



OVERVIEW

Public Employee Pension Transparency Act

Background

Most state and local governments offer their employees defined benefit pension plans. In fact, state and local governments have promised pension benefits to about 20 million active employees and another seven million retirees and their dependants.

Under these plans, the employees are promised an annual payment that begins when the employee retires, where the annual payment depends on the employee's age, tenure, and late-career salary. When a government promises a future payment to a worker, it creates a financial liability for its taxpayers, which must be fulfilled when the worker retires.

To prepare to meet their future pension liabilities, governments typically contribute to and manage their own pension funds, which are pools of money dedicated to providing the promised retirement benefits. If these pools do not have enough funds to pay for the retirement benefits of public employees, governments will be forced to transfer funds from their general operating budgets to ensure payments are made. This will require additional taxes, spending cuts or both. In most cases, Constitutional protections make a default on public pension obligations unlikely.

Reforms Needed

Public pension accounting should ideally provide citizens and government officials with a sense of how indebted taxpayers are to state and local government employees. However, the government accounting standards currently used allow states to use procedures that severely understate their liabilities.

Using the revised standards of the Governmental Accounting Standards Board, state and municipal public pension officials have disclosed unfunded liabilities of \$1.2 trillion. However, even this enormous number fails to convey the true debt level because public pensions can calculate their liabilities using unreasonably high discount rates. In many instances, they also severely distort the fair market value of assets in order to hide debt. A forthcoming study by Stanford University Professor of Finance Joshua Rauh estimates the true amount of unfunded liabilities for states and major municipalities, as of 2014, at \$3.4 trillion—nearly triple the amount reported by the pension funds themselves.

Under current law, government accounting standards result in public pensions discounting their liabilities at the expected rate of return on their assets. Economists have stated that this approach is analytically misguided, as the magnitude of pension liabilities should be viewed as independent of how a pension's funds are invested. In practice, these standards set up a false equivalence between pension payments,



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which are in most cases guaranteed by Constitutional protections, and the much less certain outcome of an investment portfolio.

Summary of the Resolution

The Public Employee Pension Transparency Act would address this situation by encouraging state and local government pension plans to disclose the true nature of their liabilities with the Secretary of the Treasury. This information would be available to the public through a searchable website. State and local governments that fail to disclose the requested information would have their federal tax-exempt bonding authority eliminated. The bill also expressly states that state and local pension obligations are solely the responsibility of those entities and that the federal government will not provide a bailout.



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