Teacher Pension Workshop: Connecting Evidence-Based Research to Pension Reform

Pension Math: Public Pension Spending and Service Crowd Out in California

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Public Pension Spending and Service Crowd Out in California

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As We Progress This Morning, Keep This in Mind……

“It’s not even a matter of higher math…. It’s fifth-grade arithmetic.”
As We Progress This Evening, Keep This in Mind......

“It’s not even a matter of higher math.... It’s fifth-grade arithmetic.”

— California Governor Jerry Brown, Oct. 13, 2011
Our Focus Began as a Graduate Student Project in 2009-2010

Introductions
California's public employee retirement systems (CalPERS, CalSTERS, and UCRS) together administer the pensions of approximately 2.5 million Californians. Between June 2008 and June 2009, these three public pension funds lost a combined $100 billion in pension value (see Table 1). The ability of these three funds to meet their future obligations has significant implications for the fiscal health of the state and public employers, the effective underwriters of many public pensions.

In this policy brief, we ask two questions: (1) what is the current funding shortfall of CalPERS, CalSTERS, and UCRS, and (2) what policies would prevent a similar shortfall in the future? The data presented in this report are all from publicly available sources, primarily the quarterly and end-of-year published financial reports of each fund. In addition, we sought and received input from actuaries and pension advisors at Stanford University and other institutions to support our analysis and conclusions.

Measuring Today's Funding Status
Complying with Governmental Accounting Standards Board (GASB) requirements, public pension funds classify future pension liabilities at the same rate they expect to earn every year on invested assets.1 We believe this rule leads to understated publicly supported pension liabilities.

About the Authors
Howard Borenstein, Stan Markuzes, Cameron Percy, Usha Wang, and Mottitz Zander are graduate students at Stanford University's Stanford Institute for Economic Policy Research (SIEPR) and the Public Policy Program at Stanford. Howard Borenstein and Mottitz Zander are graduate students in Stanford's International Policy Studies Program. This graduate team prepared this report on California public employee pensions as part of the Public Policy Program's Public Policy Program at Stanford's International Policy Studies Program.

1. The California Public Employee Retirement System (CalPERS), California State Teachers' Retirement System (CalSTERS), and University of California Retirement System (UCRS).
“Going for Broke” Key Policy Recommendations

• Adopt probability-based funding targets
• At a minimum, funds should be 80% certain of covering at least 80% of liabilities, (an “80/80 strategy”)
• Make contributions at the Normal Rate without exception
• Amortize shortfall repayments over at most half the duration of liabilities
• Invest in less volatile asset classes (predominantly fixed income)
• Offer employees a hybrid system of both defined benefits and a 401(k) style system
Few “Going for Broke” Policy Recommendations Implemented

- Adopt probability-based funding targets
- At a minimum, funds should be 80% certain of covering at least 80% of liabilities, (an “80/80 strategy”)
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Pension Debt
California Public Employee Pension Systems

**Market Basis**
- Total Pension Debt: $992.4 billion
- Pension Debt Per Household: $76,884

**Actuarial Basis**
- Total Pension Debt: $247.6 billion
- Pension Debt Per Household: $19,183

http://pensiontracker.org
Pension Tracker Team

Day-to-day operations
• Olympia Nguyen
• Several student Research Assistants

Principal Investigators
• John Shoven, Economics Professor, former Director, SIEPR
• Greg Rosston, Public Policy Program Director

Technical support
• Jeremy Bulow, GSB Professor of Economics
• Bill Sharpe, GSB Professor of Finance (emeritus)
CalPERS, CalSTRS Actuarial Funded Ratios Relatively Unchanged Since 2009

CalPERS reflects PERF only; CalSTRS reflects DB only.
Source: Comprehensive Annual Financial Reports
“Market” Basis Shows CalSTRS Funded Ratio Under 40%
CalSTRS Unfunded Liability On Market Basis Nearly $400 Billion


Sources: CalSTRS, Pension Tracker
Related SIEPR Research and Outreach

- Case studies
  - CalPERS
  - CalSTRS
  - Independent systems
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Pension Math Crowd Out Report

• Geographic focus:
  - State of CA, three counties, six cities, three school districts, one special district

• Included employer pension costs from 2003-present and projected costs from present to 2030

• Analyzed budgets to estimate “crowd out” of traditional services
• Provides results on Actuarial and Market basis
  - Market basis discounted future obligations at 20-year Treasury rate
• Provided projected baseline and alternative scenarios
  - Baseline as stated by pension systems/funds
  - Alternative includes 2% lower rate of return
• Crowd out assessment relied heavily on changes in pension share of spending
Employer Contribution Rates Now Double Those in 2008-09

Employer Contribution Rates Generally Projected to Increase Through 2029-30

Employer Contribution Rates Generally Projected to Increase Through 2029-30

Exceptions

Employer Contributions On Average Five Times Higher Than in 2002-03

Employer Pension Contributions, 2002-03 to 2017-18

Average increase 400%

Employer Contributions On Average Five Times Higher Than in 2002-03

Example: Pacific Grove rose from $300,000 in 2002-03 to $4.4 million in 2017-18

Average increase 400%

Pensions Grew Much Faster Than Operating Expenditures

Employer Pension vs. Operating Expenditure Growth, 2002-03 to 2017-18

Pension Share of Operating Expenditures Generally Increase Thru 2029-30

Pension Share of Operating Expenditures Generally Increase Thru 2029-30

Employer Pension Share of Operating Expenditures: 2029-30 vs. 2017-18

Exceptions

School District CalSTRS Contribution Rates To Peak At 18.1% in FY 2021

CalSTRS School District Contribution Rates

Source: CalSTRS
School District CalSTRS Contribution Rates To Peak At 18.1% in FY 2021

CalSTRS School District Contribution Rates

Source: CalSTRS
CalSTRS State Rate Will Increase From 9.3% to 15.3% By FY 2030

CalSTRS School District and State Contribution Rates

CalSTRS State Rate Will Increase From 9.3% to 15.3% By FY 2030

CalSTRS School District and State Contribution Rates

State rate hits ~21% under alternative projection

CalPERS Schools Pool Rate Will Increase to 25% By 2024

CalPERS Schools Pool Employer Contribution Rates, 2018-2030

Source: CalSTRS
CalPERS Schools Pool Rate Hits 31% In Alternative Scenario

CalPERS Schools Pool Employer Contribution Rates, Baseline and Alternative Projections

School District Contributions Double or More by 2030

Projected Change In Total School District Contributions, 2018-2030

Traditional Services Crowded Out, 2003-2018

• **State**
  - Social services,* higher education

• **Counties**
  - Public assistance, welfare, public protection, health care

• **Cities**
  - “Soft” services, such as library, cultural, park, recreational
  - Some evidence of public safety crowd out

• **School districts**
  - Salaries, likely both total employees and salaries paid
  - Interview results show wide impact

*Includes services to the elderly, blind, disabled and other children and adults, and licensing and regulating foster homes, group homes, residential care facilities, day care facilities, and preschools
Policy Solutions

• Currently limited to agencies “paying more”
• Adoption of more “private-sector like” assumptions, methods
• Agency flexibility w.r.t. benefits
  - One-size fits all, currently determined statewide
• Governance
  - Increase board expertise
  - Eliminate governing board, administrative conflicts of interest
    - Example: board members, administrators often receive same benefits
Contact Information

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