SAN FRANCISCO BUSINESS TIMES

Will public pensions become a flashpoint in the scramble for tax hikes?

San Francisco City Hall could one day see a showdown between public employees' pay and benefits and the taxpayers that pay them.

By Mark Calvey – Senior Reporter, San Francisco Business Times - Aug 6, 2020

Public employees' pay and benefits are expected to become a growing source of controversy as San Francisco and other cities as well as the state of California wrestle with budget holes blown open by the Covid-19 pandemic.

Underfunded public pensions have been a growing concern for several years. But the pandemic-induced downturn and subsequent drop in government tax revenues is shining an increasingly harsh light on municipal and state finances and the power of public-employee unions to safeguard their members' pensions from budget-cutters.

“There has to be a limit on the influence of public labor unions, during times like this especially,” Jim Wunderman, CEO of the Bay Area Council, told me. “We can’t let them make the call on what’s best for the overall society because their interest is protecting the interest of public employees. That’s what they do.

“But the leadership in the community has to take a bigger look and balance interests,” Wunderman said. “At a time like this, being a public employee is a pretty good spot to be in.”

Public employment and the traditional pensions that often come with those jobs has been a pretty good spot to be in for some time. Many teachers, nurses, transit workers and other public employees continue to enjoy defined benefit pension plans, while those working in the private sector have mostly lost those types of pensions that provide a guaranteed monthly income that often moves higher with inflation. Today, most private sector workers depend on defined-contribution pension plans, such as 401(k) plans, which often means placing the security of one’s golden years on a rising stock market.

Wunderman expects more public attention on the pay and benefits public employees are receiving as taxpayers are asked to dig deeper in their pockets to pay higher taxes while struggling to hang on to their own jobs and save for retirement.

“If this goes forward like this, I have a strong sense that people are going to start looking very very hard at the nature of tax vs. public employee, public union, relationships," Wunderman said. “There’s a perception that public labor is not doing its part.

“I think if that were put to the voters’ test, I strongly believe that the public would weigh in on the side of fiscal control rather than continuing a system that really only benefits a small sector of society," he said. "Most people don’t have a guaranteed pension anymore.”

The burden of public pensions, many of them underfunded, is a growing concern among businesses and other taxpayers. Some view public employees’ pay and retirement benefits as a cost that cannot change while others disagree. The final determination might occur at the ballot box and the courthouse.

Just last week, a much anticipated ruling was made by the California Supreme Court that upheld a 2012 state pension reform provision that prevents so-called pension spiking, while leaving in place the California rule that sets a high bar for cutting back pension benefits for existing workers, Fitch Ratings said in a note this week. The ratings service defined spiking as the practice of allowing excess compensation to be earned by employees nearing retirement in order to inflate future benefits.

"Fitch views the court's affirmation of the anti-spiking provision as a positive step toward eventually achieving the savings envisioned by the state's comprehensive 2012 reform package," Fitch said. "However, most of these savings will be limited and take decades to emerge.

"In the meantime, retaining the California rule leaves governments in California with little discretion to manage their pensions, and underscores that near-term funding trends will be driven by more immediate factors, including asset performance, actuarial and economic assumptions and the ability of participating governments to continue making rising contributions," Fitch said.

Wunderman pointed to California Public Employees' Retirement System, the nation's largest public pension fund, and its goal of 7% annual returns on investments to meet its obligations. In the year ended June 30, CalPERS earned a 4.7% return. That could mean the fund will turn to cash-strapped cities and other public employers participating in CalPERS for additional funds.

"Where does that money come? It comes from two places, cutting services or raising taxes," said Wunderman, who proposes that the state issue Economic Recovery Bonds, which would raise money through short-term borrowing to close the budget holes created by Covid-19, without resorting to higher taxes.

"Why not borrow at today's very low interest rates to address what is a short-term problem?" Wunderman asked. Still, the financial strains at the local and state levels could have broader implications.

"People are going to focus on why have these budgets risen so much and what are we paying for?" Wunderman said. "If the government isn't willing to drive costs down, then the only way to do it is through the ballot box." Wunderman might be among the more vocal expressing concerns about public pensions, but he's far from alone.

Site-selection consultant John Boyd of The Boyd Co. told me that public-pension obligations are now getting extra attention in site-selection decisions.

"That's why a lot of lower-tax states with positive business climates have been so successful in increasing the number of corporate headquarters, because it's in line with fiscal prudence to be headquartered in a state that's not in a fiscal crisis."

Warren Buffett shares those concerns.

"If I were relocating into some state that had a huge unfunded pension plan, I'm walking into liabilities," the CEO of Berkshire Hathaway, Wells Fargo's largest shareholder, told CNBC last year. "Who knows whether they're gonna get it from the corporate income tax or my employees — you know, with personal income taxes or what. That liability — you can't ship it offshore or anything like that. And those are big numbers, really big numbers."