Public Pensions Face $2 Trillion Deficit

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Much like we were early citing the coming fiscal disaster that are state budgets [Dec 16, 2007: California in a State of Fiscal Emergency - Coming to a Theater Near You] so we will be early to the disaster that is the US public pension system. As we clearly now see, there is no political will to make hard decisions that alienate any of the potential voting public. So, much like the state (and city) budget crisis, I expect the nation to continue to kick the can, doling out pensions we cannot afford to the public worker - until we run into a wall at 180 mph.

And then your grandchildren will be asked to foot the bill "in the public interest" or "to keep the system stable" or "this is what we promised". And when the bill for Medicare comes due sometime later in the decade - perhaps when it starts eating up 20%+ of all US GDP - we'll hear the same thing. At some point there will be no extra sources to borrow from, so Federal Reserve Chief Geithner? Summers? will be printing new US pesos at a rate that makes Ben Bernanke's quantitative easing look like child's play. It's all the same pattern - played over and over, just in different future liability accounts.

But for today, let us focus on the public pension issue - one of the many reasons it's in the "national interest" to make sure the stock market goes in the "right direction". We've already used up almost every accounting trick known to man to obfuscate the problem. Just this weekend in the Wall Street Journal, we have Illinois:

- Illinois routinely covers those gaps with short-term measures, **putting off bills and paying less than is recommended into the state's pension fund.** The pension plan **has unfunded liabilities of nearly $80 billion** -- among the worst in the nation, **with no solution in place for catching up.**

I know you scoff at $80 billion now because you've become numb to large numbers after the epic bailouts of the past few years, but just over a decade ago, the Federal Reserve arranged a bailout of the hedge fund Long Term Capital Management because it posed a threat to the global financial system.... for under $5 billion. That's how extraordinary these $200, $300B bailouts are - and people have become immune to the numbers. So Illinois alone (1 state) is talking $80B... and growing.

So after the accounting tricks, the next step will be for states to issue new debt to pay for these obligations (akin to paying off 1 credit card with new borrowings on a 2nd credit card) This is already happening.

- Messrs. Quinn and Hynes said spending decisions by past governors left the state in a deep hole that the recession made deeper. In 2003, for example, Illinois under then-Gov. Rod Blagojevich sold $10 billion in 30-year bonds to cover two years' worth of payments to the pension fund. The proceeds from the bond sale went into an investment portfolio that included stocks; the expected profits haven't materialized, leaving Illinois far behind

And then "some day" when that charade ends, out will come the hands to the federal government (i.e. your grandchildren). This is what is currently happening for state budgets under the guise of "stimulus". It's already so obvious we can spot it years ahead of time, but as with all things American - we will stick our head firmly under the sand and "see no evil, hear no evil" is the order of the day.

That is but one state... we looked at the entire country in a story not even a year ago, and Bloomberg pegged the potential bailout at $1 Trillion. [Mar 4, 2009: Bloomberg - Hidden Pension Fiasco May Foment Another $1 Trillion Bailout] The latest FT.com story, using figures by New Jersey's pension fund chairman, says to think $2 Trillion. The states, if private corporations, would have gone bankrupt long ago and shed these financial promises they simply cannot make. But since they are public entities - instead we shall go down the long and winding path outlined above.

The tax obligations on the American people - which in this specific case is simply a transfer of monies from the general citizenry to the public worker so he/she can retire early with benefits available to almost no one in the private sector below C-level executive - shall be enormous. The (ahem) partial "solution" (I don't believe "new taxes" will pay for it all) will be further loss of purchasing power (living standard) when the Fed has to continuously print money to bail out the system in the coming 2 decades. As frightening as the public pension figures are - Medicare liabilities in the decade ahead will make it look like peanuts.

But for now... as good citizens of the modern Roman Empire we "party on dude". Everything is fine... Uncle Ben made all our problems go away, and our head is firmly under the sand... who has some stock for me to buy? After all the best solution to massive unfunded pension liabilities is for ~~the government~~ the free market to help get stock prices up! Kill a few birds with 1 ~~Plunge Protection Team~~ stone.

- The **US public pension system faces a higher-than-expected shortfall of more than $2,000bn that will increase pressure on many states' strained finances** and crimp economic growth, according to the chairman of New Jersey's pension fund.
- The estimate by Orin Kramer will fuel investors' concerns over the deteriorating financial health of US states after the recession. **"State**

and local governments are correctly perceived to be in serious difficulty," Mr Kramer told the Financial Times. **"If you factor in the reality of these unfunded promises, their deficits will rise exponentially."**

- Estimates of aggregate funding requirement of the US pension system have ranged between $400bn and $500bn, but Mr Kramer's analysis concluded that public funds would need to find more than $2,000bn to meet future pension obligations.
- A shortfall of that size could **force state governments to take unpalatable decisions such as pouring more public money into their funds or reducing pension benefits.** State and local governments have already cut spending to close budget deficits.
- Mr Kramer, chairman of New Jersey's investment council and also a senior partner at the hedge fund Boston Provident, **warned that outdated accounting models and unrealistic expectations of future returns had led states to underestimate their pension requirements.** (*something we've argued in multiple blog pieces - but remember, in America, if you are unhappy with the math, just change the accounting. The national accounting board - under political pressure - did it for the banks early in 2009 and it's been smooth sailing since then. Magically, almost all our banking problems went away once you said what is on the balance sheet is not what it used to be, but in fact something much higher in value via new accounting.*)

Oh and look at this - the "mark to model" (i.e. myth) rather than "mark to market" accounting that was newly introduced to the banks in early 2009, is a hallmark of the pension funds. No wonder the obligations have been vastly understated.

- **Public pension funds do not use mark-to-market accounting, relying instead on actuarial numbers** that average out value of assets and liabilities over a number of years – a process known as "smoothing". Mr Kramer's analysis used the market value of the assets and liabilities of the top 25 public pension funds at the end of the year.

In English this is the equivalent of saying my house is worth $325,000 due to the actuarial table... even if it would only fetch $190,000 if I had to sell it on the open market. So the pension funds hold the asset at $325,000 and presto magic, our assets are inflated - and shortfalls appear much smaller than reality. Remember, put your head under the sand and it all works out in the end.

- **"The accounting treatment of public retirement plans is the political leper colony of government accounting. It is a no-go zone,**" he said.

And so the surreal life of "everything is fine, just trust us" continues. Back to the Matrix.

http://seekingalpha.com/article/181037-public-pensions-face-2-trillion-deficit