TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
HOUSE BILL NO. 835, H.D. 1

FEBRUARY 28, 2012

PROPOSING AN AMENDMENT TO ARTICLE VII, SECTION 6, OF THE HAWAII CONSTITUTION, RELATING TO THE DISPOSITION OF EXCESS REVENUES

Chair Oshiro and Members of the Committee:

The Legislative Committee of the Employees' Retirement System of the State of Hawaii (ERS) supports H.B. 835, H.D. 1 that proposes to deposit excess general fund revenues into a fund that will help to fund pension benefits and other post-employment benefits for state employees.

As of June 30, 2012, the ERS had an unfunded actuarial accrued liability (UAAL) of $8.164 billion. One of the main reasons for this large UAAL is attributed to a previous state law provision that allowed for excess ERS investment earnings to be credited against the annual employer contribution requirements. For example, if the State was required to contribute $100 million to meet its annual required employer contribution payment, and the ERS realized excess investment earnings of $50 million, then the State would contribute only $50 million instead of $100 million. When the ERS earned more than its assumed investment return assumption, the State reaped the benefits. The investment return assumption is a long-term assumption and when the investment markets cycled downward in the 2000's the excess investment earnings from the prior decades were not in the System to help cushion the blow.

Over a 36-year period from 1967 to 2003, the ERS credited over $1.68 billion to the State and county employer contribution requirements (funds). Recently, the ERS Actuary determined that if those contributions had been made to the ERS, then combined with the investment earnings on those contributions, today the ERS's UAAL would be approximately $500 million. This means that the ERS would have a funded ratio of more than 95% if that had occurred. If the System were in that position today, the recommended contribution rate to the System would likely be less than 10% of pay.

Therefore, it seems appropriate that excess general fund revenues be earmarked to help restore financial health to the ERS, since the ERS excess investment earnings helped the general fund in the past.

As a result, the ERS supports H.B. 835, H.D. 1 that assists with the funding of the ERS.

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: CONSTITUTIONAL AMENDMENT, Deposit excess revenues to reduce unfunded liabilities for post-employment benefits of state employees

BILL NUMBER: HB 835, HD-1

INTRODUCED BY: House Committee on Labor and Public Employment

BRIEF SUMMARY: Amends Article VII, section 6, of the state constitution to provide that if general fund revenues in any one fiscal year are projected to exceed general fund revenues in the previous fiscal year by 7% or more, the legislature shall deposit such amount into one or more funds to reduce the unfunded liabilities for pension benefits and other post-employment benefits for state employees.

EFFECTIVE DATE: Voter approval

STAFF COMMENTS: The proposed measure provides that when general fund revenues are projected to exceed general fund revenues of the previous fiscal year by 7% or more, the excess revenues shall be used to reduce the unfunded liabilities for benefits and other post-employment benefits for state employees.

Originally, the "disposition of excess revenues" provision was enacted in tandem with the general fund spending limit. Although initially not a part of the spending limit discussion, the refund provision was proposed to insure that consideration be given to returning excess funds to taxpayers rather than to remain a target for excessive public expenditure. While this measure proposes that excess revenues be deposited into one or more funds to reduce the unfunded liabilities for pension benefits and other post-employment benefits for state employees, its enactment could have the same effect as "repealing" the "excess revenues" provision.

While the "repeal" of the mandatory refund provision may have political appeal because lawmakers have tacitly complied with a minimum $1 refund per taxpayer, the refund provision serves a purpose. That purpose is making sure the general public is aware of their state finances. This provision insures people are reminded of just how much money the state is keeping for itself while maintaining the high burden of taxes. If the true spirit of the excess revenues provision is to be maintained, then another alternative should be considered and that would be to require that the legislature make a permanent downward adjustment in income or general excise tax rates as these are the two largest tax resources which benefit the general fund.

No doubt the unfunded liabilities of the state retirement and health systems should be of major concern; however, relegating the funding of these liabilities to excess general fund revenues is an abdication of the responsibility to fully fund these benefits. The message here is that lawmakers will continue to spend on state programs and services and ignore the fact that there is insufficient funding of these benefits and they will only put money in if there is something left over. Lawmakers knew there was a problem as early as the 1980's when the retirement system went from a contributory to non-contributory basis and the benefit ratio was reduced. Recommendations to also reform the health benefits were made at the same time but ignored. Lawmakers refused to scale back the benefits perhaps in fear of offending the public employee. Despite the fact that in the private sector retirement plans went from defined benefit plans to defined contribution plans, lawmakers resisted making changes.

Adding to the problem was that in those years when the earnings of the benefit plans allowed the earning to be taken from the plans, the legislature took millions out of the system and used those funds to expand government programs and services. As a result, when the earnings waned, the corpus shrank along with its sustainable earning power.

Fully funding these liabilities should be a permanent fixture of the state's general fund budget and be paid before any money is spent on current services just as much as repayment of the state's debt obligations is first call on the state's resources. Absolving the legislature of making the tough choices between funding these liabilities and spending on new or expanded state services or even reforming these benefits is irresponsible and totally unacceptable to taxpayers.

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From: mailinglist@capitol.hawaii.gov
Sent: Monday, February 27, 2012 7:39 PM
To: FINTestimony
Cc: Brenda.Kosky@gmail.com
Subject: Testimony for HB835 on 2/28/2012 10:00:00 AM

Testimony for FIN 2/28/2012 10:00:00 AM HB835

Conference room: 308
Testifier position: Support
Testifier will be present: No
Submitted by: Brenda Kosky
Organization: Individual
E-mail: Brenda.Kosky@gmail.com
Submitted on: 2/27/2012

Comments: