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Daniel Weintraub: Pension changes would create long-term savings

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Gov. Arnold Schwarzenegger's proposal to create a new pension system for public employees in California will be bitterly fought this fall if it lands on a special election ballot with the rest of his policy agenda.

Supporters will cite the need to change a system that now requires private-sector workers to pay taxes that subsidize increasingly generous public pensions. Today's government employees retire with payouts of 60 percent to 100 percent of their highest annual salaries, plus yearly cost-of-living increases.



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Opponents will say that dropping those pensions in favor of 401(k)-style accounts will make it harder to recruit qualified employees to public-sector jobs where, the unions argue, pay has historically been less than for comparable work in the private sector.

One thing that shouldn't be in dispute is that the proposal would, over time, dramatically reduce the cost of California's public pension system. The savings would begin in a trickle but eventually represent a torrent of new money that would be available to reduce taxes or go toward other public purposes, from education to roads and health care.

But there are early signs that those who oppose the change are going to try to portray the proposal as more expensive than the status quo, using misleading numbers. Beware.

The governor's plan would replace the current, guaranteed pension benefits with an individual account for each new worker hired after July 1, 2007. The employees would contribute some, the taxpayers would contribute some, and the workers would own their accounts, taking them with them at retirement or passing them on to their heirs when they die.

General employees who also participate in Social Security could contribute up to 3 percent of their salary toward their individual retirement account and have that amount matched by a 6 percent contribution from the taxpayers. Public safety workers could contribute up to 4.5 percent of their salary with a 9 percent match from the taxpayers. For workers who are not also part of Social Security, the maximum match from the taxpayers would be 9 percent for general employees and 12 percent for public safety workers.

While these employer contribution amounts are generous compared to what most private employers pay, they are less than taxpayers are contributing today. For state employees, taxpayers are paying about 17 percent of payroll toward retirement benefits for the general work force, and up to 33 percent of salary for the pensions of Highway Patrol officers. Many local government plans are even more expensive.

The employers' contributions fluctuate (which is part of the problem with the current system) but they have rarely been below the maximum called for in the governor's plan. For state employees, the taxpayers' obligation toward retirement has been lower than 6 percent of salary only three times in the past 15 years.

Analyses by the nonpartisan Legislative Analyst and by the California Public Employees' Retirement System (CalPERS) show that once all current employees are retired and every worker is participating in the new plan, savings to taxpayers would be hundreds of millions of dollars a year, and possibly more than \$1 billion annually.

A recent analysis by CalPERS, however, introduced a new wrinkle into the discussion that has been picked up by others around the Capitol and is being used to confuse the debate needlessly.

The question is what happens to the current plan after it is closed to new workers. Of course, the taxpayers have a contractual obligation to the current retirees and those now working and must continue to pay into their retirement plan until the last of those workers leave the system. But this is a liability that must be paid whether the current system is changed or not. It is not a new cost.

The timing and extent of this cost will depend on how it is accounted for. The expense could be paid evenly over, say, 30 years, or it could be front-loaded,

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with most of the cost coming in the first years after the policy is changed.

The CalPERS analysis assumed that most of the costs would be paid early, and the result shouldn't surprise anyone. If you quickly prepay most of the retirement costs for hundreds of thousands of public employees, the upfront numbers are going to be high. The analysis showed that under such a plan, the first-year costs to the taxpayers would be about \$820 million, and the 10-year costs would be about \$1 billion. But even after paying off these current obligations, the cumulative savings after 30 years under the new plan would be nearly \$36 billion.

Opponents are focusing on those early numbers in an attempt to make it look as if the change would be costly to the taxpayers. But again, those costs are a legal obligation today, and must be paid regardless of what happens.

As a fiscal matter, this proposal amounts to an investment that pays big dividends for the taxpayers down the road. And that's exactly the kind of reform that will be needed to get the state's revenues and spending back into balance over the long term.

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