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PENSION BLUES

How Pension Liabilities are Mismeasured

The *Financial Times* is running a series of articles on the looming pensions crisis. One focusing on how U.S. municipalities hits a lot of the notes we have been singing here at *Via Meadia* over the years. A taste:

> The governor's office for Illinois, a state with notoriously weak finances, this week issued a stark warning about what might happen if it reduced the assumed rate of return for its Teachers' Retirement System.
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> "If the board were to approve a lower assumed rate of return taxpayers will be automatically and immediately on the hook for potentially hundreds of millions of dollars in higher taxes or reduced services," the state's senior adviser for revenue and pensions wrote in a memo.
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> Unlike corporate pensions, US public pensions discount their liabilities using the rate of return they expect to generate on their investments. Some experts complain that these rates have been set unrealistically high.

How unrealistically high? One analyst cited in the article suggests that the real cost is $5 to $6 trillion, compared to the official valuation of $1 to $2 trillion. Either way one calculates it, there's a pension meteor heading for American state and local governments—which is to say, taxpayers, retirees, and people who depend on city and state services (like schools). The way we are doing things now, students are going to get less educational opportunity because incompetent and crooked grownups failed to plan adequately for retirement.

The day of reckoning isn't going to be pretty.

And as this article in the *FT* shows us, investors around the world are starting to pay attention to the lies baked into the cake of the U.S. municipal and state debt markets. Risk premiums are likely to drift up for these debts, especially once the current era of financial repression ends, and states and local governments are going to pay a significant price in higher debt service costs for the bad decisions they've made and the pensions they promised but have no means to pay out.

Posted: 3 hours ago | Author: WRM