to 1968 in my case. And I know there are many, many similarly situated in the Fire Department who are looking at this unknown and making a determination that they very well may have to retire before the implementation of this plan, if, in fact, it does become legislation.

So I think it is certainly a concern that needs to be brought to the attention of the committee. I think it is an impact that no one thought of, quite frankly, at the White House and OMB, and that's another example of what has been disturbing about this whole process, is that it seems like it was an outline thrown out there and filling in the details later.

The actuaries have done an analysis of the plan, and it appears that it will cost the Federal taxpayers upwards of $24 billion to go with the administration's plan, as opposed to roughly $12 billion under Ms. Norton's plan. And we find it very, very difficult to embrace that kind of a concept, to delay the payment of the bill and increase it in the out years, and, in effect, cost the Federal taxpayers double what is necessary.

So we would hope that you would look at the comments that have been made here today toward looking at addressing the unfunded liability, because it certainly is a serious problem facing the District, and it is an issue that is now affecting the employees, not

only the retired employees, but the current active. It could have, unless addressed properly, I believe, a devastating impact on public safety here in the District.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Tippett follows:]

Mr. Chairman, members of the Committee and staff; I am Thomas N. Tippett, Chairman of the Pension Committee, D.C. Fire Fighters Association.

By way of background I am a 29-year veteran of the D.C. Fire and Emergency Medical Services Department; have served as President of the D.C. Fire Fighters Association for 12 years; and am presently serving as the active fire fighter representative on the D.C. Retirement Board.

In my capacity as President of the D.C. Fire Fighters Association, I have served on numerous Pension Task Forces, work groups, Mayoral Pension Transition Teams and have testified many times before House and Senate Committees . . . The subject matter then, was as it is today . . . how do we address and solve the District's unfunded pension liability?

I believe it is vital, as we discuss the proposed legislation dealing with the unfunded liability . . . that we don't forget or overlook the past legislative history that has brought us to this point.

- 1916 - Congress instituted the Policemen and Firemen Relief Fund. Employees contributed 1 - ½ percent of salary. Any deficiencies in the fund were made up by the D.C. Government.

- 1924 - Congress increased employee contributions to 2 - ½%; established a formula for sharing expenses of 60% from D.C. revenues and 40% from Federal revenues.

- 1968 - Congress permits the city to calculate pension funding for only the normal cost accrued each year.

- Nelson Commission Report very critical of the methods of Congressional financing for police, fire and teachers retirement system.

- 1974 - Rep. Rees, D-CA, in response to the Nelson Commission Report recommendations introduced H.R. 15139, to establish and finance a retirement fund for police and fire fighters. This Bill died because OMB failed to acknowledge a Federal responsibility to assist the District in funding retirement benefits granted prior to Home Rule.

- 1976 - Rep. Rees again reintroduces pension funding legislation, to include teachers and judges. OMB again voiced strong opposition and the Bill was not considered by the Full House.

- 1978 - Rep. Mazzoli, D-KY, introduced same Bill. It was amended in Sub-Committee and further during the conference with the Senate. Bill HR 6536 was passed by House/Senate and sent to White House. President Carter pocket-vetoed the bill, indicating it was too costly to the Federal government.

- 1979 - President Carter signs PL-96-122 - The District of Columbia Pension Reform Act, into law.

Major Changes in Pension System as a Result of PL 96-122 After 2-15-80

- To **retire**, a member must be **50 years of age** - with **25 years of service**. (Formerly 20 years of service, 2-1/2% for first 20 years, 3% thereafter).

- **Annuity** will now be based on an average **high three-year salary**. (**Formerly** based on **last** salary.)

- **Eliminated** Disability Retirement for **aggravation of an off-duty injury**.
  (Formerly could retire for aggravation of an off duty injury.)

- **Disability retirement** now based on a medically determined **percentage of impairment**. Minimum benefit - 40% of salary.
  (Formerly minimum benefit - 66-2/3% of salary.)

- **Restrictive earnings limitation** on disability retirees.

- **One COLA** per year (per D.C. City Council legislation).

- 2- ½ for first 25 years - 3% after 25 years, maximum of 80%.

- Established D.C. Retirement Board.

- **DCRB** will **invest** annual **$52M Federal payment**. The payments to continue for 25 years.

Proposed New Legislation to Address the Unfunded Pension Liability

- 1994 - D.C. Delegate Eleanor Holmes Norton introduces HR 3728.

- 1996 - D.C. Delegate Eleanor Holmes Norton introduces HR 1996

  No definitive actions taken on either of these proposed laws during either the **103rd** and **104th** Congress.

- D.C. City Council, **per Congressional mandate, establishes a third retirement system** for police and fire **effective October 1, 1996**.

  New system requires **25 years of service** to be eligible for retirement.

2-1/2% credit for each year of service.
One COLA per year, **3% cap**.

Employee contribution increased to 8%
(Formerly 7%)

The D.C. Fire Fighters Association **has supported** in testimony before the Congress:

- The **elimination** of the **twice** per year COLA and replaced by a single COLA.
- The **elimination** of the equalization clause which gives members who retired prior to 1980 the same salary increase as active members. This would be replaced by providing retirees with a single COLA. This would serve to **stabilize** the actuaries' assumptions and prohibit the Mayor from adding to future liabilities.
- **Increase** the **employee contribution** from 7% to 8% **for all members**.

The Present

Chairman Mica, today you have invited us here to offer comments on President Clinton's National Capital Revitalization and Self-Government Improvement Plan.

I will do my best to do that . . . however, it wasn't until April 9, 1997 that leaders of the police and fire unions, along with other city representatives were invited to attend a meeting at the White House for a pension briefing by

OMB staff. It was during this briefing that we finally met the creators of the pension part of the Clinton rescue plan. However, the meeting left unanswered several outstanding issues that are causing consternation among our members. Until three weeks ago, the only information I had received concerning the Clinton plan was from the White House press release of January 14, 1997 and the news media.

In our opinion, the Clinton Administration committed a great injustice to the active and retired members of the public safety family - particularly our elderly retired members and their widows - by prematurely announcing a plan that had the potential to adversely impact their monthly annuity, but offered no specifics.

Again, it wasn't until the April 9, 1997 briefing that the White House acknowledged in a handout, that "for employees already retired as of the freeze date, the federal government would be responsible for paying all future retirement benefits (including cost of living increases). Benefits for these retirees would remain unchanged by this proposal."

According to the White House Press Release dated 1-14-97, the Clinton

plan would "assume responsibility for the District's existing pension plans for law enforcement officers, fire fighters, teachers and judges".

Mr. Chairman, the key word in the press release is "**assume**"! We believe the word should be "**fund**" . . . **fund** the existing pension plans". The reason we find ourselves here today is that the Carter Administration and OMB Director Bert Lance would only fund a small portion of the unfunded liability. Mr. Chairman, it appears the folks at 1600 PA Ave., NW still don't get it. They still haven't learned from past mistakes. Had the Carter Administration properly addressed the unfunded pension liability as the Congress wanted them to, we wouldn't be having this hearing today!

Instead, they are requesting you to approve the transfer of the D.C. Retirement Board's assets, now approximately $4.0B to a third party trustee who will use the assets to pay benefits to the beneficiaries until these assets are gone. Once spent, the Federal government would be responsible for annually allocating payments from general revenues to pay benefits. We believe this is sheer folly!

Mr. Chairman, I totally support your statement of 2-15-97 when you

said "at a time when we need to be looking for ways to infuse real cash into our pension systems - Social Security as well as Civil Service - the D.C. proposal appears headed in the wrong direction." Your statement continues, that "from the budget documents, it would appear that the Administration is proposing to raid the current assets . . . to pay for short-term annuity obligations."

To that statement, we add a hearty, "Amen". The pension fix of the Clinton plan is not, in our opinion, a "pension rescue", but a pension raid - pure and simple!

The District of Columbia fire fighters respectfully suggests the third party trustee be mandated to invest the approximately $4.0 billion in assets for maximum return, and that a payment formula be designed by the Congress that would finally recognize the Federal obligation, as well as the city's responsibility to the police officers and fire fighters hired prior to home rule.

It is our understanding that the actuaries have several models that were used in the past that could pinpoint the amount needed to address the pre

home rule liability. However, nothing suggested thus far has been so bizarre as what the President is proposing!

By way of information, we requested the D.C.R.B.'s actuaries Milliman & Robertson, Inc., to run the numbers and see how much money the Federal taxpayers would have to pay out if the Clinton Pension Plan was enacted. Mr. Chairman, these numbers are staggering!

The following is a brief summary of what the Clinton Plan actuarial information reflects:

- The current trust fund would run out in the year 2010.
- In the year 2011, after the trust fund has been depleted, the feds will be required to pay approximately $647 million.
- Benefits payments continue to increase until 2023 reaching a maximum payment of $769.7 million a year.
- Payments start to decline in 2023; however, from 2022 until 2033 [over 10 years] they stay in the $700 million range.
- By the time the **last expected survivors** and **participants** are **deceased**, the **Federal taxpayers** will have **paid** more than **$24 billion**, exclusive of the $4 billion plus earnings in the funds, while under the pension legislation submitted by Delegate Norton, the Federal Government would contribute $295M a year for 40 years for a total of $12B.

The obvious question is, why should the taxpayers pay out this type of money instead of a flat amount over 40 years ($12B) to fund the plan totally?

In addition to the financial concerns raised by the Administration Plan, there remains an equally serious problem of what will be the benefit levels for current employees.

Again, the devil is in the details and the only details we had received prior to the April 9, 1997 meetings were contained in the press release.

The press release called for the current plan to close October 1, 1997. "No new benefits would accrue." "The District would have to set up **new plans** for its **current** and **future** employees". Would that mean "no new liabilities" would include future COLAs? Will the current level of retirement benefits be carried over to the District's new retirement plan? The White House staff was not able to provide these answers.

The current workforce has legitimate concerns over what impact the Clinton plan will have on their retirement benefits. We were astonished to learn at the April 9, 1997 briefing, that the freeze date had been moved up

to June 1, 1997. While we don't believe this is a realistic date, never the less it shows the **lack of understanding** on the part of the White House over the **potential** for **massive retirements** among the **senior members** of the **police** and **fire** departments. Due to the constant changing of the freeze date, (it has been changed three times) the current work force is deeply concerned as to what impact the President's plan will have on their current retirement benefits.

As I speak, we have over 200 senior Fire Department officials and fire fighters - plus many more members of the Metropolitan Police Department - who are now eligible to retire and are nervously following the deliberations over the Clinton plan.

Again, the uneasiness is being fueled by the lack of specifics in the Clinton plan. There is nothing to indicate that promises made to current employees and retirees will be honored.

These seasoned veterans of the police and fire departments have circled the date September 30, 1997 on their calendars. This is the date they will be forced to retire . . . due to the fact that the old retirement plan will close .

. . and they will be placed into the new retirement system yet to be designed by the D.C. Government.

Obviously, the District cannot afford such a mass exodus of seasoned, experienced public safety members.

In conclusion Mr. Chairman, I must apologize for being so negative regarding the pension part of the Clinton plan, but the lack of specifics has left me no other choice.

The District of Columbia Fire Fighters Association, as we have always demonstrated, are ready and willing to come to the table to discuss the very important issue of funding our pension system. All we need is the invitation. We want to support a final plan, not work to defeat a proposed one.

Mr. Chairman, this concludes my statement. I am prepared to answer questions from the committee.

Mr. MICA. Thank you for your testimony.

I will now recognize Mr. James Baxter, who is the treasurer of the Washington Teachers Union.

Welcome, sir. You are recognized.

Mr. BAXTER. Thank you, Mr. Chairman and members of the committee.

My name is James Baxter, and I am the treasurer and the chair of the Pension Committee for the Washington Teachers Union. I am pleased to be here today on behalf of the WTU and the president, Barbara Bullock.

The Washington Teachers Union appreciates the invitation to address President Clinton's Capital Revitalization and Self-Government Improvement Plan; specifically, that portion of the plan that relates to the pension systems which provide retirement benefits for teachers, judges, police, and firefighters.

We are especially pleased that the President has proposed this bold venture, and we sincerely hope that the Congress will, at the very least, adopt his recommendations as a beginning step in the resolution of a very serious problem.

Clearly and simply, the current situation regarding these pension plans cannot be allowed to continue. These pension plans established by Congress—the police and fire in 1916; the teachers in 1920; and the judges in 1970—were victimized by the Congress' failure to fully fund.

When the District achieved home rule in 1975, as we have heard in former testimony, these plans were turned over to the District along with $2 billion in unfunded pension liability. By 1980, that unfunded pension liability had grown to $2.8 billion.

When the Congress passed the Retirement Reform Act of 1979, two things happened: One, a plan was put into effect that began the Federal Government's attempt to deal with the debt it had passed on to the District; and two, it created a complex formula by which the District would make annual pension payments into the plans.

The District held up its end, contributing through September 1996, $1.9 billion in excess of the actual retirement costs for the period, but still less than the actuarially determined cost to fully fund the system. The Federal revenue stream continues to the tune of $52 million per year. Yet, what has happened? What has happened is that the unfunded liability, the debt, has grown from $2.8 billion in 1980 to $4.4 billion in 1996. It is estimated to reach in excess of $6 billion by 2004.

What is clear is that the District has done the very best it could, even to the point of making its contributions in excess of these costs. What is also clear is that the Federal Government's failure to fund what it promised has saddled the District with a debt it can never overcome and caused our members to question whether or not there will be a pension system when they reach retirement age.

It is against this factual background that we are pleased to receive the President's plan and recommend its acceptance to you. At this point, we are attempting to inform ourselves about the various options which have been suggested to implement this plan.

We are not prepared today to recommend one over the other. However, we can pledge to you and to this committee our intent to work closely with you, with our friends on the City Council, and with all other parties to find and support the plan that best meets the needs of our members and serves the public interest.

I said at the beginning that I hoped you would view the President's plan as the beginning step in the resolution of this issue of pensions. As helpful as the President's plan may be, we are concerned that it may not go far enough. Here is why.

On February 25, 1997, the D.C. City Council received testimony on the President's plan. In addition to OMB director, Franklin Raines, many others offered comment on the plan. One of those groups was the prestigious and respected Greater Washington Society of CPAs. Their chairman, Bert Edwards, put forth a sound analysis of the plan. One aspect of his analysis is of concern.

I quote from his testimony: "The President's plan unequivocally recognizes the funding in the Retirement Reform Act of 1979 was simply too little. Pursuant to the above studies and others, the plan accepts responsibility for much of the unfunded liability. However, based on the Greater Washington Society of CPAs' current understanding, the plan may leave the District with an unfunded liability estimated at $1.2 billion."

Mr. Edwards goes on to point out that the Retirement Board's actuary, Milliman & Robertson, Inc., believes that the projected $4.3 billion unfunded liability, at September 30, 1998, is actually only about 78 percent of what they believe the real unfunded liability may be. They project an actual unfunded liability of $5.5 billion.

What that says to us is that, even should the Congress pass the President's plan as is, we feel the District will be left with an unfunded liability estimated at $1.2 billion. Were that to be the case, the District and our members would find ourselves right back in the situation we faced at the beginning of this crisis. We cannot be expected to create and maintain a fiscally sound system, a fully funded pension plan, if we face the prospect of another billion-dollar-plus unfunded liability.

Therefore, Mr. Chairman, while we continue to explore the options as to how the President's plan may be implemented, I do make the strongest of recommendations. I strongly urge you to agree that this reassumption by the Federal Government can only cure the existing pension crisis by including the entire unfunded liability.

To pass any plan which would result in another unfunded liability would be to fail in the resolution of the original problems created by the Congress in 1975. I urge you to commit now to full resolution and not to defer until later problems we can anticipate today.

In that regard, I would like to state that Congresswoman Norton's proposal has strong financial attributes that must be considered as we forge forward with an interest in trying to reconcile the differences in the pension plan, in particular, the notion of having costs which would be amortized and that would, for two major reasons, have dual benefits.

One is current funding and an increased amount of the liability, over a 40-year period, and, of course, if it were in a shorter period,

that's all the better to those persons that are now annuitants or annuitants to be, that face the anxiety of not knowing the outcome; and two, the reduction of future payments to the Federal Government, which would be, from that aspect, somewhat self-serving. And as was spoken earlier, the costs would be potentially twice—or at least less by two times the amount that it would be without such a proposal.

Thank you for the opportunity to address the committee. The Washington Teachers Union looks forward to working closely with you in the resolution of this difficult issue.

Thank you.

[The prepared statement of Mr. Baxter follows:]

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TESTIMONY BY THE WASHINGTON TEACHERS' UNION
By James O. Baxter II, Treasurer
House Committee on Government Reform and Oversight
Civil Service Subcommittee

Thank you, Mr. Chairman.

My name is James O. Baxter, II and I am Treasurer of the Washington Teachers' Union, AFT, AFL-CIO. I am pleased to be here today on behalf of the WTU and of our President, Barbara Bullock.

The Washington Teachers' Union appreciates the invitation to address President Clinton's Capital Revitalization and Self-Government Improvement Plan; specifically, that portion of the plan that relates to the pension systems which provide retirement benefits for teachers, judges, police and firefighters.

We are especially pleased that the President has proposed this bold venture and we sincerely hope that the Congress will, at the very least, adopt his recommendations as a beginning step in the resolution of a very serious problem.

Clearly, and simply, the current situation regarding these pension plans cannot be allowed to continue.

These pension plans established by Congress; the police and fire in 1916, the teachers in 1920, and the judges in 1970, were victimized by the Congresses failure to fully fund. When the District achieved Home Rule in 1975 these plans were turned over to the District along with the $2.0 billion in unfunded pension liabilities. By 1980 that unfunded liability had grown to $2.75 billion.

When the Congress passed the Retirement Reform Act of 1979 two things happened. One, a plan was put into effect that began the Federal government's attempt to deal with the debt it had passed on to the District. And, two, it created a complex formula by which the District would make annual pension payments into the plans.

The District held up its end, contributing through September of 1996, $1.9 billion in excess of the actual retirement costs for the period, but still less than the actuarially determined cost. The Federal revenue stream continues to the tune of $52 million per year, yet what has happened? What has happened is that the unfunded liability -- the debt -- has grown from $2.75 billion in 1980 to $4.4 billion in 1996, and is estimated to reach in excess of $6.0 billion by 2004.

What is clear is that the District has done the very best it could, even to the point of making contributions in excess of costs. What is also clear is that the Federal government's failure to fund what it promised has saddled the District with a debt it can never overcome and caused our members to question whether or not there will be a pension system when they reach retirement age.

It is against this factual background that we are pleased to receive the President's Plan and recommend its acceptance to you.

At this point we are attempting to inform ourselves about the various options which have been suggested to implement this plan. We are not prepared today to recommend one over the other. However, we can pledge to you and to this Committee our intent to work closely with you, with our friends in the City Council, and with all parties to find and support the plan that best meets the needs of our members and serves the public interest.

I said in the beginning that I hoped you would view the President's Plan as the "beginning step" in the resolution of this issue of pensions. As helpful as the President's Plan may be, we are concerned that it may not go far enough.

Here's why. On February 25, 1997 the D.C. City Council received testimony on the President's Plan. In addition to OMB Director, Franklin Raines, many others offered comment on the Plan. One of those groups was the very prestigious and respected Greater Washington Society of CPAs (GWSCPA). Their chairman, Bert T. Edwards, put forth a sound analysis of the Plan. One aspect of his analysis is of concern.

I quote from his testimony: "The President's Plan unequivocally recognizes that the funding in the Retirement Reform Act of 1979 was simply too little. Pursuant to the above studies (and others), the Plan accepts responsibility for much of the unfunded liability. However, based on GWSCPA's current understanding, **the Plan may leave the District with an unfunded liability estimated at $1.2 billion.**" (Emphasis my own.)

Mr. Edwards goes on to point out that the Retirement Board's actuary (Milliman and Robertson, Inc.,) believes that the projected $4.3 billion unfunded liability at September 30, 1998 is actually only about 78% of what they believe the real unfunded liability may be. They project an actual unfunded liability of $5.5 billion.

What that says to us is that even should the Congress pass the President's Plan as is, we fear the District will be left with an unfunded liability estimated at $1.2 billion. Were that to be the case the District, and our members, would find ourselves right back in the situation we faced at the beginning of this crisis. We cannot be expected to create and maintain a fiscally sound, fully funded pension plan if we face the prospect of another billion dollar plus unfunded liability.

Therefore, Mr. Chairman, while we continue to explore the options as to how the President's Plan may be implemented I do make this strongest of recommendations. I strongly urge you to agree, that this reassumption by the Federal government can only "cure" the existing pension crisis by including the entire unfunded liability. To pass any plan which would result in another unfunded liability would be to fail in the resolution of the original problems created by Congress in 1975. I urge you to commit now to full resolution and not to defer until later problems that we can anticipate today.

Thank you for the opportunity to address the committee. The Washington Teachers' Union looks forward to working closely with you in the resolution of this difficult issue.

Mr. MICA. Thank you for your testimony.

Ms. Kane, it sounds like you put half your lifetime into trying to get this pension fund in order. Wouldn't it break your heart to regress to 1979, as far as spending out any of the assets?

Ms. KANE. Very definitely, sir. We agree that, with the finding of Congress in 1979 that having an unfunded pension system is unsound, and that it's not sound Government practice, and it's not good for the beneficiaries and the participants.

Mr. MICA. The problem we face is trying to come up with the difference to meet some of the annual operating shortfalls for the District, and this obligation to meet benefit requirements is just—I mean, it's doing the same thing at the Federal level. What did we put in, a shortfall of $30 billion? $30 billion, which is now getting up there.

Let's see. I was encouraged to hear Mr. Tippett say that their employee group had offered some concessions to try to put things in financial order. And I think you clarified the point that the new hires are now paying 8 percent, and they have a cap of 3 percent for their COLAs, and that was proposed, also, for all of the old employees.

Is that correct? Did you say that you also had offered that?

Mr. TIPPETT. For the older employees, what we proposed was a single COLA.

Mr. MICA. Right.

Mr. TIPPETT. Currently, they are entitled to a twice a year COLA.

Mr. MICA. And going from 7 to 8.

Mr. TIPPETT. Seven to eight. And also elimination of what's called the "equalization clause," which gives some actuaries grief in that it allows the Mayor to have control over a large number of retired employees by tying their annuity to active employees' salary increases. So by eliminating the equalization clause, you would put everyone under a single COLA, and it would be much easier to cost out.

Mr. MICA. If we did that—maybe Ms. Kane or Ms. Norton or you, Mr. Tippett, have run the figures on that—what kind of funds does that inject?

Ms. KANE. Mr. Chairman, going from the twice a year to a once a year, we did have the figures run last year. Eliminating the twice a year COLA would have decreased the unfunded actuarial liability, as of October 1, 1995—of course, it has increased a little since then—from $5.15 billion to $5.09 billion. That's a $60-million difference.

Mr. MICA. Is that annualized?

Ms. KANE. No, that's absolute.

Mr. MICA. Absolute.

Ms. KANE. That's absolute. The annualized difference would have been about $2 million a year.

Mr. MICA. That's all?

Ms. KANE. The difference, yes. It is perhaps one of those issues that is more a lightning rod than an actual dollar cost.

But, as Mr. Tippett said, the Council has taken the action for all the new hires. The Council has taken the action for anyone who was hired from 1980 on. The Council could not take action for any-

one hired prior to 1980, to change that, because the home rule charter, also passed by Congress, prohibited the Council, and continues to prohibit the D.C. Council, from changing the benefits, including retirement benefits, for anyone who was hired prior to December 31, 1979.

So, in order to make a change in that area, the Council had asked the Congress to do it, tied to the passage of legislation similar to Ms. Norton's, which would be part of the solution to the whole problem.

Mr. MICA. And what would the 7 to 8 do, if included in legislation, on those that are not now covered but could be covered?

Ms. KANE. The dollar amount—I don't know if we have what the change would be, going from 7 percent to 8 percent for current employees who are not in the new hires program. I do know, when the Council ran the numbers, that the difference between 7 percent and 8 percent, and being able to fund the new hires program, did make a difference.

Mr. MICA. You might be getting a whisper in your ear.

Ms. KANE. The difference, I'm told, is about $5 million a year, to go from 7 percent to 8 percent.

Mr. MICA. That's only 7. Anything else that could be done?

Mr. TIPPETT. Well, Mr. Chairman, the equalization.

Mr. MICA. Equalization, what's that worth?

Mr. TIPPETT. That I don't know, but I think there is certainly a dollar figure to be attached to it. What it is we can provide for the committee, but we haven't run that number.

Mr. MICA. Well, I believe the Federal Government probably has some liability here. I don't know if it's $4.8 billion. But, to me, it would be a travesty for any of the employee groups to participate and see the $4.2 billion drawn down. I mean, that, to me—you all ought to be out in the streets yelling and screaming.

I just can't believe it's even under consideration. Now, I know the constraints that put it under consideration, but that's not a justification. I'd encourage you—and, I mean, endorsing the plan and the merit to the plan, and all this, and now Mr. Baxter tells me his calculation is that they are off $1.2 billion. I hadn't heard that figure before, $1.2 billion.

So not only are they going to spend what took 17 years to get some cash in, they are going to end up giving you twice the obligation, $24 billion, even if we took the Norton plan, and you end up with more unfunded liability than they are projecting. It's just a horrible situation.

I will pledge to work with any of the groups, with the board, with Ms. Norton. This is sort of like the last stand. We're out there, and they have killed off all the rest of the Indians, and this is Custer, the last stand. But, in the private sector, I could never accept anything like this, and it would be a travesty to accept it for public employees, be they District of Columbia employees or Federal employees.

For the most part, we have already done it for the Federal employees, but letting things progress further would be a horrible mistake. So we will work with you.

I've learned a lot from the hearing. It's been helpful. We will work with Mr. Davis.

Ms. Norton, I yield now to you.

Ms. NORTON. Thank you, Mr. Chairman.

First, I want to, Ms. Kane, congratulate the board on the performance of the assets. There has been, over time, considerable improvement in the performance, and you are at the top, another indication that the District is more than doing its part, and the board is more than doing its part.

I think I should add, for the record, that Frank Raines was very helpful to the board and to me when there were very harmful articles run by the Washington Post about the board. And I immediately asked Frank Raines, who was then at Fannie Mae, if he would help me, at no cost to the District, to make recommendations to the board, and he did.

We did not find that the fund was poorly managed at all. What we did find is that there were things that the board could do here and there that would improve the performance, and the board was already beginning to do many of those things. Now the board has put into effect fully, so far as I understand, all of Mr. Raines' recommendations.

Mr. Tippett, my good friend, I thought I heard in your testimony some guilt by association. Since Frank Raines was there when Jimmy Carter vetoed the bill, Frank Raines vetoed the bill. I would bet the other way around. Frank Raines had been a Washingtonian who had worked with the District and probably knows more about District finances than any human being, and I bet—I've never asked him—that he recommended the opposite and lost to the President, particularly given where he has stood, generally, on our issues.

I do want to say that you are taking the position that I believe is the only position that fiduciaries can take, and I respect the position you are taking. At the same time, I also want to say that Mr. Raines and the administration have not set out to make a "raid" on the assets. They didn't say, "Here's some money. Let's go get it." They were absolutely forced into this position by this Congress, and nobody should forget that.

They have got to pay for this entire bill, and they saw the assets there, and they recognized that there was no way to get there from here while leaving those assets there, unless the Congress was going to step up to the mat and do something different. Now, you haven't heard the chairman today indicate that he's prepared to do that, even though he commiserates with you about the raiding of your assets.

Ladies and gentlemen, this is a puzzle. This is like a crossword puzzle, and I invite your participation in the puzzle. Is there a way that anyone, including your experts, can think of to help us get through this puzzle: deficit reduction, on the one hand, but funding this proposal on the other. I mean, that's why I say things like, in 2002, if I'm here, I would revisit this. I recognize that, if this plan went through, part of the assets would be gone.

One of the reasons I would revisit it is not just to save the Government money, but you just watch out, the same Congress that put you in this bind now will try to get that out of, I bet, will try to get that out of benefit reductions, except you can't get here from there either. By benefit reductions, you can't get from where we

will be in 2002 with $700 million by taking it from the workers. Nothing would be left. So either we're in an impossible position now, or we're in an impossible position then.

The retirees have my respect, because, as Mr. Tippett indicated, when we were in a bind here trying to come up with a plan somewhat like mine, and we said, well, everybody is going to have to make a little bit of a sacrifice in order to get there, well, the retirees stepped right up, and the employees stepped up, did their part. The District took that and ran with it, and now we're still left with unfunded liability.

I have only one question. By the way, in this puzzle, put these two things. The administration was not only trying to deal with the pension plan, which, in my estimation, is No. 1; No. 2 is Medicaid. Either one of them, left unsolved, takes us over the side, or leaves us in the water, whatever is your metaphor. So they had to find a way to deal with pensions and Medicaid.

They take back the Federal payment, we get much more in the long run, but they still couldn't do it by taking back the Federal payment. After putting the Federal payment on the table to help pay for the bill, they went through hundreds of accounts—hundreds—taking a little bit here and there until they had paid for this plan in the first 5 years. It is a puzzle, and I invite all the best thinking of your experts.

I am concerned with something. Ms. Kane, it's in your testimony. In the prepared testimony, you say that the cost of administering the retirement fund now is about $16 million a year and that it would go to $22 million a year with a third-party trustee. I wonder if you could elaborate on how you get to that expanded or increased cost.

Ms. KANE. That is the number that's in the President's budget submission. We don't know how they got to that, but that is in the pending appropriation.

Ms. NORTON. I see. That's where you got it from.

Ms. KANE. We underspend the $16 million, most of which goes for management fees now. The fund is aggressively managed. The actual operations of the board, the staff, and all this, is a very, very small expense, but most of it goes for management fees. A lot of our assets are aggressively—actively managed, I should say, so there are fees associated with that.

We understand that Treasury management or even a trustee might be more passive, so we would assume the cost for custodial fees would go down. But that is a question. We don't know where that number came from.

Ms. NORTON. I wonder if they have startup for a third-party trustee to get going, or what. I will ask.

Ms. KANE. We don't know. If the funds are transferred, there will have to be a lot of thought. There will be costs associated with the liquidation of assets. When you are selling them and you are not buying them, there are always transaction costs there, if that's where it comes from. We are invested for the long term, and so there will be additional costs, also losses, if the assets are sold in the short term.

Ms. NORTON. Mr. Baxter's testimony, and I take it the rest of you agree, as well, that the District would be left with unfunded liability, under the President's plan, of $1.2 billion.

How do you arrive at that figure? What's the basis for that figure?

Mr. BAXTER. This is information that was provided by the Washington Society of CPAs.

Ms. NORTON. Does the board have any information comparable? Oh, I'm sorry, Mr. Baxter.

Mr. BAXTER. I was going to say, initially, at least in some of the meetings—the most recent meeting, I did not redact any information from the most recent one that we had. Mr. Tippett did speak to that, and things were fairly indecisive at the conclusion of that.

But, from the onset, at first blush of the proposal, there was not, at least on the table at the time, vocalized an intent to take all the unfunded liability. Maybe my colleagues here will concur with me. And the thought is that there would have been a $1-plus billion unfunded liability that would remain with the District, that being only one derivation, in kind, of the plan.

Now, there have been other alternatives that have been presented since then that speak to all of the unfunded liability being taken by the Federal Government, as well as what was talked about earlier in regard to some of the assets remaining with the District.

Ms. NORTON. So assets and liability remain. I mean, I know there's talk about assets remaining, but your testimony says unfunded liability remaining. That's what I'm trying to clarify.

Mr. TIPPETT. Madam Chair, Mr. DeSeve indicated at the last meeting that they intended to leave approximately $1.2 billion with the District, to take care of future liabilities associated with disability retirements and any other transactions that may occur, leaving the District with no unfunded liability. At least that's the impression that was left with us when we left that day. However, it's a very fluid plan, I should say.

Mr. BAXTER. Mr. Tippett speaks to the most recent meeting.

Ms. KANE. We have not seen the legislation. Nobody has seen it.

Ms. NORTON. We haven't either.

Ms. KANE. So it has been unclear, and there have been various interpretations and various representations. At the time that Bert Edwards testified, the information available was that the Federal Government would take all liabilities up to what's called the "freeze date," whether that's October 1, 1997—that's a movable date, too—or whether it's June 30, or whatever, that they would take all the liabilities up to that point, and they would take 100 percent of the assets.

If that had happened, and if that does, indeed, turn out to be the case—and it does not appear, at the moment, it may be the case—the District would be left with the liability for anything earned by current employees from that date forward, until the day they retire, for those new benefits. Someone who is on board, a firefighter who has been on board for 12 years, they might then be 33 years old, because you start as a firefighter at age 21. They would have 20-some-odd more years to work for the District.

The Federal Government would take responsibility and liability for everything they earned up to that age 33, and the effect that any future earnings would have on those benefits, but we understand they are still not planning to take any liability or any responsibility for anything that that firefighter earned from age 33 forward until retirement, except insofar as it affected, through seniority, et cetera, the value of current benefits.

So the question is, how is the District going to pay for those? Because the amount of money that the firefighter would contribute and what it might earn would not add up to what it would be worth.

Ms. NORTON. But they were leaving assets.

Ms. KANE. Well, this afternoon I heard Mr. DeSeve say most, if not all, of the assets would go to the Federal Government, which is different than saying some would. We don't know. But if they are to accept liability for the benefits earned up to a freeze date—and let's assume that's October 1, 1997—and leave with the District liability for what's earned then forward, and disability, approximately $1.2 billion would be the cost of that. And it either has to be funded or it's unfunded.

Ms. NORTON. My impression is that the administration, working with all of these strictures, its approach has continued to be a work in progress.

Ms. KANE. Yes. My understanding is that the latest version of the memorandum of understanding, which the Council, at least as of 1:30, had not voted on, and I do not believe was actually planning to vote on it today, did call for most of the assets to go to the Federal Government, but not all of them. But there was no dollar amount.

Ms. NORTON. Mr. DeSeve informed me, before the hearing, that he had had a very productive meeting with the Council, and they might even get to the point where they could vote on it today. I think they are ironing out some of their differences.

Mr. Chairman, I appreciate the way in which you have highlighted the difficulties of this plan, and I very much respect the considerable expertise of this committee, and would welcome the help of this committee in helping the District and this member to solve this puzzle.

Thank you very much.

Mr. MICA. I thank the gentlelady, and certainly will work with you, the District Committee, and others.

We thank you for your testimony, and I guess I don't have to encourage you to stay active on the issue. I hope that we can find a satisfactory resolution, and I know, if we all work together, we can do a good job for those folks out there who put their lives on the line daily to serve the District. We thank you again for your testimony and your participation today.

There being no further business to come before the subcommittee, this meeting is adjourned.

[Whereupon, at 5:10 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

1400 L. Street, NW, Suite 300
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Telephone (202) 535-1271
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April 28, 1997

BY FAX AND MAIL
Mr. George Nesterczuk
Staff Director
Committee on Government Reform and Oversight
Subcommittee on Civil Service
B-371-C Rayburn HOB
Washington, D.C. 20515

Dear Mr. Nesterczuk:

Thank you for your letter dated April 24, 1997, requesting information on pension liability and obligations of the District of Columbia Retirement Board (the "Board"). The following information is provided in response to your inquiries. All calculations are based on the assumptions, data, and methods specified in the October 1, 1996 valuation report prepared by Millman & Robertson for fiscal year 1998. Millman & Robertson, Inc. (M&R) is the enrolled actuary retained by the Board pursuant to the District of Columbia Retirement Reform Act (93 Stat 866, Public Law 96-122), codified at D.C. Code §1-701 et seq (1981 Ed.).

Please note that the liabilities shown in questions 1-4 exclude judges. As of 10/1/96, there were 68 active judges and 52 retirees and beneficiaries with a total liability of less than $0.1 billion.

Question 1. Current pension liability for pre-1980 annuitants; number of pre-1980 annuitants.

Our actuaries have indicated that as of 10/1/96, there were 3,538 pre-1980 annuitants. The liability is not split into pre- and post-1980 annuitants, however, they estimate that approximately 25% of the liability is for pre-1980 annuitants.

Question 2. Current pension liability for post-1980 annuitants; number of post-1980 annuitants.

As of 10/1/96, there were 8,776 post-1980 annuitants. As noted above, the liability has not been split into pre-and post-1980 annuitants, however, it is estimated that approximately 75% of the liability is for post-1980 annuitants.

Question 3. Current pension liability for active employees hired pre-1980; number of such employees.

William E. Better • Mary A. Collins • Robert W. Corby • Kenneth M. Cox, Sr. • Mitchell A. Johnson • Betty Ann Kane
Maria Day-Marshall • Martin L. Pfeifer • Martha F. Rogers • George R. Suter • Thomas N. Tippett • Fred B. Ugast
Berna Gunn-Williams
Jeanna M. Cullins
Executive Director

Mr. George Nesterczuk
April 28, 1997
Page 2

As of 10/1/96, there were 3,817 employees hired pre-1980 with liability of approximately $1.9 billion.

Question 4. Current pension liability for active employees hired post-1980; number of such employees.

As of 10/1/96, there were 7,746 employees hired post-1980 with liability of approximately $0.9 billion.

Question 5. Actuarial normal cost of the pension system; amount of employee and employer contributions to the pension fund and annuity payments (current and projected).

The net normal cost for fiscal year 1998 is $131.3 million and is projected to increase with payroll at the assumed rate of 5% per year. The remaining items are shown in the attached exhibit originally prepared by Millman & Robertson for the Pension Benefit Guarantee Corporation (PBGC).

Should you have any questions, please do not hesitate to contact me at (202) 535-1271. I look forward to seeing you at the hearing scheduled on Tuesday, April 29, 1997. We are still attempting to make the actuary available before the hearing. However, given his current schedule, it does not appear likely.

Sincerely,

Joanna M. Cullins
Executive Director

Attachment

EXHIBIT 1

Projection of District Payment Under Current Law

	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04
1. Net Pay-As-You-Go Cost								
a. Benefit Payments	$376.4	$386.9	$411.7	$436.3	$462.3	$489.6	$517.6	$545.9
b. Employee Contributions	36.3	33.5	38.8	40.7	42.7	44.8	47.0	49.4
c. (a) - (b)	$340.1	$353.4	$372.9	$395.6	$419.6	$444.8	$470.6	$496.5
2. 10-Year Amortization of UAL Growth	($26.9)	($54.2)	($50.3)	($46.7)	($43.4)	($40.3)	($37.4)	($34.7)
3. 25-Year Amortization of Changes	$7.9	$8.2	$8.2	$8.2	$8.2	$8.2	$8.2	$8.2
4. Total 1c. + 2. +3.	$321.1	$307.4	$330.8	$357.1	$384.4	$412.7	$441.4	$470.0

FY 1997 and 1998 figures are actual certified District Payments from the valuation report. Note that net pay-as-you-go cost estimates used for FY97 and FY98 District Payments are short-term projections intended only for use for the annual certification.

FY 1999 through 2004 figures are based on the following:

- Benefit payments as projected in Millman & Robertson February 11, 1997 letter to D.C. Office of Personnel Director Larry A. King.
- Employee contributions based on October 1, 1996 (FY 1997) payroll of $506.5 million, as reported (pg 1-5) in the Jan 1, 1996 valuation report increased 5% per annum.
- No Actuarial gains or losses.

Written Testimony of
Joshua Wyner, Executive Director

Chairman Mica and Subcommittee Members, thank you for the opportunity to comment on the pension aspects of the Clinton Administration's National Capital Revitalization and Self-Government Improvement Plan. The DC Appleseed Center is a nonpartisan organization of lawyers and other professionals volunteering our time and professional abilities to advocate systemic reform of management and financial structures in the District of Columbia.

Over the past two years, DC Appleseed has focussed much of its analysis and advocacy work on improving the financial relationship between the District and Federal governments. Our work -- both on the unfunded pension liability and Federal Payment issues -- relates directly to the Administration's National Capital Revitalization and Self-Government Improvement Plan. In June 1996, DC Appleseed released its report, "*The District of Columbia Pension Dilemma -- An Immediate and Lasting Solution*," which addressed precisely the issue before this Subcommittee today.

DC Appleseed is pleased that the Clinton Administration and Congress have focussed on resolving the single most important issue affecting the financial security of the District and one-third of its employees. As you requested, DC Appleseed will address four subjects in our written statement.

- The effects of the District's unfunded liability.
- The similarities and differences between the District's unfunded liability and the unfunded liabilities for Federal civil service retirement systems.
- Ownership of assets currently under the control of the District of Columbia Retirement Board.
- DC Appleseed's perspective on the Clinton Administration's Plan.

I. Creation of the Unfunded Liability

Before addressing these four topics, I would like to briefly outline the history of the unfunded liability because DC Appleseed believes that this history informs the appropriate resolution. No financial difficulty faced by the District is more grave than the mushrooming $5 billion unfunded liability of the pension plans that cover the District's police officers, firefighters, teachers, and judges. One fact is clear—even if the District were to solve all its other financial problems overnight—if this one problem is not also solved, it is large enough to ensure that the District will never emerge from its current financial crisis and that, in fact, the crisis will deepen with each passing year.

A. Pre-Home Rule Management By the Federal Government

The District's unfunded pension problem began long before the establishment of Home Rule in 1975. Between 1916 and 1970, Congress created the District pension plans at issue (the police/firefighters, teachers, and judges plans) and defined the participants' benefits. The plans were created as defined benefit plans that promised to pay participants a lifetime annuity without regard to how much money had been set aside to fund these benefits -- an unfunded plan design that resembled the majority of public sector retirement plans at the time.

Prior to the establishment of Home Rule in 1975, employees and the District government both contributed to the plans, but those contributions went into the Federal Treasury rather than into a separate pension trust fund dedicated to providing benefits to participants. Thus, contributions to the plans were spent by the Federal government to fund Federal operations, and benefits were paid each year from available Federal Treasury general revenues. As a result, even when compared to significantly under funded state and local plans, the District plans became egregiously under funded.

It is not surprising that, during the period before Home Rule for the District of Columbia, the District employees participating in the plans were subject to the same arrangement as Federal employees. Prior to Home Rule, all aspects of the District government were treated as though the District was a small Federal agency. All of the plans' participants, who were working for the District of Columbia, were on the Federal payroll: there were no independent District of Columbia bank accounts; all taxes and other revenue, even those payable to the District, were deposited in the Federal Treasury; and all District payments to vendors, creditors, and others were paid with checks from the Federal Treasury.

B. Transfer of the Problem to the District Following Home Rule

The unfunded pension liability crisis arose as a result of the manner in which the plans were transferred from the Federal to District government shortly after Home Rule was established in 1975. In 1980, the Federal government enacted legislation that transferred to the District responsibility to make retirement benefit payments to the plans' participants, but did not transfer funds adequate to pay for those benefits that had already accrued. Specifically, the Federal government transferred to the District $2.7 billion in pension liability that had arisen under the Federal government's stewardship, but transferred assets and promised future Federal payments valued at only $687 million. Thus, the District was left with over $2 billion in unfunded pension liability for which the Federal government accepted no responsibility (see chart attached as an Appendix to this testimony). Such an unfunded pension liability transfer would be prohibited by the 1973 Employee Retirement Income Security Act (ERISA) if it involved employers in the private sector.

Solely because of the underfunding in 1980, the unfunded liability has grown to exceed $5 billion today. *The District has done nothing to exacerbate the unfunded liability.* Indeed, the District has fully funded all benefits that the plans' participants have earned since the 1980 transfer of liability. In fact, every year since then, the District government and the plans' participants have made contributions to the plans that have more than covered the costs of the benefits that participants earned in that year. The excess contributions made by the District have *reduced the rate of growth in the unfunded pension liability* inherited from the Federal government.

The DC Appleseed Center is not alone in drawing the conclusion that the entire current liability is attributable to the period of Federal control over the pension plans through 1979. Since issuing its report in June 1996, the DC Appleseed Center has asked the American Academy of Actuaries to review the actuarial conclusions contained in our report. The Academy has done so and has concurred that the unfunded liability and its growth can be traced entirely to the period of Federal

control over the plans before 1980. In its July 9, 1996, testimony before Congress, the U.S. General Accounting Office independently reached the same conclusion, citing with approval the findings in the DC Appleseed Center report (excerpt attached).

II. Specific Questions Posed to the Panel

With that history in mind, allow me to answer the four areas of inquiry posed in your invitation to submit a written statement.

A. The Effects of the District's Pension Plans' Unfunded Liability

The effects of the unfunded pension liability on the District are dramatic. As you know, the unfunded pension liability is approximately $5 billion today. As a result of this Federally-created liability, *the District pays $200 million more in annual pension payments* than it would otherwise have to pay if these plans had been fully funded by the Federal government at the time it gave the District responsibility for the plans. That represents 4% of the District's 1996 budget. Further, the existence of the large unfunded lability severely restricts the District's ability to borrow money at reasonable interest rates.

In the future, the effect on the District will become more serious. If this problem is not solved by 2004 -- a mere seven years from now -- *the District will need to make contributions of approximately $1 billion per year* to fund accruing pension costs, make benefit payments, and comply with Federal funding requirements. Of these annual contributions, the District will be required by Federal law to pay *$490 million dollars every year forever* just to keep the unfunded pension liability from growing further. The remainder of the $1 billion payments by the District will cover actual pension benefits and normal costs for only one-third of the District's employees.

In addition, the unfunded liability substantially diminishes the financial security of the employees covered by these plans. Of course, employees were more secure prior to the transfer of the plans to the District government in 1980. Prior to the transfer, participants received a Federal guarantee that, when they retired, they would receive retirement benefits from the Federal Treasury. However, following the transfer, in place of the Federal government's guarantee to pay their pensions at retirement, participants received a "guarantee" of retirement benefits from the District. But, while the Federal government had paid participants' retirement benefits from the revenues of the Federal Treasury, the District's pension obligations could be satisfied only out of the hopelessly underfunded plans or the District's own limited revenues.

B. The Similarities and Differences Between the District's Unfunded Liability and the Unfunded Liabilities for the Federal Civil Service Retirement System

There are obvious similarities between the District's unfunded liability and the Federal Civil Service Retirement System (CSRS). First, they were both created by the Federal government.

Second, the manner in which the District plans were managed -- so-called "pay as you go" -- was the practice at the time for funding other Federal pension plans. Specifically, retirement contributions were collected and retirement benefits were paid, but there was no logical correlation or nexus between the amounts collected and the amounts paid. As a result, the underfunding of the District plans mirrors that of the Federal CSRS funding.

However, there is one critical difference between the unfunded liability in the District plans and liabilities in the Federal CSRS plan. The liabilities for CSRS are held by the entity that created those liabilities, whereas the unfunded liability for the District's plans has been transferred by the entity that created them -- the Federal government -- to an entity that did not -- the District. Even though -- for over 60 years -- the Federal government collected and then spent contributions from the District and its employees, set contribution and benefit levels for these plans, managed disability retirement determinations, set cost-of-living adjustments, and paid out benefits, the District must now pay for the benefits accrued during the pre-Home Rule period.

C. Ownership of Assets Currently under the Control of the District of Columbia Retirement Board

DC Appleseed recognizes that there is a strong equitable argument for the District's keeping a major portion of the $4.1 billion assets currently under the control of the District of Columbia Retirement Board. Specifically, the District has paid far more than the plans' normal costs into the Retirement Fund for each of the past 16 years. Accordingly, even if the Federal government reassumes the liability for these plans, a portion of the assets equal to the District's overpayments should perhaps remain with the District. Nonetheless, DC Appleseed recommends that the entire $4.1 billion of the plans' assets be transferred to the control of the Federal government primarily because this asset transfer makes feasible the Federal government's acceptance of the unfunded pension liability.

D. DC Appleseed's Perspective on the Administration's Pension Proposal

The unfunded pension liability crisis must be solved if pensioners are to be secure and the District's financial situation resolved. For a variety of reasons, DC Appleseed believes that the Clinton Administration has offered the best possible resolution to this problem.

First, the Administration's proposal is equitable. The pension problem began when the participants were under Federal control and paid by the Federal government. At that time, contributions withheld from the participants and contributions paid by the District government were deposited into the Federal Treasury and treated as Federal revenue in the year of receipt. Thus, the Federal government not only failed to pay its share, but also used participants' withholdings (and District contributions) as general revenue.

Second, the only alternative proposals -- to increase annual Federal contributions over a period of time -- (1) are unlikely to occur in the current Federal budget balancing climate and (2) will

not eliminate the negative effects of the unfunded liability on the District's fiscal health and will not allow the District to borrow at reasonable interest rates for up to 40 years. By contrast, the immediate resumption of the plans' liability by the Federal government will enable Congress to immediately eliminate the negative effects of the unfunded liability on the District.

Finally, under the Clinton Plan, the District would not be coming to the Federal government empty handed, but would be transferring $4.1 billion to the Federal government. Almost half of this money was contributed by the District *in excess of pension liabilities created between 1980 and 1996* when the District was responsible for the plans. In other words, the District would be making a contribution of approximately $2 billion to the Federal government, which could be used to offset some of the cost of the unfunded liability to the Federal government. Rarely, if ever, does Congress get an offer by a city or state to contribute money to the Federal government, let alone an offer of billions of dollars.

* * * * *

DC Appleseed recognizes that, if the Federal government reassumes this liability, it will have to decide how to fund the plans liabilities once the $4.1 billion in assets transferred to the Federal government are spent to fund pension benefits as they become due. Indeed, we understand that there is significant debate in Congress with regard to how the Federal government will resolve the unfunded pension liability of the Civil Service Retirement System and Military Retirement System. However, that debate need not be resolved in order to resolve the inequitable arrangement that currently exists for many District employees.

The District's financial condition can never rebound if Congress allows the important debate concerning Federal unfunded pension liabilities to derail the reassumption of the District's unfunded liabilities, which unquestionably originated with the Federal government. This is a matter of equity, not charity. The fiscal health of the Nation's Capital deserves the undivided attention of the Nation.

As long as it includes Federal reassumption of the entire unfunded liability, the Administration's pension proposal will solve the unfunded pension dilemma. Resolving the District's pension liability crisis alone will not solve the District's numerous financial and operational problems. However, it will provide a tremendous boost. DC Appleseed stands ready to work with Congress and others with a stake in this problem in order to achieve an effective, equitable, and enduring solution.

APPENDIX I: Summary of Transferred Unfunded Pension Liability

A. Summary of Unfunded Liability Growth During First Four Years of Home Rule

Unfunded Pension Liability at 1/1/75	$2.0 billion
Growth of Unfunded from 1975 - 1979	0.7 billion
Total Unfunded Liability in 1979	$2.7 billion

B. Summary of Federal Contributions to Unfunded Liability

Federal Cash Transfer in 1980	$ 38 million
Present Value in 1980 of Promised Federal Payment of $52 million for 25 years	649 million
Total Value of Federal Contributions	$687 million

C. Summary of District's Unfunded Inherited Pension Liability

Total Unfunded Liability in 1979	$2.700 billion
Total Value of Federal Contributions	.687 billion
Unfunded Liability Transferred to District	$2.013 billion

United States General Accounting Office

GAO

Testimony

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Committee on Appropriations
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DISTRICT GOVERNMENT

Information on Its Fiscal Condition and the Authority's First Year of Operations

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The Unfunded Pension Liability

In looking at the District's financial condition, the unfunded pension liability represents one of its greatest long-term challenges. Today, the unfunded liability stands at $4.7 billion and is expected to increase to $7 billion in 2004.

The Congress created defined benefit pension plans for District police officers and fire fighters in 1916; teachers in 1920; and, judges in 1970. These funds were financed on a "pay as you go" basis. The responsibility for these payments and the related, and then undetermined, unfunded liability were transferred to the District as part of Home Rule. The District of Columbia Retirement Reform Act, Public Law 96-122, in 1979 committed the federal government to pay $52.1 million annually from 1980 to 2004 to partially finance the liability for retirement benefits incurred before January 2, 1975.[9]

In 1980,[10] the federal government provided $38 million to the District in addition to the first of 25 annual payments of $52.1 million to the pension funds authorized by the Retirement Reform Act. The then present value of these payments equalled $649 million. The present value of the pension liability at the time of the transfer equalled $2.7 billion, resulting in an unfunded liability to the District of over $2 billion.

[9]See District Pensions: Federal Options for Sharing Burden to Finance Unfunded Liability, pages 14-18 (GAO/HEHS-95-40, December 28, 1994).

[10]GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

Since 1979, the District has funded[11] (that is, covered the costs of the benefits participants have earned in that year) all benefits that the pension plans' participants have earned since 1979, and paid in an additional $1.2 billion towards the unfunded liability. Table 1 shows an analysis of the unfunded pension liability since the plan was transferred to the District.

Table 1: Unfunded Pension Liability

Dollars in millions

Fiscal year	Unfunded pension liability	District contribution	If fully funded 1979 net normal cost	Excess District contribution
1980	$2,006	$108	$89	$19
1981	$2,134	$110	$93	$17
1982	$2,336	$136	$89	$47
1983	$2,874	$143	$85	$58
1984	$2,936	$174	$103	$71
1985	$3,393	$165	$110	$55
1986	$3,594	$175	$119	$56
1987	$3,458	$173	$96	$77
1988	$3,614	$179	$103	$76
1989	$3,853	$193	$106	$87
1990	$3,820	$222	$118	$104
1991	$4,005	$225	$112	$113
1992	$4,249	$254	$121	$133
1993	$4,152	$291	$135	$156
1994	$4,337	$307	$142	$165
1995	$4,526	$297	$135	$162
1996	$4,780	$337	$133	$204
1997	$4,973	$321	$126	$195

Source: D.C. Retirement Board.

Despite these efforts, the unfunded liability is now estimated at $4.7 billion,[12] and is expected to increase to $7 billion[13] in 2004 due to the

[11] D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

[12] D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

[13] GAO/HEHS-95-40, December 28, 1994 and D.C. Appleseed Center, The District of Columbia's Pension Dilemma—An Immediate and Lasting Solution.

accumulation of interest owed on the unfunded portion of the pension liability transferred to the District back in 1979. Similarly, the District's pension payment, which is currently approximately $300 million a year, is expected to increase to $490 million starting in 2004.

The Appleseed Foundation[14] concluded that these pension plans' unfunded liabilities should be the responsibility of the federal government since the liabilities are the results of federal actions predating the Home Rule Act. Our analysis shows that if the District did not have the responsibility for the costs of these plans related to the unfunded liability, the pension expense in its proposed fiscal year 1997 budget would be reduced by $195 million from the $321 million currently shown in the proposed budget to $126 million. This change would have a major impact on the projected budget deficit for fiscal year 1997.

Similar to the Medicaid discussion, many other factors also need to be considered longer-term in deciding the best way to address the escalating pension costs that the District will pay.