



Orange County Taxpayers Association

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Members and Friends of OCTax:

Here's OCTax's assessment of Governor Brown's "Twelve-Point Pension Reform Plan," and some thoughts on whether, how, and when it might be implemented.

1. Equal sharing of pension costs: all employees and employers.

Most elected officials of either party (city councilmembers, county supervisors, etc.), are eager to show their "get tough with the unions" credentials, routinely require that employees pay a portion (5%, for example) of the costs of their pensions. Then the elected officials just as routinely grant a 5% pay raise to compensate the employees for this new "cost." The new, higher salary compounds every year forever, so the union members never actually pay anything. (Jack Dean, the tireless chronicler of public employee pension excesses, calls this the "Reed Royalty effect" because OCTax was first to make a fuss about it.) The Governor's plan, which would require that all new and current employees transition to a contribution level of at least 50% of their pension costs, probably could be gamed in this manner too, but at least it would raise the visibility of the scam.

OCTax analysis: good idea, but it won't work without hard guidelines to prevent elected officials from granting pay raises to shelter employees from having to pay higher pension premiums.

2. "Hybrid" risk-sharing pension plan: new employees.

Creates a pension plan for new hires that includes a reduced defined-benefit component, a new defined-contribution component (similar to a 401k), and new participation in Social Security. It envisions replacing 75% of an employee's salary based on a career of 30 years for safety employees and 35 years for general employees. Still very generous compared to private-sector pensions.

OCTax analysis: good idea, provided that specific language is added to prevent over-generous elected officials from making the new combination of benefits as generous, or even more generous, than the old. The more components to the plan, the more opportunity for unions and their compliant managers to wheedle ways to enrich it.

3. Increase retirement ages: new employees.

In 1932, when the State created its retirement systems, the retirement age for general employees was 65, about the same as average life expectancy. Today, general employees can retire at age 55; safety

employees can retire at 50. Life expectancy is much higher now, so retirement benefits must be paid for decades rather than a few years. Governor Brown's plan would raise the retirement age to 67 (same as Social Security) for general employees and something less than that for safety employees.

OCTax analysis: today's union members probably couldn't care less about benefits for their future "brothers" that are yet to be hired. They simply want to ensure that their own current pensions are secure. For that reason, this proposal may have a chance to pass. It will be difficult: public employees, present or future, love early retirement. They can double-dip in another job in or out of government, or just do nothing and enjoy lifetimes of inflation-adjusted pensions. (Public sector pensions are automatically boosted by up to 3% per year to compensate for inflation. That's rarely the case in the private sector.)

4. Require three-year final compensation to stop "pension spiking": new employees.

Pension benefits in the private sector typically are calculated as a percentage of the employee's pay during the final three years of work. Pension benefits for most public employees are calculated on the final single year of pay. This maximizes public-sector pensions in two ways: first, the final year of service usually is the highest-paid; second, it enables public employees to "spike" their pensions by 30% or so in the last year of service by foregoing vacation time, working overtime, foregoing food and uniform allowances, coaxing supervisors to grant end-of-career promotions and other sly devices.

OCTax analysis: this one is perfect. Do it now, Governor, not just for new employees but for existing employees. Union lawyers claim it's not legal to make this change for existing employees; has anyone really challenged that assumption? Pension spiking is legalized fraud, pure and simple.

5. Calculate benefits based on regular, recurring pay to stop pension spiking: new employees.

Pensions can be spiked by gimmickry: supplementing salaries with special bonuses, unused vacation time, unused sick leave, inflated or unplanned overtime, special pay for tasks that a private sector employee would consider a normal part of the job. The Governor's plan would define pensionable pay as the normal rate of base pay, excluding all the gimmicks.

OCTax analysis: this one is perfect too. Implement it now, for future and existing employees.

6. Limit post-retirement employment: all employees.

Governor Brown says "Retirement with a pension should not translate into retiring on Friday, returning to full-time work the following Monday, and collecting a new pension and salary." His plan would limit government retirees to working 960 hours or 120 days per year. It would prohibit all retirees who serve on public boards and commissions from earning retirement for that service.

OCTax analysis: still too lenient, but better than nothing.

7. Felons forfeit pension benefits: all employees.

Public officials and employees would forfeit pensions and related benefits if convicted of a felony in carrying out official duties, seeking office or appointment, or obtaining salary and pension benefits.

OCTax analysis: well, duh.

8. Prohibit retroactive pension increases: all employees.

Governor Brown calls this “an irresponsible practice.” That was obvious to everyone who was awake when the Orange County Board of Supervisors (and their peers in other venues) granted the “3% at 50” retroactive pension to safety employees in 2001, and granted the “2.7% at 55” retroactive pension to general employees in 2005. The Governor adds: “Of course, neither employer nor employee pension contributions for those past years of work accounted for those increased benefits. As a result, billions of dollars in unfunded liabilities continue to plague the system” (and, OCTax adds, plague the taxpayers). The Supervisors said, “no one told us this wouldn’t work.” Wrong. OCTax told some of them privately about the cost of the giveaway in 2001, and warned them all in public session in 2005.

OCTax analysis: this is an absolute no-brainer. Pass it.

9. Prohibit pension holidays: all employees and employers.

In boom times, a pension system’s investment portfolio occasionally may exceed 100% of the actuarial requirement to pay future pensions. In such cases, the system may stop collecting pension payments from employers and employees. That’s a “pension holiday.” But when the market dives, so does the pension system. Governor Brown’s proposal would prohibit pension holidays. The Orange County Employees’ Retirement system (OCERS) has never granted a pension holiday, although in 2000 we accepted the proceeds of a county Pension Obligation Bond in lieu of the regular contribution to the fund.

OCTax analysis: this may not need to be a state law. The pension system’s board of directors should be credited with a little common sense and latitude. That said, it’s rarely a good idea for a pension system to take a pension holiday. The implied “excess” of funds is an invitation to agencies to scramble for more money for one program or another, like terriers yapping and jumping for a pork chop dangled over their heads. More importantly, there’s already a better mechanism to manage excess earnings: the pension system’s actuary will recommend that the excess be “smoothed” into the system over a period of five years or so, thereby dampening the possibility of dramatic investment gains or losses.

10. Prohibit purchases of service credit: all employees.

Many pension systems (not Orange County) allow employees to buy “airtime,” which is additional years of retirement for time not actually worked. The system thus acquires the full risk of delivering retirement income based on the airtime. That risk can be significant, and it is uncontrollable and unpredictable.

OCTax analysis: pass it. “Airtime” is a pension-padding racket.

11. Increase pension board independence and expertise.

The Orange County Board of Retirement consists of nine members: four are elected by the public employee unions, four (including me) are appointed by the Board of Supervisors, and one is *ex officio* (the County Treasurer). In addition, there is an alternate member, elected to represent the unions when one of the regular union representatives is absent. (Curiously, the appointed members, who most directly represent taxpayers, have no alternate.) Board members have varying levels of investment experience and knowledge. The Governor proposes to add two independent public members with

investment experience to the CalPERS Board, and recommends that other Boards (such as OCERS) make similar additions.

OCTax analysis: probably a good idea to have more experienced public members on boards of retirement, including OCERS, although OCTax also believes in the value of level-headed laypeople. “Experts” recruited to the Board will have biases and can make mistakes too; the investment record of high-priced big shots on Wall Street hasn’t been wonderful recently.

12. Reduce retiree health care costs: state employees.

The Governor’s plan would require more state service to become eligible for health care benefits at retirement. New employees would be required to work for 15 years to become eligible for the state to pay a portion of their retiree health care premiums. 25 years would be required to become eligible for the maximum state contribution to the premiums. The plan also would end the anomaly of retirees paying less for health care than current employees. Finally, rules requiring retirees to look to Medicare for health care services would be fully enforced.

OCTax analysis: good idea, although health care issues tend to become so convoluted with exceptions and deviations that’s it’s probably futile to predict the benefits to taxpayers.

Imponderables.

1. Is the Governor serious about this? Probably. He’s smart enough to know the trouble the state is in.
2. How much of this will be approved by the union-controlled Legislature? Probably not much. The Legislature may approve items 6, 7, 8, 9, and 10, if we’re lucky.
3. When will it be approved? The Legislature already has announced that it will take a full year just to study it. We don’t need a study; everyone already knows the facts. The Legislature may route it to the mysterious “never-ending-study-of-doom” file, hoping everyone will forget about it until all the current incumbents have moved on.

Whatever and whenever the outcome, OCTax thanks and congratulates the Governor for coming up with a fairly good plan. It’s the first indicator of progress since the problem mushroomed to huge proportions in 2001 and 2005.



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President, OCTax