



# Restoring Public Confidence in Our Pensions

By Rich Hansen

On a recent episode of *Real Time*, the HBO political talk show that always features a segment of panelists pitting liberal against conservative guests, the conversation centered on Wall Street speculators and the banking collapse that precipitated the recession the country is still struggling through. Host Bill Maher tried to bring this financial discussion to an end with a joke about the Republican response to President Obama's State of the Union address in which the public safety net was mocked as becoming more like a "hammock." Laughing, Maher said the reality is that there are plenty of what he called "corporate welfare" recipients lounging in that hammock.

Seeing an opportunity, the conservative guest jumped in citing public pension unions whose retirees get \$100,000 per year "FOR-EV-ER!" And, the liberal Maher agreed! He went on to recall a California mayor who reportedly said he cannot run a city that supports three police departments, the one that works and the other two that are retired. These comical exaggerations easily overshadowed the voice of reason coming from another panelist who reminded the audience that the average public sector pension comes in at about \$50,000 per year.

Public workers are in trouble when their supposed supporters are willing to throw them into the same "freeloading" welfare hammock with corporate executives. As the economic crisis lingers, these attacks on public pensions keep getting worse, with jealousy seeping into the minds of people who would normally support teachers and other public service workers. These traditional supporters see cuts inflicted on their favorite government programs while it looks like public pensions soak up scarce resources. At the same time, their own tight personal budgets make it difficult to see how raising taxes might be a means to solve the problem.

At a FACCC Policy Forum held at Grossmont College in January, Carolyn Widener, the community college faculty representative on the CalSTRS Teachers' Retirement Board (TRB), suggested that to defend public pensions, we must champion the notion that similar pensions should be available to all Californians. CalPERS has estimated that the private sector faces a retirement shortfall of \$6.5 trillion, a figure far greater than the unfunded liability of public pensions. So it makes sense to argue that the private sector could be in better shape under a public sector retirement model, but it may be difficult to reverse the historical trend that has been flowing so strongly in the opposite direction.

Over the last 20 plus years, upwardly mobile middle class workers all too willingly exchanged compensation in the form of pensions for higher in-pocket salaries. Over the same period, corporations went on the offensive against pensions held by their unionized workers, repeatedly weakening these plans. In some cases, corporations turned to bankruptcy under which they could default on pension liabilities. It is disturbing to see recent discussions on conservative talk shows suggesting that the bankruptcy option should be made available to states as a means of ducking their pension responsibilities.

While the state bankruptcy idea hasn't found much traction, a Legislative Analyst's Office (LAO) video released on February 10 may indicate the nature of the coming pension debate here in California. In the video, the Director of State Finance Jason Sisney lists three principles the LAO employs in its analysis of public pensions: (1) retirement benefits are a part of overall employee compensation; (2) retirement savings, through deferral of some compensation, is good policy; and (3) a well-managed and properly funded retirement system, therefore, is a good thing.

Recognizing that public pensions are worthwhile, his critique calls into question the management and funding of the public pension systems. Some of the graphs and generalizations are questionable, especially as they relate (or do not relate) to the CalSTRS system, but the first target of the LAO analysis is concern over an increase in the percentage of state general fund expenditures going to support state retirements. Sisney shows data in which the percentage ranges from a low of about two percent in 1991-92 to a high of about seven percent projected for 2011-12.

Of course, the fixed cost of state retirement support would naturally represent a higher percentage of expenditures as the state slashes spending during the current recession. So an increase is not unexpected, but instead of explaining the various factors driving the statistic, the LAO uses it to create a false sense of alarm. In fact, the amount of state support for CalSTRS has remained stable over recent years. Teachers contribute 8.0% of their pay, and their districts contribute another 8.25%, to which the state adds only another 2.0% for a total ongoing CalSTRS income of 20.75% of teachers' pay. The rest of the cost of the retirement system comes from the fund's earnings on its investment of this revenue. In a separate account, there is also a contribution of 2.5% from a special state resource that is designated for inflation protection for retirees.

The LAO video turns next to these investment earnings, raising concerns about the unfunded liability of the state's pension systems. Again, this is a quite natural result stemming from the decline in stock values during the recession. Unfortunately, Sisney exaggerates the problem by accusing the pension systems of a tendency to not fully fund costs as they accrue and, instead, threatening to pass on to future generations the current cost of retirements. This is clearly not true of CalSTRS. The system gives close attention to its unfunded liability and has made steady progress toward 100% funding since the early 1970s. [See graph on following page.] The stock market boom of the 1990s propelled the system above 100% funding in 1998, 1999, and 2000, but the market downturn pushed the level down to between 80 and 90% from 2003 to 2008. While not a welcome sign, this range is certainly within the bounds of what might be considered prudent and proper.

When the 2009 valuation dipped below the 80% funding level, CalSTRS staff recommended reconsideration of its actuarial investment earnings assumption. In December 2010, the Board voted to lower the Defined Benefit expected rate of return on investments from 8.0% to 7.75%, despite the fact that the CalSTRS portfolio earned 12.7% in 2010. Any change in contribution rates would require legislative action, and in the Winter 2010-11 CalSTRS publication, "Connections," TRB Chair Jerilyn Harris set the stage for such a move when she listed an increase in contribution rates among steps to address the unfunded liability problem. This doesn't sound like an irresponsible system.

Still, the LAO video gives no credit for any of the corrective actions the pension plans have taken. Instead, it complains that the benefits themselves are too generous and inflexible. In the video, Sisney calls for employees to shoulder a larger proportion of the cost of these benefits and proposes that public employee pensions ratchet down to resemble, more closely, the retirement plans available in the private sector – just the opposite of Widener's advice that the current public retirement plans become the model for the entire workforce. In this regard, the LAO recommends what it calls a "hybrid" plan with a less generous defined benefit portion backed up with a defined contribution component.

This conclusion rests on how the LAO report distorts reality. While it is correct to note that pensions are part of overall compensation, the LAO ignores the fact that the state enjoys an advantage over the private sector with regard to salaries. Public employees have always accepted less in-pocket money because their reward came in the form of benefits that include a secure retirement. Studies show that, in terms of overall compensation, public and private workers come out about even with public workers deferring more into retirement while private workers take more home in-pocket. Would the state be able to join the private sector world of bonuses and profit sharing? Would the state be willing to offer the level of private sector matching funds that would make a defined contribution plan attractive to public employees? In both cases, it is hard to see how the state, as a public enterprise, could maintain a retirement system based on a private sector model.

Other distortions occur when the LAO report alludes to the kind of overly generous retirement benefits that have recently been making the headlines. Such abuses are not prevalent in the state system; they are found mainly at the local municipal and county level. Sisney never acknowledges that the median CalSTRS retirement benefit amounts to about \$49,000 per year, and he does not explain that most of the state's teachers don't earn Social Security. Those who receive a Social Security benefit from work in other careers see their payments severely reduced because they qualify for a CalSTRS pension.

It's extremely disappointing to see the LAO fail so miserably to provide a careful analysis of the "pension problem." Instead, Sisney's video presentation reflects all of the general public's misconceptions about public pensions and does little to identify solutions, unless of course, the state's solution is the same as that pursued by the private sector: eliminate pension security.

It is also distressing to see that the LAO has been using YouTube to publicize its reports, most recently its pension analysis. Not content with its role as an ostensibly non-partisan advisor to the Legislature, the LAO now takes aim at the public. In this instance, it is hard to determine whether the LAO is influencing or is being influenced by public opinion. Public workers might have expected a more professional approach, but the LAO video makes it clear that we have a difficult task ahead in defense of public pensions.

As this *FACCTS* journal goes to press, full-blown protests have sprung up in Wisconsin where the Tea Party-influenced governor backed up by a Republican-controlled legislature has gone beyond financial considerations to attack not only the cost of public pensions but also the foundation of public employee collective bargaining. In an effort to stall the governor's initiative, Democratic representatives have traveled outside the state's borders, leaving the legislature without a quorum. It will be instructive to see how this episode plays out because the governor may have over-played his hand. His actions leave no doubt that the anti-public pension sentiment is promoted by anti-labor interests. This is how budget balancing becomes partisan.

Here in California, public pensions have their own set of enemies, some of whom make little effort to cover their partisan connections. One example is the California Foundation for Fiscal Responsibility (CFFR) founded by the late state legislator, Keith Richman, and now led by Marcia Fritz. The group has deep ties to the Howard Jarvis Taxpayer Association. While in the Assembly, Richman repeatedly authored bills aimed at weakening public employee retirement benefits, and he used CFFR to promote anti-public pension ballot initiatives. Last year, Fritz decided to pull back another such initiative that had been proposed for the November election.

At present, CFFR is promoting what it calls alternatives A and B for California's public pensions. Both would amend the state constitution to replace defined benefit with defined contribution plans, place stringent limits on benefits, and require full funding.

While it is doubtful that we will face a showdown similar to what is playing out in Wisconsin, the state initiative process opens the door to any group with sufficient funding to pursue its agenda, and there's lots of money behind the anti-public pension campaign. In addition, pension reform has been discussed in conjunction with getting Republican votes for Governor Brown's tax extension ballot initiative. Ultimately, we face the challenge of reversing public opinion that appears to have turned against public employee pensions. To this end, CalSTRS has initiated a public relations campaign, and organizations like FACCC will get involved.

If the tax extension measure qualifies for a June ballot, the campaign will provide an opportunity for the public service sector to coalesce around a common issue and tell its story to Californians. Let's hope this becomes an ongoing media effort in support of public employees, the work they do, and the sustainable pensions that they have earned at the end of their careers.

## CalSTRS Historical Funding Levels

