

## PUBLIC PENSION REFORM

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Limited government is essential to prosperity. Conversely, having to pay for a large and growing public sector curtails entrepreneurial activity by diverting capital away from the private sector. At the state and local level, that outcome has become a major problem, with states and municipalities facing large public pension shortfalls. Although pensions are a state and local matter, the size of many pension deficits could likely lead to calls for federal assistance. Congress should resist such calls.

### **Congress should:**

- ◆ Hold hearings aimed at clarifying the Governmental Accounting Standard Board's (GASB) decision-making process in setting discount rates of public pension plans.
- ◆ Resist calls for bailing out underfunded state public pensions.

A central factor contributing to public pension underfunding is dubious accounting facilitated by the Governmental Accounting Standards Board, an independent, quasi-private organization. For years, GASB allowed public pension managers to calculate employer contributions using discount rates based on high investment returns, usually in the 7 percent to 8 percent range. Although some pension funds can achieve such return rates, they need to do so year on year in order to keep up with the growth in pension liabilities, which rise in an uninterrupted straight line.

Given the fixed nature of public pension liabilities, pension managers should use a risk-free rate, based on investment return

projections consistent with 15- to 20-year Treasury bonds, in the 3 percent to 4 percent range.

GASB reformed its pension accounting standards in June 2012, when it approved GASB Statement 67, to replace GASB Statements 25 and 27—under which pension plans could base discount rates not on the certainty of liabilities coming due but on the projected returns on plan assets—effective in mid-2013. Although a small step in the right direction, the reform did not go nearly far enough. Although the new rules call for establishing discount rates for “unfunded” pension liabilities on a lower rate of return, that rate may still be too high. Worse, supposedly funded pension plans can continue to use the same high discount rate as under GASB Statement 25.

That adoption of a dual discount rate makes little sense. Congress should seek to find out why GASB adopted that standard.

Experts: Ivan Osorio, Aloysius Hogan

### ***For Further Reading***

Ivan Osorio, “More than Good Enough for Government Work,” American Enterprise Institute, April 25, 2012, <http://www.aei.org/publication/more-than-good-enough-for-government-work/>.

Robert Sarvis, “The High Cost of Big Labor: Understanding Public Pension Debt,” Competitive Enterprise Institute, July 2014, <http://cei.org/content/understanding-public-pension-debt>.