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BLUE MODEL CRISIS

The Pension Treadmill Is Accelerating—And Governments Can't Possibly Keep Up

The U.S. public sector pension system is hurtling toward a catastrophic and potentially unavoidable collapse. That's the implication of two recently-released reports assessing the fiscal soundness of the state-run retirement plans.

The first report shows that even as state and local governments shovel more and more money in, they are falling further and further behind as liabilities balloon exponentially. From *Pensions & Investments*:

> Contributions to public pension plans have increased in recent years, but their unfunded liabilities have increased more, according to an analysis by the Society of Actuaries released Wednesday.
>
> Between 2006 and 2014, employer contributions increased 76%, up to $85 billion in 2014 from $48 billion, and employee contributions increased 30%, to $37 billion from $28 billion. Total unfunded liabilities increased 150% to $1 trillion in 2014 from $400 billion in 2006, and the plans studied were 73% funded by the end of 2014.

The second report shows that even a white-hot bull market through 2020 would not be enough to start closing the pension hole. Most likely, unfunded liabilities (already in the trillions of dollars) will surge. And in the case of a stock market collapse, all bets are off. Also from *P&I:*

> U.S. public pension funds' unfunded pension liabilities are expected to rise through 2020, even under positive investment return scenarios, said a report Tuesday from Moody's Investors Service. […]
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> Under the first scenario with a cumulative investment return of 25% for 2017-'19, aggregate net pension liabilities for the 56 plans fell by just 1%. Under the second scenario with a cumulative investment return of 19% for 2017-2019, net pension liabilities rose by 15%. Under the third scenario with a 7.2% return in 2017, -5% return in 2018 and zero return in 2019, net pension liabilities rose by 59%.

How did we get here? Powerful public sector unions have been able to lobby legislatures to increase future benefits—an easy way for politicians to win political capital without spending any money in the present. Many state and local governments have hidden the extent of their true liabilities using distorted discount rates and other types of accounting sleight-of-hand. In some states, courts have essentially made pension benefits untouchable once they have been promised.

The impact of this looming crisis will have wide-reaching impact going far beyond public employees' retirement plans. They could force major cutbacks in vital state functions like infrastructure, education and healthcare, and produce vicious political fights over resources that bring governments to a standstill—as is already happening in Illinois. A wave of Puerto Rico-style bankruptcies could have a major impact on business investment and produce a vicious downward spiral in the states and localities affected.

While policymakers should continue pushing to reform public sector pensions—in particular, moving new employees to defined-contribution 401(k)-style plans so misgovernance on this scale can't happen again—the stark numbers in the reports from the ASA and from Moody's show that we need to be focusing on mitigation as well. How will we respond to this unfolding crisis so that ordinary people who rely on government services are not forced to bear all of the pain?

Though it threatens to hobble state and local governments in the not-so-distant future, the pension situation remains under-addressed by the Washington political class. They should start paying attention. The last thing we need is another national crisis that catches the U.S. government off guard.

Posted: Yesterday at 1:03 PM