

“PUBLIC PENSIONS FOR RETIREMENT SECURITY”

Little Hoover Commission

February 2011

Comments by State Treasurer Bill Lockyer

**The report makes no attempt to answer a fundamental question:
What should be the goal of public pension systems, or any retirement
system?**

Problem 1 – The report is long on rhetoric and short on thoughtful analysis. “Instead of retirement security, the public pension became a wealth generator,” the report declares. Snazzy sound bite.

The report also asserts that “public pensions no longer bear any resemblance to an appropriate or adequate amount of income needed in retirement.” Provocative claim. But the report provides no backup.

It wouldn’t have been difficult to do. Some experts say retirees need 75 percent of their working income to maintain their standard of living. Others have suggested 77 percent to 88 percent.

What is the appropriate standard? The report doesn’t delve into that foundational issue. Instead, it says this: “Today, a 30-year state worker retiring at age 63 can expect to receive 75 percent of the highest-paid year – every year for the rest of his or her life.” The report clearly implies that is a bad thing. But it never tries to answer the question of whether getting 75 percent of your highest pay is inherently bad and, if so, why.

In short, the Commission gives policymakers no guidance on what constitutes an adequately secure retirement.

The main recommendation – besides being legally dubious – has no foundation.

The report claims governments cannot generate enough savings if they only cut benefits for new hires. The only way to provide the “immediate savings of the scope needed,” the report says, is to reduce future benefits promised current workers, but not yet accrued.

Problem 1 – The Commission makes no attempt to quantify that assessment, presents no data to support its linchpin recommendation. How much would the move save immediately or in the long run? How much would it save compared to other reforms? The report fails to answer such questions.

Problem 2 – The report does not quantify the scope of the immediate savings needed. Needed to do what, exactly? To avoid what, exactly? The report doesn’t specify.

[Note: The report does not attempt to quantify the savings any of its recommendations would generate.]

The report distorts testimony to make the case for its central recommendation, and to support its assertion that pension costs “will crush government.”

In presenting its central recommendation, the report claims “actuaries estimate that in the next few years, government agencies in the CalPERS system will need to increase contributions into their pension funds by 40 percent to 80 percent from 2010 levels (emphasis added).”

At a couple of other spots, the report reiterates that government contributions are expected to rise 40 percent to 80 percent, and stay at that level for “decades.”

One of these passages adds this rhetorical aside: “It is practically enough money to fund a second government, and it will – a retired government workforce.”

Problem 1 – Use of the plural “actuaries” is misleading. The citation for these comments comes from the written testimony of one actuary – John E. Bartel.

Problem 2 – The assertions take liberties with Mr. Bartel’s testimony.

The Commission asked Mr. Bartel to answer these questions: “How bad is the problem going to get? In general, what percent of payroll will communities need to devote to pension costs in coming years?”

So, Mr. Bartel’s testimony was limited to local agencies. He started his response with a series of seven caveats to explain that the Commission’s question is “a very difficult question to answer accurately.” Complicating variables, Mr. Bartel noted, include: actual investment returns; investment return assumptions; the extent to which the agency pays the members’ contribution; whether the agency hires employees to replace departing workers; and other factors.

The Commission takes one actuary’s caveat-laden testimony and presents it as actuarial consensus that government contributions, with no clear distinction made between the State and local agencies, will have to increase by 40 percent to 80 percent and remain at high levels for decades.

[Note: Mr. Bartel on March 10 addressed a Santa Rosa pension task force. He said the city’s pension contributions will have to rise substantially, even under optimistic scenarios, according to a report in the Santa Rosa Press Democrat. But he also said he did not consider California’s public pension system to be in crisis. The paper said Mr. Bartel told the panel the system’s problems aren’t serious enough to warrant abandoning the defined benefit program in favor of a defined contribution approach. “Just because things are not looking good ... is not a reason to junk the retirement system,” the paper quotes Mr. Bartel telling the task force.]

The report omits or ignores inconvenient data.

Problem 1 – The report ignores CalPERS reforms adopted last year as part of the budget solution. The reforms increased all workers' contributions, and lowered benefits and raised retirement ages for new workers. Those reforms will save the State an estimated \$10.7 billion to \$13.5 billion through 2040, according to a CalPERS analysis.

Problem 2 – The report uses data from FY 2008/09 to present CalPERS' and CalSTRS' unfunded liability. More current data was available. The data show that market gains from the last two years have reduced both systems' unfunded liability. CalPERS' funded status has increased from 61 percent at the end of FY 2008/09 to an estimated current funded status of close to 70 percent. The Commission did not use the more current data.

Problem 3 – While distorting Mr. Bartel's testimony about employer contributions, the Commission dismisses conflicting data from CalPERS, some of which is in the report. CalPERS projects the average employer contribution will increase from about 21 percent in FY 2011/12 to a peak of about 26 percent in FY 2023/24. That's an increase of 24 percent – not 40 percent to 80 percent. And that lower peak is not maintained for decades. By 2033/34, CalPERS projects the average contribution will decline to 20 percent. It then will decline to about 16.5 percent in 2042/43 and remain at that level through 2062/63.

The Commission also ignored publicly available data on local agencies' costs. CalPERS' chief actuary has projected that average local employer contributions to miscellaneous workers' pensions will rise through FY 2016/17, then generally decline and level off through 2030/31. The data counters the report's claim that employers' pension contributions will stay at highly elevated levels for "decades." You won't find these numbers in the report.

Problem 4 – From the State’s perspective, contributions won’t come close to crushing government. In FY 2011/12, the State General Fund will spend \$2.38 billion on CalPERS contributions. That works out to 2.8 percent of the \$84.6 billion General Fund.

Knowledgeable observers agree that increased contribution levels are a more significant problem for local agencies – whether they participate in CalPERS or an independent pension plan – than for the State. The report, however, makes no meaningful distinction between the State and local governments when discussing the budget impact of increased contributions.

The report’s credibility is undermined, and its bias revealed, by rhetorical pot shots.

Problem 1 – From the start, the report goes overboard trying to make its case. The second paragraph of the executive summary likens the public pension problem to the subprime mortgage scandal. It talks about funds’ value being “inflated by optimistic market return estimates.” It calls employer contribution levels “teaser rates” that are “re-setting” at a higher cost to taxpayers. “A public pension, like a house, is not a get-rich-quick scheme,” the report lectures. “As a house is for shelter, a pension is for long-term financial security.”

Set aside the inappropriate, inaccurate comparison to the subprime mortgage debacle. What the report fails to mention is that the “optimistic market return estimates” actually have been conservative.

CalPERS’ current assumed rate of return is 7.75 percent (likely to be reduced to 7.50 percent next week). Over the past 21 years, CalPERS’ portfolio has generated an average annual return of 8.6 percent. In 15 of those years, it beat the 7.75 percent assumed return rate. You won’t find that in the report.

Problem 2 – The report asserts public pensions, instead of helping provide retirement security, have become “a wealth generator.” That statement might be true if limited to charlatans who have gamed the system to enrich themselves. But it’s unduly inflammatory when applied to average rank-and-file workers.

About half of CalPERS retirees receive annual pensions of \$18,000 or less. 78 percent receive \$36,000 or less. Only 1.7 percent of CalPERS retirees receive annual pensions of \$102,000 or more.

The report omits this data. Instead, it emphasizes what it calls a “trend toward higher-income pensions.” Workers who retired in 2008/09 with more than 30 years of service receive an average annual pension of more than \$66,000, the report says. What it doesn’t say is that these workers comprise only 22.5 percent of the total.