
NYT: A Plan to Avert the Pension Crisis

LOS ANGELES — IT isn't politically feasible for Washington to bail out Detroit, but President Obama and Congress must step in to avert the worst fiscal collapse in urban American history.

They must intervene, because symptoms of the municipal illness that made Detroit, with an estimated $18 billion in liabilities, the largest city in American history to declare bankruptcy are showing up in other cities. Emergency response times are lengthening in cash-starved cities. Libraries, parks and recreation facilities are shortening their hours or closing. Potholes go unfilled, sidewalks unrepaired and trees untrimmed. All that makes urban life rewarding and uplifting is under increasing pressure, in large part because of unaffordable public employee pension and health care costs.

Do we want to live in a city like Detroit, where if you call 911, it takes nearly an hour to get a response? Will Washington sit by as this tragedy is re-enacted in one city after another and our urban standard of living falls to third world levels, with the streets around us resembling those in post-apocalyptic video games?

President Obama should propose, and push Congress to establish, a public employee pension reform program, similar to a plan proposed by the economist Joshua D. Rauh, now a professor of finance at Stanford's business school and a senior fellow at the Hoover Institution.

In our version of the plan, the program would essentially serve as an insurance agency. It would not bail out distressed local retirement plans. Instead, cities, and perhaps states, would be permitted to sell bonds to cover their pension liabilities, with the federal government guaranteeing repayment. Participants would pay fees — a kind of insurance premium — to finance the program, so there would be no net cost to Washington. The program would give cities access to low-cost, long-term capital. But in exchange for what would amount to federal bond insurance, the cities would have to agree to certain reforms of their pension and health care programs for current and former workers. At a minimum, those reforms should include a single national standard for projecting returns on pension investments — remarkably, there isn't one — and negotiated reductions in current benefits.

Some will argue that the causes of Detroit's epic civic failure are unique: white flight on an unprecedented scale, the collapse of auto manufacturing, decades of inept, often corrupt, municipal government. One significant cause of its financial debacle, however, is unfortunately shared by an alarming number of other cities, and that's the burden of unaffordable pension and retiree health costs.

Detroit's municipal debt is around $18.2 billion, or more than $26,000 for each of its 700,000 residents. Employee pension and retiree health schemes account for $9.2 billion of the liabilities. Until recently, officials thought the programs were fully financed. Now it appears they are short by at least $3.5 billion. That's because Detroit consistently overestimated investment returns on its pension funds.

It is not alone in this kind of wishful actuarial accounting. California's giant state pension fund, the world’s sixth largest, continues to assume it will earn 7.75 percent on its investments, even though its actual returns have been less than half that for a decade. Los Angeles continues to project similar annual yields on its investments, when the actual average returns are closer to 5 percent. As a consequence, the city’s unfunded pension obligations probably will grow to around $15 billion over the next four years.

According to Moody’s, the credit-rating agency, Illinois’s net public-employee pension liabilities now amount to $133 billion, or 241 percent of the state’s total annual revenues; in Connecticut, 190 percent; in New Jersey, 137 percent; and in New York, 17 percent.

America’s state and municipal pensions concede that they are underfunded by more than $1 trillion. If a more realistic expectation of returns on investment is pegged at 5 percent, then that collective liability climbs to $2.7 trillion. Moody’s further estimates that the median state has financed only 48 percent of its future pension liabilities. Already, about one-fifth of state general spending goes to pay for pensions and service debts, a proportion that will soar in coming years.

In California, where more than 20,000 state and local retirees receive annual pensions of more than $100,000, the cities of San Bernardino, Stockton and Vallejo have filed for bankruptcy. Los Angeles’s public employee pensions are inexorably pushing the city toward bankruptcy — perhaps within four years. Chicago now pays $1 billion each year to its retired teachers alone. In New York City, pension costs have grown to $8 billion from $1.8 billion over the last 12 years.

A wave of municipal bankruptcies won’t just decimate city services and retirees’ lifestyles. They would also fundamentally undermine investors’ confidence in the municipal bond markets.

Won’t a federal insurance program simply create a “moral hazard” by making civic bankruptcy more attractive? There’s little risk of that. First, Chapter 9 of the bankruptcy code is so onerous that it’s hard to imagine any city pursuing it except as a last resort. Second, the pension reform provisions required to participate, however beneficial, would be so politically difficult to undertake that only municipalities in the most dire straits would sign up.

To be clear, we must avoid demonizing public employees and their unions. Concessions on their part should be negotiated within the collective-bargaining framework and not imposed unilaterally, as some governors have tried to do. Union leaders must embrace this process because it’s the right thing for their members’ long-term interests. If they’re not included in the process and changes are forced on them, the result will be social strife and years of legal challenge.

Mr. Obama, Congress, local politicians and labor leaders can keep that from happening. We should insist they do.

Richard J. Riordan, a Republican, was mayor of Los Angeles from 1993 to 2001. Tim Rutten was a journalist at The Los Angeles Times from 1972 to 2011.