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Keynote Speaker – Dr. Thom Reilly

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Reilly served as the County Manager and CEO for Clark County, Nevada for five years where he was responsible for the fiscal management responsibilities of the County's $5.8 billion budget and administrative oversight to close to 12,000 employees.

Dr. Reilly has held senior administrative positions with the State of Nevada, overseeing income maintenance programs and the statewide child welfare system. He served as Director of Clark County Administrative Services and is the former vice president of corporate social responsibility for Caesars Entertainment, Inc.

Under The Reilly Group, Thom serves as Executive Director of the Caesars Foundation, the philanthropic arm of Caesars Entertainment, Inc. He currently serves as Chairman of the Board for the Children's Advocacy Alliance as well as Chairman of the national GLAAD Board. He on the editorial board for the academic journal *Administration in Social Work* and recently completed a seven-year term on the editorial board for *Public Administration Review*.

In October 2005, Reilly was elected a Fellow of the National Academy of Public Administration (NAPA). He received his master's and doctorate in Public Administration from the University of Southern California.

Keynote Address of Dr. Thom Reilly

My years in both state and local government have made me a passionate non-partisan. I stand before you today believing very strongly that the policies and financial issues surrounding public pay and benefits are bipartisan issues and the failure to make needed reforms will have a profound impact on the ability of state and local government to function effectively.

States and local governments are still struggling to recover and balance their budgets more than five years after the great recession began. As a result, officials were forced to lay off workers and make painful cuts in education, police and fire protection, safety-net programs and other essential services to try to cope with plummeting tax revenues. Their ability to perform their core functions and deliver essential services to their citizens has been seriously compromised. Like most economic downturns, service demands from citizen's increase at a time when there are fewer revenues. This economic downturn, like most recessions before, has disproportionally hit the poor the hardest.

While the poor economy has blown gaping holes in state, county and city budgets, much attention has focused nationally on how public workers are compensated, particularly with regards to personnel benefits and the ability of state and local governments to fund them. The policies and practices that determine public sector pay and benefits have become a significant part of the national conversation in the United States and Europe.

State and local governments are facing huge pension and retiree health care obligations that have significantly contributed to their financial woes. Nationwide unfunded liabilities for pension and retiree health care (that is the shortage between states' assets and their obligations as a public employer) range anywhere from $1.4 to over $4 trillion, depending upon what assumptions one uses. 34 states (including Nevada which is at 71% funding) now fall below the "red flag" funding threshold of 80% . Despite some commentary, being at 80% funded does not mean the funding ratio is OK, it means that falling below this percentage indicates that the pension fund is in serious condition. The Governmental Accounting Standards Board (GASB), which sets the accounting standards for the public sector, has adopted new rules that could increase the gaps further. These rules adopted in June 2012 and effective beginning in FY 2015 for some portions and FY 2016 for others , will likely show public pensions funds, including Nevada's, are in a weaker financial position that previously thought. States and local governments will now have to uniformly calculate their net pension liability – that is the difference between the projected benefit payments and the assets set aside to cover those payments- up front on financial statements. Under the rules, pension funds that are considered adequate could continue to forecast investment returns with their historic averages. Funds lacking sufficient cash to cover benefits must lower their projections to about 3 to 4 %.

Some analysts have suggested that state and local governments have significantly underestimated their pension costs since they do not use their investment assumptions to project future growth and measure what they will owe retirees in the future in today's dollars. This practice has been prohibited in the private sector since 1993. In addition, the typical public pension plan assumes its investments will earn average annual returns of 8 percent over the long term. However actual experience has been much less, 5.7 percent over the last 10 years.

Pension and health care costs for retirees have been rising faster than inflation for several reasons. Low interest rates have reduced the returns on pension funds used to pay benefits and retirees are living longer. Further, many of the promises made to public employees are simply not sustainable and many jurisdictions are struggling to make payments into these systems, leaving less each year to spend on core governmental services**. Such obligations hobble governments' capacity to act and crowd out essential services and safety-net programs for citizens.** The recession was not the primary cause of the pension and retiree health care problem but it contributed to it by reducing the value of investments. In some cases, in order to balance their budgets and/or to increase services, state and local governments have failed to make the necessary contributions into the pension funds, and/or they borrowed from the funds at the same time, creating deeper and deeper shortfalls.

The adoption of many pension and post retirement benefits has occurred within a tight circle of individuals (elected officials, public managers and union/employee groups) largely out of the public view. These groups have often failed to insist upon transparency. Union and employee groups have enjoyed considerable influence with legislators on this issue and public managers often benefit from the very contracts they negotiate.

To simply blame overspending or state and local governments' failure to save during the boom period of the last decade would be unfair. The problem is much deeper than this. Two examples illustrate how the behavior of states and local governments contributed to this staggering problem. In the spirit of non-partisanship, one involves a Republican governor and another involved a democratically controlled city council.

Former Republican governor Christine Todd Whitman, who planted the seeds for New Jersey's fiscal failure nearly 15 years ago, largely caused the dire straits in which New Jersey finds itself. A popular Republican, Whitman captured national attention as a Governor who fought to balance a budget while also broadly reducing taxes. Although the real cost of doing so would come to haunt nearly every New Jersey governor thereafter. As the stock market climbed during the mid 1990's, so did the value of New Jersey's pension funds, so that Gov Whitman chose to forgo $2.5 billion worth of payments into the system. Being able to essentially "borrow" from the pension fund at the expense of tax breaks seemed viable as long as the stock market kept rising. No harm No foul. Instead of making pension fund payments, she proposed and won approval to borrow from these funds. The high interest borrowing against the pension funds and additional tax cuts through her second term set the stage up for a disaster when the tech bubble burst in 2000. Between June 2000 and the fall of 2002, the state's pension fund fell nearly $25 billion to $57 billion. It should be noted that Nevada Constitution treats PERS as a trust fund from which no borrowing is allowed.

The rampant mismanagement of pension funds did not take place only in state chambers. The City of San Diego is still suffering the consequences of a pension scandal, which came to light in 2002. What started with a series of bad judgments beginning in the 1980s veered towards malfeasance and criminality in the 1990s. In 1995, the City Manager worked out a deal with the pension fund trustees to contribute less to the pension fund than what the actuaries to ensure solvency. In return, the majority of trustees, who happened to be city employees and union members, received increases in benefits. The benefits piled on. As payments were lowered and benefits rose, the City of San Diego's pension fund was becoming more and more a house of cards. Like New Jersey, financial amnesia took hold as the stock market soared higher, hiding the shaky ground on which the pension system was already standing. To make matters worse, the newly seated Democrat-controlled city council, passed additional measures providing new benefits without requiring additional contributions. City administrators, elected officials, and union leaders worked closely together and went to extraordinary efforts to conceal their self-dealing from the public as they agreed to hide the fact that they did not have the necessary money and worked out a deal to further increase employee benefits as long as the pension trustees, again city employees and union officials, agreed to forgo the required funding. A whistle blower led to Securities and Exchange Commission subpoenas. As a result, a significant amount of the city budget is being diverted to cover pension and retiree health care obligations. Today, despite a pension reform ballot initiative being passed by voters, approximately, 20%, of the general fund budget is comprised of payments into the pension fund.

The lack of transparency in adopting public worker wage and benefits decisions has been occurring without the press or public taking much notice. At the local government level in Nevada and elsewhere, more often than not, collectively bargained wage and benefit agreements are typically placed on the consent agenda for approval. If the agreement is discussed the only portion covered centers on the cost-of-living adjustments. More costly terms, conditions, and elements of the contract, which are buried deep within the agreement, are seldom, if ever publically discussed. Independent analysis of the cost of the increase are rarely if ever provided nor is there any discussion on how these costs will be paid for in the future. Recently enacted legislation requires local governments to present fiscal impact statements, but the new law does not specify either the level of detail or the format for such statements. Therefore, more definition is needed to flesh out this requirement.

This lack of transparency extends to the state level too. Nevada legislators, who have the sole authority to set PERS pensions have voted to increases PERS benefits during times where the plans faced large unfunded liabilities and were already more generous that most other states. In 1997, automatic postemployment pension benefits increases were enacted and in 2001, the service credit (or benefit multiplier) per year of employment was increased from 2.5 percent to 2.67 percent. (keep in mind that the national average is 1.95). The consequences and associated debt, which are substantial, was passed off to future generations to grapple with.

So who makes more –the public or private sector? The answer is not so simple, as many commentators, researchers and pundits would like for you to believe. The standard for setting public pay and benefits dictates that public employees should be compensated in a manner comparable to their private sector counterparts. This is consistent with economic and efficiently principles and concepts of fairness and equality. Historically, there has been a trade-off for working in the public sector – the promise of job security and solid health and retirement plans in compensation for forgoing larger wages in the private sector. While wage comparisons between the public and private sectors are often mischaracterized and have failed to account for many differences in education and job type; the divide between the two has narrowed considerably. Disagreements on pay and total compensation comparison studies vary due to different approaches, methods and data.

With regards to salaries, there appears to be an education divide, without a college degree employees do better in the public sector. Public employees with a college degree do worst. While there is still a lack of consensus on what pay disparities exist and whether these differences are justified between public sector and private sector employees, there seems to be little dispute with regard to benefits. Public employees have traditionally received more generous benefits. The controversy centers on how much to value deferred benefits such as pensions, retiree health care and even job security. Most public pension plans guarantee retirees a set income for the rest of their lives, indexed for inflation. In addition, many public employees have access to subsidized retiree health care that requires little or no co-payment. These types of benefits have mostly disappeared in the private sector.

The current way we reward and manage employees is skewed too heavily towards pensions and retiree health care. The system places too much emphasis on time served and longevity. Don't get me wrong, institutional knowledge and being loyal to an organization is a good thing; however, when too much emphasis is placed on it, it results in a much more expensive system and creates significant challenges for service delivery, efficiency and responsiveness. The practice of providing deferred compensation has been carried out in ways that often hide a full accounting of the costs from the public and pushes a significant amount of the costs onto future generations of taxpayers, elected officials and public managers. The result has been to transfer current fiscal deficits into future debt, with interest.

It also places barriers on the ability to recruit the best and brightest and the talent we need in the public sector to make progress on many of the difficult and intractable problems we are facing.

An enormous problem with the defined benefit (DP) plan, which is the primary pension plan for public workers, is its lack of portability. It contributes to employees staying with one employer no matter how unhappy or unproductive they are, or how much they desire to move because they often want to maximize their retirement pay-out and/or are financially penalized by leaving early. Employees commonly refer this is the "golden handcuffs". Increasingly, younger employees tend to move around from job to job, city to city, and state to state in search of new opportunities, promotions and experiences. Hybrid plans that combine elements of existing defined benefit plans with a new 401-k-style system where money is invested on behalf of the retiree has been adopted in various jurisdictions such as the city of Atlanta Georgia as well as with the Federal Employee Retirement System. Under cash-balance plans, workers get an individual retirement account that both the employee and employer contribute to while the employer guarantees a minimum return. These plans have the potential to increase active participation of public employees in the retirement planning while transferring some of the risk away from the taxpayer. Moving public employees to these type systems will also allow portability of these benefits so they can follow workers if they choose to switch jobs and move to the private, non-profit or to another public sector job.

They would allow for a more flexible workforce, infuse new ideas and talent into the work setting, and reduce the incentive to stay at one job for an entire career. While Nevada PERS allows for portability of benefits within participating public agencies, there is no such transferability with federal, private and non-profit organizations. In other states, portability among state and local governments is limited. For example, within San Diego, the city, county and state all have separate pension plans and portability of these plans is nonexistent.

While clearly not settling the debate, in my book, *Rethinking Public Sector Compensation; What Ever Happened To The Public Interest?* I weigh in by providing a comparative model analyzing public versus private compensation by considering lifetime compensation. Two public-private comparisons were made: one comparing a typical blue collar job, that of a janitor; and the second, a white-collar jobs, a civil engineer. Given the increase in longevity, the fact that public workers on average retire 5 years earlier than their private sector counterparts, and with a defined benefit plan that is indexed for inflation for life, the divide between the two sectors increases significantly, favoring the public employee, when lifetime wages are considered. Assuming both public and private janitors live until the age of 78, the public sector janitors tend to enjoy 24 years of retirement, with pension payments and post-retirement health care totaling more than $2.6 million dollars. Seven years after the public sector janitor retires, the private one can finally put of his or her mop and enjoy the sunset years. However, compensation that the private sector retiree receives from Social security payments and 401(k) distributions will total $638, 100 less than those of their counterparts from the public sector. With all other variables remaining the equal to the janitor example, a private sector engineer will earn nearly $1.5 million dollars less than some on the same job in the public score over the same lifetime…and will retire seven years later than their public sector counterpart.

So what has been occurring nationally? The issue of public sector compensation has clearly been on the minds of legislators. 43 states have recently passed some type of pension reform in the last several years. Lawmakers have enacted changes to increase employee contributions; increase age and service requirements for retirement; limit cost-of-living increase and cap benefits for new employees. Early reforms by state and local governments primarily applied only to future hires (which did little to address current budget gaps); however recent reforms have applied more to current workers and even retirees.

While reforms have been enacted, many of these fixes have fallen short of comprehensive reform. The majority of legislation has not included retiree health care reform and has focused only on new employees, which means most of changes will not result in any budget relief for decades.

Many pension experts and lawmakers have reached the conclusion that even with stronger market returns, public pension system will not be able to cover retiree benefits in the long term without some type of combination of raising taxes, significant benefit cuts and/or changing how retirement plans are structured and designed. With the realization that reducing benefits for new employees will not be enough to keep pensions solvent, some states and local governments have turned to reducing benefits for current retirees and employees. Several states and local governments have passed laws restricting or eliminating future cost-of-living adjustments; others have redesigned pension plans that have impacted current employees; and voter-approved ballot initiatives have altered not only plans for new employees but for existing workers. Predictably, litigation has begun in these jurisdictions. Within the last several years, at least 24 jurisdictions have faced legal challenges alleging pension reform measures are unconstitutional. The outcomes of these cases could have a dramatic impact nationally on how public retirement plans are managed.

I thought it might be useful, as the Governor’s office and Legislature are examining these issues, to provide a brief overview of some of the more significant reforms and litigation occurring nationally.

Although courts have generally held that increasing existing employees’ contributions into pension and retiree health care is permissible; altering pension benefits for current employees and retirees have largely been deemed legally off-bounds since they are protected by most states. State statutes, constitutions and case law consistently define a public pension as a contract between the state and its employees that cannot be impaired. However, this is currently being tested. Since 2010, 10 states have frozen, eliminated, or trimmed the annual cost of living (COLA) increase they pay current retirees. While many public pension plans are in fact created by statue, it is being argued that what a legislature may do by law, it may also undo. While a South Dakota judge recently ruled that cost-of-living increases could be suspended and are not contractually protected; the Colorado Court of Appeals ruled they were Legal challenges are pending in some of the other states .

Rhode Island passed one of the most far-reaching retirement-system overhauls last year by not only suspending cost-of-living increases for retirees but raising retirement ages for existing employees and switching them to a new designed pension plan. It changed its traditional system of a defined contribution plan, to a hybrid in which the state guarantees only a part of each pension with a 401(k) –style plan makes up the rest. Unlike what Governor Walker did in Wisconsin, which spared public safety, the Rhode Island plan affects all state employees equally. Unlike other states that applied reforms only to new employees, the Rhode Island plan extends to both new and current employees. Similar to the jurisdictions that have targeted reforms to current retirees, the Rhode Island plan is being challenged by employees and retirees in court.

Two California cities attracting national attention for voter-approved public pension reforms are also on the same path to litigation. Recently, voters in San Jose and San Diego overwhelmingly approved ballot measures on public pension overhaul. The San Jose plan requires current workers to either switch to a lower pension or pay more to keep their existing pension. The San Diego plan places all new hires in a 401(k)-style investment plan. Both plans allow current workers to keep pension amounts already earned, only reducing future amounts. The supermajorities on these ballot initiatives suggest that there may not be much sympathy for preserving pensions and other retiree benefits for public employees when most private-sector taxpayers will never earn comparable benefits for their own retirements. As the public becomes aware of the more generous benefits packages that public workers receive, and cities and counties are forced to cut vital services to meet their pension obligations, taxpayers' resentment has grown. The ease in which these ballot initiatives passed may result in other municipalities following their lead.

The recent Chapter 9 bankruptcies in California, resulting from dwindling tax revenues and unsustainable pension and other post retirement obligations to public employees, could set precedent on how local governments deal with soaring pension costs. In particular, disputes between bondholders and bond insurers are brewing over how pension and other post retirement obligations are treated in a municipal bankruptcy. At issue is whether the pensions of government workers take precedence over other payments in a municipal bankruptcy. Unlike other cities such Central Falls, Rhode Island that filed for bankruptcy, the California jurisdictions that have recently filed, San Bernardino, Stockton and Vallejo, make their statewide pension contributions to the statewide plan, CalPERS. Public employees are also protected by state constitution. Since it declared bankruptcy, the county of San Bernardino has missed their biweekly payments into the state's retirement system. CalPERS maintains that contributions to its fund can never be suspended, even in a bankruptcy and has filed legal action. CalPERS also purports that under state law, bankrupt agencies cannot reject their contacts with CalPERS and it has priority over other creditors. Wall Street bondholders and insurers disagree, arguing the federal bankruptcy law trumps state authority and that CalPERS should be treated as an equal creditor. Both sides have vowed to appeal to the US Supreme Court. Ultimately, the US Supreme Court is probably going to render a decision as to whether or not federal bankruptcy law trumps not merely state law but also trumps the fact that a city is simply an operating unit of the state and can do what the state allows it to do. San Bernardino will be the first place where this gets litigated. Depending upon how the courts rule, it may open to window to local governments reneging on current pension and post-retirement promises to their employees. The case will set important precedence as to who gets paid when a government runs out of money.

Many states have moved to increase employee contributions for their public retirement and retiree health plans. The concept is based on the facts that similar to Social Society and defined contribution plans, there should exist equal employee /employer participation. As previously mentioned, Courts have generally held that existing pension benefits are protected, but increasing existing employees' contributions is generally permissible, which can significantly address a portion of the current underfunding. California recently passed the California Public Employees' Pension Reform Act of 2013, which increased employee contributions not only for new employees but also potentially for existing employees. I say potentially because the avenues for increasing the contributions for new employees are still unclear.

This is one area where Nevada may want to review. The issue of how much public employees' financially contribute to their retirement in Nevada is problematic. Employees under the employer/employee pay plan (approximately 18% of Nevada employees are enrolled in this plan) contribute 11.88% as a documented payroll deduction; while those enrolled in the employer pay plan (approximately 82% of Nevada public employees) contribute $0.00 from their actual paycheck. Nevada statutes require that the latter workers take "lower salaries" in lieu of paying into their retirement plans; however, in a collectively bargained environment whether this actually occurs can be illusory.

This means if the rate goes up, the employee's share of the increase must be paid either by reducing his or her salary or reducing the cost-of-living adjustment (COLA) by the amount necessary to finance the employee's share. The problem lies in the latter circumstance. For example, if the rate goes up 1 percent, the employee's statutory share of the increase is ½ percent. If the employee simultaneously gets a 3 ½ percent COLA does that mean he or she would otherwise have gotten a 4 percent raise? Employees often bargain for a pay raise when the contribution rate goes up, even though they contribute nothing. The reality is in many local governments, employers and employees on the employer-paid plan have long abandoned the notion of the employee's share, even to the point of putting language in contracts to the effect the employer pays 100 percent of the rate. This is entirely contrary to the certification public employers have to file with PERS that the rate change was funded either by a salary reduction or paid by the employer "in lieu" of a raise which would otherwise have been awarded. Furthermore, if this tradeoff was actually occurring, I don't think we would consistently rank as having the highest local government salaries in the nation. The reality is that even during the recession, local government salaries have continued to increase at a significant pace.

State and local governments are also debating over what types of pay can be counted toward a public worker's pension. At issue is what type of enhance pay such as lump-sum payments for unused sick or vacation time, longevity pay, employee allowance for vehicle and uniforms and specialty pay for being bilingual or for public safety issues. Other states have moved to prohibit the purchase of service credits or "air time" by public employees. Many jurisdictions, including Nevada PERS, allow employees to purchase up to five years of service credit allowing them to retire early and collect full benefits without penalties. These programs were supposed to be designed to be cost neutral to the employer, with the employee paying the full cost of purchasing the increased retirement benefit. In reality, this isn't really a no-cost benefit for employers. Analysis more often than not, have found that jurisdictions significantly under-priced the benefit. Finally, longevity pay has been gradually phased out in most jurisdictions. According to the Bureau of Labor Statistics, only 7% of public sector employees still have access to longevity payments. This is not the case with some governments in Nevada. For example, in Clark County, non-management employees receive longevity pay equal to 2.85% of their gross salary after 5 years. The rate escalates 0.57 of 1% for each year of employment. Despite having eliminated this perk for all management level employees while I was County Manager, the practice continues for most non-management employees with the cost to Clark County translating to over $25 million per year. If you add the PERS impact, there is an additional $7 Million. When you add UMC costs, the total amount the County spends on a yearly basis for longevity checks to its employees approaches $40 Million!

Finally there are some advocates for federal intervention in establishing mandatory pension-funding requirements, similar to what exists in the private sector. In 1974, the federal government via the enactment of the Employee Retirement Income Security Act forced private firms that offer defined-benefit pensions to maintain adequate funding ratios. Currently no corresponding legislation exits in the public sector and therefore, there is no requirement that state and local governments adequately fund their pension systems.

However, it will be the courts that have the most dramatic impact on the ability of state and local governments to reform public pay and benefits. The outcome from current litigation in several states will either significantly expand or restrict the ability to manage these public retirement plans and other post-retirement benefits.

I understand the reality of a limited legislative session in Nevada, a need to prioritize the many competing and pressing issues confronting Nevada …… as well as balancing the real and urgent needs for short-term fixes with the need for long term and sustained reforms. However, the ability of local and state governments to fulfill their responsibility to citizens is being compromised and the need for comprehensive and sustained reform is critically needed. If public managers, along with elected officials and employee/union groups do not comprehensively address this issue, fed-up citizens will head to the ballot, and their remedies will likely be much more punitive and draconian than any legislation or policy changes. It is imperative that the unfunded liability for pensions and other post employment benefits be addressed in a timely, comprehensive and fair manner. Further, public employee compensation must be sustainable, allow for us to recruit and retain a talented and competent workforce and reflect the reality of a new emerging workforce. **The responsibility of government is to ensure that citizens receive essential services and it is this principle that should drive the debate and inform the development of effective solutions.**

Thank you for allowing me to share my thoughts on this important issue.