In our opinion: Public pensions a ticking time bomb

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Summary

As the old joke goes, denial is not just a river in Egypt. When it comes to the need to reform public pensions, it is rampant nationwide, and it's not funny.

When the recession hit in 2008, most public pension fund investment portfolios fell far below their guaranteed rates of return, which generally were at about 8 percent. The resulting deficits created holes states have struggled to fill as the nation's economy continued to sputter.

States face limited options in dealing with this problem. They can raise taxes on all state residents, pulling more money from taxpayers' wallets and further slowing a tenuous economic recovery. They can cut pension benefits, drawing the ire of employee unions. Or they can reform pensions all together, moving public employees to self-directed 401(k) plans, following the course set by many private companies. Again, that is an option unpopular among public employees.

In many cases, truly solving the problem would take a combination of all of the above, which is a recipe for political stalemate.

Adding to the problem, lax accounting rules have allowed public employee pensions to understate the deficit. Andrew Briggs, a scholar at the American Enterprise Institute, said this has made the problem appear to be about $1 trillion nationwide, when in reality the combined liabilities of all public pensions are more than $4 trillion.

The result of this is that this allows governments to continue hiring and offering generous retirement benefits they really can't afford, all the while acting as if things aren't so bad.

Failing to come to terms with this simmering problem could be disastrous for all involved. It could, as Reboot Illinois COO Madeleine Doubek wrote recently in the Huffington Post, mean unemployment for teachers and other public employees, less funding for schools, roads and public services. It could result in credit devaluations for state and local governments, which would make borrowing money more expensive, adding to the burden of taxpayers.

That's the situation staring at Illinois this week as the state Assembly prepares to go back into session to find a solution. The state's unfunded pension obligation is estimated at $100 billion. Earlier this month, Moody's Investors Service downgraded Illinois' bond rating to A3.

While that is a low rating for a state, Moody's said it "is consistent with the General Assembly's inability to steer the state from a path to fiscal distress." The unfortunate irony is that Illinois otherwise has a "diverse and large economic base, with above-average wealth levels." But its pension liabilities, and the inability of its politicians to solve the problem, are dragging the state toward ruin.

Illinois is hardly alone. Last year, the Pew Center on the States issued a report that said states continue to lose ground when it comes to funding pensions and retiree health care. Standing in the way of solutions, however, is the fact that, for many states, the problem won't fully mature into a crisis until the long-term. In the meantime, they have enough cash to cover short-term obligations, but even with strong market returns in coming years they will be unable to keep up.

In Montana, lawmakers recently passed changes to its public pension plans, but an association of retired public employees wants to launch a court challenge because it would lower the annual cost-of-living adjustment from 3 percent to 1.5 percent.

Many cities face similar challenges. Some have filed for bankruptcy. Detroit, stung by a decline in the auto industry, a general flight to the suburbs and pension problems, is offering creditors pennies on the dollar.

The good news is that state and local governments are better equipped to deal with this problem than the federal government is in dealing with its long-term entitlement crisis.

A number of states already have instituted reforms or imposed cuts. The question is whether their actions have gone far enough to avert a crisis. Utah reformed its pension system after the recession, but a recent report by the state auditor's office said there is only a 43 percent probability the system's assumption of a 7.5 percent annual return on investments will come true.

If not, taxpayers would have to make up the difference. Taxpayers always are the option of last resort. But they also are the ones whose economic freedom is necessary for the economy to grow and prosper.