

# AN ACT TO REMEMBER

## HIGHER PENSIONS — HIGHER PROPERTY TAXES

PETE MILLARD

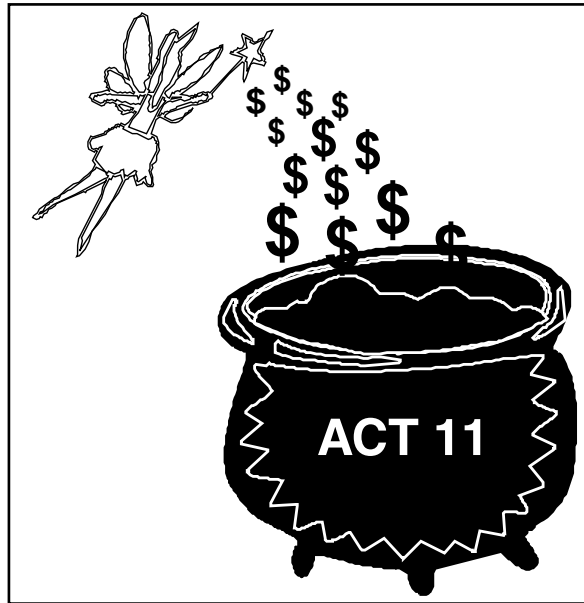
A multibillion dollar, pension-sweetening bill benefiting hundreds of thousands of past and present government employees and elected officials was passed by the Wisconsin Legislature with little fanfare or media coverage near the peak of the stock market boom in 1999.

Assembly Bill 495 became Act 11 after it was pushed through the Legislature in five days as an attachment to the 1999-2001 biennium budget. Less than four years later, Act 11 stands to be one of the biggest budgeting boondoggles in the history of the state.

### **The \$14 Billion Handout That Looked Good to Everybody**

Not only did the bipartisan plan involve a \$14 billion handout, but it will result in higher local taxes for the next 10 or more years to make up for losses that the Wisconsin Retirement System has suffered because of the down economy.

"Wisconsin legislators overwhelmingly voted to approve the bill even though warnings of the state's actuary were loud and clear," said Cathy Lawton, a West Bend resi-



dent and a 2002 Independent candidate for the 59th Assembly District. Lawton first learned of the pension-sweetening deal when she was gathering state fiscal data for use in her campaign. For the past 14 months, Lawton has crusaded against Act 11 to demonstrate how disingenuous legislators have been in protecting the interests of taxpayers.

Lawton's main criticism of elected officials' management of Act 11 after the legislation was passed and the stock market went into a four-year tailspin is that someone should have intervened to undo what was done to enhance pensions.

"There were no courageous legislators willing to tee up Act 11," said Lawton. "Why not? Probably because it would have been political suicide to bring up anything having to do with pension abuses after the Milwaukee County pension scandal erupted and resulted in more than a dozen recall elections."

Lawton, who placed second in the November 5, 2002, general election behind

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*Pete Millard is a reporter and columnist for the Business Journal, Serving Greater Milwaukee.*

GOP winner Daniel LaMahieu, is a managing director of Intecap Inc., Chicago, a company that specializes in economic valuations.

"It is ironic that everyone in Madison is currently caught up in the property-tax freeze, but there has been no attention given to controlling the underlying factors that are driving up property taxes," said Lawton.

More than 1,200 units of local government and state agencies contribute a percentage of their payrolls into the Wisconsin Retirement System. If those costs increase because of Act 11, the money to pay for the retirement bonuses will come from property-tax collections.

"Local officials are right to be mad as hell at state elected officials when they are on the receiving end of a big-cost debacle like Act 11," said Lawton.

Pure and simple, Act 11 was a well-conceived scheme for legislators to get their hands on \$14 billion of surplus money squirreled away in a Wisconsin Retirement System (WRS) account. By changing state laws and restructuring how the Wisconsin Department of Employee Trust Funds disperses billions of dollars to annuitants, legislators were able to increase pension payouts (including their own) and give government employers that contribute to the WRS a contribution holiday, albeit a brief holiday.

Under Act 11, \$200 million of the total amount credited to the employer reserve has been used to create separate credit balance accounts of each WRS employer. Individual employer credit amounts vary from several thousand dollars to several million dollars, depending on the employer's total payroll.

Not to be forgotten in the pension scheme, three long-time Wisconsin politicians got their hands on \$200 million of pension money that was used to balance the 1999-2001 budget. This was money that was returned to state agencies contributing a percentage of their employees' salaries to the WRS.

## History of the Bill

Former Governor Tommy Thompson signed Act 11 into law December 16, 1999, as part of the 1999-2001 budget bill. Several provisions of the act boosted the pensions of 240,000 current state and local government employees, 1,500 elected and executive officials, 20,000 police and firemen, and more than 100,000 pensioners. A secondary bonus of Act 11 was that Wisconsin Legislators found \$200 million that was applied to the state's budget.

The main purpose of the bill was to close a Department of Employee Trust Funds (ETF) surplus fund called the Transaction Amortization Account (TAA) and transfer out \$4 billion, which in 1999 present-value dollars would be worth \$6 billion today, according to the former state actuary. The TAA was an account in which market gains and losses are recorded. It was the buffer account whose purpose was to smooth the impact of investment gains and losses on three Trust Fund reserves: the annuity reserves, the employee reserves, and the employer accumulation reserve. ETF was left with \$10 billion in the TAA. However, since Act 11 eliminated TAA over a five-year period and created a Market Recognition Account (MRA) instead, lawmakers decided to dole out 20 percent of the TAA's remaining \$10 billion each year over a five-year period, with market losses and gains after 1999 to be credited instead to the new MRA. The MRA would become the new accounting mechanism that would smooth the fixed investment trust earnings over a five-year period to replace TAA. The change to the MRA would mean a faster recognition of gains and losses than had occurred with TAA.

The phase-out of the TAA over the five-year period greatly increased the fixed effective rate interest credits to active and eligible inactive WRS members, and the fixed dividends for annuitants, for the ensuing five years.

To illustrate the impact of the bill, ETF documents show the \$4 billion transfer provided a 9.6 percent dividend over and above

the 7.5 percent fixed annuitant dividend granted for 2000, bringing the final fixed dividend rate in 2000 to 17.1 percent.

Under the old law, paper gains and losses of the invested assets of the fixed trust were credited to the TAA. Then, 20 percent of the entire TAA balance as of December 31 each year was withdrawn and disbursed among the three reserves. Act 11 still allows the regular 20 percent distribution (until the TAA is phased out in five years), but it also ordered, simultaneously, the one-time transfer of \$4 billion to the three reserves.

### **Paper Gains**

Perhaps the biggest flaw of the phase-out of the TAA in favor of the MRA was that the \$10 billion in the old account was unrealized paper gains that disappeared between 2000 and 2002. Lawton claims that because the TAA was closed, because the \$10 billion sum was frozen and applied to the subsequent five years in \$2 billion increments, and because the annual losses from 2000 and later years were divided by five to be spread out over the subsequent five years, WRS pensioners are now getting benefits significantly greater than they would have had under the old TAA.

"The bottom line is that Act 11 is the gift that keeps on giving," said Lawton. According to her calculations based on the annual reports filed by ETF, Act 11 artificially reduced contribution rates from employers by about \$238 million per year from 2000 through 2002. Act 11 also provided additional pension improvements totaling another \$105 million per year.

Lawton estimates that \$343 million per year directly related to Act 11 is being ignored, or not budgeted for, and that liability for not

recognizing these items for years 2000, 2001, 2002, and 2003 is mounting.

Lawton claims there is also a negative cash flow in WRS. The system received \$1 billion in contributions and has \$2.5 billion in annual payouts.

Based on Lawton's calculations, Act 11 benefit improvements cost taxpayers about \$6 billion in 1999 present value dollars, the reduced contribution rates so far cost about \$900 million, and the TAA to MRA transition will cost \$10 billion. That brings the overall cost of Act 11 to Wisconsin taxpayers to \$17 billion, and nobody seems interested in fixing the problem.

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On top of the Act 11 giveaways, there are the ravages of the stock market decline over the past three years. WRS assets are off by \$30 billion, and WRS liabilities exceed assets by \$12 billion, said Lawton.

The target eight percent investment return was not met during the period 2000-2002, and large losses were realized as the retirement fund plunged to \$50 billion from \$68 billion in 1999.

"I think a supplemental contribution to WRS is needed now," said Lawton. "ETF disagrees and says they have 40 years to make up the losses." That is the view of ETF secretary Eric Stanchfield. "The system is designed so that over the long term, contribution rates remain fairly stable," he stated. "We expect the investment markets to return to historic norms."

ETF's official stance on Act 11 and how it will affect taxpayers is as simplistic as the pension-sweetening scheme is complex. Retirement systems are funded into perpetuity, said Julie Renneau, Communications Director for the Department of Employee Trust

Funds. “The economy goes up and its goes down. The state has 40 years to recover some of its losses. If the markets had stayed up, you would not be hearing anything about this topic,” she said.

But the markets didn’t stay up, and now the reality is government employers who pay for their employees’ retirement plans are on the brink of owing 10 times more in retirement benefits because government officials went after a \$13.9 billion pension fund surplus to enhance benefits of public employees and officials and pay down their own swelling budget shortfalls.

Former Assembly Speaker Scott Jensen (R-Waukesha) and former Senate Majority Leader Chuck Chvala (D-Madison), with the blessing of four-term GOP Governor Thompson, collaborated to rush the pension-improvement bill through the Legislature. While Jensen and Chvala publicly despised each other, they managed to find common ground when it came to Act 11. Both men still serve in the Legislature, and both are fighting felony charges related to alleged campaign fund abuses.

The people benefiting from Act 11 are the more than 400,000 current and retired employees of state government, including Thompson, Chvala, and Jensen — they received a pension enhancement of eight percent — and employees of more than 1,000 local units of government. They are part of the Wisconsin Retirement System, which is run by the Department of Employee Trust Funds and receives funding from the State of Wisconsin Investment Board, as well as employee and employer contributions.

It is the employer contributions, which historically have been low, that have critics worried. There is talk of freezing property-tax rates in virtually every community in Wisconsin, either by local initiatives or legislative edicts. There is little doubt employer contributions from local and state government will rise dramatically in coming years at a time when no one can afford the increases.

Act 11 had other detractors in addition to Lawton, who picked up on the problem three years after it was enacted. The complex nature of the bill and the fact that it was only on the floor of the Legislature for five days didn’t give opponents of the proposal enough time to fight it, said Scott Dennison, the former state actuary and research director for the Legislature’s Joint Survey Committee on Retirement Systems. The joint survey committee is responsible for advising legislators on all matters related to pension benefits.

Dennison wrote a report in October 1999, warning legislators and the governor that they were considering pension changes that could have dire consequences for taxpayers in the future. Legislative leaders were so annoyed by Dennison’s report and his failure to support the plan that they forced him to resign his post shortly after Act 11 was passed and signed. He is now a mathematics professor at the University of Wisconsin-Oshkosh.

Senator Bob Wirsch (D-Kenosha), a co-sponsor of Act 11, claims that Dennison’s performance under fire was sub par. “He was just a disgruntled employee who couldn’t take the stress of working with the Legislature and ended up doing a poor job,” said Wirsch, who served as the co-chair of the Joint Survey Committee when the bill was introduced.

Dennison was asked to produce actuarial tables that would support a pension-enhancement plan, but instead he proved the plan was ill-founded. When Dennison was first given the assignment to provide data on the impact of Act 11, he was told he had four days to run the numbers. That was a monumental task because much of the data and computer programs were in the hands of the state’s actuaries, Gabriel Roeder & Smith Co., Southfield, Michigan. Dennison immediately contacted the state’s consulting actuaries about the job, but the firm refused to accept the assignment on such short notice, stating that the job would require a minimum of eight working days. The actuarial firm’s response didn’t faze lawmakers. Dennison was told to produce his own

report, even though he didn't have all the data or the staff to complete an accurate analysis.

"I was put in a terrible position, ethically speaking," said Dennison, a La Crosse native who been the state actuary for West Virginia prior to accepting the Wisconsin job in 1997. "I couldn't believe what I was being asked to do."

Dennison attached a disclaimer to his hastily produced report that pointed out his analysis was incomplete. Several lawmakers on the Joint Survey Committee were livid over Dennison's disclaimer. Dennison was not the only government employee to leave state employment after the bill was signed. David Stella, a former ETF administrator who was a voting member of the Joint Survey Committee, left his post in early 2000. Stella voted against Act 11 as a member of the committee and then left ETF for a better job, said an agency spokesman.

ETF agreed with the position Dennison was taking, said David Mills, the agency's deputy secretary. Considering that the stock market downturn that started in 2000 and persists today was of a greater magnitude than anyone could have imagined, the WRS would have been better off if the money shifted from the smoothing account had remained to offset the market decline, said Bob Willett, the controller for ETF.

ETF attempted to challenge Act 11 in the Wisconsin Supreme Court, but the high court determined the agency did not have standing. The Wisconsin Police Association challenged the pension benefits law, but the Association was turned back by the court.

Among legislators, Milwaukee County Executive Scott Walker, a former Republican Assembly representative from Wauwatosa, was one of 20 representatives who voted

against the pension-enhancement plan. The Assembly voted 79-20 in favor of Act 11, and the Senate approved the bill 23-10. Walker eventually rode into his new office based on the taxpayer revolt against the super-sweet Milwaukee County pension plan.

"Legislators had the benefit of reading [Dennison's] report from the Joint Survey Committee that raised all kinds of red flags, and they still passed it overwhelmingly," Walker said.

Even though the state pension plan had no upfront lump-sum payments for elected officials or their appointees, as the much-maligned Milwaukee County Board plan did, the costs for the state's enhanced pension will dwarf the county's plan, said Walker.

The only Democrat to vote against the pension plan was Bob Ziegelbauer, a small business owner from Manitowoc. He claims the real harm done by Act 11 was the commitment of taxpayers to a higher level of benefits than was justifiable given the value of the assets in the retirement account.

"This was not so much a grand conspiracy as much as it was an accumulation of incompetence in what is a complicated area," said Ziegelbauer, who has an MBA from the Wharton School of Business at the University of Pennsylvania and an undergraduate degree from Notre Dame.

Ziegelbauer said legislators listened to their leaders and believed in the fairy tale of getting something for nothing. "Not many of my colleagues will ever pass a quiz on how a pension system works," he said.

"I'm glad I'm not in state government anymore," said County Executive Walker. "How legislators deal with future pension shortfalls is not going to be pretty." Waukesha County

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officials, including County Executive Dan Finley, lobbied hard in Madison to have the pension improvement bill killed. Norm Cummings, the Waukesha County director of administration and a former administrator for the Wisconsin Department of Administration, estimates that, eventually, local governments will pay 60 percent of the cost of improving state pensions.

"The alarming reality of increasing pension benefits across the board is that decision-makers who implemented the plan are not the ones who will be held accountable for paying for it," said William McReynolds, a former Racine County Sheriff who was sworn in as Racine's new County Executive in April. "We have enough problems already with skyrocketing health-care benefits, just to cite one example."

#### **Time Bomb**

Local officials view Act 11 as a time bomb that will blow budgets to smithereens. The contribution holiday promised to government employers was short-lived. Municipalities, school districts, and state agencies got what they bargained for with lower rates in 2000, 2001, and 2002 by buying into the pension-sweetening bill. Rates have increased a modest 0.4 percent for 91 percent of the employees covered by WRS in 2003 and 2004.

As financial and budget directors for local governments watch the U.S. stock market limp along in the last half of 2003 while the burden of pension payments increases, they fear that contribution rates will skyrocket in 2005 and beyond. Official comments from the Department of Employee Trust Funds don't soothe the fears. In fact, ETF is already telling government employers to brace for more contribution increases in 2005 because of investment losses.

"Raising contribution rates alone will not offset the investment losses we've experienced over the last couple of years, but increased

employer and employee costs are a direct consequence," said ETF secretary Stanchfield last June when he announced the second consecutive 0.4 percent rate hike.

In the meantime, municipalities are reminded of what they were promised when the bill was passed. Advocates of the legislation promised lawmakers, municipal officials, and other government officials that the bill would be "revenue neutral" and would "not cost them a penny," said Rich Eggleston, a spokesman for the Wisconsin Alliance of Cities.

Today, state agencies and local governments with employees in the retirement system know they were lied to and are expecting to pay considerably more into the retirement fund. They will have to cover losses that resulted from the legislation taking \$4 billion from the fund as part of a one-time handout, the \$10 billion paper gains transfer from TAA, and the stock market tanking.

In the meantime, Wisconsin government employers are obligated to maintain high levels of benefits at a time when investments are not performing as well as they had performed at the end of the twentieth century. Municipalities, school districts, and state government agencies have no other option but to turn to taxpayers for more money.

"Contributions will increase to fund benefits that are promised by statute," said ETF's Renneau. "If you look across the nation, many states require contributions of four to five percent."

For the past two years, most government employers participating in the WRS paid contribution rates of 0.4 percent of their payroll for retirement plans. Considering that most employers are reeling from higher healthcare costs and struggling to keep those costs down, the last thing they need now is for their retirement benefits costs to increase tenfold.