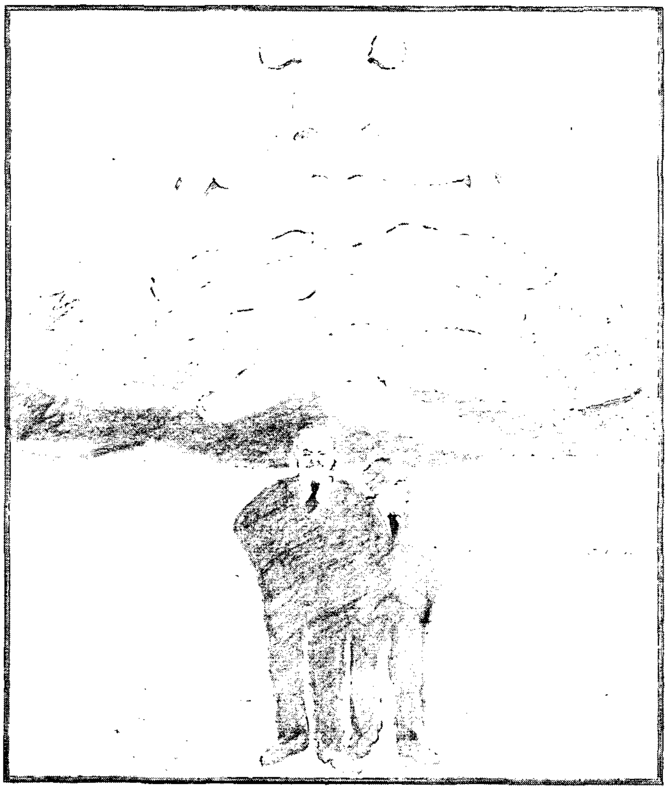
The huge pension debt-- except the lawmakers' own fund

ILLUSTRATION BY SUSAN DOUGLAS



By LAURA FREDERICKS

Compared to the federal Social Security system, California's public-employee pension systems are in mighty good shape. They're only about $24 billion under-funded. The federal government no longer makes any pretense about the Social Security system, which is no longer viewed as a sinking fund arrangement that makes payments out of investment income. But California's miscellaneous pension funds are supposed to do just that. And they have assets of some $12 billion to meet estimated long-range obligations of about $36 billion. This deficit is the product of unanticipated inflation, increased benefits and, in most cases, poor financial planning.

These deficits are usually called "unfunded liabilities." And the systems are able to operate efficiently despite the lack of assets simply because the obligations need not be met immediately. The liabilities have existed for a number of years, increasing gradually with inflation or new benefits — without comparable increases in contributions from employers and employees. But now the state has come to the realization that some day it must pay the piper and that unfunded liabilities cannot be carried forever.

The state administers five basic pension systems. The biggest — and one of the two soundest — is the Public Employees Retirement System (PERS), which provides retirement benefits to most state and a variety of other workers. The second largest — and the one in worst financial condition — is the State Teachers' Retirement System (STRS). It has never been funded properly, and the unfunded liability is so great that it may continue looking like California's little Social Security system for many years to come.

Two relatively small systems provide benefits to the state's judges, legislators and statewide elected officials. The Legislative Retirement System (LRS) was completely paid off last year at a cost of $28 million, but the Judges' Retirement System is in extremely poor health. There are also 20 counties which administer benefits under a special 1937 law. These 20 funds are autonomous and reasonably stable.

The iron-clad rule

One of the reasons why it is difficult to reform pension funds is an iron-clad rule of law that once a benefit is granted, it cannot be taken away. Thus, reductions are possible — but not for any employees who have already accumulated benefits. The courts have adopted this position to protect individuals against cutbacks in retirement credits which they are promised at the time of employment. Here is a look at the condition of the five systems:

Laura Fredericks, a student at the University of California at Santa Barbara, prepared this article as a Journal *intern.*

• **Public Employees Retirement System.** With more than 700,000 working and retired members, PERS is larger than all other retirement systems in California combined. Members are classified in one of three categories:

Miscellaneous members constitute nearly 90 percent of the total and include all staff, operational, supervisorial and other workers who do not fall into one of the following special categories.

Safety members, roughly 9 percent of the total, include all California Highway Patrol, police, firemen and other workers whose jobs have been designated as "safety" occupations. Highway Patrol officers receive slightly different benefits than others in the group.

State industrial members include some 5,000 employees in the Department of Corrections and the Youth Authority. Their benefits are only slightly different from those received by miscellaneous members.

Membership in PERS is mandatory for all state civil-

ILLUSTRATION BY SUSAN DOUGLAS

service employees. PERS also has contracts with about 1,000 California cities, counties and special districts. In addition, PERS administers the federal Social Security system for state workers and the Legislative Retirement System, which operates on a separate fund.

Both contribution rates and benefits are calculated according to the final salary of the employee and his or her total years of service. Active members pay into the system at varying rates (5 to 6 percent of salary for miscellaneous workers, 7 percent for local, 6 percent for safety and 8 percent for Highway Patrol), which — when combined with employer contributions and investment earnings — are supposed to cover all foreseeable future payments.

According to PERS legislative liaison Howard Sarasohn, PERS is not a typical public pension program because it operates on a reserve funding basis; as a new benefit is added, contributions are promptly increased. Thus Sarasohn claims that, even though PERS is currently carrying an unfunded liability of more than $7.5 billion (largely as a result of inflation over the past five years), it is sounder than ever before. Indeed, PERS is now considered the bright spot among California's pension systems because it will be able to meet its obligations without any major reforms. By the time payments are due, PERS should have the money in the bank.

PERS meets potential deficits by increasing employee and employer contribution rates over a set period of time, and 30 years is generally considered a prudent period over which to amortize such liabilities. There are, nevertheless, certain trends which could threaten the financial stability of the system. Of concern to PERS and other systems is the rapid increase in disability retirement claims, especially among workers in the safety category. Disability retirement usually provides the retiree with close to maximum-level benefits at a much earlier age. In a recent five-year period, disability claims increased 110 percent, and safety disability costs are rising at twice the overall rate.

A related problem, unique to PERS, involves employees in the miscellaneous or industrial categories seeking to move into the safety classification. The main attraction is earlier retirement, and many groups are getting it. Safety workers have traditionally received enriched benefits because their work is considered exceptionally dangerous or demanding, and because optimum performance often requires youth and physical agility. Thus, earlier retirement for safety-category employees makes sense. But now many public employees without those kinds of jobs want safety workers' special benefits.

In an attempt to find some means of controlling the growing safety category, the Legislature last year passed a bill directing the state Finance Department to study the various classifications of PERS employees, especially the safety segment and its growing membership.

The Brown book beat

Thus far, five books on Governor Brown have appeared on the market, four of them within the past few months. Here is a listing of the four new hardbacks, with comments from a review by Lou Cannon in the *Washington Post*. Cannon, former *Journal* correspondent in Washington, is now the *Post's* western bureau chief based in Los Angeles.

JERRY BROWN: The Man on the White Horse, by J. D. Lorenz. Houghton Mifflin. 267 pages. $8.95. *"Lorenz's entertaining account is flawed by a bad dose of sour grapes."*

BROWN, by Orville Schell. Random House. 307 pages. $10. *"It is the kind of book that might have been written by the governor's mother, Bernice Layne Brown, except that one suspects Bernice would have been a bit more critical."*

JERRY BROWN: In a Plain Brown Wrapper, by John C. Bollens and G. Robert Williams. Palisades Publishers. 272 pages. $9.95. *"While authors Bollens and Williams try to be analytical, they are constantly defeated in their own prose."*

JERRY BROWN: The Philospher Prince, by Robert Pack. Stein and Day. 293 pages. $10. *"Those poor souls who are merely seeking information will learn more about Jerry Brown from Robert Pack's biography than they ever wanted to know."*

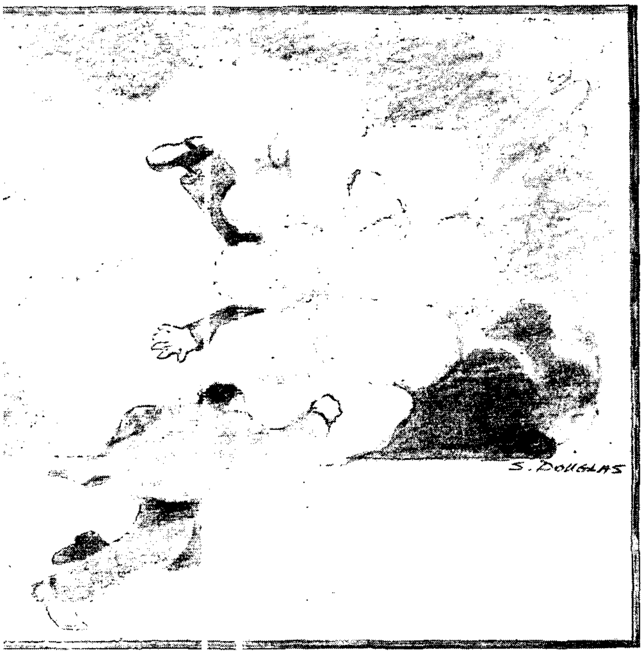
The fifth book, a paperback, is **JERRY BROWN: High Priest and Low Politician,** by Ed Salzman. California Journal Press. 127 pages. $2.95.

• **State Teachers Retirement System.** With 332,000 active and 65,000 retired members, STRS is much smaller than PERS but in far worse financial shape. An unfunded accrued liability of $8.2 billion, which is expected to increase again this year, has made STRS the New York City of California's pension systems.

STRS has been in debt since the day in 1913 when it began paying retirement benefits for the state's certified teachers. Operating on a pay-as-you-go basis, it has never provided adequately for future benefits and increases. Today, the problems resulting from poor fiscal planning, inflation, earlier retirement and longer life-expectancy have been compounded by a tradition of inadequate employer contributions to the fund, leaving STRS dangerously in debt.

In 1971 the Legislature passed the William E. Barnes Act which attempted to bail out the system by increasing school-district contributions and pledging state general fund contributions of $135 million annually for a 30-year period. The state contribution is, however, specifically designated to pay for past deficiencies and retired teachers' benefits. It does nothing to fund current or future obligations.

Furthermore, the Barnes Act was based on an incorrect actuarial assumption that 16 percent of payroll (8 percent from teachers and 8 percent from districts) would be enough to keep the system in the black. In 1975, a new actuarial study found that 21.1 percent of payroll would be required



to pay just the normal costs of the system (day-to-day pension payments) plus the interest on the unfunded liability. To amortize the entire $8.2 billion deficiency would require a total of 24.75 percent of payroll for a 40-year period.

Recent legislation has attempted to increase both district and general-fund contributions over a five-year period to help meet the system's immediate financial obligations. But further legislative action is required before the bill becomes operative. Even with this short-term program, it is obvious that the next generation of California taxpayers will inherit the same problems — and by then they will be worse.

Most of the financial problems with STRS are not due to excessive benefits for the state's retired teachers. Working teachers pay 8 percent of every paycheck toward their retirement benefits, one of the highest contribution rates in the state. Teachers who have retired within the last couple of years, on inflationary wage scales, are receiving realistic benefits. Older retirees, however, are not so lucky. Despite the cost of living increases granted last year, most older retirees are finding their pensions fall far behind cost of living increases and barely provide enough for survival. (STRS gives a 2 percent annual cost of living increase to retired teachers.) Currently the goal is to step up contribution rates to 21.75 percent of payroll by July 1st, 1979. This is often referred to as the "infinite funding level" because the system could continue operating indefinitely without increasing or decreasing the size of the unfunded liability. The $8.2 billion unfunded liability would remain; in fact, before the infinite funding level is finally reached, that amount will probably have increased.

• **Judges and Legislators.** California also has two small, exclusive retirement systems providing pensions for legislators, constitutional officers and judges. Both built up huge unfunded liabilities over the years as a result of poor — or no — fiscal planning. Because both systems are relatively small, no one paid much attention to the growing debt. Then last year the Legislature took care of number one. The Legislative Retirement System (LRS) has only 188 active and 143 retired members and is administered through PERS but with a separate fund. The Legislature simply appropriated $28 million to pay off all past accrued liabilities and stepped up state contributions to fund all current and future benefit payments. Thus, the Legislature has, in effect, a fully funded retirement system.

For the Judicial Retirement System (JRS), salvation has not come quite so easily. The most recent report on the system estimated the outstanding financial obligation at about $400 million. JRS has never had any means of advance funding, and contribution rates have consistently been insufficient, considering the benefits received by California's judges. The scale is based on salaries of practicing judges rather than on an individual's final salary and total years of service.

The startling size of the unfunded liability is somewhat misleading. It represents the value of benefits due in the future. Legislation passed in 1977 gave JRS until 2002 to reach a fully funded status. According to the actuarial report, this will require an astounding increase in contribution levels from the current 27.8 percent of payroll to 84.4 percent over the next 24 years. Just to keep the system functioning without increasing the unfunded liability would require 56.7 percent of payroll. The key issue is how much of the burden the judges will bear and how much the state will carry.

• **1937 Act Counties Law.** Twenty California counties administer retirement benefits under this statute. By deciding against joining in the larger and more complex state pension system, the individual counties and their corresponding local governments are able to maintain a substantial degree of local autonomy and control. Benefits vary from county to county and by job classification. Each county board of supervisors may choose among various benefit options, thus creating a retirement system custom tailored to an area's special needs. As with PERS there are both safety and miscellaneous employee classifications. Some degree of uniformity between counties is achieved by having all safety workers under one standard formula and all miscellaneous workers under one of three different formulas.

The local governments have been relatively responsible in administering the pension systems, according to Mike Corbett, an analyst studying the law, but inflation is undermining their viability. No pension system in California has been able to keep cost-of-living payments commensurate with inflation. Disability retirement also has been a bothersome problem with the individual county pension systems. Claims have been increasing rapidly among all classifications of employees, but especially among safety workers. "Even though most of the claims are probably legitimate, the work ethic has changed in our country," says Corbett. Twenty or 30 years ago, employees would go to work despite minor disabilities or pain because they had pride in their jobs. This is no longer the case, he says. Many workers are using disability claims as a means of receiving early retirement; others are taking advantage of high disability benefits and going back to work at other jobs. Some employees have discovered loopholes and are receiving benefits from two or more systems. Such "quirks in the law," as Corbett calls them, are rapidly increasing costs for local government.

However, the 1937 Act Counties Law has generally satisfied customers. Corbett's study, although still in its early stages, has shown that all 20 counties feel that their system is the best one possible for them.

Prohibitive costs of reform

What will be the solution to growing pension problems? Assembly Speaker Leo T. McCarthy has declared a moratorium on all retirement legislation until the Finance Department study on PERS categories is completed next January. STRS and JRS are in critical shape. Both will require vast sums of state money and generations of bigger contributions before they reach full funding. The cost of complete reform is so prohibitive that for now STRS is simply striving to maintain its debt level, without further increasing the unfunded liability. As David Cox, consultant to the Assembly Committee on Public Employees and Retirement, puts it, "At times you think that just maintaining the status quo is an advancement."

The August leftovers

Legislators departed on a one-month vacation in early July after enacting the state budget and a major Proposition 13 measure designed to keep local government operating without major cutbacks for the current fiscal year. But there were still several major issues remaining to be resolved during the remainder of this year's session, which was scheduled to resume on August 7th. Here are some of those issues:

Legislative salaries. The Assembly is solidly behind a measure by Assemblyman Dennis Mangers to freeze lawmaker salaries at the current level of $23,232 until July 1979. The Senate appears reluctant to go along with the bill, which would postpone a 10 percent raise to $25,555, effective with the start of the 1979-80 session this December.

Judges' salaries. Under current law, judges will get automatic pay raises despite the fact that salaries have been frozen for all employees of state and local government. A bill by Assemblyman John Miller, who has been nominated for an appellate judgeship, would prevent judges from getting a five-percent hike this year.

Limitation on government spending. This may be the most difficult issue to resolve. Everyone seems to be for a constitutional amendment establishing a formula to limit expenditures by both state and local government. The problems are the contents of the formula and the authorship of the measure. The leading measure at the moment is SCA 42 by Senator George Deukmejian, the Republican nominee for attorney general. Democrats don't want to give him a campaign vehicle and they would prefer to tie the limit to personal income, rather than population and the cost of living. The Legislature has approved an extension until August 15th for the placement of SCA 42 or a similar proposal on the November ballot. That only gives lawmakers a week to come up with a solution, and the partisan bickering is apt to become intense.

Business taxes. Senator Ralph Dills, backed by public employee organizations, is trying to get a measure on the ballot that would take the benefits of Proposition 13 away from owners of commercial and industrial property. But it appears doubtful that this split-roll concept would be approved for the November ballot. Governor Brown has called the plan premature.

Peripheral Canal. The Brown Administration may try to move its water-project measure authored by Senator Ruben Ayala. The bill, among other things, would authorize construction of the $3.5 billion Peripheral Canal around the Sacramento-San Joaquin Delta.

Senate (26D, 14R)	SB 1355 SB 2230 AB 2190 SB 1789	AB 1222 ACA 55 SB 2143 SB 1781	SB 2005 SB 1480 AB 1073 AB 1941
Alquist (D)	NNNN	Y*YY	NNNN
Ayala (D)	YYYN	NNYY	YYYY
Behr (R)	NYYN	Y*YN	YYN*
Beverly (R)	NYYN	NYNN	YYY*
Briggs (R)	YYYN	**N*	NN*Y
Campbell (R)	YYYY	*NNN	*N**
Carpenter, D. (R)	Y**N	N*NN	NNNN
Carpenter, P. (D)	YYYY	YNYY	NYYY
Cusanovich (R)	YYY*	NNNY	NNYN
Deukmejian (R)	YYYN	NNNY	NNNN
Dills (D)	NNYN	NNNY	YNY*
Dunlap (D)	NYY*	YYYN	YYNY
Foran (D)	YYYN	NYNN	YYY*
Garamendi (D)	NYYY	YNNN	YNNY
Garcia (D)	YNYN	**YY	*YY*
Greene (D)	**N*	N*Y*	YYYY
Gregorio (D)	NYNY	YYYN	YYNY
Holden (D)	**NN	YNYY	YYY*
Holmdahl (D)	NYYN	YYYY	YYY*
Johnson (R)	YYYN	NNNN	NNYY
Marks (R)	NYYN	YYYY	YYN*
Mills (D)	NYYY	*NYY	*Y*Y
Nejedly (R)	YYYY	YNNN	NYYY
Nimmo (R)	YYNN	N*NN	NN*N
Petris (D)	*YY*	Y***	Y*N*
Presley (D)	YYYN	NNYY	NNYY
Rains (D)	NYYN	YNYY	YYN*
Richardson (R)	YYNY	NNN*	NNYY
Robbins (D)	NYYN	*YYY	YY**
Roberti (D)	YNYY	NYYY	YYYY
Rodda (D)	NYYN	Y*YN	*Y*N
Russell (R)	YYNN	NNNN	NNNY
Sieroty (D)	NNNN	YNYY	YYYY
Smith (D)	NYYY	YNYY	*Y*Y
Song (D)	****	***Y	Y***
Stiern (D)	YNNN	YNYY	N*YY
Stull (R)	YYY*	NNNN	NNY*
Vuich (D)	*YYN	YNNY	YNYY
Wilson (D)	Y**N	YNNY	YYYY
Zenovich (D)	NNNN	NNYN	YNYN

VOTING RECORDS

Listed here are the votes of legislators on recent major roll calls through mid-July. Votes selected involve issues of major importance and issues on which there was a major division of opinion, or both.

Y - Yes **N - No**
*** — Absent or not voting**

A ⅔ vote is required for urgency measures, constitutional amendments, and appropriations.

Assembly: 41 votes required for passage of bills needing a simple majority. (⅔ = 54 votes)

Senate: 21 votes required for passage of bills needing a simple majority. (⅔ = 27 votes)

Senate

BUDGET AND FINANCE

SB 1355 (Rodda) — Senate budget bill. Senate vote on whether to remove Medi-Cal abortion funds from the budget. Amendment to remove funds adopted 19-16.

SB 2230 (Deukmejian) — Would extend the deadline until August 15th for the placement of a spending-limitation constitutional amendment on the November ballot. Passed 28-7.

AB 2190 (Boatwright) — Appropriates $15.1 billion for support of state government. Senate adopts conference report, 27-10.

HEALTH AND WELFARE

SB 1789 (Campbell) — Repeals prohibition against the prescription of Laetrile for the treatment of cancer. Defeated 9-25.

AB 1222 (Vasconcellos) — Prohibits smoking in grocery stores and retail food-production establishments. Failed 18-16 (21 votes required).