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BLUE MODEL BLUES

NYT: Pensions Con New Teachers

We at *Via Meadia* haven't been hesitant to use the word "Ponzi scheme" to describe mismanaged and underfunded state and local pension systems, but the Grey Lady has typically shied away from such evocative language. Not so in its latest piece on the Puerto Rico crisis by Mary Williams Walsh—a reporter who has done more than anyone else in the mainstream media to draw attention to the scale of the crisis of governance facing city councils and statehouses as pension systems come under increasing strain.

> The teachers' pension fund in Puerto Rico looks very much like a legalized Ponzi scheme — one that might hold a warning for teachers across America.
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> Puerto Rico, where the money to pay teachers' pensions is expected to run out next year, has become a particularly extreme example of a problem facing states including Illinois, New Jersey and Pennsylvania: As teachers' pension costs keep rising, young teachers are being squeezed — sometimes hard. One study found that more than three-fourths of all American teachers hired at age 25 will end up paying more into pension plans than they ever get back. […]
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> Pension funds are so short of cash that money contributed by working teachers basically flows straight out to retirees. None of Puerto Rico's current teachers can expect to get their money back, because the fund is due to run out of money in 2018, long before they retire.

The defined benefit pension system could function in a world where the economy in a given city or state is guaranteed to continue to grow; where government actuaries could be counted on to be reliably honest about the state of pension fund assets and projected liabilities; and where the political power of public sector was sufficiently limited so that governments couldn't be perpetually forced into unaffordable benefit expansions.

Sadly, none of these conditions obtain in the current political and economic climate. First, regional economies can be sure to expand and contract as new industries spring up and then fade away (think of Detroit). This leaves governments unable to support a large population of retirees on a diminished tax base. Second, many accounting rules and regulations that apply to private sector financial institutions are not in place when it comes to public sector pension funds. Many states base their pension forecasts on wildly unrealistic discount rates and rates of return. Finally, public sector unions have grown increasingly powerful and are in many cases the most influential interest group in blue state capitals. The pressure on legislators to maintain or expand overly generous pension benefits is unrelenting.

The best solution to this problem is to phase out defined-benefit pension systems and replace them with the type of 401(k) plans that are now the norm in the private sector. If they don't, Puerto Rico-style crises are likely to proliferate on the mainland as well in the coming years and decades.

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