The Washington Post

Report warns of coming wave of municipal pension shortfalls

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Tuesday, October 12, 2010; 12:12 AM

The nation's largest municipal pension plans are carrying a total unfunded liability of $574 billion, which comes on top of as much as $3 trillion in unfunded pension promises made by the states, according to a report released Tuesday.

The report calls the unfunded pension obligations "off-the-balance-sheet debt" that threatens to starve services such as police protection, recreation centers, parks and libraries.

"The ability of local governments, particularly cities, to provide the levels of service they do now is threatened by this liability," said Joshua Rauh, a Northwestern University business professor who co-authored the report with Robert Novy-Marx, a University of Rochester professor.

The report is based on an analysis of pension funds in 50 major cities and counties that together account for two-thirds of the nation's 3 million local government employees. It argues that cities routinely cling to unrealistic projected investment earnings to understate their pension liabilities, a strategy that has been exposed by the financial crisis and recession, which severely diminished investment returns.

The result is a growing wave of pension shortfalls that threatens to wash over many local governments in the near future, the report said. The authors calculated that each household in the 50 cities and counties they studied owes an average of $14,165 to current and past government employees for their pensions.

The report says that five major cities -- Boston, Chicago, Cincinnati, Jacksonville and St. Paul -- have pension assets that can pay for promised benefits only through 2020.

Philadelphia, for example, has assets on hand that can only pay pension promises through 2015, the report says. But that assertion is disputed by some Philadelphia pension officials.

"Unless someone has a crystal ball, they have no idea what the future holds in the markets," said Bill Rubin, vice chairman of the city's $4.2 billion pension fund. "We can meet our obligations and we have a plan in place to be able to meet our obligations in the future."

Philadelphia Mayor Michael A. Nutter (D) has declared unsustainable the city's tradition of offering guaranteed pensions to employees and said he wants to replace pensions with defined-contribution plans such as 401(k)s, raising the hackles of municipal employee unions.

Rauh, who previously completed a report that pegged the pension liability of states at $3 trillion, says the mounting debt crisis is going to force major changes on public pension plans sooner or later.

He says cities and counties should trim benefits by raising retirement ages for plan participants and lowering cost-of-living adjustments. Once promises are curtailed, he said the debt can be refinanced and spread out into the future. He added that new employees should not be given guaranteed pensions, and instead be shifted to defined-contribution plans.

"We need fundamental reform of the ways employees in the public sector are compensated," Rauh said. "It is not feasible to make promises of risk-free pensions when in the private sector [nearly] everyone has to share some of the risk."

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