

The Coming Pension War

by Carolyn Widener

When Mr. Schwarzenegger, in his State of the State address earlier this year, described California's pension system as "another government program out of control," he echoed the rhetoric of those claiming Social Security is headed for a crisis. Across the nation, a pension war is waging, with the most historic battle scheduled to be fought later this year in California.

Steven Moore, former director of the conservative Club for Growth and an economic advisor to the Governor, spelled out the relationship between the national and California campaigns this way: "If California moves from a traditional defined benefit (DB) pension plan to a 401(k)-type defined contribution (DC) plan, the nation is likely to follow."

Among the public funds the Governor targeted for mandatory change is CalSTRS, a defined benefit (DB) pension serving all California's public school educators from kindergarten through community college. Shortly after he endorsed ACA 5 (Richman) and ACAX1 1 (Richman) – the actual bills which call on the State Legislature to close defined benefit plans to new public employees and teachers beginning in July of 2007 – the Governor announced that he would seek financial support for his campaign from some of the same out-of-state sources who support privatizing part of Social Security. John Broder, in *The New York Times*, describes them as "...antitax advocates, free-market enthusiasts and Wall Street interests (including) Grover Norquist, the president of Americans for Tax Reform, a Washington lobbying

and research group." Joining them in California, the Howard Jarvis Taxpayers Association plans to sponsor a statewide ballot initiative if the State Legislature rejects the Governor's proposals.

Gearing up to oppose the proposals, public employee unions are worried that their new members will lose disability and death benefits while they face an increased risk of outliving their DC retirements. Opponents also fear collateral damage to current faculty and retirees as well as to taxpayers. Carl Friedlander, president of the LA College Faculty Guild, has warned that "without new teachers and their district employers contributing to the defined benefit (DB) fund, retired faculty are likely to find themselves without their modest two percent simple

COLA. And when purchasing power drops below 80 percent, there will be no funds available to restore it.”

In voting to oppose the proposed Richman/Schwarzenegger changes at their February board meetings, the majority of trustees at CalSTRS relied on actuarial assumptions that indicated these proposals would increase total employer and General Fund contributions until the end of 2019-20, and there would not be a cumulative net savings until 2028-29. Additional analyses predicted that not only would educational employers’ costs go up, but their supply of experienced teachers might well go down, as new teachers’ DC retirements would lack the current DB Program’s incentives that have motivated educators to perform additional service and retire later.

HOW DANGEROUS IS THE PROPOSED PENSION CHANGE FOR CALIFORNIA TEACHERS?

Because California teachers are not in Social Security, if they are forced out of the CalSTRS defined benefit, they will be among the few Americans with no guaranteed pension of any kind. Examining the record of DC plans for public employees in other states leads to an alarming conclusion: with all their retirement in defined contribution accounts, those who begin teaching careers after July of 2007 in California will be among the most vulnerable retirees in the United States.

DB plans, such as CalSTRS, pay a guaranteed retirement benefit monthly for a member’s lifetime, based on a formula: years of service, multiplied by final average salary, and then multiplied by some age-factor percentage. With no risk to the individual member, defined benefit plans are managed with a “long-term horizon” by a professional staff. The oversight board members of such plans have a fiduciary duty requiring them to act solely in the interests of the plan’s participants. Additionally, most DB plans provide comprehensive benefits, including early retirement, disability, cost of living adjustments and death benefits.

In contrast, a DC plan is an individual account in which contributions are invested and earn income. The balance in that account is the total of what the participant gets when he/she retires. It’s quite possible for retirees to outlive their retirement savings. Many California teachers have “supplemental” retirement savings in 403(b) (TSA) or 457 accounts. These are examples of DC plans as are 401(k) accounts in the private sector.

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With DC plans, what working people wind up owning is less money and more risk. Different investments carry different risks, but too many people are adverse to risk, and the investments they choose are too conservative to adequately fund their retirement. They don’t diversify or regularly rebalance their portfolios. If they pay fees to professionals to do it for them, then the fees reduce their savings – as do the more conservative investment allocation they must adopt as they near retirement. Additionally, individuals in DC plans must hope their parents timed their births correctly – so they reach retirement age in a decade when the volatile market is up, rather than down.

To document how those with DC plans retire with less money, the National Education Association (NEA) cites this example: the 2000 study of the Nebraska Public Employee Retirement Systems revealed that between 1983 and 1999, the system’s DB plans yielded an average of 11 percent per year; while the system’s DC participants earned returns of six percent.

The bottom line: most DB plans provide a superior income replacement ratio for retirees. Again, looking at 40 years of comparison statistics in Nebraska, the teachers’ DB benefit is 55 percent of final pay, whereas the state employees’ DC benefit is only 35 percent.

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IF IT'S SO DANGEROUS, WHY DO IT?

If DB plans are so much better than DC plans at providing retirement security, then why destroy them? Part of the answer is that the "privatizing campaign" is part of "the national conservative crusade to roll back the New Deal," according to *The Journal* editorial of July/August 2004, which continues:

One after the other, the social safety nets put in place by FDR and subsequent presidents are being assaulted in the current national campaign of privatization. Social Security has problems? Privatize it. Medicare in trouble? Privatize it. Oh, someone in our state pigged out on a DB plan? Privatize every pension in California by converting everything to defined contribution plans.

Those who are ideologically motivated are joined in this effort by those with a financial interest – the vendors themselves. A 1998 study by the U.S. Department of Labor (DOL) of fees and expenses for 401(k) defined contribution plans showed expenses ranging between 0.99 and 1.40 percent. In contrast, a May

2003 review of 12 of the nation's largest DB plans revealed an average expense ratio of 0.25 percent, including costs of administration and investment management. Does it matter a lot? You can bet your retirement it does! Administrative and investment expenses are critical to returns in DC accounts – a DOL study determined a one percent increase in expenses could reduce an account balance at retirement by 28 percent.

A final reason, Richman says, is that he wants public employee pensions to be more like the private sector...but only part of the private sector fits his argument. While there has been an increase in the use of DC plans among smaller employers, the majority of large private sector companies have defined benefit plans as their primary retirement vehicle. The National Association of State Retirement Administrators reports that only 17 percent of Fortune 100 companies have a 401(k)-style plan as their primary retirement plan. CEOs' defined benefit packages are also alive and well, although generally not described in detail until they get in trouble. The latest example to make the news is Franklin Raines who is slated, according to the *LA Times*, to receive a monthly pension of more than \$114,000 for life (in addition to his \$8.7 million in deferred compensation and more than \$5.5 million in Fannie Mae stock) after being forced out after five years.

DID TEACHERS DO ANYTHING TO PROVOKE THIS ATTACK?

Richman claims that the "employee pension programs (of California's state and local governments)...have produced current fiscal problems, billions of dollars in unfunded liabilities, long-term budget imbalances and potential criminal charges." He is clearly claiming that all public defined benefit pension plans are alike – and equally guilty of abuse. Yet, Richman would be hard pressed to make any of these claims stick against the California State Teachers' Retirement System. For example,

CRIMINAL CHARGES: Apparently, this charge refers to fraud; that is, spiking final retirement formulas with disability claims. Teachers don't do this! They teach with cancer, MS and hearing loss, as well as pay the high co-payments on their prescriptions to

reduce stress, rather than retire from it – trying to last for 25 or 30 years until they’re over 61 or 63. Indeed, statistics from CalSTRS show that experienced teachers are working longer and older to reach these maximums – a good thing for public education in a state with an acute shortage of experienced teachers.

LONG TERM BUDGET IMBALANCES one would guess refers to the volatility of employer contributions. Many pension boards set employer contributions annually and can ask cities, counties, even the State to contribute zero one year and 17 percent the next...but that’s not how it works with CalSTRS. Its board doesn’t set contributions. The State and districts have known that their employer contribution, set by the Legislature, is 8.25 percent – since 1990! To handle the recent losses to the investment portfolio, caused by the volatile stock market, CalSTRS is considering raising contributions – but Richman and other legislators will have the final word.

UNFUNDED LIABILITIES: Almost every defined benefit plan in the country has these now – as the investment portfolios struggle to recover from the worst stock market decline since 1929. Indeed, from 2000 through 2002, the S&P 500 plunged 49 percent. Yet, this is the same volatile market Richman wants every public employee to handle all alone in a DC account! Before the great stock market run-up in the 90s, CalSTRS was even more seriously “under-funded” for decades – and recovered! At a recent meeting, the CalSTRS board identified twelve possible directions to take to address the current problem, including increasing employer contributions. One thing is certain – without new employee contributions to the defined benefit system, its unfunded liability will be exacerbated. The original estimated increase in employer contributions would need to be substantially increased if the Richman/Schwarzenegger pension proposals become law.

CURRENT FISCAL PROBLEMS: It’s hard to see what pensions have to do with the current State budget crisis. Everyone agrees: California has a budget problem. Everyone also agrees that if the Richman/Schwarzenegger pension

proposals pass, California will still have a budget problem – and, for a while anyway, a bigger one. “Richman admitted that it could be 10 to 20 years before his proposal garners serious fiscal relief,” wrote Gary Delsohn and John Hill in *The Sacramento Bee*. CalSTRS estimated \$5.9 billion in extra costs for taxpayers in the first 10 years alone. Meanwhile, the State’s General Fund contribution to CalSTRS has been steadily declining. Prior to 1998, the contribution level was 4.3 percent of creditable compensation. In 1998, it was reduced to 3.102 and its current level is 2.107.

TOO GENEROUS BENEFITS: This charge is the “most unkindest cut of all” – no teacher retires with three percent at 50, or two percent at 55. Even those with over 30 years of service retiring in their 60s, who benefit from “bonuses” enacted in the 90s, still have no guarantee of secure retirements – because a safe, secure retirement depends on access to affordable health care. When it comes to health care, retired teachers are extremely vulnerable: teachers, as a group, do not have retiree health care – from the State or from CalSTRS. Rather, for the shrinking number of teachers who have them, retiree health benefits were negotiated locally.

In short, while “pension abuse” may exist, CalSTRS has not committed it.

WHICH SIDE WILL WIN THE PENSION WAR? Unlike the expected multi-year debate on Social Security, the pension war in California will be fought to a finish this year. The initial battle is already underway as the Legislature debates Richman’s bills, so the time for FACCC members to enlist is now. Every FACCC member needs to aim the mouse at the computer and fire off a letter urging legislators to reject this radical privatization plan as damaging – not only to new public employees’ retirements, but also to the future of education in our state. Then set about educating your colleagues, family, friends and neighbors. If we all do this, we’ll win! ■

FACCC member Carolyn Widener currently serves as vice president of the Teachers’ Retirement Board and chairs its Benefits and Services Committee. After originally being appointed to the Board in 2001, she was elected to represent community college educators in 2004. She is a professor of english at West Los Angeles College and has been the executive vice president of the Los Angeles College Faculty Guild since 1996. Her opinions in this article are her own, and should not be construed to represent positions of the CalSTRS Board of Trustees or CalSTRS staff.

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