Public Pension Shortfall Estimated at $2 Trillion

By Editor Test   *Wed, Jan 6, 2010*

Public pension funds still assume interest rates of 8% when estimating future returns, one analyst noted.

The U.S. public pension system faces a shortfall of over $2 trillion, and the chairman of New Jersey's pension fund believes that the deficit will strain many states' finances and hurt growth, the *Financial Times* reported.

"State and local governments are correctly perceived to be in serious difficulty," Orin Kramer told the British newspaper. "If you factor in the reality of these unfunded promises, their deficits will rise exponentially."

The aggregate funding requirement of the US pension system has been estimated at $400 billion to $500 billion, but Kramer's analysis set the figure much higher.

Kramer, who is also a senior partner at the hedge fund Boston Provident, warned that outdated accounting models and unrealistic expectations of future returns had led states to underestimate pension requirements.

Instead of mark-to-market accounting, public pension funds rely on actuarial numbers that average out value of assets and liabilities over a number of years, a process known as "smoothing." Kramer used the market value of the assets and liabilities of the top 25 public pension funds at the end of the year.

He also looked at market interest rates, which corporate pension funds use and which are much lower than the 8% that public funds use to calculate future returns. Even using 8%, the US public pension system would still require about $1 trillion in additional funding, he said.

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

Thirty-six of the 50 US states, including California and New York, have plunged into budget deficits since fiscal year 2010 began, which for most states was July 1 2009, according to the National Conference of State Legislatures.

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