

State of South Carolina

Office of the Governor

MARK SANFORD
GOVERNOR

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May 26, 2008

The Honorable Robert W. Harrell, Jr.
Speaker of the House of Representatives
Post Office Box 11867
Columbia, South Carolina 29211

Dear Mr. Speaker and Members of the House:

I am hereby vetoing and returning without my approval H. 4876, R-295, a bill that would change the way mandatory and *ad hoc* Cost of Living Adjustments (COLA) are granted for state retirees.

This bill is fundamentally flawed, and as such will prove to be a real problem in the long run to both taxpayers and retirees.

The old saying is that when you are in a hole, quit digging – yet this bill artificially and arbitrarily raises the projected rate of return for the retirement fund so that more spending can take place now – though we have already accumulated over \$20 billion of unpaid-for political promises. We have absolutely no plan for addressing the existing liability – which would put you in jail if you did this with private pension fund assets – and yet we are going to add to spending commitments. We have made our concerns known in written form to the Treasurer's Office and, unfortunately, he has chosen to look past what we believe are his fiduciary responsibilities in acquiescing on this proposal.

At the core, we continue to believe that the state should not spend money it doesn't have and should instead try to honor past promises before making new ones.

South Carolina taxpayers are already on the hook – in large part without their consent – for over \$27 billion in liabilities related to retirement and health care benefits. This invisible mortgage represents almost three times the state's budget and means each and every state taxpayer is in debt an additional \$14,000 – over and above more than \$9 trillion in national debt.

H. 4876 potentially adds another \$2.6 billion to this \$27 billion unpaid-for political promise while artificially boosting expected returns, to bizarrely justify more spending. Specifically, the eight percent investment return assumption is out of line with other states facing similar retirement issues. Factoring in inflation, our rate of return would move to five percent – higher than the national average and that of neighboring states. In fact, according to the actuary group,

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Milliman, South Carolina's optimistic expectations are 11 percent higher than the national median for public funds, 33 percent higher than Georgia's retirement system, and 43 percent higher than North Carolina's. In the real world, if you chose to assume a higher return in your savings account – higher than your neighbors' returns – and then increased your spending instead of paying down your existing mortgage, it would be considered financially reckless. No matter how you slice it, this bill does something similar at the state level.

With regard to the COLA-specific portion of the bill, we think the logic is left wanting on two fronts.

First, the bill's present-term solution disregards historical trends and, as a consequence, will likely create shortfalls in the future. We've been very clear that there needs to be complete transparency in the retirement system – and that includes building in the total cost of the COLA. This legislation doubles the COLA assumption from one percent to two percent – while historically the average COLA has been about three percent. As you will recall, S. 618 in 2005 enacted the guaranteed one percent COLA, but left open the option of a further COLA increase on an *ad hoc* basis by the Budget and Control Board. As a result, this bill either locks in future COLAs at two percent annually or continues the practice of underestimating the annual *ad hoc* COLA that will almost certainly be approved by the Board.

Second, even if it is a cost neutral proposal – which we have serious doubts about – the bill seems to misplace its priorities. Rather than dedicating the reduced liability to building up the COLA, we believe the first order of business should be to reduce the overall liability. As much as retirees care about COLA as a way of guarding their returns from inflation, most retirees I talk to care even more that government will honor its commitment to the viability of the system itself – because without it there is no payment onto which a COLA can be added.

The State Retirement System's unfunded liability is still 18 months shy of the 30 year cap. I predicted when the General Assembly enacted S. 618 in 2005, the unfunded liability would be back close to this cap in just a few short years. Fast forward to today, roughly six years has been added to the unfunded liability since that bill was passed. Another short-term “fix” that does nothing to address the long-term liability is, in my view, unacceptable.

At its core, this bill looks to guarantee a two percent annual COLA increase. While that may in itself be a worthy endeavor, we'd ask the General Assembly to first explore options based on this common-sense notion of paying for existing promises before making new ones. We've recommended reforms such as closing the state's defined benefit retirement plan to new entrants and moving back retirement eligibility to 30 years from the current 28. We've also suggested that budget writers use more surplus dollars to pay down the overall liability, and this year's passage of H. 3789 would allow them greater latitude in doing so. Unfortunately, this year the General Assembly also went in the opposite direction and took two steps back by taking \$42 million from the reserve account dedicated for retirement.

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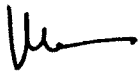
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We continue to believe greater steps need to be taken so that the state's financial burdens are not handed to the next generation of taxpayers, and I'd ask that you consider our concerns outlined above as you reconsider this legislation.

For the above reasons, I am vetoing H. 4876, R-295. I would strongly ask for our children's sake you do the same.

Sincerely,

A handwritten signature in black ink, appearing to read 'Mark Sanford', with a stylized flourish at the end.

Mark Sanford