

Myths and Facts about Privatizing Public Employee Retirement in California

Proponents of the Pension Privatization Gamble have circulated a number of myths to back their scheme. Here are the facts.

1. *“Public employee pension costs are devastating government budgets throughout California.”*—Assemblyman Keith Richman

Despite the misleading statements, privatizing pensions will not balance state or local budgets. According to financial experts, forcing new employees into private 401(k) stock market retirement accounts will actually create huge transition costs of over \$7.6 billion for California’s teacher and public employee pension systems. The LA County Retirement Agency accountants and actuaries project an additional \$1.29 billion in transition costs, and warn that the County won’t see any net savings for the next 20 years.

2. *Throughout the state, important services are being cut to make mandatory pension payments.*—Assemblyman Keith Richman

The problem with the state and local budgets is not pensions. The problem is with the revenue side of the budget, which relies almost solely on booming personal income and the stock market. So, in times of economic downturn, government budgets go down too.

From 1998 through 2001, while the stock market was strong, government employers made little or no payments to CalPERS, saving taxpayers over \$6 billion. Over the last 25 years, the employer contributions rate has fallen dramatically from a high of almost 20% of payroll costs in the early 1980s. The recent economic downturn has changed all that. The State, for example, made no pension payments for the category of miscellaneous employees in 2000, but, when the stock market performed poorly, had to pay 14.83% of payroll in 2004.

3. *“At the statewide level, California’s two largest pension funds, CalPERS and CalSTRS, are each underfunded by more than \$20 billion.”*--Assemblyman Keith Richman

In reality, unfunded liabilities are normal and acceptable for the funds, which very recently were overfunded at a rate of 123.5%, resulting in employers cutting their contributions by over \$6 billion. CalPERS is healthy and considered to be in good shape. Two Wall Street rating agencies, Moodys and Fitch, both rated CalPERS as AAA in 2005. Almost every one of the over 40 public pension funds in California is in very healthy condition.

Over the past 10 years, employer contributions to CalPERS averaged only 11.7%, with employees contributing 11.5% and the market earning 76.8% of the income that goes to the pension fund. Employer contributions have fluctuated wildly as state and local governments used money they would normally have contributed for pensions to pay other expenses.

4. *“But increasingly, due to union backed changes in the law over the last seven years, public employees are retiring on lavish pensions.”* —John Coupal and Richard Rider

Some 400,000 retired California school employees, police, firefighters, garbage workers and health professionals receive an average CalPERS benefit of \$19,128 per year. That’s barely above the national average of \$18,000 per year for public employees, but given California’s high costs of living, the pension is hardly “lavish.” The average age for retirement from public service in California is 60. The very few men and women who draw large pensions worked for the state or other public agencies for many years at the top level of government. Less than 1,000 of the 400,000 CalPERS beneficiaries, or 0.0025 percent, are at this level.

5. *Public employees are double dipping, and getting both fat retirements and Social Security payments.*—

Many public employees, including most municipal workers and teachers, **do not** enjoy the benefits of social security. Almost every private sector worker in the United States pays into the Social Security system and has the right to draw benefits. However, many government agencies did not sign up their employees in Social Security and therefore the employer does not qualify for benefits.

6. *“During the last 20 years, most private sector companies have moved their retirement programs from defined benefit programs that provide retirement benefits based upon a formula of years employed and final salary to the 401(k)-type plans that match employee contributions to their own accounts.”*

—Assemblyman Keith Richman (R-Northridge)

The majority of large private sector companies have a defined benefit plan similar to the public pension plans. Since 1985 the number of large employers offering a defined benefit plan as their primary retirement vehicle has increased. The National Association of State Retirement Administrators reports that only 17 percent of Fortune 100 companies have a 401K style plan as their primary retirement plan. The Federal Bureau of Labor Statistics reports that since 2000, the percentage of all employees in the US covered by DB plans has increased. Recently, SBC reinstated its defined benefit plan after a hiatus of several years. Other examples include Chevron, Unocal, Lockheed Martin, Boeing, Albertson’s, Boise Cascade, Louisiana Pacific, Safeco, and Weyerhaeuser. The only sector of the American economy that has increased the use of DC plans is smaller employers, partly to avoid complex federal pension oversight that doesn’t apply to the public sector.

The state of Nebraska recently converted back to a defined benefit plan from a DC plan. In Florida, where employees could leave the DB plan for the 401(k)-style plan, most opted to stay in the traditional pension program. Kansas studied a proposal, but found that “conversion from the current defined benefit plans for Kansas public employees would not result in lower employer contributions.”

7. *“Employees have an opportunity for increased retirement income based on their investment decisions.”*—Assemblyman Keith Richman

A 2004 study by Cost Effectiveness Measures, Inc. (CEM is an independent firm that tracks pension performance), found that CalPERS added more value to its investments at a lower cost than other large pension funds. According to the *SF Chronicle*, the median DC plan return from 1990 to 2002 was only 6.86%, but for the same time period, CalPERS rate of return was 8.9%. When costs are taken into account, the story is even clearer.

CalPERS earnings from 1990 to 2002 after costs are deducted were 8.53%, while the average 401K domestic security earned only 4.86% for the same period (after costs of 2% are deducted).

Again, the state of Nebraska recently converted back to a defined benefit plan from a DC plan. A study showed that, after 30 years, the typical worker posted an average annual return of only 6% to 7%, while money managers running the previous traditional pension plan posted 11% average annual returns. In addition, 401K style plans do not include disability and death benefits for family members. Experts agree that the chances are very high that a 401K style plan would not provide adequate retirement benefits.

8. *“Portability features provide a potential for more retirement income for employees who have several changes during their careers.”*—Assemblyman Keith Richman

According to a study conducted by the human resources consulting firm Hewitt Associates, 57% of employees who leave their companies choose cash payouts – including the monies contributed by the employer for the purpose of retirement – rather than rolling the funds over to the next employer’s retirement plan.

Furthermore, as a result of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) adopted in 2001, member contributions of a DB plan offer similar portability as DC plans. Upon separation from employment, member contributions may be “rolled-over” to a private 401(k) or Individual Retirement Account (IRA), thereby sheltering the funds from tax penalties.

9. *“This reform proposal will not impact the benefits promised to any current public employee or retiree.”*—Assemblyman Keith Richman

Current employees are also at risk, because even though benefits will not change, the cost to provide those benefits will go up. Current benefits are partially funded by the revenue stream from newer, younger employees entering the system. The privatization plan dries up this revenue stream, creating a huge unfunded liability.

Employees could thus be affected in the following ways, as the system seeks to absorb lower returns and increased costs of operating two retirement systems:

- * Employee contributions could be increased.
- * Retiree cost of living raises will be decreased
- * Future raises could be absorbed into new pension-related costs.

California’s economy will suffer as well because CalPERS invests \$19.4 billion in the California economy, financing 40,000 new homes and thousands of middle class jobs.