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RESEARCH SUMMARY

A Lost Generation but Renewed Hope: Oregon's Pension Crisis and the Road to Reform

Oregon's pension crisis has placed pressure on state policymakers as they try to reform their pension system. One of the most controversial issues they face is whether they can legally eliminate benefits for work that current and future government employees have not yet performed. A number of states, including Oregon, have embraced the "California Rule," a legal doctrine that, in Oregon, is based on a misunderstanding of federal Contract Clause precedent. Under this rule, states have been prohibited from reducing pension benefits for current government employees, even for work that lies in the future and may not be performed for decades. This rule has limited pension reform options and led to an inequitable treatment of younger workers.

In "A Lost Generation but Renewed Hope: Oregon's Pension Crisis and the Road to Reform," Scott Andrew Shepard discusses how the Oregon Supreme Court has belatedly, but not yet completely, attempted to reject the California Rule. It still uses its 1996 adoption of this rule to suppress the application of certain state constitutional provisions and legislation designed to rein in pension spending. But the state would not violate any constitutional norms or face any lingering objection from the US Supreme Court even if it eliminated all pension benefits for prospective work done by current and future employees.

BACKGROUND

The official base rate at which Oregon's public employers must contribute to their employees' pensions increased by nearly 20 percent between the 2015–17 period and the 2017–19 period. This base rate is likely to increase even more within the next few years, illustrating the structural funding deficit in which Oregon's pension funds now find themselves. While the foundations of the current crisis have existed for decades, two major setbacks exacerbated Oregon's pension problems and added more than 50 percent to the Public Employees Retirement System (PERS) deficit, which currently totals approximately $21 billion.

- The legislature made a 2013 attempt at pension reform that the Oregon Supreme Court struck down almost in its entirety in 2015. This judicial override reinstated approximately $5 billion in benefits to current workers and retirees, thus adding $5 billion to the total pension funding shortfall.
- While PERS investments earned a positive rate of return in 2015, that return was less than one-third of the rate of return that pension authorities had predicted. This mismatch between expectation and reality resulted in a further $3 billion shortfall.

REFORM OPTIONS

Reform the Oregon Constitution

A 2015 Oregon Supreme Court decision recognized explicitly what it had ignored in its previous 1996 decision: that the federal Contract Clause has no prospective effect. Now Oregon courts must work to revive the state constitution's pension reform provisions that the 1996 decision had suppressed. Enacting a constitutional amendment could also help ensure that the state does not repeat its past mistakes. Doing so would enable the state to consider long-term solutions to its pension funding shortfall.

Move to a defined contribution plan

Oregon could shift from a defined benefit pension system, under which the state is obliged to make certain fixed, predetermined payouts to former employees during their retirement, to a defined contribution system, in which the state makes certain fixed, predetermined payouts into employees' individualized retirement accounts regularly during their term of employment. This change would require payments to be made as they are due, rather than being shifted to future generations. This inability to promise now and pay later would have a corollary benefit of thwarting government employers' impulses to make extravagant pension promises.

Revise the discount rate

Oregon's discount rate (or assumed-savings rate, in the state's unique terminology) has been falling slowly over the last few budgets, from 8 to 7.5 percent, but it still remains far too optimistic. The discount rate is an estimated rate of return that assumes the high payout from a risky investment without also assuming the corresponding potential loss. But various experts suggest that the appropriate method of determining the true liability generated by a pension fund is to compare the discount rate with the actual present value of the liabilities. This rate is usually somewhere between 4 and 6 percent.

LESSONS FOR OTHER STATES

Despite Oregon's current pension crisis, the state can still offer many lessons for other states that are navigating their way out of similar crises. Other state supreme courts that are facing similar constitutional and legal debates must be on the lookout for the next pension case that could give them the opportunity to review their adoption of the California Rule and the treatment of benefits not yet earned by workers. Favorable court decisions will grant the respective state assemblies immense additional opportunity to address their pension crises.