Opinion

Daniel Weintraub: Cozy state pension deal costs taxpayers billions

By Daniel Weintraub -- Bee Columnist
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On the afternoon of Sept. 10, 1999, as the Legislature was preparing to adjourn for the year, state Sen. Deborah Ortiz of Sacramento rose on the Senate floor and asked her colleagues to approve a measure to raise the pensions of state employees.

Speaking for less than 45 seconds, Ortiz mentioned first that the bill would give the Senate's own security staff the classification of peace officer, which would enhance their retirement benefits. She rattled off the new retirement formulas that the bill created for each group of state workers. And she said the legislation would allow state employees who had been in a less generous and less expensive retirement plan to jump to the state's top tier retirement program.

"It's got all the provisions that have been negotiated, and I ask for an aye vote," Ortiz concluded.

She got it. Without a word of debate, and not one question, the Senate quickly approved the bill, SB 400. The vote was 39-0. One member was absent.

The measure approved that day will cost taxpayers at least $10 billion over 20 years, plus uncounted billions for similar increases granted later at the local level. The legislation began a wave of public employee pension increases at a time when private sector employees were seeing their own retirement benefits shrink or disappear entirely. And the bill relied on a fundamentally flawed assumption -- that state employees, not the taxpayers, were entitled to the fruits of the long-running boom in the stock market.

That assumption turned the idea of a defined benefit pension plan on its head by guaranteeing employees benefits of a certain size when they retired and then also rewarding them for temporary gains in the retirement fund as if they had had their money at risk.

SB 400 was the brainchild of the California Public Employees Retirement System, known around the Capitol, and around the world, by the shorthand CalPERS. The details were negotiated behind closed doors by representatives of Gov. Gray Davis and the state employee labor unions. The agreement was added to the bill while it was in the Assembly, where, after a final round of amendments, it was quickly approved and sent to the Senate and then on to the governor for his signature.

The measure's fast track was typical for bills enacting new contracts with state employees. Members of both parties in the Legislature have long deferred to the governor on such matters. But this was not the typical agreement with employees that expires after a year or two. It was an expensive change in the state's obligation to fund its retirement system that would live on long after the contracts signed in 1999 expired.

At the time, the governor and state lawmakers were told that the bill was essentially cost-free. The additional benefits for state retirees would be paid for, pension experts said, by a huge surplus that was then earning interest in the state's retirement fund. But the surplus quickly disappeared when the stock market boom went bust, and the taxpayers were left holding the bag.

Now lawmakers and pension officials acknowledge that the benefits are costing taxpayers at least $500 million a year, part of $2.2 billion in new pension costs that have added to the state's huge budget deficit. But that price tag will surely climb even further because of follow-up legislation that has given other employees pension boosts to match those granted in 1999.

In a 1999 memo to a Bee editorial writer, the governor's director of personnel administration, Marty Morgenstern, said that even with the new benefits, the cost to taxpayers for the retirement system would be less than 5 percent of the total payroll expense through 2011. Yet in the current fiscal year, because of the benefit hikes and loss of value in the retirement fund, taxpayers are paying about 15 percent of payroll for pension benefits for most state employees and 33 percent for the Highway Patrol.

"If I had known, if anybody had known, that the market was going to tank for three years, and our contribution was going to go up the way it is, sure we wouldn't have done it," Morgenstern said. "You think this would have been passed this year? It wouldn't have been passed this year. It was passed when times were good."

Sen. Jim Brulte, a Republican from San Bernardino County, said his party went along with the measure because the experts at PERS "told us we had plenty of money." He added: "I believed them at the time. They were wrong. And I'm not sure I'll ever believe them again."

Cal-PERS officials have said since that the odds were 100 to 1 against the three down years in the stock market that flattened the retirement system's investment fund. With the surplus gone, the taxpayers lost the cushion that was supposed to cover the benefit increases and have had to pay more on top of that to keep the fund afloat.

"The costs \[to taxpayers\] are higher, both because of an increase in benefits and because of the downturn in the market," said Ron Seeling, chief actuary for Cal-PERS. "If either one of those had not happened, we wouldn't be increasing employer contributions."

While Sen. Ortiz was the official author of the bill, she said she had little to do with negotiating its terms. She was asked to carry it as the chairwoman of the pension committee and the member with the most state employees in her district.

Ortiz, who grew up in Sacramento, has worked throughout her tenure in the Legislature to boost pay and benefits for the state employees who have been not only her constituents but her neighbors, and in some cases family.

"We relied on what PERS was presenting at the time," Ortiz said. "This was going to be no risk to the general fund, that the fund was solid, and this was the appropriate thing to do."

Had she known how the decision would turn out, Ortiz said, "I think we obviously would have analyzed the implications in a different way. We certainly would have altered how we projected the burden and our ability to sustain the benefit. It might have had a different outcome."

Now that the benefits have been granted, however, it will be very difficult to turn back the clock. The employees who have already retired have their higher pensions locked in. For those who are still working, any changes would apply only to future earnings, and even that would be a complicated and politically unpopular fix in a Legislature where public employees are a powerful force whose political committees contribute millions of dollars to campaigns.

The bill's most dramatic feature was a new formula for Highway Patrol pensions that allows officers to retire with up to 90 percent of their pay at age 50. Officers now get 3 percent of their final salary for every year they worked for the state.

An officer with 20 years on the job, for instance, can collect 60 percent, and one who works for 30 years can get 90 percent of his pay at retirement.

The measure also raised the benefit formula to 3 percent of final salary for each year worked at age 55 for state peace officers and firefighters, and 2 percent at 55 for other state workers. The bill also ended a two-tier pension system that since the early 1990s had routed new employees into a less generous and less expensive pension plan, and it gave cost-of-living increases of up to 6 percent to those who had already retired.

The measure had the support of Cal-PERS and the public employee unions, of course, and very little opposition. One source that raised questions was the California Taxpayers Association.

"No one can guarantee that PERS' contribution rates can be continued in the future," Cal-Tax President Larry McCarthy wrote in a letter asking Davis to veto the bill. "If the stock market should drop, as some experts are suggesting after the country's longest-ever economic boom, PERS cannot be expected to realize the investment returns of recent years. As a result, retirement contributions would then go up, at taxpayer expense."

But nobody in the governor's office or the Legislature wanted to listen to McCarthy. State employees were still celebrating after helping elect the state's first Democratic governor in 16 years. And Cal-PERS, whose board is heavily weighted toward public employees, was eager to spend the bounty of several years of double-digit returns.

At first, the PERS board wanted to simply sponsor legislation increasing the benefits. But Morgenstern objected, saying the pension deal should be folded into his broader negotiations with state employees and used as a bargaining chip.

"The argument was not only is there a surplus, which will take care of the liabilities produced by this, but that, over the years because of the good return, the state had been pocketing a billion or two a year, or a couple of billion over the last couple of years," Morgenstern said. "Shouldn't the employees, given there had been no improvement in 30 years and some of their retirees were below, or at least at, the poverty level, shouldn't they benefit?"

Morgenstern said he took the issue to Davis and warned him it could be 1979 all over again. That year, when Davis was chief of staff to Gov. Jerry Brown and Morgenstern was personnel director, Brown had refused to negotiate a pay raise for state employees, only to see the Legislature send one to his desk. Brown vetoed it and the Legislature overrode his veto. Then he vetoed the money out of the budget and they overrode that, too.

"I told the governor, 'This bill is going to be on your desk,' " Morgenstern said. " 'You have two choices. You can let me negotiate and try to cut the costs down. Or you can deal with this bill that going's to come to you with probably close to a unanimous legislative vote and the whole PERS board behind it.' He said go negotiate."

Morgenstern says he was able to trim the cost of the package by tweaking the retirement formulas proposed by PERS and shifting some of the cost of the premiums to workers. Most of the reductions came from the state's general workforce. The Highway Patrol was left alone, and other public safety workers also got pretty much what PERS had recommended -- a bow to the political power of the police and fire unions.

At the time, a staff analysis told Morgenstern that his negotiations had shrunk the annual price tag from $606 million down to $370 million. But today, CalPERS lists the annual cost at more than $500 million. Morgenstern could not account for the difference.

In any case, after negotiating the deal with the state labor unions, Morgenstern took it to the Legislature. The bill was amended to reflect the agreements in mid-summer, reviewed by two Assembly committees and sent to the floor. At that point, it still dealt only with state workers. After all, it was linked to their labor contracts, and one of the justifications for the bill was to make it easier for the state to compete in the labor market with local government.

But on Sept. 7, in the Assembly, along with some other technical amendments, a line was added to the bill making the higher benefits for state police and firefighters also available to local government employees. Neither Ortiz nor Morgenstern remembers how that amendment came about. It was not mentioned as the bill was presented on either the Assembly or the Senate floor.

It would turn out to be the most expensive piece of the entire bill.

The pension debate

The following is a transcript of the Senate floor speech delivered by Sen. Deborah Ortiz (D-Sacramento) on Sept. 10, 1999, in favor of SB 400, which increased pensions for state workers at a cost to taxpayers of at least $10 billion over 20 years. The bill also opened the door to a round of local pension increases that will cost billions more but have never been fully tabulated. Ortiz's comments took less than 45 seconds to deliver and were followed by no other discussion or debate on the bill. The measure passed, 39-0, and was signed into law by Gov. Gray Davis.

"Mr. President and members, this is the last of the MOU bills. This essentially deals with, you'll be happy to know, sergeants, here, that have been long overdue awaited their classification as peace officers. Additionally the 2 percent at 55 for state, classified school employees, improved peace officer firefighter, 3 percent at 50. Tier 2 plan will be available to employees but allows many to buy into tier 1. It's got all the provisions that have been negotiated, and I ask for an aye vote."

SB 400 video

Real Player: 56k **/** LAN/Cable/DSL
Quicktime: 56k **/** LAN/Cable/DSL

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