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How Unions Are Bankrupting California

by Steven Greenhut

If you asked any southern Californian about the biggest union-related news story in recent years, the likely answer would be this year's four-month-long labor dispute between cashiers (and other workers) and three of the region's largest supermarket chains.

The strike/lockout was widely covered for some obvious reasons. It disrupted most people's lives. Store hours at almost all major grocery stores were curtailed; food selection was limited; and shoppers who continued to frequent Ralphs, Vons, or Albertsons stores were forced to cross picket lines manned by increasingly surly workers.

Shouting matches and occasional scuffles between strikers and customers made for good copy. So did revelations that leaders of the strike earned roughly $300,000 a year and that the main sticking point in the contract was a proposal that employees pay between $5 and $15 a week to help fund their generous health-care benefits, a surprisingly paltry amount in an age when most people contribute something to their health plans.

State Attorney General Bill Lockyer kept the matter on the front page after he stood arm-in-arm with the picketers one day, then filed a lawsuit against the store owners the next, accusing them of unfair collusion in their profit-sharing agreement. Other politicians couldn't keep their mugs away from the TV cameras. They rushed in to show solidarity with the union members. This was, indeed, big news.

Yet during that time, and in the few years preceding the strike, the state's media were disturbingly mum about a far more significant labor matter that soon enough would be threatening the wallets of California taxpayers. Quite simply, under the administration of Governor Gray Davis, who was booted from office by Arnold Schwarzenegger during last year's historic recall election, the government had been giving government-employee unions almost everything they asked for. In particular, the governor and the legislature were making outrageous pension promises, with little criticism or exposure by the so-called media watchdogs.

This really was the biggest labor story of recent years, and it touched on the perils of unionization, of government employees in particular.

Ludwig von Mises made the argument against unionization succinctly when he wrote in *Christian Economics* in 1964:

> What is today euphemistically called the right to strike is in fact the right of striking workers, by recourse to violence, to prevent people who want to work from working. This means that the authorities have surrendered to the unions an essential attribute of their governmental func-

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> tions. . . . The statesmen and politicians who step by step . . . granted this quite exceptional, tremendous privilege to the unions were guided by the belief that raising wage rates above the height the unhampered market would have fixed them is beneficial to all those who want to make a living by earning wages.
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> If a union succeeds in forcing the employers to pay higher wage rates than those they were prepared to pay under the prevailing state of market conditions, this is not a victory for "labor," i.e., for all those who are anxious to earn wages. It is a boon only for those workers who will be employed at the new rates. It is a calamity for all those whom it condemns to lasting unemployment.

In the private sector, businesses that foolishly cave in to union pressure and intimidation often find themselves scaling back and sometimes going out of business. The Rust Belt is littered with companies that locked themselves into excessively generous salary and benefit packages, only to find that their businesses were incapable of competing in the marketplace. Because of over-generous pensions, American companies found themselves more than $200 billion in the hole after the recent recession, according to published reports.

Market Reality Check

In the marketplace the bottom line offers a check on bad decision-making. Promise too much, and company profits will tank. Pensions and salaries will have to be reined in if the company is to remain profitable or at least stay in business. But in the government sector the problems of unionization are magnified because there is no bottom line. Politicians have every reason to grant benefits to their political allies.

What happens when the government sector over-promises and the bill comes due? Californians are learning that lesson right now. Taxpayers, of course, are going to be the ones on the hook. Given the degree to which California politicians are politically beholden to powerful government-sector union lobbies, it's unclear whether anyone will stop the hemorrhaging.

In 1999, at the urging of Davis, the legislature passed a bill that allows governments to give public-safety employees—police, firefighters, prison guards, sheriffs' deputies—a "3 percent at 50" pension plan. At age 50, employees could receive 3 percent of their salaries for every year worked, with a top payment of 90 percent of total final salary.

The legislation, which passed with wide bipartisan support but was pushed mainly by the Democratic majority, created an instant 50-percent annual increase in retirement benefits for union workers in localities that approved the pension spike. Before the change, public-safety officials were allowed a "2 percent at 50" plan, which granted top retirement benefits of 60 percent of final salary.

Supporters of the law still argue that it didn't mandate any benefits, but simply gave localities the power to offer added pensions if they could afford them. In reality, once the California Highway Patrol received 3 percent at 50, the floodgates opened. Every police and fire-fighting agency argued that it had to offer similar goodies lest they be unable to attract qualified applicants. That was nonsense; the line for police and especially for firefighting jobs typically goes around the block whenever these highly paid jobs are available in California. But never mind any logic; this was a union power play.

Even though the benefits have spread across the state like a wildfire, and the bill is starting to come due, few politicians are willing to confront the retirement-benefit bonanza.

One of the few warning voices is Orange County Treasurer John Moorlach. He has impressive credentials. In 1994 Moorlach predicted the largest municipal bankruptcy in U.S. history. He saw the trouble signs and provided a detailed analysis to the media, which ignored him.

Moorlach was right. And he is right again, as he predicts statewide budget collapses as the result of the retirement bonanza granted in the midst of the dot-com boom, when

politicians and union officials argued that the pension spikes would not cost taxpayers anything. Well, they didn't cost the taxpayers anything as long as the stock market performed at record-setting levels.

Taxpayers on the Hook

There are two types of retirement plans: defined contribution and defined benefit. Most private-sector employees have the defined contribution variety—a percentage of wages is invested in a set fund. The company is obligated only to provide a set amount of money. If the investment soars, the retiree does well; if it doesn't, the retiree does less well. The company's liability is limited.

Government employees get a defined-benefit plan, which guarantees a rate of return. The formula is: contributions plus investment income minus expenses. If the amount of guaranteed benefits explodes and the investment income doesn't keep up, the employer must make up the difference.

The employer, in the case of public-safety employees, is the taxpayer. Many government employees, such as prison guards and state police, work directly for the state. That means hundreds of millions of dollars of additional costs imposed on an already strapped general fund. Most others, such as local police, county sheriffs, and firefighters, work for municipalities. So these negotiated benefits are sending some cities to the brink of insolvency.

An *Orange County Register* article from February 14, 2003, captured the gist of what was then just starting to happen: "California cities and counties are bracing themselves for the fiscal equivalent of a perfect storm—a combination of the erosion of millions of dollars from their budgets and a deluge of increases in payments to their police officers' and firefighters' pensions." The article quotes city officials in Orange County complaining about devastating increases, such as a 384 percent increase in pension payments in one year in the city of Orange alone. The retirement spike is costing Orange County $400 million, amortized over 30 years. That's one-quarter of what the 1994 bankruptcy cost the county, Moorlach fumes. And this enormous amount is only in one county.

Here's the news from the April 2, 2004, *San Diego Union Tribune*: "San Diego County's pension deficit is larger than originally reported and could require contributions of more than $300 million a year if investment returns do not offset losses, the fund's actuary, Paul Angelo said yesterday. . . . Board members pointed out that throughout California, many pension funds are not currently 100 percent funded because of stock market losses."

Is it because of stock market losses, or because government officials, pandering to a politically powerful interest group, made over-generous promises?

Here's another story from the April 2 *Union Tribune*: "State payments into a giant pension fund that gives 470,000 active and retired state workers some of the best benefits in the nation have soared in the past three years, adding to the state's budget crisis. In a classic case of bad timing, the annual payments the state is required to make to the nation's largest pension fund made a remarkable 18-fold increase as the state struggled with multibillion-dollar budget shortfalls."

Again, is it really bad timing? Or perhaps the same philosophy that got the state into its enormous budget hole also got it into its enormous pension hole. A *Los Angeles Daily News* article from April 4 gets closer to the heart of the problem: "Thousands of retired public employees in California are getting $100,000-plus pensions, and the number will soar in coming years, squeezing government budgets and forcing cuts in services or higher taxes, experts say."

The reason for such high pensions, of course, is gutless politicians. "At all levels of government, the rate of compensation has gone up much more rapidly than it has in the private sector and, most importantly, faster than the personal income of the people who pay for this," Steven Frates, senior fellow at the Rose Institute in Claremont, California, told the *Daily News*. "There has been a

wealth transfer. It has gone from the citizens to the people in government," he added. "You often hear people in government cry that there are going to be cuts and we're hurting the poor and the little children. The fact of the matter is the citizens of the state, county and city are making life better, not necessarily for schoolchildren or people in need, but for government employees."

Meanwhile, the city of Richmond, the first California city to offer its cops and firefighters the "3 percent at 50" benefits, teeters on the brink of bankruptcy, in no small part due to that "no cost" benefit.

And the prison guards, the notoriously aggressive union members who secured 35 percent pay hikes over five years and the shutting down of most of its non-union private-prison competition thanks to generous contributions to Gray Davis, were under fire in a wide-ranging prison-corruption probe. The pay and benefit increases were so outrageous that some union officials considered rolling them back slightly.

Corruption, bankruptcy, tax increases, excessive benefits . . . these are the fruits of an aggressive government-sector union movement and politicians who are in sync with its agenda or too fearful of union power to say no. Without a profit-loss balance sheet, such abuses can go on indefinitely. Taxpayers, of course, will have to pay to fix the mess, and—unlike in the corporate world—the abusive government officials and union reps will probably escape any judgment.

Despite the realities, now finally being covered thoroughly in the California media, state voters still seem to choose politicians who promise bigger government and the most taxpayer-funded goodies. It's still a good sell to promise to stand up for the hard-pressed union member, even if that union member typically is an overpaid bureaucrat who is busting the state and local treasury.

There's no ready solution to the current mess. Some critics have argued that if the budget deficit gets deep enough politicians will stop granting even more benefits to the bureaucrats. Fat chance, really. Even as California struggled with a $22 billion deficit and a $7 billion structural deficit, the legislature proposed 100 bills that would have increased spending by $60 billion. Union advocates in the legislature continue to promote plans that would offer even more generous retirement benefits for public-safety officials, allowing them to retire with 100 percent of final pay. Even a fiscal meltdown can't force responsibility on these legislators.

The only answer is to relentlessly cut government in every place and in every way. Note that police, firefighters, and prison guards are the absolute worst abusers of the process. They use their "public safety" status and union power to shame officials into constantly ratcheting up their salaries and benefit packages. It's time to craft alternatives to these "services," to show the public how much safer it can be without these overpaid bureaucrats.

Like Europe, California is facing the consequences of advanced welfare-state sclerosis. Those of you who don't live here shouldn't laugh too hard. The problems documented above are coming to a state capitol near you. □