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# Vallejo could be a harbinger of more California city bankruptcies

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In 2008, the California city of Vallejo took the unprecedented step of filing for bankruptcy. A combination of falling revenues caused by the collapse of the real estate bubble and rising public pension costs cratered their finances. Other California cities and counties are watching how Vallejo manages, and may well follow suit.

Indeed, former Los Angeles Mayor Richard Riordan recently said <sup>[3]</sup> the City of Los Angeles will likely declare bankruptcy by 2014, with excessive pensions being the primary reason why, and that the current administration is ignoring the approaching fiscal tsunami. A primary problem, he says, is the utterly unrealistic assumption that Los Angeles public pension funds will return 8% a year. A steady return of 8% is difficult even in good times, and nearly impossible in rough economic periods like we are facing now. Such rose-colored glasses estimates were also made by state public pension funds like CalPERS, and resulted in equally disastrous results. Rather than making money, the pensions have been losing money. This means state and municipality pension funding now must make up a serious shortfall. Riordan concludes that for Los Angeles to survive it must slash pensions, raise the retirement age, make employees pay more, and eliminate Cadillac pension benefits.

Vallejo appears to have been the poster child for excessive pension benefits and public worker salaries. A report by the Cato Institute released last year said <sup>[4]</sup> 74% of Vallejo's budget went for police and firefighter salaries and pension benefits. Regular public employees can retire at age 55 with at 81% of their final year's pay. Police and fire employees have it even better, retirement at 50 at 90% pay. This certainly seems real cushy as well as financially unsustainable to me.

But wait. I've quoted Riordan and the Cato Institute. Riordan is a Republican with a net worth of \$100 million. The Cato Institute is a right-tilting libertarian think tank in DC. Such folks probably have little use for unions, so maybe all this is just a stealth effort to destroy or cripple public employee unions? Because that's what the battleground is here. Public employee unions are facing off against their own municipalities, with all manner of players jumping in both sides. Do some on the Right see this as an opportunity to clobber the unions? Sure. But I've not seen anyone dispute what Cato said about Vallejo's finances or say that public pension obligations are not the primary reason that such cities are facing financial disaster.

The machinations continue. A pro-union bill, AB 155, was floated in the State Senate which if passed, would have made it much harder for municipalities to file bankruptcy by making them get permission from a state commission first. This could take several months, stalling things, and if you don't think unions would try to stack the commission with those favorable towards them, then I've got a nice bridge to sell to you. (And of course, anti-union forces would do the same.) However, the bill has been placed in the [Senate Inactive file](#) <sup>[5]</sup>, probably after a "broad coalition, including over 200 local government agencies" opposed it.

Four years ago, Vallejo became the first California city to allow [private arbitrators](#) <sup>[6]</sup> to settle pay disputes with its union workers. This June, Vallejo became the state's first city to repeal such arbitration. You better believe other cities are watching this carefully and may well follow suit.

Nearly two weeks ago, a municipal-bond insurance firm asked the Vallejo bankruptcy court to force the city to pay off their default by using money from [vehicle registrations](#) <sup>[7]</sup>. They say the law does not exempt the city from seeking refuge under bankruptcy laws. Lawyers for the city disagree.

So, you can see how convoluted this is getting. It'll take years to work out. Vallejo is just the most prominent of the municipal bankruptcies. Others most certainly are coming. We need to prepare for it now.

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