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No options for counties on pensions

By Rebecca Rosen Lum
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IBM just did it. So did Verizon. Within the past two months, the two corporate giants froze their workers' pensions. Employees learned that future years on the job wouldn't increase their pension checks.

More and more firms are trying to cut costs this way. So, if it's good for private companies, why hasn't the public sector jumped on board?

Answer: It can't.

Public agencies across California, including Contra Costa County, are facing soaring pension costs that threaten to wipe out money desperately needed for public services.

But the state Constitution's contracts clause and two key court decisions lock in the retirement benefits. Once a public employee starts earning traditional pension benefits, that employee is guaranteed increases for every additional year of work.

"It's a huge issue with huge consequences," said Steven Frates, senior fellow at the Rose Institute of State and Local Government at Claremont McKenna College. "It's only now beginning to be dimly grasped."

Take Contra Costa, where union contracts are up for negotiations this year. In 2002, the county promised its public safety workers pension benefits equal to 3 percent of their salary for every year worked. A worker who retires after 30 years is guaranteed 90 percent of his salary for the rest of his life.

If the county's investments do poorly, taxpayers are still on the hook to pay the worker's pension. Unlike the private sector, the public agency cannot switch over current workers to a 401(k)-style plan in which the employee absorbs the risk and his retirement benefits depend on how well the worker invests.

Young sheriff deputies and firefighters can get an additional 3 percent for each year worked in the future -- even if future county officials determine they can't afford to continue increasing the payout.

Employees in their 20s might be reaping the benefits into their late years of life. For the longest living and their spouses, "We're talking about a 75-, 80-year commitment," Frates said.

Contra Costa County paid $186 million in retiree benefits this year -- 15.5 percent of the general fund -- and will pay $200 million next year. With thousands of workers entitled to pensions, the balloon will grow larger each year.

Alameda County, which last year adopted a similar pension formula for its public safety workers, saw its pension costs rise by $11 million in a year to $78 million, says Patrick O'Connell, county treasurer and tax collector

How did state and local governments end up carrying this load? Several factors contributed.

When coffers overflowed in the late 1990s, then-Gov. Gray Davis approved an elite retirement benefit for the California Highway Patrol. Police and firefighter groups throughout the state demanded a comparable deal. Most won it. Other public employee groups secured a more modest version of the pension hike.

Then the economy tanked. Pension fund assets nose-dived with the stock market. Just as state and federal aid was slowing, cities and counties had to pick up the pension shortfall.

Last year, retiree costs for state employees worked out to $2.6 billion. That's what it takes to run the entire Cal State university system. Next fiscal year, the state pension tab will climb to $3.5 billion, and $4.6 billion by 2008, says the

California Legislative Analyst's Office.

In contrast, automakers, airlines and tech companies are cutting off pensions -- which companies oversee and primarily fund -- and swinging to 401(k) plans, for which employees must absorb the investment risk. Existing pensions are not revoked, but the promised payout amounts stop growing.

IBM's change, which affects 117,000 employees, could save from $2.5 billion to $3 billion over the next five years. Verizon will yield an estimated $3 billion by freezing pensions for 50,500 managers.

But union representatives condemn the corporate beeline to 401(k)s.

"We created Social Security and the pension so old people wouldn't go to the poorhouse, not so they could play the stock market," said Roland Katz, business manager for Public Employees Union Local No. 1 in Contra Costa.

Chuck Idleson, spokesman for the California Nurses Association, called it a "heartless approach."

"What that means," he said, "is you could be relegating people to poverty in their final years."

Today, 401(k)s outnumber pensions 2 to 1 in the private sector, according to the federal Department of Labor. In contrast, 90 percent of public employees have traditional pensions.

And the taxpayer cost is much more than first expected, said Matthew Scanlan, managing director of the San Francisco-based Barclays Global Investors, one of the world's largest pension asset managers.

Worst case? Illinois. The unfunded pension tab there was $35 billion in December, according to the Labor Research Association. The state's total annual budget is $43.1 billion.

Philadelphia came up short on its pension payments in 2003 by $2.6 billion, even after it sold $1.2 billion in bonds. San Diego is spending more on pension payments than on the entire police department.

Frates predicts other agencies will eventually pay more in pension costs than for key services.

"Somewhere along the line, the two lines will intersect," he said. "The day the county says 'We can't hire any more sheriff's deputies because we're spending it all on retirees,'" it will hit home.

There is one out -- and it's a grim option. If a government agency goes bankrupt, all agreements are wiped off the table.

Short of that, there's nothing public agencies can do to stop the escalation of payments to workers, says Assemblyman Keith Richman, R-Northridge. But they can lessen the pain by offering more modest benefits for new hires. That is one of many changes Contra Costa is putting on the table during contract talks.

"The only option is to quit digging the hole deeper," said Richman, who has pitched four failed pension reform bills in the state Legislature and is working a fifth, which he introduced in September.

Public finance analysts say the answer for the pension hikes that began in 1999 may come in the form of a massive taxpayer bailout.

But lawmakers could find themselves whipped by voter backlash before that.

It is inevitable, Frates said, "when one guy has to work at 70 and sees his neighbor retiring a millionaire at 50."

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How They Differ

401(K)
PENSIONS

• Named after the IRS code that authorized them in 1978, these are also called "Cash Balance" plans.

• Workers have an individual account funded with voluntary paycheck deductions. In some cases, the employer may match the worker's contribution up to a set percentage.

• The worker manages the account, and takes the investment risks. If the portfolio does not perform well, the employee may have very little in retirement.

401(K)

PENSIONS

• Also called "Defined Balance" plans

• Worker receives a guaranteed benefit at retirement based on age, rate of pay and number of years worked.

• The employer bears most of the cost, manages the account and makes up the difference if the investment returns sink beneath the guaranteed pension payment. The employee is guaranteed a set payment for life.

Source: Economic Policy Institute