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Dan Walters: Schwarzenegger drops pension reform, but the crisis continues

By Dan Walters -- Bee Columnist
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Gov. Arnold Schwarzenegger may have abandoned his pension reform measure due to inartful drafting and a very artful opposition campaign by public employee unions, but that doesn't mean the problem has vanished.

California has the nation's most generous public pension benefits - due to local and state politicians' Pavlovian responses to union demands - and soaring costs are siphoning money away from more urgent public needs and pushing some local governments to the brink of insolvency.



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The high-tech stock market bubble of the late 1990s temporarily fattened pension investment funds, and union-controlled pension boards, led by the immense California Public Employees' Retirement System, provided superficial assurances that benefits could be expanded dramatically without cost to taxpayers. Politicians of both parties, from then-Gov. Gray Davis down, were eager to please the unions - particularly those representing police and firefighters - and fattened the benefits.

When the dot-com bubble burst, those blithe assurances vaporized, and governments at all levels were left scrambling. It was the same underlying dynamic and the same political mentality - using short-term windfalls for tax cuts and permanent spending - that led to the state's budget crisis. And the rising pension costs exacerbated the budget squeeze at all levels.

The state's pension costs soared to \$2.6 billion a year - a sizable chunk of its "structural deficit" - while many local governments were hit with staggering bills from CalPERS as it adjusted to stock market declines, and larger cities and counties that maintained their own pension funds had similarly jolting experiences.

The poster child for irresponsible pension management is the state's second-largest city, San Diego, which once was widely admired for its prudent fiscal policies. San Diego's union-dominated pension board and its City Council joined in the giveaway orgy and then, by all accounts, the city deliberately and secretly avoided appropriating enough money to cover its new obligations. To compound their misconduct, city officials apparently hid the underfunding from Wall Street. There are myriad official investigations into the San Diego mess, with criminal charges a possibility for those involved. The political fallout forced Mayor Dick Murphy, a former judge, to resign.

As legal and political aspects of the San Diego scandal are played out, the pension system's financial mess remains unresolved. Unlike most forms of government spending, pension obligations cannot be reduced once they're granted; benefits have the same legal standing as bonds or other forms of debt. San Diego's city manager wants the city to slash 355 city jobs, reduce library hours, cut back on child care and close all community service centers, largely so that it can stash away more money to cover a \$1.4 billion deficit in its pension fund - recommendations he made last year only to be ignored.

The expanded pension benefits that politicians dispensed during the brief windfall of paper profits may be legally untouchable, but we could - and should - learn from the experience. Politicians cannot be trusted to exercise fiduciary prudence, because they are driven by immediate political pressures and disinterested in the long-term consequences of their actions, as both the pension imbroglio and the state's immense budget crisis attest. And open-ended pension commitments are inherently dangerous, as the financial meltdown of United Airlines proves.

Schwarzenegger was on the right track with his pension reform, limiting new public employees to defined-contribution plans, rather than cost-be-damned defined-benefit plans, to produce some stability in taxpayers' burden. It was widely condemned as "privatization" to tie it to President Bush's controversial Social Security overhaul, but in fact the administration said that the new plans could be administered by CalPERS and other pension systems, not private firms.

Were benefits more dependent on what CalPERS and the other funds earned on investments, rather than open-ended hits on taxpayers, perhaps workers and unions would be more vigilant about those investments and less tolerant of pension fund trustees' side-agenda high jinks.

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