Funding Public Pensions
Where did we go wrong?

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… and are you sure?

Tom Sgouros
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• As of 2015, Illinois at 40%, Kentucky at 38%, New Jersey at 37.5%, Connecticut barely above 50%.

• New Jersey owes $136B, annual budget about $34B.

• Illinois owes $120B, about twice their annual budget of $56B.

• About $1.1 trillion in funding gap, according to Pew, only counting state level systems.

• Cities and counties have underfunded systems too. Funding gap, trillions more.

• Lots of underfunded plans, disaster around the corner.
• Lots of systems are technically underfunded yet meeting their obligations.

Why are there accounting rules?

- To answer the question: “How are we doing?”

- Standardized rules allow inter-system comparisons, and learning from experience.
A little history

- Military pensions originally, police and fire later
- By the 20th century, most states were at least thinking about it and many cities had police and fire pensions.
- Pension coverage for non-public safety not really widespread until the 1930s.
- Systems began as pay-as-you-go.

- Converted to actuarial basis over the course of the 1970s-1980s.
- Even so, lots of different rules made it hard to compare systems.
- GASB stepped in to standardize. 25,27 in 1994 then 67,68 in 2012.
- Funding situation seems only to have gotten worse since then.
Conversion of pay-as-you-go to actuarial funding.

Objections to GASB
- Legal
- Chronological
- Actuarial
- Mathematical
- Financial
- Economical
- Political
- Philosophical
Legal

Zero threat of liquidation

Bankruptcy ≠ Liquidation

Chronological

Urgency of a debt is an important quality.

Case 1: I have $600 and owe you $1000, tomorrow.

Case 2: I have $600 and owe you $20 per week for a year.
Actuarial

Do not need full funding to pay off all debts.

Unless system is closed.

See the famous piggy bank.

Mathematical

What is the point of imprecise financial reports?
Financial

“It’s tough to make predictions, especially about the future.”
Yogi Berra

Rate of return debates: much heat, little light.

Economical

Is a pension debt really as scary if we consider the size of the economy that supports it?

The rules do not permit that, but why not?
Political

Overfunding is a risk, too.

Don’t laugh.

Philosophical

A pension system is a form of collective action, not individual.

Its goal is mutual benefit for all the participants.

Accounting for individual contributions per GASB rules contravenes this goal.
A film by D.W. Griffith

Fired for being the oldest worker in the shop.
Helpful intertitles.

WHAT SHALL WE DO WITH OUR OLD
IMPOSSIBLE TO
OBTAIN EMPLOYMENT
AT HIS AGE

Stealing food for his starving wife.
Meanwhile, the starving wife is on her deathbed.

Released from jail, too late to save her.
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OPEB!

- Same problem as with pensions, two differences.

- Nobody has been saving yet.

- Health care costs go faster than inflation.
The standard playbook

- Pension obligation bonds
- Closing a pension plan
- Defined contribution plans
- Early retirements

Pension obligation bonds

- Investing on the margin
- Timing is key, but impossible to predict
- Results roughly equivalent to a system not making its marks
- Pressure to roll over immense
- Fixed borrowing costs encourage large bets
Closing a plan, “DC” pension

- Removing one of the legs of security, probably the more stable.
- Shifting to a blended pension is partial closure, so same problem.
- “Defined contribution” is a misnomer, a linguistic invention of the 1970s.

Arguments for Full Funding

- Reduces volatility
- Accounting clarity
- Cheaper to run
- “Generational equity”
What would a real solution be?

- Align accounting and incentives.
- Acknowledge inflows as a source of strength.
- Find better methods of enforcing fiscal discipline.
status quo post

Government

Employees

Income

Pension Fund

Retirees

Doesn’t mean don’t worry
Thank you

Questions?