

# Detroit Free Press

## Mackinac Center for Public Policy: Pension ‘assumptions’ are the trouble in Detroit, statewide

By James Hohman and Jack McHugh

*Detroit Free Press guest writers*

The failure of Detroit’s pension systems has been blamed on a long list of abuses and unfortunate economic events. Unfortunately, that has had the effect of understating the most fundamental source of the failure: deeply flawed assumptions about future investment and payroll growth.

The state Constitution requires governments to pay for pensions as they are earned, but doesn’t specify a particular formula for doing so. The take-away, essentially, is: “Make good, reasonable assumptions about future investment and payroll growth — ones that don’t require the world to suddenly become free of surprises and setbacks — and, on that basis, set aside enough each year to cover the future benefits each employee has earned for another year of service.”

Two things stand out about this instruction. First, if the assumptions going in are flawed, then the pension system’s performance will reflect that. Second, politicians and policymakers have plenty of room to make such unrealistic assumptions — and strong incentives to do so. Rose-colored assumptions about tomorrow mean officials can get away with putting insufficient amounts into the pension system today.

And that’s exactly what happened in Detroit. Import-

tantly, this isn’t unique to the Motor City. Almost every state and municipal pension system has done the same, including Michigan’s largest, the one for public school employees. Officially, the school pension system has \$24.3 billion in unfunded liabilities, and this is understated because of optimistic assumptions very similar to those made by the officials in charge of Detroit’s retirement system.

The common woe-is-us explanations for Detroit’s pension failures — falling payrolls and tough markets — are just excuses. Investment growth projections are supposed to be long-term and reflect the reality that recessions and bear markets do happen. And if year after year payrolls are shrinking rather than growing, then officials should adjust their assumptions to reflect reality.

There’s plenty of blame to go around, but a proper understanding of the causes of Detroit’s pension failures is necessary to avoid the same fate in other cities and in the far larger school employee pension system. Last year, state legislators ducked a chance to fundamentally reform that state-run system. Let’s hope they revisit this before the same flaws cause it to follow the same path as Detroit’s pensions.

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