Massachusetts Taxpayers Foundation

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000
FAX 617-720-0799

Testimony of Michael J. Widmer
President, Massachusetts Taxpayers Foundation
Before the Joint Committee on Public Service on House Bill 59
October 31, 2013

I am here today to testify on House Bill 59, *An Act providing retiree healthcare benefits reform*.

Massachusetts governments face staggeringly large unfunded retiree health care liabilities that total more than $46 billion for the state and municipalities. These enormous liabilities, combined with existing pension obligations, threaten the long-term stability of local government finances and are already imperiling municipalities' ability to provide basic services, including education, public safety, and transportation.

In fiscal 2012, municipalities spent an estimated $800 million on health care for retirees, equal to nearly 90 percent of the $899 million in unrestricted aid provided by the state to fund important local services. Without any reform, retiree health care is projected to cost municipalities more than $1 billion within five years and nearly $1.5 billion in 10 years.

While the state has a large unfunded liability in its own right—a little more than $16 billion—this testimony focuses on the cities and towns that shoulder $30 billion in unfunded liabilities.

Taxpayers have long understood government pension liabilities and the impact on local budgets, but government obligations for other post-employment benefits provided to employees (OPEB), namely retiree health care, have only recently started to receive similar attention. Reporting requirements now force governments to disclose their OPEB liabilities, and the numbers show that retiree health benefits are no longer the marginal annual budget items they were when initially offered to employees. Instead, the rapid acceleration of health care costs combined with overly generous benefits have created staggering unfunded OPEB liabilities which exceed unfunded pension liabilities in almost all Massachusetts communities.

To shine a light on this problem, the Foundation in February 2011 released a groundbreaking report (*Retiree Health Care: The Brick That Broke Municipalities' Backs*) which showed that the state's 50 largest municipalities face $20 billion in unfunded retiree health care liabilities, more than double their unfunded pension liabilities. This report, along with the Foundation's continued outreach and a follow-up report in January 2012, received widespread media coverage and earned the Most Distinguished Research award from the national Governmental Research Association in 2012. Virtually every local and regional newspaper in the state, as well as the *Wall Street Journal*, have cited the Foundation's work on this issue.

As a result of the increased scrutiny of retiree health care liabilities, the state created an OPEB Commission to examine retiree health care reforms. The Commission met throughout 2012 and issued a final set of recommendations in January 2013 that are the basis of the Governor's reform legislation.

For municipalities across the state, the OPEB problem dwarfs the well-known pension problem. The unfunded retiree health care liabilities for cities and towns total approximately $30 billion, more than twice their unfunded pension liabilities. This is the amount municipalities would need to set aside today in order to pay for the cost of benefits already owed to current employees and retirees. While a handful of Massachusetts communities have begun to fund their OPEB liabilities with modest contributions, the aggregate liability is more than 99 percent unfunded.

The Foundation's reports analyzed the impact that funding these liabilities would have on property taxpayers. In some communities, funding OPEB liabilities over the next 30 years would add as much as $2,000 to single family homeowners' property tax bills. The 2011 report also showed that 36 of the state's 50 largest municipalities would require an increase of at least $500 in their average single family tax bill—an increase that would remain in place for at least 30 years—in order to meet their annual required contributions.

Since the Foundation's 2011 report, liabilities have grown. For example, Springfield's unfunded liability is now more than $1 billion, increasing by $268 million since fiscal 2008. Even in those communities which have reported a decrease in liabilities, that is usually because of a change in the discount rate—the return a municipality assumes it will earn on its investments—or other assumptions. For example, by simply raising the discount rate by one percentage point, from 3.5 percent to 4.5 percent, Andover lowered its unfunded liability by nearly $42 million in fiscal 2011.[1]

The Legislature's action in passing municipal health reform in 2011 will help control health care costs in the long term, but it is far from a full-fledged solution to the retiree health care problem. Communities—and taxpayers—simply cannot fund these benefits in their current form, and strong reforms are urgently needed.

While House Bill 59 proposes some important reforms, it falls far short of addressing the magnitude of the problem and includes some provisions that undermine the entire bill.

Among the positive reforms:

- The Governor's bill changes eligibility for most employees from age 55 with 10 years of service to age 60 with 20 years of service. At the same time, the bill appropriately exempts all current retirees, employees within five years of retirement age with 20 years of service, and employees within five years of Medicare eligibility with nine years of service from these changes.

[1] The change in the discount rate and medical cost growth assumptions reduced the liability by approximately $70 million, while changes in demographic assumptions and the effect of not addressing the liability over last two years added $40 million, for a net reduction of approximately $30 million.

- Most importantly, the bill does not limit the reforms to new hires. Applying the reforms to active employees is crucial to any meaningful OPEB reform because the liabilities reflect the costs to provide benefits to those current employees and retirees who are already eligible to receive them. Applying reforms only to new hires would have no effect on reducing the enormous unfunded liabilities.

However, the legislation unfortunately includes an exception for many teachers that will raise their eligibility age by only two years. While non-public safety employees would not be eligible until age 60 for retiree health coverage, teachers—including those at the early stages of their careers—would be eligible for full benefits as soon as age 57, provided they qualify for the maximum pension. Furthermore, despite the OPEB Commission's clear recommendation to do so, the legislation does not require municipalities to pro-rate benefits for part-time employees. As a result, one of the most egregious aspects of municipal retiree health benefits is unaddressed, and part-time employees in many municipalities will still receive the same benefits as full-time employees.

But perhaps most troubling, municipalities would be permanently prohibited from changing their level of premium contributions after an employee's retirement, instead limiting those changes to prospective retirees only. Stripping municipalities of the flexibility to reduce their contributions for retirees is a major step backward that revokes their most important tool in controlling retiree health costs.

The bill further erodes local authority by ending municipal discretion in deciding whether an employee must retire directly from the municipality in order to receive retiree health care benefits, instead requiring that the municipality provide benefits for individuals who do not retire directly from the city or town as long as they have either 20 years of service and enroll in Medicare, or 25 years of service and receive a pension within five years of leaving employment.

Furthermore, under the Governor's proposal, the very small number of municipalities that currently do not make any contribution to premiums would be required to start contributing at least 50 percent of the premium cost for all current and future retirees, adding significantly to their local budgets.

Without much stronger reforms, retiree health care costs will be a growing burden on local budgets for years to come, continuing to siphon resources away from important public services such as education, public safety, and transportation.