OPINIONS

Stock market soars — and so do public pension costs

BY *DAVID CRANE* POSTED 05.26.2015

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The way our government accounts for public employee pension promises is nothing short of fraud, yet no public official has gone to jail or paid a price for what surely ranks among the largest muggings of citizens in US history. Let me explain.

As the stock market reaches record levels, little is heard anymore from public officials who used to blame market declines for rising pension costs. A few years ago, the CEO of the California State Teachers Retirement System (CalSTRS) attributed his pension fund's deficit to the 2008-09 market decline. Yet despite a stock market that now stands 2.5 times above its 2009 low, CalSTRS's shortfall is so large that to help address the deficit, California recently enacted legislation that will divert at least $170 billion from classrooms over the next 30 years. That means current and future schoolchildren are paying off past pension promises.

> *Why do pension costs climb even when markets rise? The answer is captured by an aphorism: "Live by the sword, die by the sword."*

Despite the bull market, the state's other big pension fund, the California Public Employee Retirement System (CalPERS), recently imposed a 50% increase in pension costs on local and state governments, and there will be more. The diversion of government revenues to pension costs explains in part why, despite record revenues higher than before the Great Recession, state spending on social services, courts, parks, universities and other programs is lower.

Why do pension costs climb even when markets rise? The answer is captured by an aphorism: "Live by the sword, die by the sword." The sword in this case is financial accounting for public pension plans. Believe it or not, US public pension fund officials get to choose how to account for public pension promises. They could choose an honest path but not surprisingly, California officials select an approach that – initially – artificially suppresses the reported size of liabilities created by pension promises. That allows them to claim that the future costs created by the promises will be smaller than they really will be. But eventually that choice cuts the other way. In fact, the more that liabilities were suppressed by aggressive accounting in the past, the greater the rebound effect in the future. The truth can no longer be hidden and public pension liabilities gallop at a fast pace. At that point not even a bull market can keep up.

One of the most expensive examples of that behavior took place in 1999 when California's leaders gave a massive pension boost to government employees. Though that act amounted to the single greatest issuance of debt in state history, public officials chose an accounting method that supported a claim that the retroactive increases wouldn't "cost a dime." They were right. Instead, the boost cost 800 billion dimes, and counting. Worse, those dimes are being extracted from schoolchildren, college students, young teachers, welfare recipients, park users, fee-payers, taxpayers and other Californians who are paying more but getting less. To add insult to injury, citizens weren't even given the choice of approving the pension boost. That's because, unlike general obligation bonds that require voter approval, under current law politicians can make retirement promises without voter consent. Obscured by shady accounting, protected from voter review, and fueled by political contributions from interested parties, that's how hundreds of billions of dollars of pension costs get loaded on to innocent citizens without their knowledge or consent. Only now are the full costs starting to show up. When that happens, citizens get angry with the public employees who receive the pensions. But those recipients did nothing wrong. They are not responsible for accounting choices by pension fund board members and officials.

The dollars diverted from services and the taxes raised on taxpayers to pay off the 1999 pension boost will never be recovered. At least AIG paid back its 2008 bailout. But there'll be no payback from this theft. Worse, California officials are still choosing accounting methods that hide the true cost of new pension promises. That means more theft is taking place every day.

Our public officials have a choice. They don't have to obscure financial truths. They should choose to protect innocent citizens. If they don't, they should pay a price.

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Ed's Note: David Crane is a lecturer and research scholar at Stanford University and president of Govern For California.

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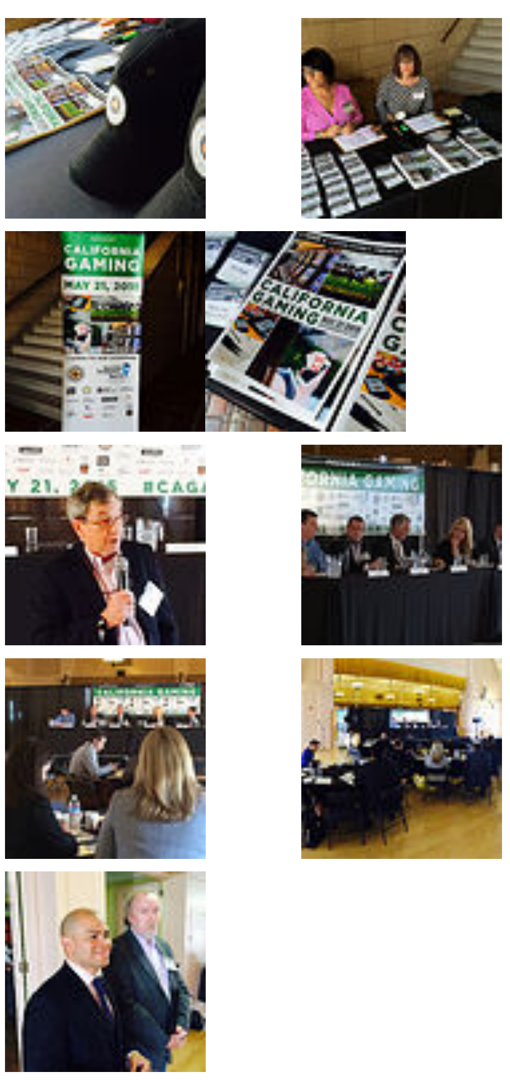

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