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Capitol Journal

News & Views from the 50 States

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Pension Peril

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The next issue of Capitol Journal will be available on September 2nd.

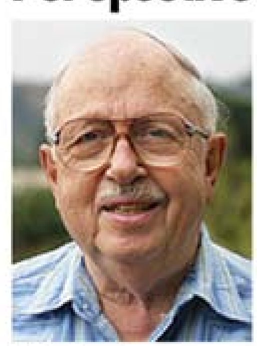
Top Story

In underestimating its pension costs, Detroit mirrors scores of U.S. cities, many of which have liabilities exceeding Motown's.

SNCJ Spotlight

The Shadow of Detroit: Pension Gaps Threaten Cities and States

A Cannon Perspective



With Lou Cannon

Detroit's bankruptcy made a brief splash last month before being driven from the headlines by terrorist warnings, congressional intransigence and the sexual shenanigans of a New York City mayoralty candidate and the San Diego mayor. But as a possible portent for other cities and states buried under mountains of pension debt, Detroit promises to be the enduring news story of the summer.

Sure, Detroit is in some ways a special case, dependent more than any other major American city on a single industry. In its glory days Detroit made most of the country's cars; it now produces less than half of them. The city has more often than not been dreadfully managed; its former mayor is in prison.

With all that, however, half of Detroit's liabilities when the city filed for bankruptcy were pensions and health care benefits owed to retired municipal workers. The city had municipal debt of $18.2 billion, with the pensions and health benefits accounting for $9.2 billion of the total. These were supposed to be fully funded; in fact, there was a shortfall of $3.5 billion. Alas, that's not unusual. In underestimating its pension costs Detroit mirrors scores of U.S. cities, many of which have liabilities exceeding Motown's, as well as that of many states.

The week in session

States in Regular Session: CA, MA, MI, NJ, OH, PR, SC

States in Special Session: DE "b", KY "a"

States in Recess: DC, IL, NY, PA, US, WI

States Adjourned in 2013: AK, AL, AR, AZ, AZ "a", CA "a", CO, CT, DC, DE, DE "a", FL, GA, HI, IA, ID, IL "a", IN, KS, KY, LA, MD, ME, MN, MO, MS, MS "a", MT, ND, NE, NH, NJ "a", NM, NV, NV "a", OK, OR, RI, SD, TX, TX "a", TX "b", TX "c" , UT, UT "b", VA, VA "a", VA "b", VT, WA, WA "a", WA "b", WV, WV "a", WV "b", WY

States currently prefiling for 2014 Session: AL, KY, MT, TN, WY

Letters indicate special/extraordinary sessions

— Compiled By FELICA CARILLO
(session information current as of 8/15/2013)
Source: State Net database

Chicago is in especially perilous shape. The Windy City has attracted business and reduced its horrific crime rate under the leadership of Mayor Rahm Emanuel, the former congressman and White House chief of staff, but the pension fund for retired teachers is near collapse, and four other funds for retired city workers are $19.5 billion short. Overall, Chicago has funded just 36 percent of its pension obligations. Philadelphia, using 2011 figures, has funded just 50 percent.

Thirty-six cities, counties or other local government entities in the United States have filed for bankruptcy in the past five years. The majority were small special districts, but the list also includes Jefferson County, Alabama, and the California cities of Stockton, San Bernardino and Mammoth Lakes. A recent state audit of Stockton, a city of 300,000 in California's central valley, blamed poor accounting practices and a series of misguided financial decisions.

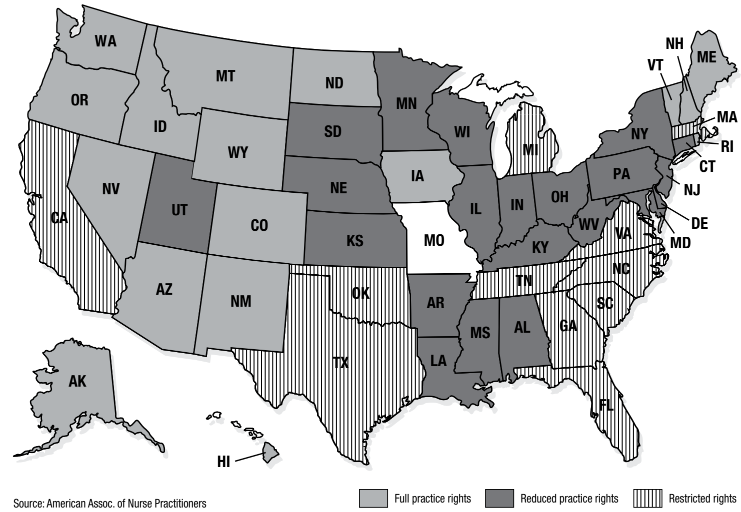
Looming larger than any municipal missteps are unfunded pension liabilities of the states, totaling an estimated $2.7 trillion or 17 percent of gross domestic product (GDP). The states themselves say their pensions are 73 percent funded, but the ratings agency Moody's says this considerably understates the magnitude of the problem.

Dissatisfied with state estimates, Moody's did its own calculations in June and found the states have set aside just 48 cents for every dollar in pensions they have promised. In a view shared by many economists, Moody's claimed that states and cities were distorting pension numbers by failing to take proper account of market risks. For instance, California's state pension system, the nation's largest, assumes a 7.75 percent annual return on its investments in perpetuity, a rosy view that fails the test of history.

But California comes out relatively well on Moody's scorecard, largely because much of the duty to pay pensions in the Golden State falls on local governments. The state that fares by far the worst in Moody's estimate is Illinois, where pension obligations amount to 241 percent of the state's annual tax revenues. According to the Moody's study, pension obligations are 190 percent of tax revenues in Connecticut, 141 percent in Kentucky, 137 percent in New Jersey, 133 percent in Hawaii and 130 percent in Louisiana.

The current political flashpoint of the pension battle appropriately is Illinois, where Democrats hold the governorship and a super-majority of the Legislature. But the governor and legislative leaders do not see eye to eye. Gov. Pat Quinn has long been trying to prod the Legislature into passing a pension-reform bill. In July, he became so exasperated he used his line-item veto authority to strip legislative salaries from the state budget. Legislators promptly sued, claiming the governor had acted unconstitutionally. A court hearing is scheduled Sept. 18.

Bird's eye view



'Scope of practice' still hot issue

With the Affordable Care Act set to add millions of Americans to health insurance rolls come January, many states considered bills this year to allow health professionals other than medical doctors to perform some procedures currently limited only to physicians. One such scenario is still playing out in the California Assembly, where last week Sen. Ed Hernandez (D) removed language in a Senate-approved bill (SB 491) that would have allowed nurse practitioners to operate completely independent of physician oversight after 6,240 hours of supervised practice, a.k.a. to have "full practice" rights. The measure moves to the Assembly Appropriations Committee, which will also consider another Hernandez bill (SB 493) that would allow pharmacists to give immunizations and prescribe some drugs. Currently, some states allow NPs to have a collaborative agreement with a doctor while others require an NP to work under a doctor's supervision or within a doctor-led team.

Whatever happens in Illinois, unfunded pension costs are putting increased pressure on states and even more on municipalities. Former Los Angeles Mayor Richard Riordan and journalist Tim Rutten, writing in *The New York Times*, said that "emergency response times are lengthening in cash-starved cities" while libraries, parks and recreation facilities are shortening hours or even closing. Cities are also falling behind on street and sidewalk repair.

Riordan was frustrated last year by public employee unions, who opposed his attempt to put a pension reform initiative on the Los Angeles ballot. Lacking sufficient backing, he withdrew the proposal. Now Riordan and Rutten are calling for a public employee pension reform plan patterned after a proposal by economist Joseph Rauh, a professor of finance at Stanford's business school and senior fellow at the Hoover Institution.

Riordan and Rutten want President Obama to propose and Congress to enact a program in which cities and states could sell bonds to cover pension liabilities with repayment guaranteed by the federal government. The program would be financed by fees charged participants. In exchange for federal bond insurance, which would provide access to low-cost capital, cities and states would have to agree on certain reforms of their pension and health care programs, including a single national standard for projecting returns on pension investments.

Upcoming elections
(08/16/2013 - 09/06/2013)

08/27/2013
Maine Special Election
Senate District 19

It's an intriguing idea but one that most public employee unions would be likely to resist based on their previous insistence on lofty investment projections. It's also unlikely that a divided, do-little Congress would be willing to dive into the pension thicket — at least unless or until there are more bankruptcies on the scale of Detroit. States are of necessity more willing — 30 of them have enacted pension-related legislation in 2013 — but in most cases the reforms do not go far enough to close the pension gaps.

Public employee unions are the handiest scapegoat for those who deplore the pension mess, and they certainly deserve a hefty share of the blame. But what has happened is not entirely the fault of the unions. Indeed, a principal reason that pensions are underfunded is that Americans are living longer, which makes pension promises much costlier to keep. Another main reason is political. As *The Economist* puts it in a recent report on the U.S. pension crisis: "Governors and mayors have long offered fat pensions to public servants, thus buying votes today and sending the bill to future taxpayers. They have also allowed some startling abuses. Some bureaucrats are promoted just before retirement or allowed to rack up lots of overtime, raising their final-salary pension for the rest of their lives."

This practice is known as "spiking" and has been modified, although insufficiently, in a few of the state reform bills. In California, another state where Democrats boast the governorship and a super-majority in the Legislature, Gov. Jerry Brown last year proposed a bold reform backed only by Republicans and eventually settled on a lesser one that won legislative approval. It lengthens the peak salary period from one year to three and caps the salary at which new employees can earn benefits at $110,000.

California has two mammoth funds: the California Public Employee Retirement System (CalPERS), which administers a $260 billion investment portfolio, the sixth largest pension fund in the world, for 1.7 million past and present state workers, and the California State Teacher Retirement System, CalSTRS, a $166 billion fund for teachers. State Controller John Chiang (D) last year said that CalSTRS had failed to control spiking and provided so little oversight that each of the state's school districts faced an audit only once in every 48 years. The teachers' pension fund says that it has since sought to increase oversight and eliminate spiking abuses.

Although limiting spiking and other rip-offs will help at the margins, states and cities face a daunting task in trying to reform their pension systems. The U.S. Constitution forbids states from passing a law impairing contracts, which some states interpret as meaning that pensions are a contractual promise that can't be altered. But these promises mean little if a city defaults, as Detroit workers are now learning.

"Although limiting spiking and other rip-offs will help at the margins, states and cities face a daunting task in trying to reform their pension systems."

Voters have gradually become aware of the squeeze on services caused by excessive pensions: in many cities they are paying far more to compensate retired police officers and firefighters than current ones. Last year voters in San Jose and San Diego rebelled, passing initiatives that made drastic cuts in pension benefits and were widely hailed as the dawning of a new day. Instead, public unions sued and the initiatives in these two California cities are mired in litigation.

The simplest way to reduce pension obligations would be for state and local governments to do what private industry has done and shift from a defined-benefit plan, in which a pension is based on seniority, to defined-contribution plans such as the 401k in which employees are required to underwrite a significant portion of their requirement. But although the pension battle does not break down along strict party lines, many Democrats would oppose such a solution, which in any case would face the legal challenges that have enmeshed the San Jose and San Diego initiatives.

So the likelihood, politics being what they are, is that most jurisdictions will cut back on pensions for new hires, which pose few legal obstacles, and hope to muddle through. Perhaps they'll make it, but it's no sure thing in the shadow of Detroit.

— By Lou Cannon

Budget & taxes

STATE BUDGETS BETTER...FOR NOW: This year was a good one for most state budgets, with revenues up by over 5 percent, far better than most observers predicted. That's the good news. The less good news is that, according to a report issued last week by the National Conference of State Legislatures, growth is expected to fall back below 2 percent in FY 2014.

General Fund revenue outpaced growth in expenditures by almost a full percentage point — 5.3 percent for revenue compared to 4.4 percent in expenditure growth. A variety of things contributed to that, most notably many taxpayers pushing their tax obligations into FY 2012 in anticipation of higher federal tax rates in 2013. In all, 41 states, the District of Columbia and Puerto Rico had year-over-year revenue growth in FY 2013, with five growing by 10 percent or more. States' cumulative balance, which combines General Fund closing balances with rainy day funds, rose from $54.2 billion in FY 2012 to $66.6 billion in FY 2013.

Upcoming stories

Here are some of the topics you may see covered in upcoming issues of the *State Net Capitol Journal:*

- **State budgets**
- **Fracking**
- **Health reform**

State also took significant action on taxes, cumulatively implementing $1.3 billion in tax cuts this year, or about .2 percent of last year's collections. Most were in the category of personal income taxes, with Ohio's $1.2 billion cut leading the way. But NCSL also notes that figure is misleading, saying it does not indicate the full level of legislative action.

The rosy picture is also expected to dim a bit in FY 2014, with revenue growth projection pegged at only 1.3 percent. Expenditure, meanwhile, are expected to climb by 3.9 percent, led by greater spending on higher education and Medicaid. (STATE NET, NCSL)

— By RICH EHISEN

Politics & leadership

SEBELIUS OPEN TO STATE IDEAS ON MEDICAID EXPANSION: U.S. Dept of Health and Human Services Secretary Kathleen Sebelius told state lawmakers last week that she is open to working with their own proposals for expanding Medicaid. The expansion is a key component in implementing the Affordable Care Act, but the Supreme Court ruled last year that states cannot be compelled to do so against their will.

In an address to the National Conference of State Legislatures, Sebelius said her agency is "very eager to continue these conversations with states around the country," adding that "I don't think there's any question that if you want a healthier population, looking at the opportunity to expand Medicaid has got to be a piece of the puzzle."

Perhaps more interesting to states, however, was a presentation by Cindy Mann, a deputy administrator of the Centers for Medicare and Medicaid Services, regarding a current proposal from Arkansas that is under consideration in Washington. That plan would allow newly eligible Medicaid recipients to shop for insurance through the state's health benefits exchange the same as any other consumer. Arkansas must receive a waiver from HHS to be able to implement the plan. If that happens, Mann said, the federal government will still pick up 100 percent of the tab, even if it is more expensive than the more traditional plans.

"We are open for business, eager to partner," she said. "We are very interested in entertaining a limited number of waivers. We are not at our limit."

According to NCSL, 19 states have agreed to expand their Medicaid systems while 16 have indicated they will definitely not do so. The remaining 15 are in various stages of determining what they will do. (STATE NET, NATIONAL CONFERENCE OF STATE LEGISLATURES, GEORGIA HEALTH NEWS)

In case you missed it

Each December the SNCJ staff looks ahead to issue we think will play out prominently in statehouse the next year. This week, we take stock of how we did.

In case you missed it, the article can be found on our website at http://www.statenet.com/capitol_journal/08-12-2013/html#sncj_spotlight.

POLITICS IN BRIEF: A group of lawmakers and animal advocates joined with the National Conference of State Legislatures last week in calling on Congress to reject a provision in HR 2642, the House-passed Farm Bill, they say would override hundreds of state laws and regulations related to agriculture. **OREGON** Sen. Bruce Starr, **NEW YORK** Sen. Kemp Hannon, **ILLINOIS** Sen. Pamela Althoff, all Republicans, were joined by **MINNESOTA** Sen. David Dibble (D) in calling on a joint Congressional committee to strike the provision (Sec. 11312), sponsored by Rep. Steve King (R-IA), which they said would nullify hundreds of state laws that impose "a standard or condition" on agricultural products or which make them stricter than federal standards (STATE NET).

— Compiled by RICH EHISEN

Governors

SCOTT WANTS SCOTUS TO WEIGH IN ON WATER FIGHT: In the latest skirmish in a 20-year tri-state water war, Florida Gov. Rick Scott (R) said he will ask the U.S. Supreme Court to limit how much of the precious resource Georgia can siphon out of the Apalachicola River. Scott accused Georgians, particularly residents of metropolitan Atlanta, of taking far more than their share of the river's water, which he said has devastated downstream Florida oyster fields and caused significant financial damage to the Sunshine State's oyster industry. The announcement came one day after federal officials declared Apalachicola's oyster industry to be a disaster.

Scott also accused Georgia officials of not acting in good faith, calling legal action "our only way forward after 20 years of failed negotiations" with the Peach State.

That drew a sharp rebuke from Georgia Gov. Nathan Deal(R).

"Gov. Scott's threat to sue my state in the U.S. Supreme Court greatly disappoints me after I negotiated in good faith for two years," Deal said. "More than a year ago, I offered a framework for a comprehensive agreement. Florida never responded. It's absurd to waste taxpayers' money and prolong this process with a court battle when I've proposed a workable solution."

He also questioned the timing of the suit, intimating that his GOP colleague was playing politics in the face of what most expect to be a very tough re-election campaign next year.

"While the timing seems to work for political purposes, it's ironic this comes at a time when Florida and Georgia are experiencing historically high rainfall," Deal said in a statement. "The fastest and best resolution is an agreement, not a lawsuit going into an election year."

In the hopper

At any given time, State Net tracks tens of thousands of bills in all 50 states, the US Congress and the District of Columbia. Here's a snapshot of what's in the legislative works:

Number of Prefiles last week: 40

Number of Intros last week: 153

Number of Enacted/Adopted last week: 269

Number of 2013 Prefiles to date: 26,564

Number of 2013 Intros to date: 127,910

Number of 2013 Session Enacted/ Adopted overall to date: 36,428

Number of bills currently in State Net Database: 146,090

— Compiled By FELICIA CARILLO
(measures current as of 8/15/2013)
Source: State Net database

Katherine Zitsch, manager of natural resources division at the Atlanta Regional Commission, also disputed Scott's claim that the city is the primary culprit behind Florida's oyster troubles.

"The fastest and best resolution is an agreement, not a lawsuit going into an election year."

"Metro Atlanta has one of the most aggressive water conservation programs in the country," she said.

While the region has seen tremendous rainfall this year, it has also suffered through periodic extended droughts, which Zitsch says has a far greater negative impact on Florida's oyster industry than water siphoning from Georgia.

Florida, Georgia and Alabama have been battling over water allocations for decades. Scott said Alabama officials have not decided they will join the suit. (ATLANTA JOURNAL-CONSTITUTION, ORLANDO SENTINEL, TAMPA BAY TIMES)

GOVERNORS IN BRIEF: A representative for **SOUTH CAROLINA** Gov. Nikki Haley (R) said the governor will soon announce plans to seek a second term. Haley is expected to make that announcement on Aug. 26 (THE STATE [COLUMBIA]). • **CALIFORNIA** Gov. Jerry Brown (D) filed a formal appeal with the U.S. Supreme Court to overturn a lower court's ruling that would require the state to release almost 10,000 prison inmates from the Golden State's overcrowded prisons. The high court recently rejected his call to stay that order while the court considers the state's appeal (SAN JOSE MERCURY NEWS). • Also in **CALIFORNIA**, Gov. Brown released a draft amendment for overhauling the voter-approved Proposition 65, which regulates toxic chemicals found in the workplace and requires businesses to post signs warning consumers of their presence. Opponents contend that the law exposes too many small business owners to frivolous lawsuits (THE RECORD [LEXIS NEXIS]). • **OKLAHOMA** Gov. Mary Fallin (R) said she will call lawmakers into special session to deal with the U.S. Supreme Court's June 4 ruling that a 2009 law dealing with how lawsuits are filed violated a state constitutional requirement that bills deal only with a single subject. The session begins Sept. 3 (OKLAHOMAN [OKLAHOMA CITY]).

— Compiled by RICH EHISEN

Hot issues

BUSINESS: **CALIFORNIA** Gov. Jerry Brown (D) signs SB 292, which clarifies in Golden State law that sexual harassment need not be motivated by sexual desire (STATE NET, CALIFORNIA GOVERNOR'S OFFICE). • Also in **CALIFORNIA**, Gov. Brown signs AB 533, which exempts employers of a minor under a contract for services as an extra or background performer in a film or television setting from a requirement that the employer set aside a specified percentage of the minor's gross earnings in trust (STATE NET, CALIFORNIA GOVERNOR'S OFFICE).

CRIME & PUNISHMENT: **CALIFORNIA** Gov. Jerry Brown (D) signs AB 381, which amends criminal code to provide that a person convicted of stealing property via elder abuse or other form of undue influence be liable for twice the value of the property (STATE NET, CALIFORNIA GOVERNOR'S OFFICE).

EDUCATION: The **CALIFORNIA** Supreme Court rules that trained but unlicensed school personnel may administer prescription medications such as insulin with the permission of the child's doctor and parents. The decision overturns rulings from two lower courts (SACRAMENTO BEE). • **CALIFORNIA** Gov. Jerry Brown (D) signs AB 1266, a bill that requires Golden State schools to grant equal access to sex-segregated facilities based on the gender with which the student identifies instead of their biological gender (SACRAMENTO BEE).

HEALTH & SCIENCE: The author of **CALIFORNIA** SB 492, a bill that would have allowed optometrists to expand their scope of practice to include diagnosing and treating numerous ailments related to the eye, including conditions such as diabetes, pulls that bill from further consideration this session. Sen. Ed Hernandez (D) said we will seek to bring the bill back next year (SACRAMENTO BEE).

SOCIAL POLICY: **CALIFORNIA** Gov. Jerry Brown (D) vetoes AB 926, which would have required that women providing human eggs for research be compensated for their time in the same manner as other research subjects (STATE NET, CALIFORNIA GOVERNOR'S OFFICE).

POTPOURRI: **NORTH CAROLINA** Gov. Pat McCrory (R) signs HB 589, which requires voters to show a photo ID, shortens the period for early voting and eliminates the ability to register to vote and cast a ballot on the same day. The law was immediately challenged by two lawsuits in federal court, one filed by the American Civil Liberties Union and another by the Tar Heel State chapter of the NAACP (CHRISTIAN SCIENCE MONITOR).

— Compiled by RICH EHISEN

Once around the statehouse lightly

A WELL DESERVED SALUTE: Politicos are rarely shy about patting themselves on the back. But there are definitely those who deserve it even if they won't actually do it themselves. Case in point this week comes from Atlanta, where the good folks of the National Conference of State Legislatures took a few minutes out of their annual summit to pay tribute to a very special group of lawmakers: Georgia Rep. John Yates, Idaho Rep. Frank Henderson, Virginia Sen. Charles Colgan Sr., Wisconsin Sen. Fred Risser, New Mexico Sen. John Pinto and New York Sen. William "Bill" Larkin, the last remaining state lawmakers who served in the armed forces during World War II. Four of the six — Risser, Pinto, Yates, and Colgan — were on hand to receive their NCSL Civic Medal of Honor, which also came with a nice big hug from Texas state Sen. Leticia Van de Putte. If their practically giddy reactions were any indication, the hug was as welcomed as the medal.

SHARP DRESSED MAN: Georgia Gov. Nathan Deal also made an appearance at this year's NCSL Summit, and we would be remiss if we did not note that he looked resplendent in his tailored seersucker suit. As Deal explained, his appearance coincided with "Seersucker Suit Wednesday" around the Georgia statehouse. We suppose it is a good things there is no "Shorts and flip flops" day there.

PEDAL TO THE METAL: It's over a year away from the next Iowa gubernatorial election, but one candidate is already speeding ahead with ads that take dead aim on Gov. Terry Branstad. As Des Moines TV station *KCCI* reports, Democratic candidate Jack Hatch released a video ad that mocks an incident from last April in which the governor's driver was clocked driving 84 MPH on Highway 20...with the gov in the car. Hatch's ad compares Branstad's motorized hijinks to the old Burt Reynolds movie "Smokey and the Bandit," dubbing it "Smokey and the Branstad." The video includes police footage of Branstad's car roaring down the road and cutting in and out of traffic. The gov's reaction? "I think it's a little too early to make these kinds of attacks." Uh, not in the age of the perpetual campaign, governor.

— By RICH EHISEN

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