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Daniel Weintraub: Lessons for California from Oregon's debacle

By Daniel Weintraub -- Bee Columnist
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As California's state and local governments - and the taxpayers who foot the bills -- struggle to regain control of rapidly rising retirement costs for public employees, they might want to look to the north, where Oregon has just been through a similar ordeal.

While the two states' problems have many differences, they both stem from the same root cause: an unsustainable increase in benefits that grew out of the stock market boom of the late 1990s.

In California's case, state lawmakers and local government officials acted knowingly but with bad information, granting pension increases that they were told would be paid for largely from a surplus in the retirement fund. When the surplus disappeared,



taxpayers were left holding the bag for the higher benefits. And when stocks fell still further, the public had to pay even more to erase that deficit as well. It was a double whammy.

In Oregon, the problem sprang primarily from a long-standing benefit option in the retirement plan that few realized would explode the way it did. Retirees found themselves in the enviable position of having a guaranteed benefit that was about average for public employees across the nation, plus the chance for a super-charged pension when the stock market soared.

They did well when the economy did poorly, and they did better when the economy, and the markets, took off. The taxpayers held all the risk, and the employees reaped all the rewards. It was a badly one-sided deal.

Specifically, Oregon employees had a basic plan that paid pensions equal to 60 percent of salary for public safety employees such as police and firefighters after 30 years on the job, and about 50 percent of salary for general employees. Public safety employees could retire with full benefits at age 55, and general employees, depending on when they were hired, were eligible to retire at either age 58 or 60.

This is your standard -order public employee retirement plan, and it moved along for many years without much trouble. Then the stock market took off, and retirees started to take advantage of a perk known as "money match." Under this option, employees leaving the public work force had the chance to take an alternative pension based on the performance of the state's investment fund. For each year worked, the employee was guaranteed earnings of at least 8 percent, even if the investment fund earned less, or lost money. But for years when the fund did better than 8 percent, the employee's account was credited with the actual return.

The result, as the Oregonian newspaper discovered after a public records request, was extravagant pensions. Employees who retired after 30 years on the job at age 56 earned an average of 87 percent of their final salary, the newspaper found.

And one out of every four longtime workers who retired in 2003 got pensions that were equal to or greater than their final salary.

Not surprisingly, this hemorrhage of money from the retirement fund created what is known as an unfunded liability: an obligation to pay future benefits that exceed the amount of money in the fund. This deficit grew for several years, eventually peaking at \$15 billion. At one point, the Oregon fund had just 68 percent of the money it needed to remain on pace for long-term solvency.

Lawmakers and the state's Democratic governor stepped in and made major changes. For existing employees, earnings on their accounts were limited to an average of 8 percent, rather than setting 8 percent as a floor, and their future contributions will be placed in new accounts that will earn between 0 percent and 7 percent, depending on the performance of the fund. Annual cost-of-living increases for recent retirees were suspended until the fund is solvent again.

For future employees, Oregon created an entirely new plan, a combination of the traditional defined benefit system and a defined contribution plan similar to a private sector 401(k).

In the defined benefit portion of the plan, general employees will get 1.5 percent of their final salary for each year worked - 45 percent for a 30-year employee. Public safety workers get 1.8 percent, or 54 percent for a 30-year vet.

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The employees' contributions of 6 percent of salary, meanwhile, are placed into individual accounts that are invested, with the balance fluctuating with the performance of the markets. The public agency employer can match these personal accounts with contributions up to 6 percent of salary. The worker owns the account when he or she retires.

The result is a hybrid benefit that is still better than many public employees receive and is far more generous than most private sector workers get today. But it is a more stable, predictable expense for Oregon taxpayers and one not likely to spiral out of control again, no matter what the markets do.

Gov. Arnold Schwarzenegger has jump-started the debate over the future of California's public retirement system, whose rising costs, especially for local government, are eating into budgets and forcing cuts in essential services. The Oregon lesson shows that, while the pension debate can be contentious, it is possible for policy-makers, and the taxpayers, to escape the clutches of a dysfunctional system.

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