"**Pension Accounting for Dummies: New government reporting rules are no better than the old ones**," *The Wall Street Journal*, July 9, 2012 ---
http://professional.wsj.com/article/SB10001424052702304782404577488933765069576.html?mg=reno64-wsj#mod=djemEditorialPage_t

The Government Accounting Standards Board has issued new rules that aim to crystallize government pension liabilities. It failed on that count, but it did succeed, albeit inadvertently, in making the case for defined-contribution plans.

GASB, as it's known in the trade, sets accounting guidelines for local governments. Since the board is run mainly by former public officials, its standards are often low. The board also usually takes several years to finalize rules, so it's often behind the times. Their new rules concerning how governments discount their pension liabilities are a case in point.

Financial economists have recommended for decades that governments calculate pension liabilities using so-called "risk-free" rates pegged to high-grade municipal bonds or long-term Treasurys. The argument goes that since pensioners are de facto secured creditors—even bankruptcy judges have been reluctant to slash retirement benefits—pensions are riskless and therefore the liabilities should be discounted at risk-free rates.

GASB's private cousin, the Financial Accounting Standards Board (FASB), began requiring corporations to discount their pension liabilities with high-quality fixed income assets in the 1980s. However, GASB let governments stick with their desired, er, expected rate of return, which is typically about 8%. Public pension funds have returned 5.7% on average since 2000. Achieving much higher returns over the long run would require markets to perform as well as they did in the 1980s and '90s. Would that be true.

Governments have resisted climbing down from Fantasyland because using lower discount rates would explode their liabilities. When the Financial Accounting Standards Board introduced its risk-free rate guidelines, many companies shifted workers to 401(k)s because they didn't want to report larger liabilities. Such defined-contribution plans are by definition 100% pre-funded.

Prodded by economists and investors, GASB began considering modifying its discount rate rules a few years ago. Public pension funds, lawmakers and unions, however, pushed back hard against suggestions that governments use risk-free rates, which could more than double their liabilities. No surprise, the government troika won.

GASB's new rules allow governments to continue discounting their liabilities at their anticipated rate of return so long as they project enough future assets to cover their obligations. At the time they forecast they'll run out of assets, they must begin discounting their liabilities with a high-grade municipal bond rate. The idea is that governments would have to issue bonds to pay retirees when their pension funds go broke.

But few pension funds project that they'll run dry since they're hooked up to a taxpayer IV. Those in really bad shape like Chicago's will likely rig their investment and actuarial assumptions to circumvent the new rules. FASB rejected similar guidelines in the 1980s because they were too easy to dodge. The point here is that it's impossible to get governments to come clean about their pension debt, and not just because the union allies controlling pension funds have a vested interest in obfuscating the liabilities.

In reality, nobody knows how much taxpayers will owe because so much depends on inscrutable actuarial and economic factors like interest rates 30 years from now (not even the Federal Reserve purports to be that omniscient). Slight discrepancies in assumptions can yield huge variations in estimated liabilities. One advantage of defined-contribution plans is that they don't require governments to calculate their liabilities. There are none.