The Washington Times

EDITORIAL: State pensions in the red

Public employee retirement system crisis continues to worsen

Thursday, March 1, 2012

New York is the latest state struggling to bail out its overgrown public pension system. Like the retirement programs of other state and local governments nationwide, the Empire State's program is in the red, and it's looking for $750 million in loans this year. What's worrisome is that until just a few years ago, New York pensions were considered adequately funded.

The story repeats itself from coast to coast. Government retirement programs offer overly lavish promises backed by inadequate contributions and a lack of transparency. New York's gimmick to get through this year is to offer reduced contributions today in exchange for promises of higher payments in the future. The problem with this approach is that the public employers, the state and local governments, are borrowing from the state's own pension system so they can finance their contributions to the system. It's nothing more than an accounting trick: No actual money goes in, but pensions still have to be paid out. The result is a pension system with less funding than before.

It's easy to blame the dire pension situation on the banking crisis, the recent recession and the anemic recovery, but some state pension plans were in trouble and considered inadequately funded even before 2001. That's what Cato Institute researcher Jagadeesh Gokhale concluded in a report released last week. Despite the housing and equity boom that occurred between 2004 and 2006, the share of pension plans that were considered inadequately or poorly funded continued to grow steadily through 2009 (with the exception of 2007). Using the fair market value of assets of the portfolio as the standard, about one-half of state and local pension plans had fallen below the critical 60 percent funding level by 2009.

The red ink wasn't just caused by the market crash. The numbers actually might understate the extent of underfunding. The General Accounting Standards Board (GASB) requires the pension plans to discount future payouts at the same rate as the rate of return on the investments that will be used to pay the benefits. Pension plans invest in all kinds of risky assets with fluctuating returns. They typically use investment returns of 8 percent or more as the discount rate.

This is highly problematic. First, the Dow Jones industrial average grew at the rate of 5.3 percent over the 20th century and shows no sign of exceeding 8 percent this century. Second, pension-fund liabilities usually are constitutionally guaranteed, which means states almost certainly will not default. The appropriate discount rate on these, then, is, as Mr. Gokhale says, closer to that on U.S. Treasuries. That rate currently is virtually zero.

These programs simply cost too much. Eighty-four percent of state and local employees have access to a defined-benefits plan, compared to just 20 percent in the private sector. That's bad because the payouts for public employees are about three times higher than what private-sector workers receive. States aren't going to repair their economies without dealing with this imbalance in a serious way, without the smoke and mirrors.