Massachusetts Taxpayers Foundation

August 18, 2010

An Open Letter to Legislators and Candidates:

The cities and towns of Massachusetts are caught in an acute dilemma – a severe revenue squeeze with continued cuts in local aid on the one hand, and a relentless increase in the costs of employee and retiree health care and pension benefits on the other.

It is imperative that the Legislature act in 2011 to help municipalities address the unsustainable increases in the costs of health care and pensions that are leading directly to layoffs of teachers, police, fire and other local employees. The recently passed "municipal relief" legislation fails to address either of these issues in a meaningful way. (We have attached brief summaries of the Foundation's recommendations.)

The finances of local government are under siege. Cities and towns have experienced cuts in local aid for three consecutive years with a total reduction of $700 million or approximately 12 percent during the 2009 – 2011 period. Additional large cuts in state aid in fiscal 2012 are virtually certain as the state contends with the loss of federal stimulus dollars.

While revenues are being squeezed, health care costs are growing so rapidly that they are consuming a greater and greater share of local budgets – jumping from 6 percent of total municipal spending in 2000 to 14 percent today to a projected 20 percent in 2020. Unless municipal leaders are given the same powers as the state to design health plans outside of collective bargaining, surging health care costs will continue to push municipal employees off payrolls. Modifying health plans, while still preserving benefits that are at least as generous as the state's plan, would provide large and immediate savings for cities and towns – an estimated $100 million statewide in the very first year with much larger savings over time.

To make matters worse, funding municipal pensions has become much more costly as communities respond to the nearly 30 percent plunge in portfolio values from the 2008 stock market collapse. Even with recently passed legislation that extends the payment schedule by 10 years to 2040, most communities will be required to increase their contributions to the pension fund, forcing cuts in other parts of the budget.

Sincerely,

Michael J. Widmer
President

Massachusetts Taxpayers Foundation

Municipal Health Care

Two straightforward changes would provide large and immediate savings in health costs, dwarfing the savings from all other municipal relief proposals:

- **Give local officials the power to design their health insurance plans outside of collective bargaining.**
- **Require by statute that all eligible local retirees enroll in Medicare as their primary source of health insurance coverage.**

In both cases, these changes would merely provide municipal leaders with the same tools as the state to manage health insurance costs and bring the extraordinarily generous benefits of municipal employees – the last bastion of the $5 co-pay – in line with state employees.

Allowing municipalities to change their health benefits outside of collective bargaining – as has long been done by the state's Group Insurance Commission (GIC) – would save cities and towns roughly $100 million in the first year alone and as much as $2 billion annually by 2020.

The second change – requiring retirees to enroll in Medicare – would save as much as $75 million annually with additional savings over time. Cities and towns have the option to enroll retirees in Medicare but, unlike the state, are not required to do so. Approximately 15,000 Medicare-eligible retirees in 175 communities use municipal health insurance as their primary coverage despite the fact that both the municipality and the retiree have contributed to Medicare over many years. In these communities there are another 15,000 pre-65 retirees, as well as countless future retirees, who may choose the municipal plan rather than enroll in Medicare when they reach 65, at unnecessary cost to the city or town. Moving retirees to Medicare has the further advantage of lowering the overall costs of municipal health plans by an estimated 5 percent because the group that is covered is younger and healthier.

These two proposed changes would also lower long-term costs of municipal post-retirement health benefits (OPEB) that are well in excess of $15 billion and virtually unfunded.

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State and Municipal Pensions

The 2008 stock market collapse cost municipal pension portfolios nearly 30 percent of their value. To help municipal budgets, the Legislature extended the payment schedule to fully fund municipal pension plans by 10 years, from 2030 to 2040, but failed to include any meaningful reforms that would reduce costs.

Extending the payment period may delay some of the pain but won't change the underlying reality. Many communities will still have to increase their annual contributions, and many will likely see their bond ratings downgraded, costing millions of dollars in higher borrowing costs.

Both Governor Patrick and the Republican candidate for governor, Charlie Baker, have proposed reforms to reduce state and municipal pension costs. These reforms would generate approximately $2 billion in savings over the next 30 years with nearly $800 million benefitting municipal plans. The proposals would:

- **Increase the retirement age, as Social Security has done, to reflect longer life expectancies**
  - **Raise the minimum retirement age from 55 to 60 for most employees**
  - **Raise the full retirement age from 65 to 67 for most employees**
- **Lessen the advantage of early retirement by increasing the discount for retiring early**
- **Extend the number of years for calculating the pension benefit – from the average of the highest consecutive three years to either the highest consecutive five years or to lifetime average salary adjusted for inflation**
- **Pro-rate pension benefits according to the number of years in each group classification**
- **Cap annual pensions at $100,000**