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

PSERS FUNDING

House Bill 4951 as introduced
First Analysis (8-17-93)

Sponsor: Rep. Donald H. Gilmer
Committee: Appropriations

THE APPARENT PROBLEM:

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

One approach has dealt with a statutory requirement for an annual comparison and reconciliation of actual retirement system needs with budgeted amounts. The PSERS act requires retirement system officials to annually certify to the state superintendent of public instruction and the director of the Department of Management and Budget (DMB) the actual aggregate compensation paid to public school employees during the preceding fiscal year. It used to be that the executive budget for the following fiscal year had to contain an amount that adjusted the state contribution to the system to reconcile the estimated and actual aggregate compensation. Starting with fiscal year 1990-91, however, payments of the additional contributions were to be paid over five years, with interest. This approach, called "smoothing" the contributions, was adopted in the budgets for fiscal years 1990-91 and 1991-92, and was made a part of the PSERS act by Public Act 158 of 1992. Under the provisions of that 1992 amendatory act, however, five-year smoothing is scheduled to expire September 30, 1993.

A second, more controversial, approach also was made a part of statute by Public Act 158 of 1992, after having been effected through executive orders for preceding fiscal years. That approach changed the method of funding the costs of health benefits for retirees and their beneficiaries. Prior to 1990, state contributions for health benefits were pre-funded as required by Public Act 91 of 1985, which expanded health benefits and replaced cash funding (that is, funding on a year-to-year basis) with prefunding (meaning, basically, that the benefits earned in a given year were to be funded for the future in that year). While prefunding costs less in the long run, it costs more in the short term; thus, budget negotiators and the legislature opted for a return to cash funding of PSERS health benefits. However, the PSERS act provides for cash funding only in the 1992-93 fiscal year. After the end of the current fiscal year, the act's language for prefunding would again be in effect.

With budget problems continuing to plague the state, it has been proposed that the temporary strategies in place since 1990 and ratified by 1992 statutory amendments be extended indefinitely.

THE CONTENT OF THE BILL:

The bill would amend the Public School Employees Retirement Act (MCL 38.1341) to extend indefinitely provisions for cash funding (as opposed to prefunding) of retirees' health benefits, and for five-year "smoothing" of the annually-computed adjustments of the state contribution to the retirement system. Specifically, the bill would do the following:

** delete a reference to the 1992-93 fiscal year in the provision mandating cash funding of health benefits.

** delete a September 30, 1993 sunset for the five-year "smoothing" of annual adjustments in the state contributions to the retirement system. (Under the act, an adjustment in the state contribution to the PSERS due to any difference in the estimated and actual aggregate compensation must be included in the following year's executive budget; with five-year smoothing, the payments for additional contributions to the retirement system are spread out over a five-year period, with interest being paid on the deferred amounts.)

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, part of the fiscal year 1993-94 leadership agreement was to suspend prefunding of PSERS health benefits and to continue five-year smoothing with the aim of saving an additional $215 million for the school aid fund. Of that approximately $215 million in anticipated savings, about $154.5 million is expected through cash funding of health benefits and about $60.4 million is expected through five-year smoothing of reconciliations. (8-16-93)

ARGUMENTS:

For:

The bill is essential to help balance the budget for the coming fiscal year. Without it, there would be a $215 million dollar "hole" in the school aid budget--which is encountering ample problems this year as it is. While cash funding of PSERS health insurance may prompt complaints from some, the DMB has noted that the bill would be consistent with the state retirees' health plan, which has always been funded on a cash basis. Moreover, there are only seven states (if one includes Michigan) that prefund retirees' health benefits. Cash funding for health benefits and five-year reconciliation smoothing have been in effect for several years, without adverse effect. The bill would have no effect on retirees' benefits; it merely would ease cash flow problems.

Against:

The bill would cost the state substantially more in the long term. By setting aside a little now, rather than a lot later on, prefunding of health care benefits saves money in the end; cash funding means that the opportunity to offset costs with investment income is lost. (Unfortunately, rapidly escalating health care costs mean that the sum believed necessary to adequately prefund is more than the sum just to pay today's premium.) Future state costs also rise with interest payments on amounts deferred under five-year smoothing. In essence, the bill proposes to borrow from the future to solve the budget problems of today. Cash funding of health benefits and five-year smoothing of funding reconciliations should not be a part of permanent public policy. If the strategies are truly necessary at present, the bill would do better simply to extend them temporarily.

Against:

Because it does not adequately fund health benefits, the bill, like the actions that preceded it, is unconstitutional. Article IX Section 24 of the constitution states that "the accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." In a lawsuit brought against the state, school employees and retirees argued that PSERS health benefits are constitutionally-protected "financial benefits," and that the constitution imposes a duty on the state to provide adequate funds to the PSERS.

The plaintiffs asked the court of appeals for a writ of mandamus to compel state officials to transfer money from the state school aid fund to the PSERS (Musselman v Engler, docket no. 142142). In a July 1993 decision, the court determined that it was without authority to grant the requested relief. Citing this lack of authority to grant the requested relief, the court refused to determine whether "plaintiffs had a clear legal right to the 'prefunding' of health care benefits or whether defendants had a clear legal duty to provide for the 'prefunding' of health benefits." The constitutional issues thus are very much alive, with Musselman on appeal to the supreme court, and a second case, Musselman II, being brought to the court of appeals to address additional issues. The legislature should at least await a resolution of the constitutional issues before further underfunding the retirement system and thereby endangering retirement benefits.

Response:

Health benefits are not constitutionally protected financial benefits. For one thing, health benefits were not even available until provided by Public Act 244 of 1974, enacted eleven years after the constitution of 1963; prefunding of health benefits did not come for another decade, with enactment of Public Act 91 of 1985. Further, by adequately funding current premiums, the state is fulfilling any obligation it might have regarding retirees' health benefits. Rather than await a slow and possibly inconclusive judicial process, the legislature should act to stabilize the budget now.

POSITIONS:

The Department of Management and Budget supports the bill. (8-13-93)

The Michigan Education Association opposes the bill. (8-9-93)