



Public Pension Politics: Why do we care about accounting rules?

Across the US, the total debt owed by state and local pension funds to their pensioners, less the assets they have to pay those debts, is estimated to be almost \$5 trillion. This is an alarming number that demands attention, and results in cities cutting budgets and struggling to find money to pay for public services. But where do these numbers come from and do they really mean what they appear to say? Is further austerity required, or is the “crisis” just an illusion?

Discussion of accounting rules seems like a place far away from concern about social justice. However, public sector employment plays a large role for many groups under-represented in the overall job market, and a comfortable retirement has long been an important component of that employment: a potential to step into the middle class. Across the country, this benefit is under attack, with critics calling pension systems unaffordable, unnecessarily extravagant, and blaming them for municipal bankruptcies in cities like Detroit, Stockton, Vallejo, and Central Falls, Rhode Island.

“Detroit’s original pension obligation estimated at \$3.5 billion was one of the key reasons used to justify its historic bankruptcy, the largest-ever municipal filing in the nation. [...]In the end, an estimated \$7 billion of the city’s \$18 billion in long-term liabilities was eliminated as part of the city’s plan of adjustment. About \$1.7 billion of the cuts came from pensions.”

And as a result:

“Pension checks will shrink 6.7 percent for 12,000 Detroit retirees beginning in March. Making matters worse, many also must pay back thousands of dollars of excess interest they received. [...]Henry Gaffney, 61, a retired bus driver, said he’ll pay back \$56,000 of the \$300,000 he saved by deducting \$428 from his monthly \$3,100 pension check for 19 years. He said he pays \$375 more for health insurance each month. ‘I may have to find a part-time job,’ said Gaffney, former president of Detroit’s bus-driver union. ‘I guess the city wants us to work until we’re dead.’”

Measuring pensions badly

When accountants total up the accounts in a city, county, or state's budget, they do so according to accounting rules established by the Governmental Accounting Standards Board (GASB). Some of these rules are used to assess the state of a pension fund by showing the total liability and comparing it to the assets on hand to pay that debt. These rules are meant to report, not dictate, funding of pensions. But, they are presented with the misleading language, for example, “under-funded” or “fully-funded.” Pension reformers, public agencies, and the press readily use this language to create a narrative of out of control costs ballooning in the future. This creates the imperative to austerity—cutting pension benefits—or even bankruptcy. This opens the opportunity for reformers and consultants to create tremendous public hardship through austerity measures—many of which attack pension systems. This mistakenly applies private sector logic to the public domain.

However, a pension fund should not be considered “in crisis” because it does not currently have funds today to pay a debt in the distant future. A debt to an employee who will not retire for another 30 years cannot count as a current shortfall even if it is cause for concern. In fact, under the right conditions, a pension system may be sustainable while always seeming to have more liabilities than assets. There is an important distinction between a sustainable pension and a fully funded pension. The GASB rules thus produce a sense of crisis where none is required.

At the same time that the GASB rules exaggerate the sense of crisis, they also fail to provide a useful guide to corrective action. Mass layoffs, pension bonds, early retirement incentives, moving employees to savings plans, and closing a plan entirely may all seem like reasonable actions under these rules. These policies increase risk, as we have seen in city after city, and making a city more likely to experience a crisis.

Poor response

Inspired by the wave of municipal bankruptcies following the financial crisis of 2008–2009, not only has Congress refused to provide help, but they have also tried to create structural barriers to prevent future Congresses from doing so. The Detroit bankruptcy inspired a 2013 Senate amendment to prohibit using federal dollars to support insolvent municipalities. This language reflects an analysis that generates a sense of criminality, incompetence, and immorality to financially struggling cities and the people who live there. Detroit has been drawn up as “the poster child” for financial hardship—a term historically used to describe advertisements used to deliberately evoke sympathy for diseased or deformed children and garner donations. Senator Johnson referred to “the people who live there” as debtors who belong in bankruptcy court and characterized potential federal aid as “charity.” This language of debt, the discourse of apathy, and charity is made possible by the accounting rules used to portray the financial situation.

This strategic use of conscious and unconscious stereotypes and bias rallies popular support for shrinking the role of federal government in providing support for cities, even when the situation could equally well be portrayed as a necessary remedy to decades of federal neglect.

According to Sen. Johnson's logic, “the people who live” in places like Detroit, Stockton, and Puerto Rico do not warrant the public's compassion nor the political intervention it accompanies. If the politics of austerity is financial dominance, then this is the language providing popular support for its invisible hand.

Funding Public Pensions: Is full funding a misguided goal?

is a policy brief from the Just Public Finance program of the Haas Institute for a Fair and Inclusive Society. Authored by Tom Sgouros, the brief argues that the accounting rules used to evaluate a pension system are part of the problem and examines the logic behind accounting professionals advice that public pensions be fully funded as private pensions must be.

The report can be downloaded at: haasinstitute.berkeley.edu

