MarketWatch

Opinion: Collapsing pensions will fuel America's next financial crisis

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Cash-strapped pension funds could leave millions of Americans high and dry in the very near future

The Teamsters continue to seek permission to make deep cuts to pensions in its Central States plan. An earlier version said permission had been granted.

Teamsters union retirees protest in Washington in 2016 against deep cuts to their pension benefits.

Washington has a knack for ignoring long-term financial shortfalls and painting overly rosy scenarios about the future to make their numbers work in the here and now.

Case in point: Donald Trump's unrealistic projection that the U.S. economy will grow at 3% this year, when the latest GDP forecasts have actually been reduced to 1.8% by a number of economists.

Then there is Social Security. Many politicians are just too intimidated, uninformed or complacent to tackle the unsustainability of Social Security — which by the latest tally will see its trust fund go to zero just 17 years from now, in 2034.

But while fudging GDP numbers is dangerous for America's economic outlook and the demise of Social Security in two decades is a serious long-term concern, America faces a mathematical problem that dwarfs both of these items: A pending pension crisis that could leave millions of Americans high and dry in the very near future.

Sure, it would be difficult for many if the U.S. economy stumbles under misguided Trump policies. And yes, the idea of even modest cuts to Social Security in the coming decades could serious affect millions of seniors. But take a look South Carolina's government pension plan, which covers roughly 550,000 people — one out of nine state residents — but is a staggering $24.1 billion in the red.

This is not a distant concern, but a system already in crisis.

Need a raise? This FBI negotiator shows you how

(1:25)
Chris Voss, former lead kidnapping negotiator for the FBI, knows how to get what he wants. In this episode of "Everyday Hostages," an original Moneyish series, Voss breaks down exactly how to negotiate a higher salary.

Younger workers are being asked to do much more to support the pensions of retirees. An analysis by the The Post and Courier of Charleston noted recently that "Government workers and their employers have seen five hikes in their pension plan contributions since 2012, and there's no end in sight." (Most now contribute 8.66% of their pay, vs. 6.5% before the changes.) At the same time, the pension fund has been chasing more stocks and alternative investments instead of relying on stable investments like bonds that may be much less volatile but generate only meager returns.

And if that's not troubling enough, South Carolina's pension fund is far from alone.

Read: The $6 trillion public pension hole that we're all going to have to pay for

The Michigan Public School Employees Retirement System pension fund is $26.7 billion underfunded, and mind-blowingly has paid out more benefits than it has actual assets in 41 of the last 42 years, according to some estimates. The Mackinac Center for Public Policy has estimated that, as a result, more than a third of Michigan's school payroll expenses go to retirees, not those people actually teaching children in a classroom.

Read: The Dallas pension fiasco could happen in your state or city too

It's not just government employee pensions at risk, either.

Legislators are debating help for roughly 100,000 coal miners who face serious cuts in pension payments and health coverage thanks to a nearly $6 billion shortfall in the plan for the United Mine Workers of America. And the Teamsters are seeking permission to slash benefits by as much as 30% for some 400,000 participants because its Central States plan is so deep in the hole.

It's a very disturbing trend, and according to one organization nearly one million working and retired Americans are covered by pension plans at risk of collapse — and many more plans face shortfalls that could become equally problematic if action isn't taken immediately.

The problem is only going to get worse as payouts remain bloated and investment returns remain hard to come by. With global growth minimal and the interest-rate environment still quite low by historical norms even in the face of recent Federal Reserve moves, the situation is quite urgent.

Read: Every U.S. taxpayer should watch what Calpers decides about its investment-returns forecast

The looming problems with Social Security make things even more disturbing. If older Americans never bothered to build up much in the way of retirement savings because they were expecting their pension to be there, then Social Security is quite literally the only way for them to make ends meet.

And if you really want to terrify yourself, think about what would happen to the U.S. economy if older, low-income pensioners suddenly have 5% or 10% less to spend on necessities. According to data from 2013, the average household income of someone older than 75 is $34,097 and their average expenses exceed that, at $34,382. If their benefits are cut, their spending will assuredly fall — and that reduction in spending on food, energy and other staples won't be replaced.

That's the crisis I fear most: a dramatic reduction in benefits to millions of pensioners, the failure of Social Security to bridge the gap and a substantial decline in consumer spending as a result. Then it's not just older Americans tightening their belts, but younger Americans facing a tough job market as restaurants and retailers start cutting back, too.

Nissan CEO Carlos Ghosn: How I work

(2:00)
Nissan CEO Carlos Ghosn spoke to The Wall Street Journal about the true automobile of the future, the toughest period in his career, and whether he'd rather go on a road trip with Elon Musk or Mary Barra. Photo: Robert Libetti/The Wall Street Journal

There's also a serious concern about whether simply cutting benefits or boosting contributions is enough as global growth slows and fixed-income investments yield significantly lower than in recent years. As I wrote a few months ago, some investment experts expect as little as 4% annual returns in U.S. equities, and bonds to yield less than 2% for many years to come.

So what do we do?

Unfortunately, there are no easy answers. Pension reform — as with Social Security reform — is most equitably approached as a combination of benefit cuts, increased contributions and higher eligibility ages. But since those solutions tend to offend all stakeholders, it is difficult to get past the inertia.

However, America is rapidly approaching a point of no return.

Say what you will about the solvency of Social Security, and the imperative of acting on admittedly imperfect calculations that still give us a good 15 to 20 years until the trust runs dry. But the millions of Americans relying on underfunded pension plans have an urgent need for reform in 2017.

And if they don't get it, it could have serious effects on the American economy for decades.

Debating a fix for Social Security:

- These 5 supposed fixes for Social Security won't solve its problems
- The retirement age for Social Security needs to rise to 70
- Why the age for Social Security benefits doesn't need to go up to 70
- Should the Social Security retirement age be 76?
