PUTTING STATE PENSION COSTS IN CONTEXT:
CALIFORNIA

2015 Normal Cost of California Public Employee Pensions:	**$4,427,681,086**
2015 Cost of California Subsidies and Corporate Tax Breaks:	**$7,644,828,725**
Percentage of Pension Costs to Subsidy Costs:	**57.9%**

Public pensions have been debated thoroughly in California in recent years. In 2012, the state enacted changes to the pension system that capped benefits, increased the number of years of work required to receive full benefits and committed to greater adequacy of funding. In 2013, the board of the giant CalPERS pension fund voted to change a key accounting policy that effectively raised the contribution rates for government agencies.

While many numbers are circulated in public discussion, the central issue is how much of an obligation is being taken on each year to provide benefits for current government employees such as teachers and first responders. The best way to measure this is to use an amount known as employer normal cost. Such costs can be found in the annual financial reports that each public pension plan has to produce. In the case of California, there are two main plans administered by the state: CalPERS (California Public Employees' Retirement System) and CalSTRS (California State Teachers' Retirement System). The most recent financial reports indicate annual employer normal costs of $2 billion for CalPERS and $2.4 billion for CalSTRS, or a total of $4.4 billion. [1]

How should this amount be viewed? One approach is to compare it to the financial costs incurred by the state in supporting business through economic development subsidies and other special tax provisions. While not providing an assessment of the effectiveness of any particular subsidy or provision at achieving targeted policy objectives, such as creating good paying jobs, this approach does provide an important perspective on public sector pensions.

The state's primary economic development subsidy, the enterprise zone program, was reformed in 2014 to ensure that the program promotes the creation of good jobs and has been cut back. However, the state reports in its 2015-2016 Tax Expenditure Report that “Enterprise

Zone and Similar Areas" cost the state $700 million. It notes that "Similar Areas" includes Local Agency Military Base Recovery Areas (LAMBRAs), Targeted Tax Areas (TTAs), and Manufacturing Enhancement Areas (MEAs), but does not break-out the costs between these programs and the Enterprise Zone program. [2]

California provides other lucrative tax breaks for business.[3] The most expensive is the research & development tax credit, which in FY2015 cost $1.5 billion. The water's edge election, which allows unitary multinational corporations the option of computing the income attributable to the state using a domestic rather than a global combined report, cost $800 million. The lower tax rate paid by Subchapter S corporations cost $190 million. Accelerated depreciation of research and experimental costs resulted in a revenue reduction of $140 million.

California has been one of the states that allowed corporations to apportion their taxable income by methods other than the traditional three-factor (payroll, property and sales) weighting. Those companies opting for single sales factor cost California $909 million.

Another major form of corporate tax avoidance that eats into state revenues is the use of offshore tax havens. In November 2016, the U.S. PIRG Education Fund published a report in which it calculated the impact on this practice on each state. For California, the estimated annual cost is $3.4 billion.[4]

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to more than $7.7 billion per year, as summarized in the following table.

Enterprise Zones and Similar areas	$700,000,000
Research and Development Tax Credit	$1,500,000,000
Water's edge election	$800,000,000
Subchapter S corporations	$190,000,000
Accelerated depreciation of research and experimental costs	$140,000,000
Single Sales Factor election	$909,000,000
Revenue loss from corporate use of offshore tax havens	$3,405,828,725
TOTAL	$7,644,828,725

In other words, the annual taxpayer cost of funding the retirement benefits of current California public employees belonging to the two main state administered public pension systems is only 58 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes. California could use the $3.3 billion left over each year after paying the normal cost of state pensions, to accelerate the reduction of the $119 billion of unfunded liabilities in the state's pension systems.

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[1] The CalPERS figure is taken from the State Valuation Report for the CalPERs Fund for the year ended June 30, 2015 at https://www.calpers.ca.gov/docs/forms-publications/2015-state-valuation.pdf (the employer normal cost amounts for each sub-portfolio on pages 24-28). The CalSTRS figure is taken from total normal cost on page 16 of the plan's Defined Benefit Actuarial Valuation as of June 30, 2012 at http://www.calstrs.com/sites/main/files/file-attachments/2015_db_valuation_report.pdf minus the employee contribution figure on page 48 of the report.

[2] Tax Expenditure Report 2015-2016 (California Dept. of Finance) http://www.dof.ca.gov/Forecasting/Economics/Tax_Expenditure_Reports/documents/2015-16_TE_Report_revised_01_15.pdf

[3] All the figures in this paragraph and the next come from Tax Expenditure Report 2015-2016 (California Dept. of Finance) http://www.dof.ca.gov/Forecasting/Economics/Tax_Expenditure_Reports/documents/2015-16_TE_Report_revised_01_15.pdf

[4] U.S. PIRG Education Fund, *Picking Up the Tab: Small Businesses Bear the Burden for Offshore Tax Havens:* (November 2016); http://www.uspirg.org/sites/pirg/files/reports/USP%20PickTab%20Nov16%201.0.pdf

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