Pension Disasters

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In an interview with Financial Analysts Journal last year, Nobel laureate economist William F. Sharpe, creator of the Sharpe ratio for risk-adjusted investment performance analysis, said public pensions in the United States are a “disaster” and “a crisis of epic proportions.”

“Idiotic account drives even worse economic decisions,” he contended. “This is the classic case of an organization that borrowed money while issuing purported guaranteed payments and then used the money to invest in risky securities. Where have we heard recently that this is not a good thing?”

Sadly, things are even worse for most other developed nations. A Citigroup analysis of 20 countries in the Organization for Economic Cooperation and Develop (including the U.S.) found that the nations’ $44trillion in traditional debt nearly tripled to $122 trillion once their $78 trillion in public pension and social security liabilities are factored in.

“It is really a ticking time bomb,” Charles Millard, Citi’s head of pension relations, told the Wall Street Journal.

“(M)ost of the world still relies too heavily on government pensions through pay-as-you-go social security pensions or public-sector schemes,” the report concluded. “This is unsustainable, and a rapid shift to private pension savings is inevitable in our opinion—particularly in Europe.”

The implications are stark, as “governments will have to raise taxes or cut government expenditures elsewhere to make room” for increasing pension and social security payments.

Within the U.S., the Citi report singled out Illinois, New Jersey and “many municipalities” in California as having particular difficulty meeting their pension obligations in coming years.

The mounting pension tab will be disruptive everywhere, but will come as a particular shock to Europe, as Greece can already attest. This should serve as a cautionary tale to the U.S. that we should not be so eager to adopt European socialism. It also highlights the danger of growing dependence on government and the rising tax demands of insatiable governments.

The U.S. can still place reasonable limits on benefits, shrink the size—and debts—of government and return to self-sufficiency and control over one’s own retirement planning, but time is running short.