STUDY GUIDE

PUBLIC PENSIONS: AN ECONOMIC TIME BOMB

KEY TERMS:

pension	liability	public sector
unions	bankruptcy	401K Plan

NOTE-TAKING COLUMN: *Complete this section during the video. Include definitions and key terms.*	**CUE COLUMN:** *Complete this section after the video.*
Why have major American companies taken steps to phase out pensions?	In what ways are public pensions detrimental to cities and states?
How many retired public employees are receiving pensions of over 100,000 dollars per year in California?	What can be done to avoid cities and states from suffering the consequences of public pension liabilities?
What claim do politicians often make in terms of being able to pay for generous pensions?	

DISCUSSION & REVIEW QUESTIONS:

- Towards the beginning of the video, Professor Rauh points out that, " ...pensions still live on in the public sector - among employees of the government - and they're eating city and states' budgets alive. More and more money that could go to tax cuts or better services is instead being shoveled aside to pay for these benefits. Why is this happening? Over decades, politicians have promised trillions of dollars in pensions to government workers. That includes police, firefighters, teachers, and city and state officials. You name a government job and there's a pension associated with it." Why do you think that pensions were originally created, instead of some other less costly benefit for employees? Explain. Why do you think that many state and local governments continue to offer pensions to public sector employees, even though the model of offering pensions has been proven to be so disastrous for other state and local governments? Explain.

- After providing some outrageously high examples of pension beneficiaries, Professor Rauh goes on to note that, "The system amounts to a self-perpetuating, corrupt merry-go-round. Public sector unions give large donations to candidates, who are then responsible for negotiating how much of your money goes to public sector workers. These arrangements not only promise high salaries in the short-term, but they also hide the payments that will be due down the road when it will be much too late." Do you think that the system of public employee unions funding politicians that then 'pay back' the unions with high pension jobs should be legal? Why or why not? Why do you think that people making such arrangements attempt to 'hide' the fact that the pensions will be so costly over time? Explain.

- Professor Rauh shares with us that, "State and local governments across the U.S. openly admit to 1.4 trillion dollars of unfunded pension liabilities, or 11,000 dollars per household. Unfunded means dollars that have been promised but there's no actual money in the bank. And that's just the amount they admit to. The real number, according to the Federal Reserve, is much larger – around 4 trillion dollars or 32,000 dollars per household. Pensions have already thrown California cities like San Bernardino and Vallejo into bankruptcy. And the entire state of Illinois is teetering on the edge." Why do you think that many state and local governments do not admit to the actual amount of debt that they suffer from due to having to fund public employee pensions? What might some of the primary and ancillary negative consequences be for cities and states that have to declare bankruptcy due to pension liabilities?

- Later in the video, Professor Rauh explains that politicians get away with justifying paying for public pensions they have promised because those politicians, "...lie by saying they can pay for more and more generous pensions — not by collecting more taxes, but by making investments at a guaranteed 7.5% return. But this is nonsense. It's less and less likely they'll meet their 7.5% goal over time, and their investment behavior, pouring ever more funds into ever-riskier investments, suggests they know it. But if they were to use a more realistic assessment, they'd need to raise taxes dramatically. And they love their jobs too much for that." Why will most politicians not be able to meet their promised investment goals? Why do you think that so many politicians are willing to make riskier and riskier investments with taxpayer's money? What do you think Professor Rauh means when he states that politicians 'love their jobs too much' to raise taxes? Explain.

- At the end of the video, Professor Rauh concludes by encouraging us to, "...end the current structure of public sector pensions, and move to a sustainable way of compensating our public workforce. Save your city. Save your state. Save your money." What might be some better, more 'sustainable,' means of compensating deserving public employees than with pensions? Explain.

EXTEND THE LEARNING:

CASE STUDY: Vallejo/ CalPERS

INSTRUCTIONS: Read the articles "Vallejo, Calif., Goes Bankrupt," and, "Two years after bankruptcy, California city again mired in pension debt," then answer the questions that follow.

- How many police stations does Vallejo have, and how often are they open? How often do burglaries occur? What distinction did Vallejo achieve in 2008? How many storefronts stand vacant in downtown Vallejo? What are the conditions for senior citizens like in Vallejo? Why didn't city leaders boost taxes? How many cities have filed for bankruptcy in America? How much did Vallejo's lawyers say that the city owed in unfunded pension liabilities? At the same time, how much had Vallejo's property and sales tax revenue dropped to? What has the city of Vallejo now gained a reputation as? How many of the city's nine firehouses have permanently closed? Why is Vallejo facing a budget crisis two years after filing bankruptcy? What are Wall Street and public pension funds having a titanic battle over? Who is Karol Denniston, and what did she have to say about municipal bankruptcy? What is CalPERS, and what is their argument in terms of their responsibility regarding pensions? What do Vallejo city leaders say is putting its post-bankruptcy budget under enormous strain? In the latest budget, what percentage of the general fund goes to CalPERS payments, and what explains the increase from before? Who is Marc Levinson, and what salient questions about pension plans and CalPERS does he ask in the article? Who is Dan Keen, and what does he plan to do about Vallejo's budget issues, especially in terms of city services?

- Why do you think that Vallejo opted to file for bankruptcy? Why do you think that reducing the pension liabilities was not part of the debt restructuring during bankruptcy? What do you think Vallejo can do to try to recover from the financial mess that it is in? Do you think that Vallejo will ever be able to fully recover? Why or why not?

- Towards the beginning of the video, Professor Rauh laments that almost no one is paying attention to the serious issue of public pension liabilities. Why do you think this is the case, especially considering how drastic and pervasive the consequences can be? Explain.

QUIZ

PUBLIC PENSIONS: AN ECONOMIC TIME BOMB

1. Major American companies have taken steps to phase out pensions because ____.

a. the taxes on them have become too complicated
b. older employees want other types of benefits instead
c. they are too expensive
d. European companies have mostly phased them out already

2. How many retired public employees are receiving pensions of over 100,000 dollars per year in California?

a. 32,000
b. 42,000
c. 52,000
d. 62,000

3. A retired New York City sanitation worker is getting $35,000 per year in pension payouts.

a. True
b. False

4. How much in unfunded liabilities do State and local governments across the U.S. openly admit to?

a. 1.4 trillion dollars, or 11,000 dollars per household.
b. 2.4 trillion dollars, or 21,000 dollars per household.
c. 3.4 trillion dollars, or 31,000 dollars per household.
d. 4.4 trillion dollars, or 41,000 dollars per household.

5. We can turn the odds of state and local governments going into bankruptcy due to public pension liabilities with ____.

a. public pressure
b. discipline
c. common sense
d. All of the above.

QUIZ - ANSWER KEY

PUBLIC PENSIONS:
AN ECONOMIC TIME BOMB

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https://www.reuters.com/article/us-usa-municipality-vallejo/two-years-after-bankruptcy-california-city-again-mired-in-pension-debt-idUSBRE9900Z720131001

Two years after bankruptcy, California city again mired in pension debt

Tim Reid

(Reuters) - Less than two years after exiting bankruptcy, the city of Vallejo, California, is again facing a budget crisis as soaring pension costs, which were left untouched in the bankruptcy reorganization, eat up an ever-growing share of tax revenues.

A man enters City Hall in Vallejo, California in this February 27, 2008 file photo. REUTERS/Robert Galbraith/Files

Vallejo's plight, so soon after bankruptcy, is an object lesson for three U.S. cities going through that process today - Detroit, Stockton and San Bernardino, California - because it shows the importance of dealing with pension obligations as part of a financial restructuring, experts say.

The Vallejo experience may be particularly relevant to Stockton, which is further along in its bankruptcy case than Detroit and San Bernardino and has signaled its intention to leave pension payments intact.

All three current bankruptcies are considered test cases in the titanic battle between Wall Street and public pension funds over whether municipal bondholders or current and retired employees should absorb most of the pain when a state or local government goes broke.

"Any municipal bankruptcy that doesn't restructure pension obligations is going to be a failure because pension obligations are the largest debt a city has," said Karol Denniston, a municipal bankruptcy attorney in San Francisco.

“A city like Vallejo can be reasonably managed but it is still going to be flooded out because it cannot be expected to keep up with its pension obligations.”

Calpers, the retirement system for California public employees, said it had “reached out” to Vallejo to discuss concerns. “Employers looking to cut costs have some options that can make benefits easier to manage in the near term, some of which Vallejo has already taken,” Calpers said in a statement. “We are pleased Vallejo has remained committed to delivering on the pension promises it made to its employees.”

Calpers is the largest pension system in the United States and serves many California cities and counties. It has long argued that it has a much wider responsibility than managing pensions for individual cities. It says state law mandates that it is the custodian of the entire fund, and as such is unable to renegotiate pension rates that cities have agreed to with their workers.

Vallejo, a port city of 115,000 near San Francisco that was staggered by the closure of a local naval base and the housing market meltdown, filed for Chapter 9 bankruptcy protection in 2008 with an $18 million deficit.

During its three-and-half year bankruptcy, the city slashed costs, including police and firefighter numbers, retiree health benefits, payments to bondholders and other city services.

The only major expense the city did not touch was its payments to the $260 billion California Public Employees Retirement System.

“We realized we did not have the time or the money to take on a giant behemoth like Calpers,” said Stephanie Gomes, Vallejo’s vice mayor.

Now city leaders say that growing, and unexpected, costs to Calpers are putting its post-bankruptcy budget under enormous strain. The city budget shows a deficit of $5.2 million for this fiscal year, and that is set to rise to $8.9 million next year unless significant cost savings can be found.

When Vallejo entered bankruptcy in 2008, its annual employer payments to Calpers were $8.82 million, or 11 percent of the city’s general fund, according to the city’s finance department.

When it exited bankruptcy at the beginning of 2011, the payments to Calpers were just over $11 million, or 14 percent of the fund. The latest budget pegs those payments at $15 million, or 18 percent of the general fund.

The increase comes largely from the recent decision by Calpers to lower its projected investment return rate, from 7.75 percent to 7.5 percent, and to change the way it calculates long-term pension maturity dates.

Those changes mean cities, state agencies and counties must pay rate increases of up to 50 percent over the next decade. Vallejo expects an increase in pension contribution rates of 33 to 42 percent over the next five years.

“Our five-year business plan was based on things we knew,” said Deborah Lauchner, the city’s finance director.

“Now we have to figure out a way to pay for these new Calpers rates. Every time we react to the last rate change they impose, they come up with another one. I understand they want to improve their funding status, but it’s on the backs of the cities.”

David Skeel, a bankruptcy law professor at the University of Pennsylvania Law School, said: “Vallejo made a conscious decision under enormous pressure not to mess with Calpers. That is a decision coming home to roost.”

Marc Levinson, of the law firm Orrick, Herrington & Sutcliffe, was the lead attorney for Vallejo in its bankruptcy and has the same role for Stockton. He says his clients would welcome pension reform in California, and he is the first to say that contributions to Calpers are a big problem for cities.

But, Levinson said, dealing with the issue is no simple matter.

“How does a city start a new pension plan when it can’t pay its bills?”, Levinson said. “How can a city break away from Calpers and still retain employees when other jurisdictions have a pension plan?”

Vallejo has met in full its annual payments to Calpers since exiting bankruptcy, and even accurately projected them.

“But just because a cost is projected does not make it sustainable,” said Lauchner, the finance manager.

Dan Keen, Vallejo’s city manager, said the only way for the city to meet growing pension costs is to get more concessions from city unions - contract negotiations are underway - and to cut services further.

Keen said options were to slow or freeze hiring and make other cost cuts, for example, at the city marina. But he added: “The reality is we don’t have anywhere else to cut.”

Gomes, the city’s vice mayor, said of Calpers: “It’s the biggest part of my city’s problem. I don’t know any city that can afford it.”

Editing by Jonathan Weber and Dan Grebler

https://www.aarp.org/politics-society/government-elections/info-04-2011/vallejo-ca-goes-bankrupt.html

Vallejo, Calif., Goes Bankrupt

Jobs and senior services are being cut to the bone

by Michael Zielenziger, From the AARP Bulletin Print Edition, May 1, 2011

Vallejo, Calif. At 11 a.m. on a Friday morning, you'd be hard-pressed to file a police report or meet with a detective in this sprawling blue-collar city of 120,000. The city's sole police station is closed to the public three days a week, and its three substations are permanently shuttered.

Drug sales are on the rise and so is prostitution on Sonoma Boulevard, one of the town's main drags. Burglaries are commonplace. Amid a rising tide of unemployment — 12 percent — and a surge of foreclosed homes, squatters have taken hold even in upscale areas.

"Vallejo is just going to pot," says lifelong resident Marti Thornton, 54. "It once felt like the town was getting itself together, but now things are really getting worse."

"People who used to eat at Taco Bell now are robbing Taco Bell," says Nancy, a 69-year-old resident who didn't want her last name published.

Situated at the mouth of the Napa River about 25 miles north of San Francisco, Vallejo holds a prominent place in California history. It was the first state capital in 1852, and for nearly 150 years was the site of one of the nation's most important naval shipyards.

In 2008, it achieved a new kind of distinction — the state's largest city to file for bankruptcy.

The plight of the tattered, ethnically diverse city, still dotted with Victorian homes from the 1850s, may presage the future for many financially strapped American cities: rising health care and pension costs colliding with eroding property and sales tax revenues in the aftermath of the recession and housing meltdown.

A woman sweeps the pavement of an abandoned car dealership, her home, in bankrupt Vallejo, California

Justin Maxon/RAZON

But if Vallejo serves as any lesson, it's that entering a Chapter 9 bankruptcy hardly offers a panacea.

On a recent midday, the busiest retailers in the faded downtown were establishments selling medical marijuana. Dozens of storefronts stood vacant.

"When you don't see streets paved, when you see crime soaring and squatters taking over foreclosed houses, something is wrong with this picture," says Bob Sampayan, 58, a retired Vallejo police officer. He now works with the Fight Back Partnership, a community group that organizes crime watch campaigns. Its operating hours, too, have been cut.

"Vallejo has always been the affordable American dream, but now that's all in jeopardy," Sampayan says. "We can't support the local theater group, the senior citizens center or the community arts group. All the things that help make up a community are not being supported."

The city used to provide about $80,000 each year to support the Florence Douglas Senior Center, director Vicki Conrad says. She's now trying to plug the hole in the budget with private contributions and grants. Staff and operating hours have been cut, but demand for hot lunches has risen nearly 10 percent, and the center's thrift shop is busy.

"It's harder for seniors to get the resources they need," says Conrad, 72. As gas and food prices rise, homelessness among seniors is headed up, she says. And with the police cutbacks, "people are afraid to go out at night."

The Mare Island Naval Shipyard, which built ships and submarines in World War II, was for decades the city's economic engine. In its heyday, the base employed 46,000 people, who spent their wages in local stores and restaurants. The rolls of city employees expanded.

The shipyard was closed in 1996, but the housing boom in the 2000s helped keep the local economy going. On the Vallejo highlands along Interstate 80, which connects Sacramento with San Francisco, acres of gleaming new subdivisions went up. Gays gentrified an area closer to downtown.

But then the recession and the housing crisis hit. Though parts of Vallejo retained an all-American allure, in others the picture turned gloomy. Construction stopped, Walmart left town, property tax revenues took a dive. With expensive labor contracts to fund, Vallejo found itself with a budget that didn't add up.

City leaders couldn't summon the political will to boost taxes in the middle of a slowdown. And when the gaps proved too big to close with conventional steps, Vallejo opted for the radical: In May 2008 it filed for protection in U.S. bankruptcy court.

Municipal bankruptcy remains quite rare across America. In the more than 60 years since Congress established a federal mechanism for the resolution of excessive municipal debts, only about 600 cities have filed for protection from their creditors.

Vallejo officials entered a protracted court battle with unions in an ultimately successful battle to reduce city workers' wages. The city burned through more than $8.3 million in payments to lawyers, court records show. The bad news has continued. In a court filing in January, Vallejo's lawyers noted that the city's unfunded pension liabilities totaled $195 million while overall revenues from property and sales taxes had dropped from $83 million to $65 million since 2008.

The city has outlined a five-year recovery plan. It has agreed not to disrupt pensions for former city employees but has cut payments for accrued sick leave or unused vacation time.

Jobs and services are being cut to the bone. With only a handful of police officers now working the street, Vallejo has gained a reputation as a good place for criminals to set up shop, some residents say.

In light of lengthy legal battles and the economic collapse, employees should have seen the writing on the wall, says fire chief Doug Robertson, 51. "We were overblown. Salaries, benefits, the whole thing." His department, which once had 122 members, now has 65. Three of nine firehouses have been permanently closed. Firefighters took a 25 percent pay cut and must do more work with fewer resources.

As a police siren wails in a downtown neighborhood on a recent day, credit union employee Alain Norris, 37, says that given the economic collapse around him, he's been lucky just to have a job. But for now, he says, "really, the only thing I like about this place is the weather."

Michael Zielenziger writes on business and the economy. He lives in the San Francisco Bay area.