Testimony of Dave Low
Little Hoover Commission
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You asked that I discuss the following questions and provide any additional information that will contribute to your analysis of issues related to public pension systems in California.

- If the economy recovered and state and local governments could afford all of their pension promises, would there still be a problem?
- Who is responsible for funding retirement benefits, and at what levels?
- Should/can pension benefits be tied to an adequate or appropriate level of retirement income, or should pensions remain as part of a negotiated compensation package?
- How can elements of fairness and transparency be incorporated into the process for determining pensions, for the benefit of employers, employees and taxpayers?
- Solutions for addressing immediate and long-term issues with public pension systems.

If the economy recovered and state and local governments could afford all of their pension promises, would there still be a problem?

The short answer is no, there would not be a problem if state and local governments could afford pension promises. The bigger question is whether state and local governments can afford their pension promises now, despite the economic downturn.

California, along with the rest of the nation, has suffered the greatest economic downturn since the Great Depression. The impact of this economic crash has been monumental. Over $40 billion has been cut from the budget over the past two years and there is a projected deficit of over $19 billion in the current budget year.

As a result of the stock market crash, most pension systems experienced huge portfolio losses. In 2008 CalPERS lost $69 billion. While much of these losses have been recouped, this still represents a significant investment loss and will have ramifications on employer contributions. We argue that despite these investment losses retirement benefits are still affordable. To make the case that retirement benefits are not affordable one would have to show that employers are paying substantially higher amounts for pensions than they have paid in the past or that retirement plans are funded at a substantially lower level than they have been in the past. A review of the factual history shows this is not true.

Pension Costs are Lower Today than 30 Years Ago

Pensions are generally funded using an amortization period of thirty years. Proponents for cutting pensions have attempted to portray the costs of pensions as unsustainable by conveniently hand picking a measurement period starting in 2000 and ending in 2010. This time period begins at the peak of the stock market and economic boom and ends just after the biggest economic turndown since the Great Depression. Using these figures Governor Schwarzenegger claims that the cost of pensions have risen over 2000%.

Hand picking starting and ending years to measure increases or decreases in employer costs is inherently misleading, if not deceitful. Attachment 1 shows the Employer Contribution Rate History for CalPERS from 1979 through 2009/10. If one were to select the period between 1981 through 1999 the calculation of the employer contribution rate for state miscellaneous tier 1 employees would show a decrease of 1300%.

Using the actuarially accepted thirty-year funding cycle provides a much more accurate and reliable assessment of employer contribution costs. A simple review of the chart shows that employer contributions are variable and influenced by the economy, investment returns, demographics and benefit levels.

Several important points should be noted in Attachment 1.

- The State of California and all school districts are paying less as a percentage of payroll for retirement benefits today than they were thirty years ago (in most cases they are paying over 3% less).
- From the late nineties through 2001 employers were paying substantially reduced contributions due to high investment earnings. In many cases employers were taking "pension holidays" and paying zero into the system.
- Employees, on the other hand, continued to pay their contributions during the entire period. School employees paid 7% and state employees paid 5% of their pay into CalPERS, even when employers were paying zero.
- The average school employer contribution over the entire period covered in the chart equals 7.76% a year. This means the employer and the employees paid roughly equal contributions into CalPERS.

Putting Pension Costs in Context

To determine whether there is a pension problem and to what degree, it is critical that the cost of pensions be put into the context of the entire state budget. According to Attachment 2, the Governor's May Revise budget chart "2010 Total Expenditures by Agency", the total General and Special Fund expenditures equal $114,261,000,000. Both general and special funds are taken into consideration because state employee salaries and pensions are paid from both funds.

Attachment 3 shows the total dollar employer contributions for state and school employers. In 2009/10 the state paid $3,287,572,458 and the schools paid $1,081,377,863 for a total of $4,288,950,321, equaling 3.75% of total state budget costs.

As noted above, the California budget has been cut over $40 billion over the past two years and there is a projected current year deficit of $19 billion.

Even if one assumed complete elimination of pensions for current and future state and school employees, the total savings of $4.3 billion equals only 7% of the total budget deficit. Of course, elimination of current pensions is unconstitutional. However, this extreme example exposes the fallacy behind the argument that the cost of public employee pensions are the reason the state is cutting funding for education, health care or other programs. Completely eliminating pensions would not balance the budget, eliminate the need for cuts or provide enough revenue to address the structural budget deficit of almost $60 billion over the past three years.

The entire pension obligation for state and school employees is less than the debt service on General Obligation bonds, currently $5 billion according to Controller John Chiang. We assert that the growing bond debt service poses a substantially greater potential problem for California's general fund than pension costs.

No One Size Fits All Answer

There are dozens of pension systems in California. While CalPERS is the largest, California public employees are covered under many separate systems. The Sacramento Bee printed a chart outlining the funded status of pensions systems across California on April 10, 2010, Attachment 4.

As you can see, only two pensions systems are identified as ranking "Poor" (City of San Diego, San Mateo County). On the website one can click on the colored circles and see the funded status of each pension system. Doing so shows Shasta-95%, Riverside 95%, Imperial-96%, San Diego County-92%, Huntington Beach-96% and many other systems funded at 90% or above. A total of 19 systems ranked in the category of "Best" by the Sacramento Bee. Clearly, one cannot draw the conclusion that pension systems all over California are in financial trouble based on their actual funded status.

The two systems identified as Poor in Attachment 4 are currently undergoing changes. A ballot measure was passed in the city of San Diego and changes have been made to the pension plans through collective bargaining . In San Mateo a ballot measure has been submitted. Clearly, in areas where pension plans have experienced problems there are actions being taken to address problems.

It is our position that changes to pension plans should reflect the actual circumstances related to the funded status of plans, budget situations of the employer agencies, benefit levels, collective bargaining agreements and other factors specific to the jurisdiction.

Who is responsible for funding retirement benefits, and at what levels?

Funding Retirement Benefits is a Shared Responsibility

A common principle for retirement is the three legged stool. A secure retirement has historically been based on Social Security, savings and pensions. Defined contribution plans, such as 401K plans, were originally authorized by Congress and implemented by businesses as a perk for top level executives.

On January 17, 1935 President Roosevelt transmitted the following message to Congress.

"In the important field of security for our old people, it seems necessary to adopt three principles: First, non-contributory old-age pensions for those who are now too old to build up their own insurance. It is, of course, clear that for perhaps thirty years to come funds will have to be provided by the States and the Federal Government to meet these pensions. Second, compulsory contributory annuities which in time will establish a self-supporting system for those now young and for future generations. Third, voluntary contributory annuities by which individual initiative can increase the annual amounts received in old age. It is proposed that the Federal Government assume one-half of the cost of the old-age pension plan, which ought ultimately to be supplanted by self-supporting annuity plans."

Currently, retirement benefit funding is a shared responsibility between the Federal Government (Social Security), employers (pension plans, defined contribution plans) and individuals (savings). Over time many employers have eliminated pension plans and implemented defined contribution plans. In most cases the employer contributions to these plans are less than pension plan contributions, shifting more of the responsibility for retirement savings to individuals.

Retirement Benefit Levels

Many investment advisors recommend a goal of retiring with 80% of one's income, but this amount varies based on individual needs. Achieving this level of replacement income is more challenging for those without pension plans and lower income workers.

Public employees in California have various retirement benefit formulas. For example, classified school employees receive a 2% at age 55 formula. This means a school secretary, custodian, bus driver, cafeteria worker or other classified school employee will receive two percent multiplied by the number of years served, at age 55. A full-time employee hired at age 30, working 25 years, and retiring at age 55 would receive 50% of their final compensation. According to CalPERS, the average classified school employee retirement benefit in 2010 was $1134 a month after 16.7 years of service (Attachment 5, CalPERS Facts at a Glance). As noted above, school employees pay 7% of their salary into CalPERS. The employer contribution rate fluctuates, but has averaged 7.76% over the past thirty years.

It should be noted that over 40% of classified school employees work part-time, many working four hours or less a day. These employees received prorated service credit, so a four-hour employee must work 20 years in order to earn 10 years of retirement service credit.

Most classified school employees contribute to Social Security. Many other public employees, such as teachers, police officers and firefighters do not contribute to Social Security. These public employees rely on only two of the three legs of the stool, pensions and individual savings.

Individual Savings Often Inadequate

According to MSN Money (Attachment 6) the United States savings rate has fallen to zero. Americans are living paycheck to paycheck.

The Employee Benefit Research Institute (EBRI) Issue Brief: The 2010 Retirement Confidence Survey (Attachment 7) reports numerous findings regarding retirement savings and confidence, including:

- Only 29% of workers are very confident of having enough money to pay for basic expenses during retirement.
- Today fewer workers report that they or their spouse have saved for retirement (69%, down from 75% in 2009).
- More people report that they have no savings at all (27%, up from 20% report savings of less than $1000).

- Less than 50% of workers report having tried to calculate how much money they will need to have saved by the time they retire.

These statistics and studies provide evidence that employees without defined benefit pension plans are highly unlikely to have planned for, saved for or otherwise prepared for retirement. Those with lower incomes are even less likely and risk running out of money.

Benefit Levels are Collectively Bargained

Public employee pension benefit levels and contributions are determined through collective bargaining. Trade-offs are often made at the bargaining table, including reductions in salaries, cost-of-living increases or other monetary concessions in order to increase retirement benefits. Retirement benefits levels and costs are part of the total compensation package. Our position is that collective bargaining is the appropriate forum for determining benefits, costs and responsibility for funding.

Should/can pension benefits be tied to an adequate or appropriate level of retirement income, or should pensions remain as part of a negotiated compensation package?

Pensions should remain as part of a negotiated compensation package. This process insures that both the employer and employees have the opportunity to assess, evaluate and adapt the package to economic circumstances.

If pension benefits were tied to an adequate or appropriate level of retirement income, then there would have to be an agreed upon retirement income level and a process to insure funding of this benefit level. How will this benefit level be calculated? Will it be different for those in Social Security and those not? Will the contribution level for the employee be fixed? If so, at what level? How will retirement benefit formulas be coordinated with other compensation and benefits? Once established, could the benefit levels be changed?

It is our position that the collective bargaining process provides the most practical process for both employers and employees to address retirement benefits.

How can elements of fairness and transparency be incorporated into the process for determining pensions, for the benefit of employers, employees and taxpayers?

Numerous recommendations were made by the Public Employee Post-Employment Benefits Commission related to transparency in public employee pensions and health care. I served on this Commission and support the recommendations.

Current laws related to collective bargaining and open meetings also address transparency related to sunshining of proposals and agreements.

Solutions for addressing immediate and long-term issues with public pension systems.

Where immediate and long-term issues exist, solutions are best constructed locally and implemented through the collective bargaining process. Such solutions have already been implemented in numerous cases across California.