

**INQUIRING MINDS... AUGUST 4, 2017**

**TOPIC... GOVERNMENTS IN TROUBLE**

**MODERATOR .. AL KAPLAN**

**Governments in trouble**

**We have heard much about our Federal deficit, Puerto Rico's financial problems, many cities having money problems, and at least 3 states bordering on bankruptcy (which is not available to states).**

**Governments have long had the habit of overspending for the good or necessity of their constituency.**

**Many methods have been advocated for solving these monetary dilemmas, including the obvious: raising taxes, issuing bonds, or ignoring the problem.**

**Read the enclosed recent articles and let's discuss the problems, and the potential, solutions.**

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**Blue State Budget Breakdowns**

**Public union politics hits the wall in New Jersey, Illinois and Connecticut.**

**July 4, 2017 3:57 p.m. ET**

**Budget showdowns cast a pall over the holiday weekend in Connecticut, Illinois and New Jersey, and it couldn't happen to a nicer group of politicians. While all**

**dysfunctional governments are dysfunctional in their own way, the three blue states are hitting the same progressive dead end.**

**In Illinois, Democrats spent the long weekend coaxing Republican legislators to join their suicide pact to raise taxes to plug a \$6 billion deficit and pay down a \$15 billion backlog of bills. And don't forget the \$130 billion unfunded pension liability—none of which will be solved by the \$5 billion tax hike. GOP Governor Bruce Rauner vetoed the bill on Tuesday but may be overridden.**

**After credit-rating agencies threatened to downgrade the state debt to junk, Mr. Rauner proposed raising the state's income tax to 4.95% from 3.75% and the corporate income rate to 9.5% from 7.75% for four years. In return he asked for a property tax freeze and modest reforms to workers compensation. Yet Mr. Rauner already signed off on a huge property tax hike in Chicago—homeowner bills have increased by a quarter in two years—to pay for teacher pensions.**

**The state legislature is controlled by public unions that refuse to compromise. But the budget crisis became more urgent after a federal judge on Friday ordered the state to make long overdue Medicaid payments, which had been subordinated to pensions and worker pay. While states can't go bankrupt, Illinois is showing they can default—and that they will prioritize public workers over other creditors.**

**Pensions will consume about a quarter of Illinois's general fund this year. Nearly 40% of state education dollars go toward teacher pensions, and the state paid nearly as much into the State Universities Retirement System last year as it spent on higher education.**

**Anemic revenue and economic growth can't keep up with entitlement spending. The state's GDP has ticked up by a mere 0.8% annually over the last four years compared to 2% nationwide and 1.4% in the Great Lakes region. Since 2010 more than 520,000 Illinois residents on net have fled to other states. (See the nearby chart for some state comparisons.)**

**Democrats held veto-proof super majorities in the legislature during Mr. Rauner's first two years. But House Speaker Michael Madigan wants to force the Governor to repudiate his campaign promise not to raise taxes and make Republicans share political responsibility for the state's economic failures. Amid deteriorating public services, Mr. Madigan persuaded 15 House Republicans to back Mr. Rauner's tax hike a la carte, which spared 11 Democrats in conservative districts from having to take a tough vote. The state Senate followed Monday.**

**If Republicans override Mr. Rauner's veto without insisting on substantive reforms, they'll repeat the mistake of Connecticut's former Republican Governor Jodi Rell who in 2009 raised the state's top rate to 6.5% from 5% while doing little to rationalize spending or fix the state's bankrupt political culture. See how well that turned out.**

**Democrats have since raised the Nutmeg State's top rate to 6.99%. Revenue and economic growth have slumped as high-earning residents have decamped for lower-tax climes. Hedge-fund managers are struggling to sell their palaces in Greenwich. The legislature's Office of Fiscal Analysis downgraded income-tax revenues this year by \$1.1 billion, and sales and corporate taxes are projected to fall by \$450 million.**

**Meanwhile, pension contributions have doubled since 2010 and along with retiree health care—most pay no deductible and a maximum \$15 co-pay—make up 20% of the budget. Democratic Gov. Dannel Malloy has ordered cuts to local aid while legislators debate how to close a \$5.1 billion budget gap.**

**Mr. Malloy wants to shift some of the teacher pension costs to cities, but Democratic legislators howl that this will further drive up the state's astronomical property taxes. The tax bill on a \$300,000 home in Hartford is \$22,287. Many Democrats would prefer to raise sales taxes, which shows that liberals will eventually come after everyone else after they tap out the wealthy.**

**For another example, see New Jersey where lame duck Republican Gov. Chris Christie has raided the not-for-profit health insurer Horizon Blue Cross Blue Shield to finance rising state health-care costs. State residents were taken hostage this weekend when Mr. Christie ordered a shutdown of state beaches and parks until Democrats passed a budget that requires Horizon to spend some \$300 million in "excess" reserves on expanded opioid treatment, among other public health services.**

**Democratic Assembly Speaker Vincent Prieto resisted this tax on Horizon policy holders if only because they include state workers but then compromised with Mr. Christie to return "surplus" funds to enrollees. But the shakedown is a warning to Garden State taxpayers. Pension payments have doubled over the past two years and will triple over the next five. To pay the state's bills, Democratic gubernatorial candidate Phil Murphy has promised to soak the rich—then rinse and repeat. The state's top income-tax rate is already 8.97% and the Tax Foundation says its property taxes are the highest in the land.**

**Amid these blue state meltdowns, Maine's GOP Gov. Paul LePage suspended non-emergency government functions to impel his legislature to drop a lodging tax hike and roll back a voter initiative backed by the teachers union that increased the state's income tax this year by three percentage points to 10.15%, the highest in the Northeast. Temporarily closing the DMV was a small price to pay for preventing the kind of fiscal collapses that are occurring in Illinois, Connecticut and New Jersey.**

**To adapt Margaret Thatcher, the problem with progressive governance is you eventually run out of other people's money.**

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### **Ill-Funded Police Pensions Put Cities in a Bind**

**Municipalities that try cutting the retirement plans face pushback both from the officers, some of whom quit, and from a generally pro-police public**

***Heather Gillers and Zusha Elinson***

**July 4, 2017 10:59 a.m. ET**

**When the city of San Jose had trouble affording services such as road repair and libraries because of the cost of police pensions, it obtained voter approval to pare them. What happened next proved sobering for other cities in the same pickle. Hundreds of police officers quit. Response times for serious calls rose.**

**Faced with labor-union litigation, San Jose this year restored previous retirement ages and cost-of-living increases for existing police officers, and last month it gave them a raise.**

**Police pensions are among the worst-funded in the nation. Retirement systems for police and firefighters have just a median 71 cents for every dollar needed to cover future liabilities, according to a Wall Street Journal analysis of data provided by Merritt Research Services for cities of 30,000 or more.**

**The combined shortfall in the plans, which are the responsibility of municipal governments, is more than \$80 billion, nearly equal to New York City's annual budget.**

**Broader municipal pension plans have a median 78 cents of every dollar needed to cover future liabilities, according to data from Merritt. The 100 largest U.S. corporate pension plans have 85% of assets needed on hand, according to Milliman Inc. data as of March 31.**

**And yet any attempt to bring police pensions into line with today's municipal budgets and stock-market performance runs into the reality that many officers won't stand for it—and they often have the public behind them.**

**“They have extra clout because people love police,” said Dallas Mayor Mike Rawlings. “I love police. You love police. An electrician—you don't have that emotional tie.”**

**His city, like San Jose, found itself facing widespread police-officer resignations when it moved to cut their pensions. In Dallas, the situation became so difficult the state legislature stepped in this spring to work out a solution.**

**Police pensions were the first nonmilitary retirement systems to be created in the U.S., in second half of the 19th century. In later years, when municipal budgets were tight, augmenting pension promises in lieu of raises became a way governments could make peace with politically powerful police unions without incurring immediate new spending.**

**In the 1980s and 1990s, robust investment returns made governments' pension promises look affordable. By 2001, major police and firefighter plans followed by the Public Plans Database, which tracks 150 major state and local pension plans, had a median 101% of what they needed to pay for future obligations.**

**The 2008 financial crisis wiped out pension-plan earnings at the same time that it put stress on municipal budgets, leading some cities to contribute less to the plans each year than what actuaries calculated was needed.**

**Also, many cities continued to assume robust 1990s-era investment returns when they calculated annual pension contributions. Their pension debt grew as those returns failed to materialize and cities didn't adjust their contributions to the plans.**

**Memphis, Tenn., gambled it could cut police pensions without any impact on public safety. The city council voted in 2014 to end pensions for municipal workers, including the police, with 7.5 years of service or less, and replace the pensions with a hybrid plan combining pension and 401(k)-style benefits.**

**In the following two years, about 100 officers affected by the changes left the force, out of a total of about 2,000. Homicides rose to a record 228 last year from 167 in 2014. Billboards erected by the police union around town read, “Welcome to Memphis: 228 homicides in 2016, down over 500 police officers.” Memphis currently has 1,928 officers, down from 2,416 in 2012.**

**The city’s mayor, Jim Strickland, has since pledged to increase police staffing. A spokeswoman for the city said enrollment in the police academy is increasing despite the reduced benefits package. Even so, city officials recently announced a \$6.1 million grant for retention bonuses. Meanwhile, the police union is trying to get certain benefits restored in court.**

**One of the first cities that tried to bring police pension costs down was San Jose, where former Mayor Chuck Reed asked voters to approve pension cuts as part of a 2012 ballot measure.**

**Among the hundreds of police officers who quit after voters said yes to the change was Tim Watermulder, who left to join the Oakland police department in 2013. It had been announced that the police-academy class in which he graduated would be the first to operate under a new system providing lower cost-of-living increases and a retirement age of 60 instead of 50.**

**“You start to see what police work is really like every day,” said Mr. Watermulder, 35 years old, who fought in Iraq with the U.S. military before becoming a police officer. “I really started thinking about ‘Can I do this job till I’m 60?’”**

**About 180 of 1,109 sworn officer positions in San Jose are currently vacant. San Jose has the lowest number of officers per capita among the nation’s 35 largest cities, according to a Journal analysis of Federal Bureau of Investigation data from 2015, the most recent available.**

**Response times for the most serious calls rose to an average of 7.3 minutes last year from 6.1 minutes in fiscal 2011, according to the police department.**

**San Jose is still safe compared with many other cities, but its violent-crime rate jumped last year to the highest since 2008. “A lot of it had to do with us not**

**having enough officers,” said San Jose Police Chief Eddie Garcia. His advice to other cities seeking to shore up their finances by cutting police benefits: “Don’t make a crisis into a bigger crisis.”**

**Crime has risen in many cities in recent years, not just in those that have lost officers. Per capita homicide rates are up in 27 of the country’s 35 largest cities since 2014, according to homicide data. The causes of such increases are hard to pinpoint, but there is little doubt “losing hundreds of officers would make a big difference in the ability to control crime,” said Richard Rosenfeld, a criminologist at the University of Missouri-St. Louis.**

**San Jose, to retain and recruit officers, has gone beyond rolling back changes it had tried to make in retirement ages and cost-of-living increases for existing police officers. Police got a 10% raise last month, to be followed by 3% raises in 2018 and 2019.**

**Since those measures were put in place, police-academy enrollment has risen sharply. “It looks like were now on the right track,” a city spokesman said.**

**Dallas has had an unusual struggle with the police-pension issue. The funding level of its plan for police and firefighters earlier this year fell to just 36%, among the lowest in the nation.**

**A trouble spot has been a plan created 25 years ago in an effort to keep experienced officers from leaving for police jobs elsewhere after they qualified for police pensions around age 50.**

**Officials figured they couldn’t afford sufficient wage increases to keep those officers, so instead they would sweeten pension benefits, said Steve Bartlett, who was mayor when the special fund was created.**

**That deal allowed officers who worked into their 50s to earn a pension and a salary at the same time. Terms provided for a guaranteed 8% to 10% return on the assets contributed to the plan, forcing the pension fund to make up the difference when market returns came in below that threshold. Officers who stuck around long enough could potentially accumulate \$1 million in the special fund.**

**Brad Uptmore left the Dallas police force and became an officer in Southlake, Texas. Photo: Cooper Neill for The Wall Street Journal**

**“They said, ‘Hey, the retirement is top notch. You may not be paid well initially, but in the end you’ll be a millionaire,’ ” said Brad Uptmore, a Dallas police officer for 10 years.**

**The promised return became harder to deliver after the financial crisis, as real-estate investments the fund made from Hawaii to Paris went sour and triggered more than \$500 million in losses.**

**Spooked by the losses and talk of benefit cuts, hundreds of police and firefighters quit, withdrawing \$500 million from the roughly \$3 billion fund and pushing it closer to insolvency.**

**The city sought help from the Texas legislature. In late May the state government approved a package that requires the city to contribute an additional \$25 million to \$40 million a year to the pension plan while also cutting benefits.**

**Under the legislation, a police officer who is now 40 and retires in 2035 can get a pension that year of \$95,339, compared with \$109,583 under the old pension structure, according to a hypothetical calculated by the pension fund.**

**The changes may not be enough. The plan will still have less than half what it needs to cover its liabilities, according to an estimate provided by the fund to legislators. A review by S&P Global Ratings concluded that “more reforms will be needed.” Mayor Rawlings agreed the city has “much work ahead.”**

**Many longtime Dallas police officers won’t be around to see how the changes pan out, including Mr. Uptmore. He left to join the much smaller police department of Southlake, Texas, in the spring of last year—one of 336 Dallas officers who left in 2016.**

**“Once you realize there’s no gold at the end of the rainbow, I think you stop pursuing that,” Mr. Uptmore said.**

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