The Pension Meltdown

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The Looming Pension Meltdown Is So Big That It's A Problem For Everyone

> **"We just have to explain to millennials that their parents might have to move back in with them."**
>
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A decade ago, some economists pointed out that public pension funds were $2 trillion underfunded and getting worse. Many more economists quickly jumped to balk that this staggering number couldn't be right.

They were correct: It was much worse. It has gotten to $2 trillion and much worse in just a few years.

Note that we are talking here about a specific kind of pension: defined benefit plans. A defined benefit plan is typically sponsored by state and local governments, labor unions, and many private businesses.

State and local government pension plans hold nearly $4 trillion in assets and provide retirement income to over 10 million Americans. For most of these plans, the value of liabilities for future benefit payments exceeds the values of plan assets. According to many journalists, academics, and policymakers, this failure to fully pre-fund state and local pensions constitutes a crisis.

Many sponsors haven't set aside the assets needed to pay the benefits they've promised to current and future retirees. They can delay the inevitable for a long time but not forever. And "forever" is just around the corner.

The numbers are large enough to make this a problem for everyone, even those without affected pensions. The underfunded pensions could also be one of the triggers of the unprecedented credit crisis many economists see coming in the next five years.

A defined benefit pension plan knows it owes a certain number of retirees certain monthly benefits for life. Their lifespans are often predictable when the pool is large enough.

From that, it's simple math to calculate how much money the plan should have right now to pay those benefits when they are due. But then the assumptions start.

US Pension Woes

The US Pension Benefit Guaranty Corporation and its Multiemployer Pension Program insures the pensions of 10.8 million Americans and could become insolvent by 2026.

The program posted a record deficit $65.2 billion – mostly due to interest rate changes that drive up value of PBGC's future payments to failed plans.

The plan must presume a future rate of return on the invested portfolio, an inflation rate, and in some cases, future health care costs (medical benefits are part of many plans). So, when someone says a plan is "fully funded," it may not be so if the assumptions are wrong.

Almost all public pension funds assume investment returns somewhere around 7% (and some as high as 8%+). That's highly unlikely due to the debt we've accumulated, and debt is a drag on future growth.

If you make more realistic assumptions on future returns, the unfunded liability becomes $6 trillion, according to the American Legislative Exchange Council.

A more conservative and realistic approach would force the state and local governments to fund those pension plans at a much higher level. They have only two ways to do that: either raise taxes or reduce services.

The great irony is that the retirement systems that were meant to protect public workers, shielding them from the vagaries of the market, have often accentuated the effects of market swings, increasing the threats to public workers' financial well-being. Today's strong economy means policymakers are not under maximal pressure: They can see the problem, but they do not yet truly feel it. That time will come, however, and if public pensions are going to survive over the long term, funding and investment practices must improve, and benefits need to be modernized to meet the needs of today's public workforce.

That may be the reason policymakers have turned a blind eye to this.

Millions of retirees and workers are at risk of losing their multi-employer pension benefits because their plans are forecasted to become insolvent in the near future. This would lead to these retirees receiving just a portion of their pensions. Today's crisis also puts this country on the trajectory toward a system wide collapse, and the elimination of billions in retirement dollars and tens of thousands of jobs.

Another problem is that the taxpayers who might have to cover these amounts are mobile. They can move to other states with lower tax burdens.

The broader point: As with the federal debt, some portion of this unfunded pension debt is going to get liquidated in some way. Any way we do it will hurt either the pensioners or taxpayers.

Inaction leaves Americans out to dry: the widowed grandmother whose financial stability depends on her husband's pension, the aunt and uncle who rely on their pensions after health problems forced early retirement, and young new employees, excited about their first job but scared they may never see retirement benefits.

Many plans have been faced with an impossible choice — drastically cut benefits to stay afloat or collapse entirely. Just ask the thousands of beneficiaries who have already experienced their plans falling apart and were forced to accept steep pension cuts. This includes people in New York, Ohio, Michigan, Pennsylvania, and Oregon, to name a few.

Iron Workers Local 17 in Ohio, for example, has reduced benefits for some participants by 30%, while the Toledo Roofers Local No. 134 Pension Fund has been forced to reduce benefits by an average of more than 30%.

Even worse, in New York, the Road Carriers Local 707 Pension Fund has become insolvent. As a result, these current and retired truckers will now receive as little as $570 per month — half of the $1,313 monthly benefit they expected. In total, more than 15 plans nationwide have already faced severe cuts just to remain on life support — meaning that hundreds of thousands of people no longer have access to the retirement they've earned.

If left unchecked, this crisis will decimate the retirement future of millions. Over the years, the number of retirees has grown dramatically, while the number of active participants and employers has decreased. This imbalance, combined with the market decline from the Great Recession, has put many of these vital pension plans on an unsustainable path. If we continue on the current trajectory, one of the most extensive multiemployer pensions plans in the country, Central States, will collapse by 2025 and affect approximately 400,000 people.

The Future Looks Grim

The most common solution to this problem so far has been cutting services in the hope no one notices.

"...100% of what is collected is absorbed solely by interest on the Federal Debt...all individual income tax revenues are gone before one nickel is spent on the services taxpayers expect from government."
- Ronald Reagan

It is happening nationwide, but California takes the lead, thanks to its massive pension debt. This is from a recent Brookings Institution note.

Pension and health-benefit costs are bending education finances in California to their will. The sheer magnitude of the rising costs is staggering. Large numbers of school board officials who participated in our survey indicate that the rising costs are meaningfully affecting educational services. For example, many report making cost-saving changes to district budgets that include deferred maintenance, larger class sizes, and fewer enrichment opportunities for students in response to rising pension and health benefit costs.

So in effect, today's students are paying to keep benefits flowing to retired teachers and administrators.

Bank of America analysts found an inverse relationship between infrastructure investment and pension fund contributions. Each additional $1 billion in plan contributions takes away about $2.5 billion from state and local government investment.

We have multiple parties fighting over pieces of the same pie, all hoping that Uncle Sam will step in and save them. Uncle Sam may well do it, too, but it won't remove the pain.

It will just redistribute the burden, perhaps more widely, but the aggregate amount won't change.

All this might be leading to some kind of Japan-like deflationary recession or debt monetization. If we're lucky, it will be mild and long. It won't be fun but the alternatives would be worse.

Pension Plans, IRAs and 401(k)s Are Not Safe

With so many companies in the United States failing to adequately fund pension funds, many companies have bi-passed traditional pension plans and have instead moved to defined contribution plans like a 401(k). The clear downside of a 401(k) is that Americans are now heavily invested in the stock market and bond market.

Are you comfortable with being invested in a sky-high stock market?

It seems clear that there is really nowhere to keep your hard earned retirement funds. Many corporate pension plans are gravely underfunded and Federal Programs are slowly going bust. As a result, most 401(k)s are relying on positive returns from the stock and bond markets.

We all still remember what happened to the stock market during the last market crash. While it may be true that the stock market has recovered its losses since those lows, but most people that lost during the crash still haven't fully recovered their losses.

To make matters worse, while stocks continued to fall throughout 2008 & 2009 and most peoples retirement accounts were cut in half, the wealthiest 1% of Americans made a killing by buying up cheap stocks. This resulted in the wealthiest 1% of Americans have nearly surpassed the wealth of the entire middle class.

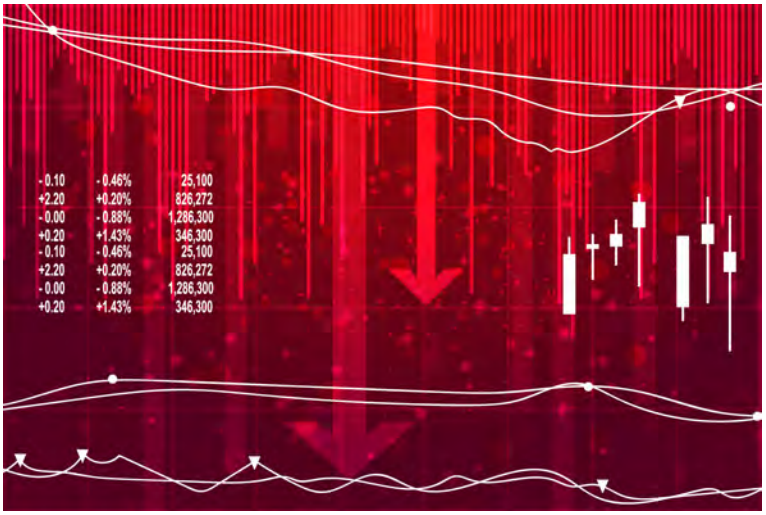
So contrary to what many economists are touting these days, we have not experienced a full recovery since the last market crash. Most of the money has been taken by the wealthiest Americans and the remains are once again at risk of major loss due to growing national debt. **Make no mistake - the middle class will be hit the hardest.**

Gold and Silver Can Help Protect Retirement Accounts

Since 2000, the Dow Jones Industrial Average is up about 140%. Gold, since 2000, is up over 400%. The stock market today is at a record high, while gold is off 23% off its all-time high. Moving forward, which asset do you think has the potential for a greater upside?

The Dow Jones Industrial Average may reach 30,000 in the very near future. Thats an increase of about 7% from where we are today. If gold was to return to its previous high of $1920 an ounce - it would rise about 30% from where it is right now. With our national debt rising at its current level, it is difficult to imagine the stock market continuing to thrive.

With the Fed continuing to print money at breakneck speed in order to pay down the national debt, the US Dollar will continue to lose its already fledgling buying power. It makes sense - the more dollars you print, the less they will be worth. But, the Fed can't stop printing money if they want the stock market to continue to rise.



Historically, silver prices tend to rise along with gold prices. The original gold to silver value was 15 ounces of silver equals one ounce of gold. The current gold to silver ratio is 87 ounces of silver to one ounce of gold. During the last gold and silver run, that ratio closed to 31:1. This illustrates that silver could very well outperform gold if the gold price rises to new record levels.

If there really is a major pension meltdown around the corner, don't you think having some physical gold ad silver in your retirement and savings account makes sense?

RESOURCES:

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