Editorial Another bad year for CalPERS

Pension fund CalPERS provides benefits to 1.8 million employees and retirees of the state government, cities and other local agencies. (Los Angeles Times)

By **The Times Editorial Board**

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The $300-billion California Public Employees' Retirement System this month reported its worst investment returns in almost a decade: 0.6%. Bad years come and go, just like good years, and large pension funds count on time healing the deepest wounds. But this particular bad year pushed CalPERS' long-term average into dangerous waters, which suggests it's time for the fund to rethink — again — just how well it expects its investments to perform in the coming decades.

It's not a mere accounting exercise. The assumptions CalPERS makes about its returns affect taxpayers and beneficiaries in at least two important ways. The more conservative CalPERS' assumptions are, the more employers and workers have to contribute to the fund to cover the projected cost of pension benefits. (And in this case, "employers" translates to state and local governments, or taxpayers.) But the higher the expected rate of return, the more aggressively CalPERS has to invest to meet its goals, and thus the greater the volatility and the risk of losses.

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CalPERS' situation is not unusual. Governmental pension funds across the country are being buffeted by poorer-than-expected investment performance. According to a national tracking service, the long-term returns for public pension funds are expected to hit their lowest mark since the service started gathering data in 2000, the Wall Street Journal reported Tuesday.

The results, combined with trends in the global economy, point to a new normal for pension-fund investors — one with less potential for the rapid growth of yore and more risk of wild investment swings.

CalPERS is responsible for the retiree pension and health benefits for 1.8 million current and former employees on the payrolls of the state and 3,000 local governments (but not those serving Los Angeles city or county) and school districts. Its funding comes from three main sources: about 13% from public employees, 22% from state and local governments and 65% from investment returns. The employees' contributions are set by contract (and guided by state law), so the main variables are the contributions from state and local employers and the amount earned by the fund's investments.

To determine how much state and local governments have to contribute to CalPERS — and by extension, how much less they have available for other priorities — the fund estimates how much it expects its investments to earn in the coming years. It's current assumption is 7.5%. That didn't seem so unreasonable last year, when the fund was averaging 7.8% a year over a 20-year period. But after its second consecutive bust, its 20-year average is down to a little over 7%, and its unfunded liability — the gap between how much it has on hand and how much it needs to cover future retirement benefits — is expected to be around $130 billion, an increase of nearly 40% over the previous year.

Granted, one reason for the abysmal results this year was that the stock market plunged in response to "Brexit" right at the end of CalPERS' fiscal year. Nevertheless, there are plenty of economists arguing that the underpinnings of investment growth are weaker now than in past decades. Productivity increases have slowed in the U.S., and the economy is growing about half as fast as it did in the 1990s. Even emerging economies around the world are growing more slowly. Meanwhile, central banks in the U.S., Europe and other industrialized nations have kept interest rates low in the face of low inflation, which has dragged down returns on such safe investments as blue-chip public bonds.

In the short term, at least, it's politically easier for CalPERS to continue counting on big returns than investing more conservatively and requiring state and local governments to pay more of the pension costs. In the long term, though, CalPERS may find itself digging a deeper hole, necessitating a much sharper increase in state and local payments when the day of reckoning arrives.

The good times almost certainly will roll again, but the question is whether there will be enough of those good years to fill in the craters left by years like the last two. It would be better for state and local governments to start grappling with the higher cost of lower pension-fund returns now, rather than waiting until more drastic and painful steps are forced upon them.

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