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March 17, 2016 11:59 am

Problems pile up for US public pensions

Attracta Mooney

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Analysis of 56 US public pension schemes has found that their funding deficits are set to grow by hundreds of billions of dollars this year, forcing some of America's biggest states and cities to cut spending and raise taxes.

Moody's, the rating agency, said lacklustre returns in 2015 and 2016 will put severe pressure on the health of US public pension plans and force states and cities to act in order to plug their pension funding gaps.

Tom Aaron, an analyst at Moody's, said the funding deficit — the difference between the assets a pension fund has and what it has to pay out to current and future pensioners — will grow substantially this year.

“Closing that funding gap continues to be big challenge for the sector,” he said.

In some of the worst-funded schemes, including the teacher pension plans in Illinois and Kentucky, the funding gap has grown to almost eight times what current teachers are paid, according to Moody’s.

Amin Rajan, chief executive of Create Research, a consultancy, said: “[Public pension plan] deficits are going from abysmal to worse. We are witnessing a slow-motion car crash.”

The analysis looked at best- and worst-case scenarios for the year to July 2016. It found that if returns went down by 10 per cent on average this year, the collective pension deficit would grow 59 per cent, to $952bn.

In the most optimistic scenario, where average returns totalled 5 per cent, the collective funding gap would still widen by more than $200bn.

Moody’s estimates the scale of the unfunded liabilities is greater than officially reported because of the generous discount rate public pension plans use to value retirement benefits. The rating agency said the schemes collectively have a deficit of $1.7tn, which could rise to $2.2tn this year if the pension plans suffered negative returns.

Olivia Mitchell, a professor at the Wharton School at the University of Pennsylvania, said public pension plans face “grave difficulties”.

“I do believe that US cities and towns will continue to suffer, and there will be additional bankruptcies following the examples of Detroit and the cities of Vallejo, Stockton and San Bernardino,” she said.

The worsening pension deficit means cities and states will have to contribute more to retirement plans, according to Mr Aaron, forcing them to either find new sources of revenue, such as by raising taxes, or reducing workforces or cutting services.

The Moody’s research additionally found that fewer than half of the 56 pension plans it examined received government pension contributions at an adequate level to reduce the funding gap.

A study by Wilshire Associates, the consultancy, published earlier this month, showed that state-sponsored pension plans in the US had just 73 per cent of the assets they needed to pay current and future retirees in mid-2015, down from 77 per cent in 2014. In 2007, this was 95 per cent.

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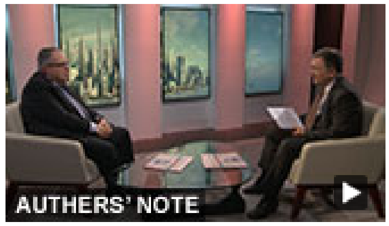

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