Will Public Safety Survive Pension Reform?

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The Command College Futures Study Project is a FUTURES study of a particular emerging issue of relevance to law enforcement. Its purpose is NOT to predict the future; rather, to project a variety of possible scenarios useful for strategic planning in anticipation of the emerging landscape facing policing organizations.

This journal article was created using the futures forecasting process of Command College and its outcomes. Defining the future differs from analyzing the past, because it has not yet happened. In this article, methodologies have been used to discern useful alternatives to enhance the success of planners and leaders in their response to a range of possible future environments.

Managing the future means influencing it—creating, constraining and adapting to emerging trends and events in a way that optimizes the opportunities and minimizes the threats of relevance to the profession.

The views and conclusions expressed in the Command College Futures Project and journal article are those of the author, and are not necessarily those of the CA Commission on Peace Officer Standards and Training (POST).

Will Public Safety Survive Pension Reform?

What will the service level be in your community in ten years?

The generous California public employee pension system may soon be remembered as a relic of the "good old days" when revenues were high, projections were constantly moving upward, and where tax dollars flowed into benefits plans in increasing amounts each year. Changes to California's Public Employee's Retirement System (PERS) are coming, and there is little anyone can do to keep the status quo. The unknown consequences will be what the impact these reforms will have on police, fire, EMS and other public safety levels across the state. Will public safety agencies be able to recruit and retain the quality candidates to which communities have become accustomed? Or will police and other public safety agencies continue to cut costs, and thus services, to balance their budgets?

A new normal may be here.

The economic crash of 2008 and 2009 caught many individuals and organizations, both public and private, by surprise. MP Dunleavy, in an April 2010 MSN Money article, quoted a Freddie Mac statistic noting that homeowner equity withdrawals totaled $243 billion in 2005 as compared to just $11.2 billion in 1995 (Dunleavy, 2010). People were spending money, and often spending it by borrowing against their homes. With the current tightening of the credit markets, this is no longer possible or fiscally prudent. The economic picture has changed. Similarly, during good economic times, it was easy for local and state governments to match their spending to their anticipated revenues. There was rarely any serious talk about saving for a rainy day.

But now the housing bubble has burst, and the unemployment rate is higher than at any time in the previous two decades. According to Dan Paranick (Paranick, 2010), the City of Simi Valley CA currently forecasts an income level of $53 million. Adjusted for inflation, this income is comparable to 1999 levels except that expenses and employee salaries (including pension costs) have risen to over $60 million. The result is a deficit that must be closed with public safety service levels and pension obligations potentially on the chopping block.

How did we get here?

The public employee pension plans implemented in the late 1990's reflected the 300% rise in the stock market between 1990 and 1999 (StockCharts.com, 2010). The unemployment rate was low, and inflation and other economic indicators were thought to be in check. With these market increases, fortunes were made, especially in high-tech industries. And this prosperity was not just in the private sector. Many local municipalities were no longer required to make pension fund payments due to PERS being "superfunded" (Calpensions.com, 2009). A municipality's funding obligation to PERS is based upon the results of an annual actuarial study and is a percentage of total salary. In this case, since the financial returns that PERS experienced were so large, the amount owed by many participating agencies in many cases was zero for a few years (superfunding). Unfortunately, cities used those monies for budget obligations instead of, perhaps, saving for a rainy day.

It was this tremendous financial market growth (Goldmacher, 2007) that helped lead to the public employees unions to pressure their elected officials to provide more generous pension offerings (Mendel, 2009). Local councils and boards, seeking the support of these unions, sponsored Senate Bill 400 in 1999 authorizing the “3% at 50” pension plan for public safety (SB 400 Analysis, 1999). This was a significant benefit for the current and future employees. Under the 3 percent at 50 plan, a public safety employee could retire as early as 50 years old with as much as 90 percent of their highest year’s salary. In today’s economic climate, though, this plan and the cities employing those participating in the plan are under fire for the current and projected costs of the pension system.

The big lie

In truth, all was not as rosy as it seemed. In 1999, CALPERS projected the required pension fund contributions by local jurisdictions to be $379 million by 2008 to maintain solvency in the fund. Due to the decline of the financial markets and the pension plan investments, the funding obligation of plan participants in 2008 was $4.6 billion, 12 times the projected amount. This under valuation is causing a significant increase in funding obligations for the plan participants, and helping fuel the argument these obligations may not be sustainable into the future (Calpensions.com, 2010).

The effort to correct the problem

After the more generous retirement plans were put into place, the League of California Cities began discussing the need to reform California’s defined benefit retirement system. As far back as 2005, led by then Assemblyman Keith Richman, the League recommended a switch from a defined benefit plan to a defined contribution retirement plan (League of California Cities, 2010). They believed defined benefit structures were not sustainable into the future because a defined benefit plan places the risk of financial market losses onto the employer, not the employee, and any fund losses must be made up by the employer. To cover the current losses in equity, PERS estimates that local cities could see their premiums rise as much as 40% with the increases being phased in over the next three years (Calpensions.com, 2010). A number of cities across the state have already begun to discuss concessions with their labor unions, in order to avoid financial disaster. Some labor unions are reluctant to give up benefits that were negotiated for over the past few decades.

One problem that public safety unions will have to overcome to avoid the potential retirement plan cuts is the public sentiment that seems to be working against them. Illustrating that sentiment, Jack Welch, former CEO of General Electric, recently stated in a televised interview that, in years past, people entering the public sector did so to serve, with the understanding that their salaries were not as high as private sector salaries, but public service offered a generous retirement plan. However, now the salaries in the public sector are now competitive with the private sector and "the taxpayers are the ones serving the public sector employees" (Welch, 2010).

<u>What, then, should we do?</u>

Currently, many news programs are overflowing with discussions on how greedy the public employee unions are for not readily providing economic concessions on their pension benefits. For instance, Bill Handel recently said during his morning radio talk show on *KFI 640 AM* in Los Angeles, that "unions who enter negotiations thinking that the current contract is the basis for the next contract are not being realistic" (Handel, 2010). This public relations battle will have to be overcome as the economy continues to drive the long-term debate to sustain or modify public pensions.

Steve Greenhut, the Director of the Pacific Research Institute's California Watchdog Center, noted in a recent article that politicians, both running for office and leaving office, have shied away from any meaningful pension reform (Greenhut, March 22, 2010). He quotes current Governor Arnold Schwarzenegger as saying in reference to unfunded pension obligations that "we are about to get run over by a locomotive." Schwarzenegger has proposed pension reform in the past, but no changes have been implemented. On April 24, 2010, however, Jon Ortiz of the *Sacramento Bee,* reported that Senate Republican Leader Dennis Hollingsworth proposed a bill that would reduce statewide pension funding costs by an estimated $110 billion over the next 30 years (Ortiz, 2010). Still, the proposals under this bill do not affect the current government employees, only future hires, so any recognized cost savings are not immediate. A hearing on the matter was set for May 10, 2010.

<u>Is pension reform the only answer?</u>

As noted in Chart A, crime is lower today than it has been in decades. The argument that additional funding is needed to combat a rising crime rate always seemed convincing enough when funding and revenues were healthy. But with government coffers at all time lows, elected officials and taxpayers are looking much harder at these claims.

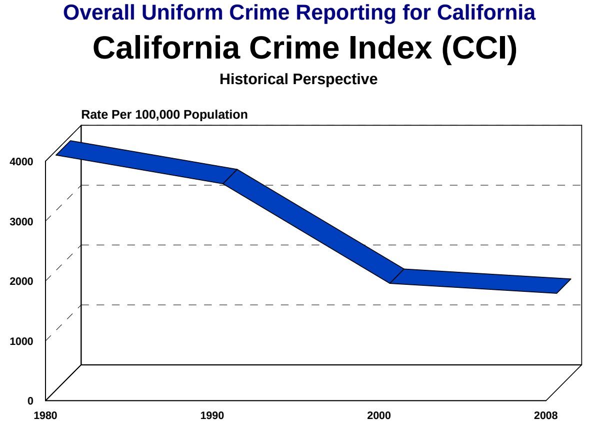

Chart A

Source: Population – California Department of Finance – Demographics Research Unit

Crime Data – California Department of Justice – Criminal Justice Statistics Center

With funding diminishing almost daily, public safety departments across the State of California have all found unique ways to cut expenses. Some have outright stopped providing previously accepted levels of service. For example, the city of Vallejo, California, declared bankruptcy in 2008. Its police department is now operating with only two-thirds of its pre-2008 staffing. Because of the reduced staffing, they now require many crime reports to be submitted directly from the victim to the Police Department via the Internet. For those citizens without internet access, a citizen volunteer will take the report over the telephone. No longer will a sworn police officer respond to the victim. Bill Powell, Support Services Manager for the Vallejo Police Department, stated they no longer respond to property crimes, even when a suspect is known. Periodically a citizen will complain to the Department Managers about the lack of responsiveness, but to no avail. The resources simply are no longer there to handle such calls for service.

In addition to service level cuts, many public safety agencies are now cutting their benefit offerings and staffing levels to balance their own budgets. The Simi Valley CA Police Department recently took a 3 percent permanent pay cut, and reduced their sworn staffing by 3 percent. The Ventura CA Police Department recently implemented a reduced benefit pension plan for newly hired employees. The Ventura County Sherriff's Department recently agreed to a concession on fully paid retirement benefits. In contrast, The Oxnard California Police Department recently entered into a multi-year contract with no concessions. Although the current situation in Vallejo, California, is not typical, the service levels of many of the state's law enforcement departments may have to be reduced out of economic necessity. Fixler (July 1988), asserted the privatization of police services can in some cases be done, although the changes may need to come gradually These changes may now need to become a reality faster if municipalities use this trend to save money.

Other cost savings measures may come in various forms. Departments can elect to consolidate services with other agencies, keeping the service in place. Other departments may elect to cut a certain service altogether and layoff the affected employee. In other cases, the use of Internet based crime reporting will likely grow, keeping a smaller number of sworn officers available for more critical problems.

What may actually happen?

The City of Vallejo may be one of the worst off financially, but they are not alone with this problem. City and state elected officials across the state are now routinely using the terms "sustainability" or "long term cost cutting." And the so-called "gold plated" "defined" contribution pension plans offered to public safety officers may be positioned squarely in their cross hairs.

Each public safety agency that subscribes to PERS may subscribe to a number of different plan offerings, some more generous to the employee than others. These differences provide agencies with a recruiting tool. When some cities begin to reduce their benefits under PERS and others do not, however, the result could be a shift in the local competitive model for recruitment. Recruitment of quality new employees could become a concern should the benefit packages continue to decline in value. As suggested in Heywood's study, public safety will have to remain competitive with the private sector to recruit qualified candidates for government jobs.

In the end, police departments across the state will likely get leaner, with pension reform and service reductions becoming part of the cost saving measures. Service levels will likely be reduced commensurate with the local economic problems the community is facing. Each department will have to find the level of service cuts that is politically acceptable for that community.

Economies rarely stay in a rally or a recession for long periods of time. The same may be true of the economic cycle of funding for public safety agencies. In the late 1990's, we were on top of the funding cycle and now find ourselves on the bottom of that same cycle. However, the upside will return as will some of the economically driven cuts currently being made, whether its generous pensions plans or service and staffing levels.

But the economic recovery may not happen very soon. In a May 19, 2010, Opinion in The Wall Street Journal, David Crane (Crane, 2010) stated that PERS projected investment returns in 1999 required the Dow Jones reach 25,000 by 2009. On May 19, 2010, the Dow Jones Industrial Average closed at 10,444, far short of PERS' projections. According to Crane, PERS may be currently underfunded by as much as $400 billion. With the State budget shortfalls, these large underfunded amounts cannot be made up in a short period of time.

Conclusion

In the years to come, public safety unions will likely recoup most of the local economic cutbacks they agreed to. The California Legislature will most likely enact new laws to create a two-tiered system for CALPERS to reduce costs and enable each participating department to remain competitive in the employment market. By handling this on a statewide basis, the need for local pension reform may be reduced. This will probably happen in 2011, after the upcoming elections and well before the next election cycle. Or, perhaps the long-term sustainability argument will follow the same path as the current argument that Social Security is going bankrupt. Today's participants may put the burden of correcting the problem on a future generation of employees and elected officials. Either way, politics will play the defining role for how this problem is handled.

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