GOOD JOBS FIRST

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PUTTING STATE PENSION COSTS IN CONTEXT:

CALIFORNIA

PUBLIC PENSION COST HAS BEEN A subject of controversy in California in recent years. In 2012 the state enacted changes to the pension system that capped benefits, increased the number of years of work required to receive full benefits and toughened funding practices. In April 2013 the board of the giant CalPERS pension fund voted to change a key accounting policy that will raise the contribution rates for government agencies. And recently, the mayor of San Jose has been leading a campaign to put a measure on next year's ballot that would enable agencies to cut back pension benefits for existing employees.

While many numbers are bandied about, the central issue is how much of an obligation is being taken on each year to provide benefits for current government employees such as teachers and first responders. The best way to measure this is to use an amount known as employer normal cost. Such costs can be found in the annual financial reports that each public pension plan has to produce. In the case of California, there are two main plans administered by the state: CalPERS (California Public Employees' Retirement System) and CalSTRS (California State Teachers' Retirement System). The most recent financial reports indicate annual employer normal costs of $4.4 billion for CalPERS and $2.4 billion for CalSTRS, or a total of $6.8 billion. [1]

How should this amount be viewed? One approach is to compare it to the financial costs incurred by the state in supporting business through economic development subsidies and other special tax provisions. While not providing an assessment of the effectiveness of any particular subsidy or provision at achieving targeted policy objectives, such as creating family-wage jobs, this approach does provide an important perspective on public sector pensions.

The state's primary economic development subsidy, the enterprise zone program, is being reformed to ensure that the program promotes the creation of good jobs and has been cut back, but in FY2013 it cost the state an estimated $850 million.[2] A new California Competes Credit will cost the state some $200 million a year by FY2016.[3]

California provides other lucrative tax breaks for business.[4] The most expensive is the research & development tax credit, which in FY2013 cost $2.2 billion. The water's edge election, which allows unitary multinational corporations the option of computing the income attributable to the state using a domestic rather than a global combined report, cost $950 million. The lower tax rate paid by Subchapter S corporations cost $230 million. Accelerated depreciation of research and experimental costs resulted in a revenue reduction of $130 million.

California has been one of the states that allowed corporations to apportion their taxable income by methods other than the traditional three-factor (payroll, property and sales) weighting. Those companies using the double-weighted sales factor cost the state $160 million, and those opting for single sales factor cost California $850 million. In coming years these amounts will decline sharply, thanks to the 2012 passage of Prop. 39, which restricted the practice.

Another major form of corporate tax avoidance that eats into state revenues is the use of offshore tax havens. In January 2013, the U.S. PIRG Education Fund published a report in which it calculated the impact on this practice on each state. For California, the estimated annual cost is $4.2 billion.[5]

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to more than $9 billion per year, as summarized in the table below.

In other words, the annual taxpayer cost of funding the retirement benefits of current California public employees belonging to the two main state administered public pension systems is only 70 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.

Enterprise Zones and Similar areas	$850,000,000
Film and TV Production Tax Credit	$120,000,000
Research and Development Tax Credit	$2,200,000,000
Water's edge election	$950,000,000
Subchapter S corporations	$230,000,000
Accelerated depreciation of research and experimental costs	$130,000,000
Double weighted sales factor	$160,000,000
Single Sales Factor election	$850,000,000
Revenue loss from corporate use of offshore tax havens	$4,211,000,000
TOTAL	**$9,701,000,000**

NOTES:

1 The CalPERS figure is taken from the Comprehensive Annual Financial Report for the year ended June 30, 2012 at http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/comprehensive-annual-financial.xml (the employer normal cost percentage on page 65 multiplied by the payroll figure on page 70). The CalSTRS figure is taken from total normal cost figure on page 15 of the plan's Defined Benefit Actuarial Valuation as of June 30, 2012 at http://www.calstrs.com/sites/main/files/file-attachments/2012_db_valuation.pdf minus the employee contribution figure on page 27 of the Comprehensive Annual Financial Report for the year ended June 30, 2012 at http://www.calstrs.com/comprehensive-annual-financial-report.

2 http://www.dof.ca.gov/research/economic-financial/documents/Tax_ExpenditureRpt_13-14.pdf

3 http://www.business.ca.gov/Portals/0/AdditionalResources/Reports/California%20Competes.FAQ.3.0.pdf

4 All the figures in this paragraph and the next come from: http://www.dof.ca.gov/research/economic-financial/documents/Tax_ExpenditureRpt_13-14.pdf

5 U.S. PIRG Education Fund, *The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure from Tax Loophole Abuse* (January 2013); http://uspirg.org/reports/usp/hidden-cost-offshore-tax-havens