The epic struggle over retirement

The same Wall Street traders who ignited the public pensions crisis now propose to fix the problem. What could go wrong?

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by Susan Greenbaum

The retirement prospects for millions of public employees have gotten shakier in the past few months amid a growing chorus of news stories about troubled pension funds. Illinois, New Jersey, Connecticut and a dozen other states are reported to be in serious fiscal trouble, with unfunded pension liabilities exceeding annual revenues. These alarming disclosures have escalated the calls to cut benefits and eliminate traditional pensions. Judges have disputed or weakened the legal claims of Detroit and New Jersey public employees to their pensions. On Oct. 1, a judge in Sacramento, California, signaled that the city of Stockton could dismiss pension debts in bankruptcy. In cash-strapped states and municipalities, pension costs are squarely in the crosshairs of officials looking for budget cuts. Increasingly, the courts seem prepared to let them pull the trigger.

Alongside these financial pressures, mainly caused by the recession, has been a relentless campaign waged by right-wing ideologues — many of them hedge fund managers — to loot public-pension funds, which presages the real retirement battle on the horizon — Social Security. In a recent report titled "The Plot Against Pensions" (PDF), David Sirota persuasively argues that privatization cheerleaders are following a model of "pensions today, social security tomorrow." Leading the pension battle is John Arnold, a hedge fund billionaire who is systematically courting political support to eliminate state pension plans and replace them with privatized defined contribution plans managed by Wall Street. This, despite the fact that public pension funds were among the biggest losers in the financial crash of 2008. Shortfalls have only grown since then. Many states have failed to make required contributions into their pension funds, while massive layoffs of public workers have worsened the balance between current contributions and future obligations. The problem is thus very real, but proposals such as Arnold's are very likely to make it worse.

Adding fuel to the fire is media coverage that pits public employees against beleaguered taxpayers. Public employee pensions are portrayed as unsustainable anachronisms that are consuming an unreasonable share of shrinking budgets. Public workers are often depicted as greedy, claiming benefits that most other workers no longer enjoy. Such portrayals forget that in

the 1970s, nearly two-thirds of all private sector workers had pension plans. The 1980s brought many changes in corporate management, one of which was the wholesale looting of company pension funds. Those workers are now required to manage their own retirement savings in defined contribution (401k) accounts that carry greater risk and have been shown to perform less well. Public employment is virtually the only sector where traditional pensions still exist, a tradeoff for lower salaries.

Latching onto this falsely bifurcated narrative, the well-funded proponents of privatization thus claim that taxpayers must choose to fund schools or pay for pension gravy dished out to retired public workers. Left unstated is the more obvious solution of raising taxes on the wealthy to pay the costs of both public services and the pensions that workers bargained for, paid into and were promised by contract.

Doubling down

Critics argue that public pensions are old fashioned, destined for conversion into privatized accounts. Economist Dean Baker has demonstrated that, on the contrary, public pension funds would have weathered the crisis of 2008 if they had not been invested in risky derivatives, especially mortgages. In other words, Wall Street shenanigans, not sound financial knowledge, posed the real threat (PDF) to the solvency of these funds. If the managers had followed a conservative investment path, there would be no problem now. But efforts to objectively gauge the sustainability of these funds are clouded by inept (and allegedly corrupt) handling of current fiscal problems.

Sirota points out that in most states the rising costs of subsidies to corporations — incentives that yield few jobs or other benefits — exceed pension shortfalls. In New Jersey and Rhode Island, the markedly higher fees paid to dubiously performing investment firms have exceeded savings from recent cuts in pension benefits. New Jersey has come under scrutiny for "pay to play" schemes between Wall Street and the state pension fund. Between 2012 and 2013, New Jersey nearly doubled the amount the pension fund paid in fees for its investments, much of it in a contract with Elliot Associates, the hedge fund operated by Paul "the Vulture" Singer.

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Astonishingly, despite having been burned by Wall Street before, the overwhelming response to pension deficits has been to increase the level of risky investments in order to make up for lost time. In Florida, the limit on "alternative" investments was raised from 5 percent before the crash to 20 percent now, even after suffering huge losses on what proved to be worthless securities. Investments in these risky funds also command far larger fees than conservative investment strategies, operate wholly in secret and have substantially under-performed conventional investments. South Carolina, for example, where more than half of the state pension fund has been put in risky alternatives, now pays $300 million in annual fees (up from $22 million in 2005) and has seen gains of only 1.3 percent. Edward Siedle wrote in Forbes that its decision to "'doubl[e] down,' dramatically increasing the money risked, may be a favorable strategy at times when playing blackjack but it's no way to run a state pension."

Some states, at least, are taking note. Warren Buffett reportedly advised the trustees of California's troubled retirement fund, CalPERS, to divest from all their hedge funds, which they voted to do last month. But New York state has gone the opposite route, signing an agreement with Goldman Sachs to increase alternative investments and consult in decisions about more than half of the fund's investments. New York City's comptroller also plans to increase, rather than reduce, poorly performing risky investments, hoping to beat the market and get ahead. San Francisco's pension fund (SFERS) is currently struggling over this same issue. Their investment officer and his principal adviser, who also operates an offshore hedge fund of his own, recommend shifting billions into hedge fund investments, for which the adviser would collect an extra fee. On Oct. 8, the SFERS trustees tabled the proposal out of concern over stories about conflict of interest. New York and California, which have two of the largest public-employee pension funds, are following different strategies. It remains to be seen what other states will do.

Why would experienced pension fund managers continue dumping public money into what appear to be risky, costly and unproductive investments? Diversification is the stated reason, and arguably irrational confidence in advice from hedge fund wizards. There also have been suggestions that campaign contributions — such as Singer's and Arnold's — play a role. For hedge fund managers, this course is win-win. In the short term, high fees and unfettered trading with billions in public pension cash offers a gold mine. In the long term, these risky and costly investments would seem to jeopardize the solvency of the very funds they are allegedly helping. But killing the golden goose is not a problem for privatization cheerleaders; in fact, it's part and parcel of a long-term plan also aimed at gutting Social Security.

False dilemmas

Polls indicate that a large share of the American public is unsympathetic or uninterested in the pensions of public workers. However, anyone who is old or expects to get old someday should pay closer attention. Why? The attack against pensions is part of ideological opposition to so-called entitlements that goes back decades, to the original enactment of Social Security. Remember that before the enactment of Social Security in 1935, most people 65 or older lived in poverty. Ordinary workers were simply unable to save enough to sustain themselves through old age. Social Security, with reforms in the 1960s, brought the overall poverty rate for people over 65 down from 35 percent in 1960 to a startling 9 percent in 2012. It is a remarkable success story.

Arnold launched his campaign seemingly independent of Charles and David Koch, the conservative billionaire brothers who through the Cato Institute and the American Legislative Exchange Council (ALEC), also have been waging war on defined benefit pension plans, and against Social Security, for decades. Model legislation from ALEC eliminating defined benefit pensions has been introduced in dozens of states and found partial success in Alaska, Nebraska and Michigan. Pete Peterson, former U.S. Commerce Secretary and head of Blackstone Group's equity investments, is another billionaire dedicated to transforming retirement through privatization. He was instrumental in effecting the Simpson-Bowles Commission that proposed cuts to Social Security. He also leads the well-funded "Fix the Debt" campaign, designed to create panic over deficit spending and allegedly runaway entitlements. These well-funded threats serve as the backdrop for today's proxy attack on public pensions. And as Sirota points out,

privatization arguments for Social Security (worth trillions) use similarly apocalyptic narratives of impending collapse under the current plan, blaming greedy recipients for the problems.

Weakening pensions is a choice, not an imperative — the crisis is political, not actuarial. As Baker pointed out, responsible stewardship would have avoided this problem, and the same principle can be applied to fixing it. Similarly, a simple fix for Social Security would be to raise the income cap on payroll contributions.

But the organized resistance to these solutions frames them as a tax increase, calling instead for more secretive and costly outsourcing of retirement investments. Deregulation and lax enforcement destroyed the private pension system and has permitted outrageous abuses of public pension funds. The same people who orchestrated the bubble and defrauded elected officials and pension fund managers into purchasing vast quantities of worthless assets that exploded and ignited this retirement fund crisis, now propose to fix the problem with more of the same. That way beckons disaster.

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