Written by **R. Cort Kirkwood** on March 7, 2011

State Pension Plans Trillions Short

State and local pensions are underfunded by at least $1.5 trillion and perhaps even more, the Washington Post divulged in a detailed examination of the crisis.

Quoting critics who think the expected rates of return on pension investments way too high, the *Post* reported that the figure could be as much $1.9 trillion or even higher, adding:

The trillion-dollar gap arises from the government method of accounting, which several experts say significantly underestimates the cost of future pension payments.

> "It's been a perfect storm," said Alicia Munnell, director of the Center for Retirement Research at Boston College. When the pension liabilities are correctly tallied, "you get a very, very large number."

Ominously, the picture is dark even using the figures that governments now use to calculate returns: more than $300 billion, the *Post* avers, continuing:

> Even under current accounting methods, state and local governments are facing massive pension shortfalls — at least $344 billion, according to calculations. …
>
> But when the accounting is revised to value future payments more accurately, in the critics' view, the amount that pensions are underfunded grows to more than $1.9 trillion, according to Munnell's calculations for 126 large plans.

The nettle that public officials must grab is how much money they need to save to meet future pension obligations.

The Problem

The problem, economist say, is that governments calculate their pension liabilities based on a return of 8 percent annually. That figure, they argue, is way too high, and governments ought to use the more realistic figure of 5 percent.

The *Post* published charts and maps showing how big that difference is.

Using the 8 percent figure, California's pension liability is $90 billion. But using what economics call the "risk-free" rate of 5 percent, the figure more than quadruples to $377 billion.

Ohio's jumps from $64 billion to $177 billion, New York's goes from zero to $163 billion, and Illinois' doubles from $66 billion to $132 billion. Wisconsin — where Gov. Scott Walker is fighting with government unions over collective bargaining, pension contributions, and health insurance premiums — skyrockets from zero to $48 billion.

Many of the states in the worst shape, the charts show, also face massive debts and deficits. But then again, even the three states that are deficit free — Alaska, Arkansas, and North Dakota — must consider the possibility, if these economists are correct, of pension liabilities totaling $14 billion, $18 billion, and $4 billion respectively.

The Solution

Several governors are fighting with state employees over wages, benefits, and pensions. GOP governors in Indiana, Wisconsin, and Ohio are locked in mortal political combat with leftist unions and their Democrat allies to stop the GOP from putting the brakes on the publicly-funded gravy train which unions have been riding for years in exchange for billions in campaign contributions.

Democrat lawmakers fled their jobs in Wisconsin and Indiana to hide out in Illinois so they would not have to participate in the budget process in those states.

Eventually, something has to be done, economists and experts warned. The *Post* quoted a letter that billionaire Warren Buffett wrote in 2008 — a warning about underfunded private pensions — at the close of which he made this observation about public pensions:

> Whatever pension-cost surprises are in store for shareholders down the road, these jolts will be surpassed many times over by those experienced by taxpayers. Public pension promises are huge and, in many cases, funding is woefully inadequate. Because the fuse on this time bomb is long, politicians flinch from inflicting tax pain, given that problems will only become apparent long after these officials have departed. Promises involving very early retirement — sometimes to those in their low 40s — and generous cost-of-living adjustments are easy for these officials to make. In a world where people are living longer and inflation is certain, those promises will be anything but easy to keep.

Jeffrey R. Brown, a finance professor at the University of Illinois, delivered this opinion about the $1.9 trillion in unfunded pension liabilities facing states in the years ahead: "By virtually any measure, that's an enormous number. … When you're short that much money," Brown told the *Post,* "at some point you have to pay the piper."