Los Angeles on the Brink of Bankruptcy

What Mayor Villaraigosa must do to save the city

By RICHARD RIORDAN AND ALEXANDER RUBALCAVA
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Los Angeles is facing a terminal fiscal crisis: Between now and 2014 the city will likely declare bankruptcy. Yet Mayor Antonio Villaraigosa and the City Council have been either unable or unwilling to face this fact.

According to the city's own forecasts, in the next four years annual pension and post-retirement health-care costs will increase by about $2.5 billion if no action is taken by the city government. Even if Mr. Villaraigosa were to enact drastic pension reform today—which he shows no signs of doing—the city would only save a few hundred million per year.

Los Angeles's fiscal woes can be traced to two numbers: 8% and 5,000. Eight percent has been the projected annual rate of return on the assets in Los Angeles pension funds. Four years ago, we strenuously warned Mr. Villaraigosa of the dangers behind the myth of that 8%, only to be told by the city controller's office that our warnings were "based on faulty assumptions which are largely disputed."

How faulty were our assumptions? Over the last decade, the two main pension funds in Los Angeles have seen their assets grow at just 3.5% and 2.8% annually.

Five thousand is the number of employees added to the city's payroll during Mr. Villaraigosa's first term as mayor. According to California's Economic Development Department, when Mr. Villaraigosa took office there were 4.73 million jobs in Los Angeles and 252,000 unemployed people. Today, there are just 4.19 million jobs in Los Angeles and over 632,000 unemployed people.

The mayor can't control the economy, but he could have chosen to control spending to keep the size of government proportional to the size of the local economy. Instead he's done the opposite: squeezing the city's productive workers to fund the salaries, pensions and other benefits of government workers.

How have city leaders responded to the crisis? Pension officials have played accounting games, like smoothing the investment return over seven years rather than five years. This is designed to dilute the near-term effect of the financial meltdown at the expense of much higher payments later.

The City Council, wincing at the mere thought of layoffs, chose to shrink the work force through an early retirement program for city workers. This costly program, suggested by union leaders, will not be paid off for 15 years. And most egregiously, rather than laying off employees, city officials have shifted certain workers to agencies like the Department of Water and Power and the airport, which have their own funding.

In order to pull the city back from the brink and put Los Angeles on the road to recovery, the following steps must be taken:

- Defined benefit pensions must be replaced with 401(k) accounts for new employees.

- Current employees must pay much more than 6% (or 9% in the case of public safety employees) of their salaries for their pension benefits. At a time when the city is contributing over 25% of payroll to the pension funds, this is only fair.

- Increase the retirement age to 65.

- Reduce city staff back to 2005 levels. Since the police and fire departments represent more than 80% of the city budget, they must also be forced to run more efficiently.

- Eliminate the $300 million spent on costly retiree health-care benefits. City workers who retire before they are eligible for Medicare enjoy health insurance subsidies up to $1,200 a month, courtesy of Los Angeles. We can no longer afford to subsidize these Cadillac plans.

As a result of his delays in responding to the city's fiscal emergency, Mr. Villaraigosa has squandered not just his career, but his relevancy. He continues to insist that bankruptcy is not an option for Los Angeles even as anyone who can count understands there is no other option.

Meanwhile, Los Angeles is still the best place to live—ask anyone who enjoys its beaches, mountains and climate. If the mayor wants to keep it this way, he'd better act now.

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