PACIFIC RESEARCH INSTITUTE

PRI Releases New Study on California Pension Crisis

January 12, 2015 – The Pacific Research Institute, a non-profit, non-partisan think tank based in San Francisco, today released a new study on California's pension crisis. "California's Pension Crowd-Out," authored by PRI senior fellow Wayne Winegarden, Ph.D., is part of PRI's California Prosperity Agenda, a 12-point plan to address California's most pressing problems. "Pension Crowd-Out" reveals the flaws with the state's current public pension systems; analyzes the severe budgetary impact on government services and the burden on California taxpayers; and provides potential reforms that could lessen the impeding adverse economic consequences.

"For years, the state government has consistently under contributed to the pension fund while overpromising benefits. The result is a critical underfunding problem further exacerbated by rising pension costs," said, Dr. Winegarden. In California pension costs grew twice as fast as tax revenues during the last decade, exerting upward pressure on the state's tax burden -- the fourth highest in the country according to the Tax Foundation. The excessive growth in pension payments is also crowding out spending on other government priorities.

The unfunded liabilities of California's defined benefit public pension plans are around $170 billion or 125 percent of total state tax revenues, or 7 percent of total state GDP, as of 2014. If risk is taken into account, California's estimated unfunded pension liabilities increase to between $300 billion and $600 billion, equivalent of between 13 percent and 28 percent of total California GDP in 2014. Given the excessively large public pension debt burden, the current policy that public pension promises, once made, are inviable impose severe economic costs on California for years to come. According to Dr. Winegarden,

- Covering the debt burden exclusively through tax increases would require the largest tax increase in California's history – an annual $28.3 billion over the next 30 years
- The necessary increase in the state and local tax burden to fully fund the state's current pension system will cause California's economy to be 21 percent smaller over the next 30 years compared to its current economic growth path due to the adverse impacts on economic growth
- If the state chooses not to raise taxes, it would need to cut total state and local tax spending by more than 8 percent across the board. Such an expenditure reduction would, among many other spending cuts, entail a $5.4 billion cut in the school

budget, a $4.9 billion cut in spending on income support programs, a $2.9 billion cut in the higher education budget, and a $1.9 billion cut to California's hospital systems (all compared to the 2012 state and local expenditures as reported by the U.S. Census).

"The vitality of California will be significantly dimmed in order to maintain current pension promises and will drive the state into insolvency. It is way past the time to reform California's state and local defined benefit pension system," said Dr. Winegarden. In the study, he makes the following recommendations to reform California's pension systems:

- Repeal the California Rule which traps taxpayers in an unaffordable pension system and ensures unequal treatment across different types of long-term contracts.
- Implement a freeze across all defined benefit programs and offer employees a choice of receiving a payment equal to the present value of their benefits or stay in a reformed defined benefit program that would include, among other adjustments, appropriate policies to accommodate market risk.
- Establish for all employees' (new and current) a defined contribution plan that meets the standards for a large firm.

"Comprehensive pension reforms would help California avert many of the adverse economic consequences while at the same time provide public sector workers with a comfortable retirement that is aligned with the private sector. Given the value of state pension assets, and the benefits from implementing a defined contribution system, California has the opportunity to significantly reduce the adverse economic and financial consequences from its current crisis." Dr. Winegarden said.

"California's Pension Crowd-Out" by Wayne Winegarden, Ph.D. is available at www.pacificresearch.org. To arrange an interview with him, contact PRI's press office at 415-955-6110 or email Laura Dannerbeck at ldannerbeck@pacificresearch.org or Rowena Itchon at ritchon@pacificresearch.org.