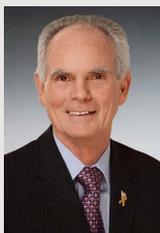


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California faces fiscal ruin from unsustainable government pension programs

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Despite its growing economy and higher tax revenue, California still faces fiscal ruin from unsustainable government pension programs.

Even in these good times, the state, local governments, public schools and our universities are

raising taxes, boosting tuition and cutting services to pay rising employee retirement costs. This "crowding-out" of services is most acute at the local level, but state government is suffering as well.

Between 2003 and 2013, annual pension costs for California governments jumped from \$6.4 billion to \$17.5 billion, and are still rising. The California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) agencies are absorbing massive increases in contributions.

The state controller reports more than \$240 billion in unfunded liabilities for state and local pension obligations. California Common Sense, a Stanford-based non-profit focusing on government transparency, calculates nearly \$160 billion of unfunded liabilities for retiree health care obligations. This \$400 billion in retirement debt is driving massive cost increases, which in turn are driving cuts in services and tax increases. And that's the optimistic scenario based on an assumed return on investments of 7.5 percent every year.

Most economists have a less-optimistic view. Joe Nation, an economist at the Stanford Institute for Economic Policy Research, says official reports underestimate the problem. Calculating unfunded liabilities using market rates pegs California's liabilities for state and local governments to be in excess of \$900 billion, just for pensions. You can see the official data for pensions reported by California agencies, along with calculations based on less-optimistic assumptions, at www.pensiontracker.org. Anyway you choose to look at the data, the numbers are huge.

Without reform, California faces a future of higher taxes and fewer services. Some local governments already face service delivery insolvency and bankruptcy. More will join them in the next recession, and public employees, retirees, residents and taxpayers will suffer, as they did in Vallejo, Stockton and San Bernardino. Financially weaker cities and school districts will not be able to raise taxes enough to cover the

inexorable increases in retirement costs so they will have to cut services, over and over again.

CalPERS and other opponents of pension reform tell us not to worry because over 20 years (1994-2014) CalPERS has earned more than 7.5 percent per year on its investments. But look at what happened to the CalPERS unfunded liabilities during that time: Unfunded liabilities grew by more than 150 percent per year. According to its Comprehensive Annual Financial Reports, the CalPERS' unfunded liability grew from \$3 billion to \$93 billion in the same 20 year period. So when CalPERS tells you not to worry, you should think twice.

The only realistic solution to this crisis is through pension reform, and we can begin by following some simple principles:

- * All workers deserve safe and secure futures and retirement plans should place employees on a path to a secure retirement, regardless of tenure.

- * Retirement benefits should be fair, sustainable and predictable for current and future public employees.

- * Benefits should be fully funded as they are earned, and incentives to underfund commitments should be eliminated.

When pension systems fail, it is retirees' futures that are put at risk. It's time to reform pensions to give struggling government employers a way to pay retirees and employees every penny of the benefits they have earned, while providing reasonable services to their residents and taxpayers. By acting now, and adopting real, meaningful reform, we can protect vital services, safeguard the long-term solvency of our public employee retirement systems and put California back on the path to a more sustainable future.

Real meaningful reform most likely will have to be driven by an amendment to the California Constitution. Under California case law, pension benefits are vested contract rights that can be changed only with great difficulty even if they have not yet been earned. Trying to change benefits for future work under future contracts for current employees runs up against the so-called California Rule, which has been followed by about a dozen states.

Even if the state Legislature wanted to act to avoid the looming retirement debt disaster, and there are no signs that it will, the California Rule, as currently interpreted, precludes significant changes for current employees. Some of the parameters of the California Rule are being litigated in several cases now in the California Courts of Appeal so the California Rule could evolve over the next year or two.

We have already seen trial and appellate court rulings demonstrating that the Rule is not absolute. *Retired Employees Association of Orange County v. County of Orange*, 12-56706 (9th Cir. 2014) (A practice or policy extended over a period of time does not translate into an implied contract right without clear legislative intent to create that right); *Alameda County Deputy Sheriff's Association v. Alameda County Employees Retirement Association*, G12658890, a part of consolidated action MSN12-1870 (Alameda County Super. Ct. 2014) (Even if employees possessed a contractual right to spike their pay in violation of law, such rights are unenforceable as a matter of law).

The California Rule also could be changed by a constitutional amendment to allow future benefits to be negotiated in future contracts for future work to be performed, just as wages are negotiated for each new contract period. Of course, public employee unions will argue that they have a vested right not to change the constitution. That question would require an answer from the California Supreme Court.

A constitutional amendment could avoid a direct challenge to the California Rule and establish less expensive benefits solely for future employees. That is the most likely approach for a ballot initiative in 2018. While perhaps side-stepping a legal fight, modifying benefits for future employees does nothing to bring down the enormous cost of benefits for current employees.

The money saved on new employees will help pay the bills, but only in modest

amounts not sufficient to avoid tax increases and service cuts. Residents and taxpayers must bear that burden.

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