Sonoma County Taxpayers' Association
Position Paper
On
Public Employee Pension Costs

The Problem

At its core, the problem we seek to address is the unaffordable cost to local public agencies of funding employee pension plans. The immediate impact of the exploding cost will be the reduction of traditional local government services, like paving streets, providing lighting in public spaces, maintenance of parks and recreation facilities, sewer and water service and social services. Another concern is the prospect of rising taxes to fund an increasingly more expensive government…one that does not provide more services, but simply the same or a lower level of services at a higher price to taxpayers.

Amid some of the hyperbole, there are four key facts that are not in dispute to any meaningful degree. They are:

- Without reform, the cost to local agencies of funding employee pensions is on a trajectory that will effectively prevent those local agencies from providing the level of basic government services taxpayers have come to expect.
- Without reform, funding the public retirement plans will constitute an unprecedented transfer of wealth from taxpayers and the private sector to unionized public sector employees. Inaction also means that the burden of paying for excessive retirement benefits is passed on to future generations.
- Unionized public sector workers are provided benefits far in excess of those available for private sector employees, including earlier retirement age, higher maximum payments and the ability to have the taxpayers guarantee their retirement income. Payments are often well above what is widely considered a necessary level of retirement income. In some cases career public employees will receive retirement income higher than their income when working.
- The impact of the recent recession and dips in investment returns are not the source of the problem. They have exacerbated what was already emerging as a problem, and even after economic recovery the burgeoning pension cost will remain as a challenge to local agencies.

How We Got to this Point – Some Historical Perspective

We identified four main trends that have contributed to the evolution of this problem.

- Public retirement plans remain largely defined benefit plans when most private plans have converted to defined contribution plans over the last several decades.

- The growth of unionization of public employees and the inherent conflicts of interest that often arise when there are close alliances between public employee unions and elected representatives who are funded and supported by the unions leaves taxpayers unrepresented at the bargaining table when benefits are negotiated.
- Changes have been made to many public retirement plans that have ratcheted up benefits to public employees to a level well above those enjoyed by private sector employees.
- Abuses such as "pension spiking" in public employee retirement plans have become common.

Guiding Principles for Reform

Especially because there is an enormous amount of heated rhetoric on this topic, it's important to establish some clear and logical benchmarks to provide some guidance as we explore reform measures, and to use as a measurement tool to determine if potential reforms meet appropriate community objectives.

We support the three following guiding principles:

- Compensation of government employees, including benefits, should be adequate to attract and retain qualified employees.
- Compensation that exceeds the amount required to attract and retain qualified employees misallocates public resources and is unfair to taxpayers because it reduces the amount available for other services taxpayers want or maintains taxes at higher levels than necessary.
- It's not appropriate to reduce benefits promised to present retirees, or to reduce earned benefits for prior service by current employees. It is reasonable and fair to be able to adjust benefits to be earned for future work, not yet rendered. Furthermore, benefit enhancements should not be applied retroactively.

It's important to recognize that whatever the objectives of government services, they clearly are not intended to enrich public sector employees at the expense of citizen/taxpayers.

Potential Reform Measures

Logic suggests that the range of possible solutions to the problem takes one of two courses, either modifying benefits or increasing revenues. Unfortunately, we've learned that a ring of legal obstacles has been erected which prevents many approaches to modifying benefit formulas, *even if the employees' unions were willing to agree to reasonable changes.* This is not only troubling because these obstacles inhibit the ability of public administrators to manage budgets, but they dramatically reduce the alternatives that remain, absent some more difficult legislative changes.

It’s our view that public administrators, elected officials and community organizations should all express their support for changes in the legal framework to remove the impediments to reasonable and prudent reforms in pensions. Such changes may include:

- Revisions to city charters
- Changes to state legislation
- Revisions to CalPERS regulations
- Voter initiative to remove any requirement for binding arbitration of salary and benefits.
- Other voter initiatives to remove legal obstacles or to impose fiscal discipline on agencies

In the interim, we recommend the following reform measures that can be made without legislative action.

Two-tiered system

A two-tiered system of benefits should be implemented immediately. In such a system newly hired employees would receive benefits under a formula that would be affordable and return the benefits to a more appropriate level. Absent any near-term way to reform the system for current employees, this two-tiered approach is essential to get onto a sustainable path for the future, and the sooner the better.

Unfortunately a two-tiered system will not having any meaningful impact on the current fiscal problem, but it will stop the bleeding by not adding to the problem. This is because a two-tiered system has no impact on the cost of funding benefits for present employees and retirees, who will remain the majority of covered employees for years to come. Most local government agencies are not hiring many new employees in the face of shrinking budgets.

We also recommend that the structure of a two-tiered system be one that mirrors the typical retirement plans for private employees. These plans typically have a guaranteed portion made up of Social Security benefits, supplemented by a retirement savings plan similar to 401K plans.

Increased employee contributions

Without the ability to reduce benefits and with public agencies lacking the resources to fund the increasingly expensive plans, one of the only remaining solutions is to require employees to pay a greater share of the costs for their plans. In some cases, public employees contribute less to their own retirement plans than is contributed by private sector employees, when Social Security is taken into account. Therefore fairness and equity suggests that public employees should contribute more than they now do.

In private industry employees contribute 6.2% (reduced to 4.2% for 2011 and 2012) of their pay to fund Social Security, which is matched by employers. Additionally, many contribute supplemental amounts to their 401K plans, over and above any employer contributions. In contrast, in Santa Rosa for example, police and fire public safety employees currently contribute nothing to their very generous retirement plans.

Reform pension abuses

A wide range of practices which have come to be known as “pension spiking” must be stopped, and rescinded where possible. These practices all have the effect of artificially increasing retirement income, well above that called for under what are already very generous benefits computed on base pay.

Pension spiking may take the form of counting sick pay, overtime and things like uniform allowances or other forms of compensation as the base on which retirement income benefits are calculated. For example, in Santa Rosa, the 9% employee share of pension contributions for public safety workers that *is paid by the City* is added to base pay to determine pensionable income. These practices are more prevalent among senior management and public safety employees than among rank and file workers.

Other practices involve promotions shortly before retirement primarily for the purpose of boosting final income. Especially prevalent among public safety workers is the practice of claiming a disability shortly before retirement in order to enhance retirement income. In some jurisdictions it’s been reported that a startling number of public safety employees retire on disability.

Taxpayers find these abusive practices all the more distasteful when the retirement benefits are already very generous. The employees are doing far worse than simply gaming the system, they are cheating their neighbors who pay the taxes that provide their retirement income. Traditionally taxpayers have exhibited their respect for public safety workers by according them special consideration like more generous retirement benefits. The existence and continuation of these abuses puts this special relationship at risk.

Cut back government services

Without reform governments will be forced to cut back drastically on services. This will mean reduced street maintenance, fewer and less well maintained public parks and recreation facilities, severe cuts to social services and similar basic services expected of local governments. We do not expect taxpayers to absorb this level of cuts to basic services willingly, and could foresee a major taxpayer revolt. Inherent in such a cutback is a greatly reduced staff of public workers. Those who retained their jobs would be in good shape, but many would be out of work, which is not a desirable outcome for our community.

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Privatization of many government functions

Many jobs now performed by public employees could be performed by private contractors.
The employees of the private contractors would be provided compensation and benefits by those contractors, but they would not be subject to the collective bargaining agreements and state laws that govern public employees which are a major hindrance in achieving meaningful reform. In fact many communities around the country already contract with private firms for some administrative services. While it may not be practical to privatize police and fire fighting, almost all other government services could readily be performed by private contractors. Since roughly 75% of fire department calls are not to fight fires but for medical emergencies, it may be possible to privatize that service to existing ambulance/EMT companies. Likewise, there is no reason a private contractor could not provide the construction, maintenance and engineering services currently performed by public works departments.

Some may see this as an extreme solution, however, given the obstacles to reasonable reform measures it may be the best remaining option.

Raising taxes is not the answer

Raising taxes is frequently the first response of those who favor more government, especially among government employees and their unions. It's harder to make the case that all other citizens who are not employed by the government benefit from higher taxes, if the effect is to take more out their pockets to support higher compensation to government workers than the same private sector employees enjoy themselves.

Further, it has been demonstrated that raising tax rates does not necessarily increase tax revenue, as individuals and businesses change their behavior in response to higher tax rates. The best way to increase tax revenue to fund government services is to enhance economic vitality, and raising tax rates conflicts with that strategy. There is more than ample evidence in jurisdictions all around the country that economic vitality is greatest in lower tax areas, and higher taxed localities often experience more economic stagnation.

In the case of Santa Rosa, the City has raised taxes several times in the past decade, each time promising voters enhanced services in exchange for the tax increase. Santa Rosa has found itself unable to deliver on those promises, due in part to the rising cost of funding pensions, and is at risk for having to divert funds that were intended for promised services to fund enhanced pension benefits. We do not think voters would approve a tax increase to fund higher pension costs.

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