The Next PERS-type Pension Fiasco?

Tri-Met tangles with pensions and payroll taxes
By John A. Charles
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In 1999 TriMet initiated an experimental shuttle in the Cedar Mill neighborhood on Portland's west side. Cedar Mill is a low-density area with many hills and cul-de-sacs, making it impractical for traditional fixed-route bus service. TriMet contracted with Sassy Cab Company to use two vans to provide specialized service within the neighborhood. Riders were required to call a day ahead of time to make reservations, and they would be provided door-to-door transit anywhere within the neighborhood. The price was the same fare required for a TriMet bus or light rail ride. A primary (if unstated) purpose of the service was to boost ridership on TriMet's Westside light rail line by bringing riders to the Sunset Transit Center.

Sassy received $12,700 a month for which they provided service throughout the Cedar Mill region for 14 hours a day, five days per week. The company made a small profit from this work.

Although the private sector service was working well, TriMet brought it in-house in September 2002. This was a requirement of its labor contract with the Amalgamated Transit Union (ATU). Expenses immediately increased by 18 percent and service was cut by 50 percent. Under Sassy the service was all-day; now it's only during the morning and afternoon peak periods. The Sassy service cost $24 per driver-hour; the unionized service is costing $49 per driver-hour.

Given TriMet's willingness to use labor priced at 100 percent above the market rate, one might surmise that the agency has a lot of cash. In fact, however, the opposite is true; TriMet is facing a fiscal crisis. The agency currently has a bill pending in the Oregon legislature to raise its regional payroll tax from the current rate of $6.22 per thousand of payroll to $7.22 over a ten-year period. That tax is TriMet's largest source of revenue and brought in more than $155 million last year.

Why would the agency refuse to use less expensive outside labor? Because TriMet managers don't really have a choice. They gave away their rights to decide a decade ago.

THE SUMMER OF '94

The roots of TriMet's financial crisis go back to February 1994, when TriMet management and the ATU reached a verbal agreement on a new contract that would vastly increase costs for the agency over the next 10 years. The agreement, negotiated behind closed doors, reduced the agency's ability to contract out work to lower-cost firms, increased wages, and dramatically raised the long-term cost of employee benefits.

Senior TriMet staff negotiated the contract. The terms of the agreement were so secret that for months even the TriMet board did not know what had been promised to the union. When details became known, it immediately created tension between Loren Wyss (Board Chairman for 8 years) and General Manager Tom Walsh, who had approved the settlement. Wyss thought that the ATU had received most of the benefits of the contract while giving up nothing in return.

The rift grew over subsequent months. Walsh sent a four-page memo in May 1994 to Bob Stacey of Gov. Barbara Roberts' office: "Tri-Met needs either a new board president or a new general manager." In early August, Wyss was summoned to the governor's office to discuss the conflict. Midway through the meeting Wyss resigned.

At the time, Walsh claimed to have had no prior contact with the governor, who appoints the seven TriMet board members. Six days later, after the Oregonian published a story quoting from the May memo, it was clear that he had helped orchestrate Wyss' ouster.

In December of that year, both the ATU and the TriMet board ratified the contract. A few days later, in a scathing letter to the editor of the Oregonian, Wyss predicted that the labor agreement would doom TriMet to rising costs and declining productivity. He wrote:

"...the contract just approved by Tri-Met union employees will protect all its members from additional contributions to their pensions for 10 years. It will also guarantee 3 percent minimum wage increases in the future, no matter what happens to the economy or to other public budgets.

"And that's not all. Unused sick leave should add annual year-end bonuses of $500 to $1,000 for those with perfect attendance records; every single dollar of health, welfare, dental and vision plans will be paid for by the public employer; retirement age will decline to 58 within 10 years; and nonunion operators who have helped keep down the cost of shuttle lines will be forced to join the union, at large increases in wage expense.

"It now appears that the Amalgamated Transit Union has succeeded in pulling off one of the greatest coups in the history of public employment in our city, while the press is focused on the voting of a few public officials. Who is guarding the public interest in this issue? Where is the discussion?

"If there is one predictable reason for transit to fail its mission, it is the burden of fixed costs, which this contract guarantees."

THE DEATH SPIRAL BEGINS

During the mid-1990s, as the Portland economy went through the most sustained period of growth in history, cash from the payroll tax poured into TriMet's offices in record amounts. At the time of the union contract signing in 1994, the payroll tax was bringing in $89.5 million per year. Within eight years it had gone up to $155.5 million. This accounted for 57 percent of all operating revenues in Fiscal Year (FY) 2001-02.

TriMet opened Westside light rail in 1998 and Airport MAX in 2001, initiated construction on the North Interstate rail line, received political approval for three more rail lines (at a likely cost of over $2 billion), and began operating the Portland Streetcar. The good times seemed to be rolling.

Unfortunately, the economy began tanking in 2000. TriMet's payroll tax revenues peaked in FY 2000-01, then declined by three percent the following year. Revenues increased by only 1.1 percent in FY 2002-03. Yet labor costs were growing rapidly. According to agency records, between 1994 and FY 2003-04 the number of employees increased 25 percent, total salaries and wages went up 75 percent, and the cost of health benefits increased 179 percent. Annual pension costs for union members went up 242 percent between 1993 and 2002.

The total cost of all fringe benefits was 60 percent of payroll in 2001 and 65 percent in 2002; they are likely to exceed 70 percent in 2003. In essence, employee benefits are rapidly cannibalizing the general fund budget.

There is also a growing problem with unfunded pension liability. TriMet, like many public employers, operates a "defined benefit" retirement plan for most of its employees (separate from the state program, PERS). This means once TriMet employees retire, they are eligible to receive certain benefits such as monthly income and health insurance for as long as they live. TriMet is required to put money into the pension fund every year to ensure that enough cash is available to pay for the obligations to current retirees. However, if the fund does not have enough money to pay for all the estimated obligations to future retirees, that creates what is known as an unfunded accrued liability.

In 1993 the unfunded pension liability for the bargaining unit plan was $38 million. By 1997 it had grown to $61 million, and by June 30 of 2002 it was $112.4 million. The growth in liability has outpaced TriMet's growth in employment, as evidenced by the fact that in 1993 the unfunded pension liability per TriMet employee was $18,630 and by 2002 it had increased to $43,230.

TRIMET'S CITIZEN ADVISORY COMMITTEE: FROM WATCHDOG TO LAPDOG

Each year TriMet convenes an outside group called the Citizen Advisory Committee (CAC) for the budget. The CAC is a seven-person group of volunteers that reviews financial data each year prior to formal budget adoption by the TriMet board. Individuals generally serve three-year terms, and the committee meets approximately two times per month from December through March. Each year the committee releases a report in April or early May, commenting on various aspects of the proposed budget.

In 1995 Tony Rufolo, a professor from Portland State University who teaches transportation economics, chaired the committee. When the committee's report was released that year, it had a harsh assessment of TriMet's performance. On the opening page the report states, "It does not appear that simply providing additional service will achieve the ridership goals that have been set by TriMet." The report continues, "While ridership has been growing, other forms of travel have been growing more rapidly, so that TriMet serves a smaller share of regional trips. This trend is clearly the opposite of expectations generated by the Strategic Plan."

The committee report criticized the 1994 labor contract for raising costs and reducing flexibility: "The CAC continues to believe that the agency must look to alternative service provision for low-density areas and must work more closely with local governments, employers, and others in developing innovative methods to improve service. The recent labor agreement that changed alternative service from a contracted status to an in-house service is seen as a roadblock to achieving these goals. In-house provision is more costly than contracting and greatly reduces flexibility in providing alternative service."

The committee was also concerned that TriMet was increasingly relying on non-passenger sources of revenues to fund operations. The report notes that TriMet had a stated goal of getting 30 percent of its operating revenue from passenger fares, but that the goal had never been met and there appeared to be no commitment to making it happen.

Professor Rufolo presented the report to the TriMet board at a public meeting in April 1995, and he didn't sugarcoat things. He said, "We've seen the goals, and we've seen the strategic plan. We just don't see the connection between the two."

The TriMet board was stunned by this review. Board member Shirley Huffman told the Oregonian, "This is the most frank of the budget reports that I have ever read."

Unfortunately, the CAC advice did not lead to any noticeable change at TriMet. Apparently some people on the board rejected the message because they didn't like the messenger. Nita Brueggeman, a TriMet board member at the time, says that although the CAC played "an incredibly influential role in the formation of the budget," Tony Rufolo "was anti-public transportation so his dissertation wasn't very helpful."

Rufolo's term on the CAC expired in 1995 and he left the committee. Never again did the CAC provide such a blunt reality check. In 1996 the report mentioned concerns (again) about the high costs of the 1994 labor contract, and reiterated the desire to recover 30 percent of operating revenues from the farebox (it was about 24 percent at the time). In each succeeding year, the CAC reports became increasingly optimistic about the future and less critical of the past.

The 2003 report, released on May 14, is essentially a puff piece that shows little in the way of independent thinking. For instance, in a section on the Interstate MAX entitled "Business Vitality," the report states, "It was exciting to learn that more businesses exist today along the Interstate MAX alignment than before construction began. All of this in spite of the fact that construction has taken place in a depressed economic environment! This demonstrates (a) the effectiveness of TriMet efforts to support existing local businesses during the construction period and (b) how light rail can serve as a catalyst encouraging economic development, even during very difficult economic times."

There is no mention of the multiple businesses that have been forced to shut down due to the disruptive effects of rail construction. Nor is there any apparent understanding of how many subsidies have been required to entice development along Portland light rail lines, including 10-year property tax abatements, grants, and reductions in system development charges.

Elsewhere the report describes the Washington County commuter rail line planned along the HW 217 corridor as a "nice 'test case' where a high-speed rail alternative closely parallels a major highway and Interstate system." In fact there is no "high-speed" rail being planned in Washington County or anywhere else in Oregon. The commuter line will average 36 mph with a top speed of 60 mph. The 18-mile trip will take 30 minutes, not including waiting time.

Moreover, we already have a test case for rail paralleling an Interstate Highway: Eastside MAX. After 16 years of experience, we know that it's not cost-effective and it doesn't relieve highway congestion. It's not really necessary to learn this again.

Rather than looking out for taxpayers, the CAC was so excited about TriMet's proposed payroll tax increase that they even reprinted a glowing editorial from the Oregonian in the report—the first time an editorial has ever been included.

From 1996 to 2003, none of the CAC reports look at the problem of rising labor costs. Mary Fetsch, TriMet's communication director, confirms, "The CAC has not discussed the issue of employee benefits." This is hard to fathom given the widespread media attention in the past 12 months to the $15 billion unfunded pension liability of the Oregon Public Employee Pension System.

Today, Professor Rufolo comments, "Tom Walsh was furious with the article that Gordon Oliver (reporter for the Oregonian) wrote and I was told afterwards that the TriMet staff were instructed to 'manage' the CAC process better to avoid such critical statements in the future." If that's the case, the strategy has clearly worked.

OPTING OUT OF TRIMET: SMALL IS BEAUTIFUL

The experience with the Cedar Mill Shuttle provides a rare glimpse into the real-world differences between TriMet's cost of service and the competitive market. Additional insights can be gained by looking at the track record of small jurisdictions that have used special provisions of TriMet's enabling statute to leave the service district. Wilsonville withdrew from TriMet in 1988, Molalla and Happy Valley in 1989, Sandy in 2000, and Canby in 2002. The results for these communities since then show that smaller transit districts are far more cost-effective than TriMet.

Wilsonville provides a much higher level of service than was formerly provided by TriMet, and customers get to ride without paying fares. Operating revenues are paid through the same type of regional payroll tax that TriMet uses, yet Wilsonville's tax rate is less than one-half that of TriMet's--$3 per thousand of payroll.

After Wilsonville first withdrew, it signed a contract in 1989 with Buck Ambulance to provide door-to-door transit service. In 1991 the first passenger van was purchased, and gradually over the course of the decade additional equipment was bought and services expanded. Annual boardings were less than 20,000 in 1992; they exceeded 160,000 in 2000. Service is provided to Salem, Oregon City, Canby, and to connection points with TriMet buses.

Wilsonville has been able to expand without raising the payroll tax in part because the districts cost per route has been declining. The cost per hour of operations in 1992 was $78. It dropped to $62 in 1995 and dropped further to $58 by 1998.

In Sandy the service between Gresham Transit Center and Sandy went from peak-hour only under TriMet's management to all day plus Saturday service when the city took it over, and fares were eliminated. Operating revenue is paid for by a local payroll tax that is slightly lower than the former TriMet tax. In the three-plus years of operation, Sandy ridership has gone up over 600 percent.

When Sandy set up its service, it took competitive bids from private firms to operate the shuttles. The city has one employee who works full-time as the transit coordinator. Costs are low because there are few employees, virtually no management bureaucracy, and the system is entirely road-based. That means the city does not have special responsibilities to maintain infrastructure, as it would if it used fixed rail; the road system is paid for by millions of other users through their gas taxes and weight-mile fees.

TriMet cannot remotely compete with Wilsonville, Sandy or the other smaller jurisdictions because it is a big, inefficient monopoly. The supposed "economies of scale" that many people thought would result from the government-mandated takeover of Rose City Transit in 1969 never happened. What we've learned is that government monopolies create diseconomies of scale, primarily in the form of administrative overhead (e.g., fulltime administrators, labor relations personnel, lobbyists, and human resource specialists), long-term liabilities in pensions and benefits, and expensive upkeep of fixed-rail right-of-way whose costs must be borne entirely by the transit agency.

One can actually trace the transformation of TriMet from a relatively small, user-financed agency to a bloated, tax-supported bureaucracy by looking at several numerical trends. For instance, in 1971 drivers constituted 73 percent of TriMet's work force. By 1999, this had declined to 49 percent. It's hard to say what the other 51 percent of employees are doing to actually improve transit.

In 1971, passenger fare revenue paid for 38 percent of all costs. Passenger fares declined to 25 percent of costs in 1981, 17 percent in 1991, and 9 percent in 2001. As users paid less of the real costs, they actually became less important to TriMet. The payroll tax is now much more important than ridership, because in a good economy the money flows in regardless of whether TriMet provides service that anyone cares about.

TRI-MET RESPONDS

TriMet has taken several measures in recent years to reduce the high costs of labor, most notably in pension reform. In July 2001 the agency developed a new defined contribution pension plan for management and union employees and submitted it to the IRS. The plan provides for TriMet to make a fixed contribution of eight percent of the employee's salary into their pension account. According to TriMet General Manager Fred Hansen, "There is no guaranteed return on investment; each employee will have the ability to direct his/her investments in a variety of investment options, and the ultimate retirement benefit will depend on each employee's account balance at the time of distribution of the account."

In recommending approval of the plan to the TriMet board earlier this year, Hansen said, "Not only does this new plan give employees control over their own investments, it also provides TriMet with a great deal more certainty in the funding of the retirement plan." He also noted that the portable nature of the plan, whereby each individual owns their retirement account and can take it with them when they leave, is more appealing to many contemporary workers who do not envision themselves staying with the same employer for 30 years or more.

The defined contribution plan will be mandatory for all new management and staff employees hired after April 27, 2003 and optional for current employees.

While this was an important step forward, in many respects it's too little and too late. Three trends are driving TriMet towards financial ruin. The first is the long-term financial obligations already incurred to current employees. Regardless of the new pension plan, TriMet is still on the hook for expensive fringe benefits that will be owed to current employees for decades to come.

The second is the inability to contract out work to lower-cost labor. Previous budget committee reports noted that the expanding market of suburb-to-suburb travel is not one easily served by TriMet's traditional reliance on fixed-route service. As regional land-use patterns continue to decentralize, the agency will need to experiment with more flexible, small-scale shuttles using outside labor. But TriMet's union agreement makes that almost impossible.

The final trend is TriMet's suicidal commitment to fixed rail, including the regional light rail program, the Portland Streetcar, and now the Washington County commuter rail line, which will run from Beaverton Transit Center to Wilsonville. Even though the agency receives federal grants to help pay for construction, the operation and maintenance of fixed rail is extremely capital-intensive. Costs of track maintenance, overhead wire repair, and upkeep associated with the many park-n-ride facilities (which are built mostly for rail, not bus service) must be borne exclusively by TriMet. The revenue simply isn't there from passenger fares to pay for all this.

HISTORY REPEATING ITSELF

Although 1994 was a landmark date in TriMet labor relations history, it was not the only instance where politics trumped common sense. In 1968, when transit service was still being provided by the privately owned Rose City Transit Company (RCT), the mayor of Portland intervened in labor contract negotiations because of fears of a possible strike. The drivers wound up with a 45-cent per-hour raise in one year, 4.5 times the average annual increase they had received in the previous three years.

That by itself may not have been so bad, but when Rose City subsequently sought to raise passenger fares from 35 cents to 40 cents to cover the increased wages, the Portland City Council, which regulated rates as a condition of the RCT monopoly franchise, denied the rate increase and then terminated the franchise agreement. The City Council then succeeded in getting a bill passed in the state legislature authorizing the creation of a government-run transit district to take over service. TriMet used the powers of eminent domain to take over Rose City's assets, and implemented a payroll tax in order to help fund the system.

This was supposed to be a small, temporary tax used to jump-start the new agency. According to an official TriMet account of that period, "After looking at seven taxing options—of the array authorized by the legislature—Tri-Met adopted a payroll tax of one-half of one percent, to become effective on January 1, 1970, and hopefully to be reduced to 1/10 or 2/10 of one percent as soon as possible" [emphasis in original].

Of course, things never worked out that way. The new tax rate was permanent, and after the dust settled, TriMet was receiving the revenue equivalent of what would have been a 25-cent fare increase for Rose City Transit, if the City Council had been willing to grant such an increase. That should have been the first clue for local taxpayers that having the government run a "non-profit" transit business was going to be a costly affair.

Moreover, much of the money was immediately used to increase TriMet wages. According to the TriMet history, "For some time, driver wages [at Rose City Transit] had been below those of comparable west coast cities. TriMet's first decision was to conclude a new 18-month contract with the transit workers' union, bringing their pay scale to a status comparable to other West Coast transit contracts."

It's clear that neither the TriMet board nor local elected officials have ever been overly concerned about protecting taxpayers. TriMet's current effort to raise the payroll tax rate simply continues a trend that began the day the Portland City Council used the government's power of eminent domain to put a private bus company out of business.

WHAT TO DO

TriMet's request for increased tax revenue could hardly come at a worse time for Portland businesses. Some are already leaving Portland to escape its anti-business climate, and a bump in taxes for transit services that many don't even use will push others over the edge. Before a tax rate is authorized, a number of other measures should be considered.

One is to abolish Fareless Square. The policy of free transit in downtown Portland was originally motivated by compliance with the Clean Air Act, but urban air quality is no longer a pressing concern. The air is better in Portland than it's probably been in 50 years and it's likely to get even better due to technological innovation.

Fareless Square presents a multitude of problems: it artificially inflates ridership; it slows down service by increasing the time it takes to let passengers on and off; it encourages Portland's population of transients to ride back and forth to Lloyd Center, to the detriment of legitimate passengers; and it costs millions of dollars in foregone revenue.

If transit is actually a valuable service, it's worth paying for it at least in part by its users. Getting rid of Fareless Square would help TriMet reach its long-stated goal of raising 30 percent of operating revenues from the farebox.

Another step toward fiscal sanity would be to abandon the quixotic rail building campaign. All of the rail lines currently on the planning agenda—light rail to Clackamas Town Center, Milwaukie and Clark County, along with the Wilsonville-to-Beaverton commuter rail line—are projects in highly suburbanized communities where there is no natural ridership base. Rail is irrelevant to a region that is steadily decentralizing, and the effort to prop up this 19th century system will require massive increases in tax subsidies.

Another change worth considering is mandating certain levels of competitive bidding for transit routes. The TriMet board could actually be split off from the agency and given a new mission of setting routes and then taking bids for the service. TriMet should be required to bid on every line, and if a private competitor has a lower-cost bid, they should get the job. This would introduce much-need market discipline to future labor negotiations.

Although these may seem like long-shot proposals, the PERS crisis has sensitized many political leaders to the problem of unfunded long-term liabilities in public employment contracts. Gov. Kulongoski has been willing to embrace a "tough love" approach to his union backers, despite their outrage, so there's no reason why the legislature couldn't take the same approach with TriMet.

On the other hand, it's hard to see why legislators would take this step when the lobbying organizations representing many of the large employers in the Portland region refuse to stand up and defend themselves. At a May legislative hearing in the House Transportation Committee, not a single business representative spoke against the TriMet tax bill. In fact, Lynn Lundquist of the Oregon Business Association and Mike Salsgiver of the Portland Business Alliance endorsed it.

The Westside Economic Alliance, a group representing employers in the most economically productive county in the state—Washington County—has remained silent publicly, even though the payroll tax forces large suburban employers to subsidize downtown interests because of TriMet's routing system that directs most service to the central city.

As of this writing, the TriMet legislation has passed the Senate and is still pending in the House Rules Committee. Given the difficulty of getting new tax measures passed this year, the fate of the bill may not be decided until the final days of the session. The outcome will dictate whether transit in Portland becomes more innovative, or simply more expensive.

(Several TriMet board members were contacted for this story. None returned phone calls.)

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SIDEBAR: UNION COMPENSATION

Early proponents of TriMet were confident that a government monopoly would provide more cost-effective transit than a private firm because it would not have to pay taxes or generate dividends to stockholders. While these may provide some advantages, they are dwarfed by the fiscal effects of unionization in the workforce, which is much more prevalent among public employees. According to the Bureau of Labor Statistics:

- In March 2002, overall total compensation costs were 44 percent higher among state and local government employers ($31.29 per hour worked) than among private sector employers ($21.71 per hour worked).
- State and local government employers? wages and salary costs were 40 percent higher than among private sector employers and benefit costs were 55 percent higher.
- In 2002, 13.2 percent of wage and salary workers were union members. Within government, 37.5 percent of workers were union members, compared with 8.5 percent of employees in private sector industries.
- In 2002, full-time wage and salary workers who were union members had median usual weekly earnings of $740, compared with a median of $587 for wage and salary workers who were not represented by unions.

According to TriMet's budget for FY 2003-04, the cost of benefits in the coming year will be:

- Health and welfare benefits: $10,061 per full-time union employee, $9,255 per management employee.
- Disability and life insurance: $347 per union employee, $414 per management employee.
- Pension expense: $9,767 per union employee, 13.7 percent of gross income per management employee. The pension expense also includes the current year portion of 30-year funding of unfunded actuarial accrued liability.
- Sick and vacation payoff expense: $260 per union employee.