Pensions crisis

US faces crisis as pension funding hole hits $3.85tn

Collective funding deficit for retirement schemes jumps by $434bn in one year

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Chicago has estimated unfunded pension liabilities that equal 19 years of the city's tax revenues © Getty

YESTERDAY by: **Attracta Mooney**

US cities and states face a "looming crisis" after the collective funding hole in the public pension system jumped by $434bn in just one year, raising fears of further Detroit-style bankruptcies.

According to academic research shared exclusively with FTfm, US public pension funds lack $3.85tn that they need to pay the retirement benefits of current and retired workers.

Joshua Rauh (https://www.ft.com/content/c9966bea

-fcd8-11e5-b5f5-070dca6d0a0d), author of the research and a professor of finance at Stanford Graduate School of Business, said: "[The large deficit in US public pensions] is a looming crisis. It is particularly a near-term issue for a number of cities."

The situation is especially difficult for cities such as Chicago, which Mr Rauh estimates has unfunded pension liabilities that equal 19 years of the city's tax revenues.

Fort Worth, New Orleans, Philadelphia and Dallas also have large underfunded pension schemes, while states such as Illinois, Kentucky and New Jersey rank badly in the Stanford research.

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Big pension deficits have already contributed to the bankruptcy of several US cities, including Detroit. Puerto Rico, the US territory, this month declared a form of bankruptcy after amassing debt and pension obligations of $123bn.

Mr Rauh said politicians will have to make unpopular decisions if they are to ward off future financial problems. This could include cutting pension benefits or raising taxes in order to contribute larger sums to public retirement plans.

Devin Nunes, a US congressman, said states and municipalities are refusing to make the hard choices on public pensions.

“Puerto Rico’s insolvency, and its dramatic economic effects on the island’s residents, should be a sobering reminder that you can’t defy economic reality forever.”

According to the Stanford research, which looked at 649 pension plans in the 12 months to June 2015, the most recent year retirement funds have produced accounts for, no US city or state is running a balanced budget for their pension schemes.

“Cities and states are not contributing amounts that are sufficient to fund the new benefits they are promising,” Mr Rauh said. He argued states and cities needed to contribute an additional $167bn to their pensions in fiscal 2015 to stop the funding hole increasing.

A spokesperson for Orrin Hatch, chairman of the US Senate finance committee, said: “This [research] further underscores the financial risks of the nation's public pension crisis and the need to act on smart policies that will help secure retirement programmes for Americans that work for state and local governments."

But Hank Kim, executive director of the National Conference on Public Employee Retirement Systems, a trade body, played down concerns about the size of the funding hole.

He added that policy decisions on pension funds should not be based on a single year's returns. "Pension funds are resilient if left alone," he said.

Last week, John Chiang, the California state treasurer, said the state had to reduce its pension obligations by more than $11bn over the next 20 years, without having to reach deeper into the pockets of taxpayers or the public workforce.

Mr Chiang proposed plans to try to tackle the state's rising retirement debt by topping up its pension scheme with surplus state money that currently earns less than 1 per cent in returns.

Mr Rauh's study, which will be published today by the Hoover Institute, a Stanford University think-tank, found the funding hole across the US public pension system ballooned after retirement plans failed to generate sufficient returns.

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funds estimate their liabilities based on future returns, with US public retirement plans using an average annual return of more than 7 per cent. But in the year to June 2015, public pension plans generated average returns of just under 2.9 per cent.

Mr Rauh's research, which assumes a lower rate of return, found that the country's collective pension hole is three times the size of the official figure. State and local governments say their unfunded pension liabilities stand at $1.38tn.

Mr Kim dismissed the Stanford research, saying: "Over the 20-30 year time horizon, pension funds have outperformed their rate of return assumption. We believe 7.5 per cent rate of return assumption is achievable in the long term."

Mr Rauh said the funding deficit of public pensions probably grew to $4tn in fiscal 2016, while remaining relatively flat so far in 2017 because of buoyant stock markets.

"[The large pension deficit] has the potential to affect the confidence that investors have in buying the bonds of some cities and some states. It also affects the money that cities have to pay for essential services, like schools and roads," said Mr Rauh.

Ed Bachrach, chairman of the Centre for Pension Integrity, an organisation that studies public pension plans, added: "A government with a serious pension funding problem is like a ship trying to sail with its anchor stuck in the mud."

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