



Source: Andrew Biggs, *The Market Value of Public-Sector Pension Deficits*; Robert Novy-Marx, and Joshua D. Rauh. 2009. "The Liabilities and Risks of State-Sponsored Pension Plans." Produced by: Veronique de Rugy, Mercatus Center at George Mason University

This week, Veronique de Rugy examines a major driver of states' fiscal woes: public employee pension funds.

Nearly all states operate defined benefit pension plans for their employees. Financed through a mix of employee and employer contributions and the investment returns on contributions, a defined benefit plan comes with a state obligation to pay a given amount in benefits. States are obligated to pay these benefits whether there are assets in the fund at the time of the employee's retirement or not.

Despite this looming obligation, states have not planned for coming retirement payouts. As a result, states' pensions are severely underfunded, with some states' funds scheduled to run out as soon as 2017.

Pension underfunding has been compounded by states' idealistic accounting, with methods based on what the assets are *expected* to return when invested. So while official reports claim that in 2008 state pensions were underfunded by \$452 billion, with total liabilities of \$2.8 trillion, these numbers change dramatically when private sector accounting methods are applied. Using methods that are required for private sector pensions, total liabilities for 2008 balloon to \$5.2 trillion and the unfunded liability rises to \$3 trillion.

It is only a matter of time before the ability of governments to pay for the retirement benefits promised to public sector workers runs up against the reality of limited resources.