

TESTIMONY OF DAVE ELDER, BEFORE THE PUBLIC EMPLOYEE
POST-EMPLOYMENT BENEFITS COMMISSION

JULY 12, 2007

THANK YOU MR. CHAIRMAN AND MEMBERS OF THE GOVERNOR'S COMMISSION ON PUBLIC EMPLOYEE POST-EMPLOYMENT BENEFITS FOR ALLOWING ME TO SHARE MY THOUGHTS ON CALIFORNIA PUBLIC PENSIONS. BY WAY OF BACKGROUND, IT WAS MY HONOR TO SERVE AS CHAIRMAN OF THE STATE ASSEMBLY COMMITTEE ON PUBLIC EMPLOYEE'S RETIREMENT AND SOCIAL SECURITY FROM 1983 UNTIL 1992. DURING THAT 10-YEAR PERIOD, I WAS FORTUNATE TO AUTHOR SCORES OF PENSION MEASURES THAT REMAIN ON THE BOOKS. SOME OF THOSE BILLS DEALT WITH STOPPING SOME FORMS OF PENSION ABUSES BY REQUIRING ACTUARIAL VALUATIONS AND COSTS BEFORE PENSION BENEFIT INCREASES COULD BE GRANTED.

I ALSO CO-CHAIRLED THE ACR 62 TASK FORCE WHICH TACKLED THE UNFUNDED LIABILITY OF THE STATE TEACHERS' RETIREMENT SYSTEM (STRS). AFTER ANOTHER 8 YEARS OF WORK, GOVERNOR WILSON SIGNED THE DAVE ELDER FULL FUNDING ACT THAT I AUTHORED IN 1990.

YOUR EXCELLENT STAFF HAS SUGGESTED THAT I SPEAK ON THE HISTORY OF PUBLIC PENSIONS IN CALIFORNIA WITH THE AIM OF ADDING SOME PERSPECTIVE TO YOUR DELIBERATIONS.

SOME MIGHT SAY THAT THE FIRST PUBLIC PENSIONS IN CALIFORNIA STARTED BEFORE WE BECAME A STATE. BY REWARDING HIS GENERALS WITH LARGE TRACKS OF LAND, WHICH WE NOW KNOW AS OUR CALIFORNIA RANCHOS, THE KING OF SPAIN WAS ABLE TO PROVIDE HIS FAVORITE MILITARY OFFICERS WITH A MEANS OF SUPPORT AND AN INCENTIVE FOR LONG AND “LOYAL” SERVICE. TODAY PUBLIC EMPLOYEES ARE REWARDED FOR LONG AND “HONEST” SERVICE WITH AN ADEQUATE PENSION NOT EVEN CLOSE TO THAT THE KING OF SPAIN DOLED OUT OR WHAT THE FORMER CEO OF HOME DEPOT WAS PAID. WHILE NOT ON THE SCALE OF RANCHOS, I WOULD LIKE TO PUT IN A PLUG FOR MY DAVE ELDER CALPERS AND CALSTRS HOME LOAN PROGRAMS STARTED IN 1981 WHICH DO PROVIDE ADDITIONAL HOMEOWNERSHIP OPPORTUNITIES FOR ACTIVE AND RETIRED PUBLIC EMPLOYEES.

TAKING THE LONG VIEW ON PUBLIC PENSIONS SHOWS THAT BENEFIT FORMULAS HAVE BEEN DEPENDENT ON A NUMBER OF FACTORS. THE FIRST PENSION FOR PUBLIC EMPLOYEES IN THE UNITED STATES WAS FOR THE NEW YORK CITY POLICE DEPARTMENT IN THE 1850’S. THIS MODEL WAS REALLY A DISABILITY BENEFIT OF 50% AFTER 20 YEARS OF SERVICE. SO IF ONE QUALIFIED, YOU COULD GET A 50% BENEFIT AS EARLY AS AGE 41 OR SO. THIS FACTOR OF 2 1/2 % AT AGE 41 (ASSUMING ONE HAD TO BE 21 YEARS OLD TO BE A POLICE OFFICER) WAS HIGH BY TODAY’S STANDARDS BUT WAS REQUIRED BECAUSE SALARIES WERE SO LOW THAT ANYTHING LESS THAN 50% OF SALARY WOULD

NOT BE ENOUGH TO LIVE ON. ALSO, THE LIFE EXPECTANCY AT THAT TIME WAS ABOUT AGE 46 SO THERE WAS NOT MUCH IN THE WAY OF COST.

EARLY IN THE 20TH CENTURY, ANDREW CARNEGIE STARTED THE TEACHERS INSURANCE AND ANNUITY ASSOCIATION NOW KNOWN AS TIAA-CREF RETIREMENT PROGRAM FOR COLLEGE PROFESSORS SO THEY COULD RETIRE AFTER LONG TEACHING CAREERS. THE CALIFORNIA TEACHERS' RETIREMENT SYSTEM WAS STARTED IN 1913 AND REQUIRED A \$2.00 PER MONTH CONTRIBUTION FROM TEACHERS AND PROVIDED ONLY A \$500 ANNUAL BENEFIT.

IN 1931, CALPERS WAS STARTED AND, IF MEMORY SERVES ME, PROVIDED A BENEFIT OF ABOUT 1.3% PER YEAR AT AGE 65. IT IS INTERESTING THAT THIS BENEFIT WAS HIGHER THAN THE 1.25% BENEFIT FACTOR AT AGE 65 FOR THE STATE'S 2ND TIER STARTED IN 1984. OBVIOUSLY THESE FACTORS REFLECTED THE CHANGE IN REAL SALARY LEVELS AND THE FACT THAT SOCIAL SECURITY OR MEDICARE DID NOT EXIST IN 1931.

AN IMPORTANT FACTOR, WHILE NOT IN ANY INFORMATION THAT I HAVE REVIEWED, WAS THE ECONOMIC ENVIRONMENT THAT EXISTED IN 1931. THE GREAT DEPRESSION PRECIPITATED BY THE STOCK MARKET CRASH OF 1929 WAS PROBABLY AN IMPORTANT MOTIVATION IN PROVIDING SOME FORM OF

ECONOMIC SECURITY FOR RETIREES AND TO ENCOURAGE RETIREMENTS TO PROVIDE EMPLOYMENT FOR NEW YOUNGER WORKERS.

THE HUGE STOCK MARKET LOSSES OF 1929 ALSO CAUSED THE CALPERS ENABLING LEGISLATION TO LIMIT EQUITY HOLDING OR STOCKS TO 25% OF INVESTMENTS. THIS RESTRICTION WAS LIFTED IN THE EARLY 1980'S IN FAVOR OF THE PRUDENT PENSION RULE, WHICH ALLOWED CALPERS TO REAP HUGE RETURNS THAT HAVE PROPELLED CALPERS FROM A \$28.6 BILLION DOLLAR FUND TO ONE OF OVER \$240 BILLION TODAY AFTER LESS THAN 20 YEARS.

MY LEGISLATION IN THE LATE 1980'S REQUIRED THAT THE REAL ESTATE PORTFOLIO MUST BE APPRAISED ANNUALLY AND MARKET TO MARKET, RATHER THAN HELD AT BOOK VALUE WHICH HAD BEEN THE PREVIOUS PRACTICE. LAST YEAR THE REAL ESTATE PORTFOLIO AT CALPERS SHOWED A PHENOMENAL RETURN BUT WILL NOT REPEAT THAT LEVEL OF PERFORMANCE NEXT YEAR ACCORDING TO WILSHIRE, CALPERS EXCELLENT INVESTMENT ADVISER.

TAKING THE LONG VIEW EXPLAINS WHY THE CALPERS SYSTEM HAS EVOLVED TO BEHAVE AS IT HAS. I THINK IT IS SAFE TO SAY THAT BENEFITS HAVE BEEN ENHANCED ABOUT AS FAR AS POSSIBLE, BARING THE PROSPECT OF RUNAWAY INFLATION. WHAT REMAINS TO BE DONE IS TO FOCUS ON THE TOTAL COMPENSATION PACKAGE OF CALIFORNIA PUBLIC EMPLOYEES RATHER THAN

JUST THEIR PENSION BENEFIT SO THEY CAN BE COMPARED TO NON-PUBLIC EMPLOYEES.

IN THE PRIVATE SECTOR, WE DO NOT HAVE SWORN POLICE OFFICERS WITH THE AUTHORITY TO ARREST. THERE ARE VERY FEW FIREFIGHTERS IN THE PRIVATE SECTOR EXCEPT IN SPECIALIZED AREAS LIKE OIL REFINERIES. WE DO HAVE PROFESSIONAL TEACHERS OUTSIDE THE PUBLIC SCHOOL SYSTEM AND MOST NON TEACHING SCHOOL DISTRICT EMPLOYEES HAVE THEIR COUNTERPARTS IN THE PRIVATE SECTOR.

THERE ARE OTHER PROBLEMS WITH TRYING TO COMPARE COMPENSATION SUCH AS TURNOVER RATES. WE ARE AWARE OF THE TEACHER AND NURSING SHORTAGES THAT ARE VERY SERIOUS AND GETTING WORSE. PRIOR TO 1984, THE AVERAGE CAREER FOR A CORRECTIONAL OFFICER WAS 4 YEARS WHEREAS TODAY IT HAS INCREASED TO 14 YEARS. THE CURRENT SHORTAGE OF CORRECTIONAL OFFICERS EVEN WITH THEIR 1 YEAR OLD 3% AT 50 RETIREMENT FORMULA, IS 4,000 POSITIONS. DESPITE THE SAME 3% AT 50 RETIREMENT FORMULA FOR CORRECTIONAL OFFICERS AND HIGHWAY PATROL OFFICERS, THE 2007-08 CONTRIBUTION RATES ARE SUBSTANTIALLY DIFFERENT AT 25.5% FOR CORRECTIONAL OFFICERS VS 32.2% FOR HIGHWAY PATROL OFFICERS. THIS DIFFERENCE IS PARTIALLY EXPLAINED BY THE FACT THAT CORRECTIONAL OFFICERS NORMALLY START WORKING AT AGE 30.3 VS 26.3 FOR HIGHWAY PATROL OFFICERS. THE AVERAGE RETIREMENT BENEFIT FOR CORRECTIONAL

OFFICERS IN 2006 WAS \$47,639 AND \$62,360 FOR HIGHWAY PATROL OFFICERS, A DIFFERENCE OF \$14,721.

IF WE LOOK AT SOME OF THE REASONS DEFINED BENEFIT PUBLIC PENSIONS EXIST TODAY WE SEE THEY ARE ATTRIBUTABLE TO COMMON VALUES HELD BY MOST AMERICANS. I THINK THERE IS A SINCERE DESIRE BY THE PUBLIC TO RECOGNIZE AND REWARD THE WORK PUBLIC SAFETY OFFICERS INCLUDING OUR MILITARY, POLICE, FIRE, CORRECTIONAL OFFICERS AND OTHERS PERFORM TO HELP PROTECT OUR LIVES, PROPERTY AND WAY OF LIFE. THIS WAS PARTICULARLY TRUE FOLLOWING WORLD WAR II. ALSO THERE WAS A CONCERN DURING AND AFTER THE GREAT DEPRESSION TO PROVIDE SOME MEASURE OF ECONOMIC SECURITY TO OUR SENIOR CITIZENS SO THEY COULD RETIRE AND THEIR JOBS WOULD GO TO YOUNGER WORKERS RATHER THAN HAVE THEM LIVE WITH RELATIVES AS MY PATERNAL GRANDMOTHER DID. EVEN MORE CONCERNING WAS THE PROSPECT OF LIVING IN "OLD FOLKS HOMES" IF NO RELATIVES WERE AVAILABLE OR WILLING TO TAKE CARE OF THEM.

UNDOUBTEDLY, OF MORE IMPORTANCE TODAY IS THE TREMENDOUS VOTING BLOCK SENIORS HAVE BECOME WITH THEIR NETWORKING AND HIGH VOTER PARTICIPATION RATES. AS PEOPLE HAVE BEGUN TO LIVE LONGER, THEY PLAN AND EXPECT TO EVENTUALLY RETIRE SO THEY SEE THE NEED FOR PREDICTABLE INCOME WHEN THEY STOP WORKING. LASTLY, WHAT MAY BE

SEEN BY SOME AS GOVERNMENTAL PATERNALISM IN PROVIDING PENSION BENEFITS IS REALLY RECOGNITION THAT OTHERWISE THE COST OF CARING FOR A POTENTIALLY DESTITUTE AND GROWING AGED POPULATION WILL BECOME THE BURDEN OF GOVERNMENT AND THEREFORE FUTURE TAXPAYERS.

AN EXAMPLE OF WHAT WOULD HAPPEN TO A LARGE PORTION OF OUR SENIOR POPULATION COMES FROM JEREMY SEGAL IN ONE OF HIS RECENT BOOKS. PROFESSOR SEGAL STATES THAT IN ORDER TO HAVE A 95% CHANCE OF THE STOCKS EARNING MORE THAN A SAVINGS PASSBOOK YOU HAVE TO HAVE YOUR MONEY INVESTED FOR 19 YEARS. PUBLIC EMPLOYEE'S MONEY IS ALMOST NEVER INVESTED THAT LONG EVEN IN A 30 YEAR CAREER BECAUSE IT IS TYPICALLY DEPOSITED ON A MONTHLY BASIS AND NOT ALL AT ONCE. THE PROBLEM OF END PERIOD DOMINANCE MEANS SOME PEOPLE'S ASSETS WILL BE REDUCED DRAMATICALLY JUST AS THEY SEEK TO RETIRE. THIS IS KIND OF LIKE BUYING A LIFE INSURANCE POLICY FROM A COMPANY THAT ONLY PAID OFF 95% OF ITS DEATH CLAIMS. KEEP IN MIND THAT 5% OF CALIFORNIA'S POPULATION IS ALMOST 2 MILLION PEOPLE.

GETTING BACK TO THE CURRENT STRS FUNDING PROBLEM REQUIRES A LOOK AT MY BILL IN 1990. THAT MEASURE ORIGINALLY CALLED FOR THE STATE OF CALIFORNIA TO CONTRIBUTE 4.1 % OF TEACHER PAYROLL TO STRS EACH YEAR RATHER THAN THE \$500 MILLION PREVIOUSLY CONTRIBUTED WHICH WAS WELL SHORT OF WHAT WOULD PUT THE SYSTEM ON A SOUND FOOTING. GOVERNOR

WILSON ASKED THAT THE STATE NOT MAKE ANY CONTRIBUTION DURING THE FIRST YEAR FOLLOWING THE ENACTMENT OF MY MEASURE BECAUSE OF STATE BUDGET SHORTFALLS. THE GOVERNOR'S AMENDMENT WAS INCORPORATED INTO THE BILL BUT I INSISTED THAT THE STATE'S CONTRIBUTION RATE BE INCREASED FROM 4.1% TO 4.2% OF TEACHER PAYROLL IN ORDER TO PAY OFF THE UNFUNDED LIABILITY IN THE SAME PERIOD. THAT MEASURE ALSO CALLED FOR THE STATE TO INCREASE ITS CONTRIBUTION BY ANOTHER 1/4 % EACH YEAR IF 4.2% OF PAYROLL WAS INSUFFICIENT TO FULLY FUND THE SYSTEM.

SINCE THAT TIME TEACHER RETIREMENT BENEFITS HAVE BEEN INCREASED FROM 2% AT 60 TO 2.4% AT AGE 63 OR FOR MEMBERS WHO HAVE AT LEAST 30 YEARS OF SERVICE CREDIT NOT TO EXCEED 2.4% PER YEAR. ALSO FIXED DOLLAR INCREASES WERE GRANTED FOR TEACHERS WITH 30 TO 32 YEARS OF SERVICE RANGING FROM \$200 TO \$400 PER MONTH. AFTER THESE MODEST BENEFIT INCREASES BECAME LAW, THE STATE'S CONTRIBUTION WAS REDUCED FROM 4.2% TO ONLY 2.017% AND THE TEACHER MEMBER CONTRIBUTION TO STRS WAS REDUCED BY 2%, THROUGH THE YEAR 2010, WITH THAT MONEY PUT INTO A SEPARATE DEFINED BENEFIT SUPPLEMENT PROGRAM. IN SHORT, BENEFITS WERE INCREASED SLIGHTLY WHILE CONTRIBUTIONS WERE DRAMATICALLY REDUCED. THESE CHANGES WERE MADE POSSIBLE FROM SPECTACULAR STOCK MARKET PERFORMANCE WHICH ELIMINATED THE PRIOR UNFUNDED LIABILITY EARLIER THAN EXPECTED. THESE MARKET GAINS WERE SOON AFTER REVERSED AND THAT LEAD TO THE CURRENT UNDER-FUNDED

STATUS OF STRS. THE SOLUTION TO THE STRS FUNDING SHORTFALL CAN MOST EASILY BE ACHIEVED BY THREE RELATIVELY SIMPLE STEPS.

- FIRST, ALLOW THE 2% TEACHER EMPLOYEE CONTRIBUTION TO THE SEPARATE RETIREMENT ACCOUNT TO SUNSET AT THE END OF 2010 AND START PUTTING THAT 2% INTO THE STRS FUND WHERE IT WAS GOING BEFORE IT WAS DIVERTED TO THE SEPARATE ACCOUNT.
- SECOND, RETAIN THE STATE'S CURRENT CONTRIBUTION RATE TO AVOID ANY FUTURE LEGAL CHALLENGES.
- THIRD, START RAISING THE SCHOOL DISTRICTS EMPLOYEE CONTRIBUTION BY 1/4 % PER YEAR UNTIL THE FUND IS ACTUARIALLY SOUND. IF THE STRS FUND GETS INTO AN OVER-FUNDED STATUS THEN THE DISTRICTS RATES SHOULD BE REDUCED BY 1/4 % PER YEAR UNTIL THE OVER-FUNDING IS REDUCED TO A LEVEL THAT PRESERVES A PRUDENT RESERVE.

BY NO MEANS SHOULD TEACHER RETIREMENT BENEFITS BE REDUCED SINCE THE 2% AT 60 FORMULA THEY HAVE IS LOWER THAN THE OVERWHELMING MAJORITY OF CALIFORNIA PUBLIC AGENCIES. ALSO ANY SUGGESTION THAT

TEACHER MEMBER TOTAL CONTRIBUTIONS BE RAISED ABOVE THE CURRENT 8% LEVEL IS AN OBSCENE IDEA SINCE SCHOOL EMPLOYEES WHO ARE IN THE CALPERS SYSTEM CONTRIBUTE 7% FOR A 2% AT 55 FORMULA. IN OTHER WORDS, THE JANITORS, BUS DRIVERS, SCHOOL SECRETARIES, AND OTHER NON-TEACHING EMPLOYEES HAVE A BETTER PENSION THAN TEACHERS! NON-TEACHING SCHOOL DISTRICT EMPLOYEES ARE ALSO IN THE SOCIAL SECURITY SYSTEM. SCHOOL DISTRICTS IN CALIFORNIA ARE PAYING 9.306% OF PAYROLL TO CALPERS PLUS 7.65% FOR SOCIAL SECURITY AND MEDICARE FOR A TOTAL OF 16.956% FOR NON-TEACHING EMPLOYEES. SCHOOL DISTRICTS AND THE STATE OF CALIFORNIA ARE PAYING 8.25% AND 2.017% RESPECTIVELY TO CAL STRS PLUS 1.45% FOR MEDICARE FOR A TOTAL OF 11.717%. THEREFORE SCHOOL DISTRICTS ARE PAYING OVER 5% MORE IN PAYROLL COSTS FOR NON-TEACHERS THAN THE STATE AND SCHOOL DISTRICTS ARE PAYING FOR TEACHER RETIREMENT COSTS. A SIMPLE WAY FOR SCHOOL DISTRICTS TO PAY THE EXTRA STRS COSTS WOULD BE TO REQUIRE NEW HIRE NON TEACHING SCHOOL EMPLOYEES TO GO INTO A 2% AT 60 RETIREMENT FORMULA WHICH IN THE PAST RANGED FROM 3% TO 9% LOWER EMPLOYER CONTRIBUTION THAN THE CURRENT 2% AT 55 FORMULA.

ANOTHER APPROACH WHICH MAY BE MORE PALATABLE TO THE CALIFORNIA SCHOOL EMPLOYEES ASSOCIATION WOULD BE TO ALLOW NON TEACHING SCHOOL DISTRICT EMPLOYEES TO JOIN THE STATE TEACHERS RETIREMENT SYSTEM AND HAVE THE DISTRICTS PAY THE STATES 2% CONTRIBUTION TO

STRS. THE SAVINGS TO THE DISTRICTS THAT VOTED TO JOIN STRS WOULD BE ABOUT 3% OF PAYROLL WITH A 5% SAVINGS FOR SCHOOL DISTRICT NON TEACHING EMPLOYEES.

THESE ARE SOME OF MY OBSERVATIONS REGARDING CALIFORNIA'S PUBLIC PENSIONS AND A FEW OF MY RECOMMENDATIONS TO CURE THE UNFUNDED STATUS OF THE STATE TEACHER'S RETIREMENT SYSTEM. IT HAS BEEN MY PLEASURE TO SHARE MY THOUGHTS CONCERNING THIS IMPORTANT AREA OF PUBLIC POLICY. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS YOU HAVE CONCERNING MY PRESENTATION OR PUBLIC PENSIONS IN GENERAL.

THANK YOU.