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Public Pensions Headed for Disaster

By Megan McArdle

The New York Times has a practically libertarian-sounding article on public pensions, and the strain they are putting on the state and local governments. Public employees rack up overtime in their last year of work, with the active encouragement of their supervisors and even local politicians, then they retire with inflated pensions that can be greater than their base salary.

New York is the understandable focus, but these problems are hardly unique to my home state. In fact, New York is among the better states on funding of pensions, because they actually have to do some. Other states kinda sorta haven't really bothered -- at least not at anywhere near the levels that would be needed. New York's problem is notable only because its public sector unions are unusually powerful.

The problem is that these things are nearly impossible to change. People have worked for twenty years or more under the expectation of pensions that were calculated this way; you can't just wait until they're 58 and say "Ha, ha, just foolin'." Worse, there's no actual procedure for doing what a private company does, which is to declare bankruptcy and have a court renegotiate the obligations with other creditors. Especially when the funds are run at the state level, we seem to be stuck with them.

One thing the New York Times article mentions, but doesn't highlight, is that these problems exist in part because the funds badly miscalculated the investment returns they could expect. It's commonplace to hear conservatives complaining that politicians just handed out these goodies to political supporters because terrible government accounting made it seem "free," and they'd be out of office when the bill came due. This is true, but it misses a couple of things:

1. Politicians in many cases really believed that these promises were free; they didn't understand the accounting problems.
2. These pension funds weren't the only ones using unduly rosy projections, though they may have been among the worst offenders. Private funds have had similar problems as equities underperformed this decade.

Financial crises often seem to get tangled up in pension problems -- it's where the gap between fixed obligation, and income, becomes most glaring. These problems have been building for a while, but we may not be able to finesse them any longer.

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