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HEADLINE: Lawmaker seeks change to state public retirement plans

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BODY:
SACRAMENTO -- Alarmed by the spiraling cost of public pensions, a Southern California legislator plans to propose introducing 401[k]-style retirement plans for public employees in California.

The measure, proposed by Assembly man Keith Richman, R-Granada Hills, is certain to face stiff resistance from the state's powerful public employee unions, who feel the current pension system, called a defined-benefit plan, provides better benefits than Richman's defined-contribution plan.

"Public pensions have been and are a very good deal," Richman said. "They're such a good deal that they're bankrupting lots of our governmental entities. By moving to defined-contribution pension plans like private workers [have], governmental agencies can save money, increase their budgeting predictability and not incur any new unfunded liabilities."

The California Public Employees Retirement System, one of the largest single pools of investor money in the world, manages almost $168 billion in assets and pays out $6 billion in pension benefits every year.

But in recent years, the system has been a growing drag on the taxpayers, as it has dipped into the state general fund to make up for investment shortfalls in a weak market.

This year the liability is $2 billion, half of which is being financed through a bond to lessen the immediate impact on the general fund.

When the market was stronger the liability ranged from zero to a few hundred million dollars. But CALPERS officials say the number should decrease in coming years as the system's investment portfolio has rebounded.

A study by the state Legislative Analyst's Office as part of its budget analysis found that California's retirement benefits are far more generous than comparable states.

A California employee who earned $60,000 in salary and retires at age 65 would earn a pension of $46,500. A comparable retiree in Texas would earn less than $41,000, and less than $29,000 in Florida or Illinois. The study recommended the state explore a defined-contribution plan.

J.J. Jelincic, president of the California State Employees Association, said his group intends to fight Richman's effort. If the state wants more stability in the system, he said, it can achieve that by putting more aside in years when the market is strong to balance out the difficult years.

Under a defined-contribution plan, employers tend to put less money away for their employees' retirement. "So the employer is putting less money into your retirement and transferring all the risk to the employee and somehow that's supposed to be a benefit to the employee?" said Jelincic, a former investment officer with CALPERS.

He added that the CALPERS system benefits the state in other ways by, for example, being one of largest investors in single family housing in the state, an activity which is profitable while benefiting Californians and contributing to the tax base.

Richman intends to introduce a constitutional amendment when the Legislature convenes in December. The plan would be the only option for new public employees, while existing ones already in the CALPERS system would be given the option to switch or stay with the current system.

If lawmakers refuse to put it on the ballot, he said, he will start a signature-gathering effort. Richman is eyeing a run for state treasurer in 2006, a position which sits on the board of CALPERS.

The current pension system is called a defined benefit plan, one in which there is a formula determining how much an employee contributes and how much he or she receives based on a percentage of highest salary earned during his or her career.

The formula varies by employee type and employer, but the typical state formula involves employees putting away 5 percent or more of every paycheck and being able to retire at age 55 with 2 percent of their highest annual salary earned, times years of service.

So someone who worked for the state for 30 years and earned $50,000 in their best year would receive a pension of $30,000.

Public-safety employees get a far more generous package of 3 percent at age 50. The paycheck contributions are invested and the interest from that is supposed to cover the payouts. When it doesn't, the state must dip into the general fund.

Under a defined-benefit plan, like a private-sector 401[k], the employee's contributions and employer matches are set aside in a specific pot of money exclusive to that employee.

The employee decides how much to set aside and how to invest the funds. At retirement age the employee has access to a large pot of money that, hopefully, has grown over time with good investment decisions.

Taxpayers still contribute because of the employer match, but the amount does not fluctuate much over time.

Market fluctuations are borne by the employee, not the employer, meaning the employee has the chance to either make more or less than he or she would under a traditional pension plan.

Experts say that public pension plans tend to make better investment decisions than the average 401[k] holder because they are run by full-time investment professionals, while individual employees have a tendency on the whole to make more conservative investments.

Ron Snell, a pension expert with the National Conference of State Legislators, said several states, including Ohio, South Carolina and Florida, have started offering defined contribution plans in the last few years, but it is too soon to evaluate their effectiveness.

The plans give government agencies greater predictability in their long-term budgeting process, he said, as the employer contributions tend to be stable from year to year.

Nebraska is the only state that has offered a defined contribution plan over the long term -- at least 30 years -- and studies have found that employees generally did worse under such a plan than traditional pension plans in similar states. That was primarily because the employees were making more conservative investment decisions for themselves than the professional pension fund managers.

But other experts say the current system is in danger of bankrupting some government agencies, especially cities that have generous retirement deals for public-safety employees.

"If we continue in the current direction, the state and the local governments in California are going to be put

in financial extremis very quickly," said Steven Frates, a senior fellow at the Rose Institute of State and Local Government at Claremont McKenna College.

"That's because a greater and greater portion of the revenues will have to be allocated to providing retirement benefits to employees, which means there's less money for cops and teachers and all that kind of stuff."

He said he believes the problems in California are not a result of market fluctuations, but of politicians who have granted overly generous benefits to politically powerful public employee unions.

Frates said the system has essentially made millionaires of many public employees at retirement age. If someone in the private sector wanted to buy an annuity that would pay them 90 percent of their salary at age 55 for the rest of their life, it would cost at least $1 million, he said.

Gov. Arnold Schwarzenegger's administration has not yet evaluated Richman's plan, said spokesman H.D. Palmer. But the governor is implementing a pension reform this year that is expected to save the state $2.9 billion over 20 years.

The governor's plan calls for delaying the entrance of new employees in certain categories into the CALPERS system by two years. The governor is also planning to float a $1 billion bond to help cover the state's pension obligations this year, rather than take the hit to the general fund all at once.

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