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Economic Sense # 4

Pension Liability & Debt Service

A Growing Share of the Budget Pie

Welcome to the latest installment of "Economic Sense," a data-driven policy summary that examines economic issues facing our state.

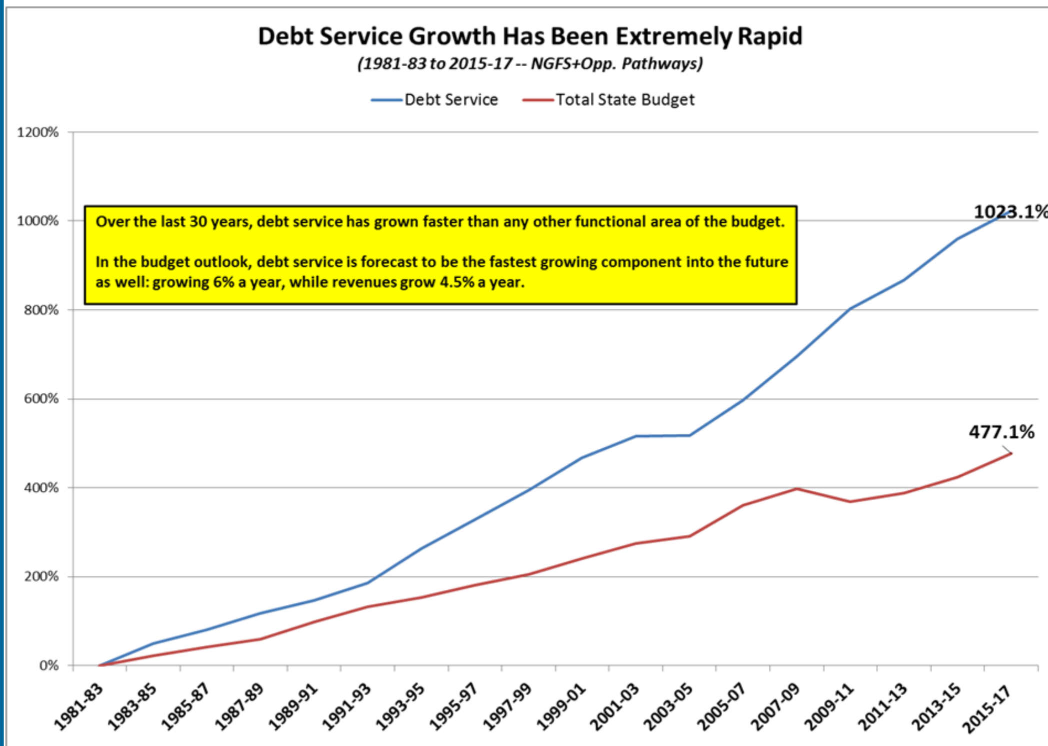
Bottom Line: Up Front

Pension liabilities and debt service are the fastest growing areas of the state budget, costing almost $4 billion together. This is more than the combined state support of the mentally ill, those with developmental disabilities, nursing homes, early learning and the UW & WSU.

These costs are putting our ability to provide essential services at risk. Reforms are needed to ensure taxpayer dollars are not consumed by long-term debt service and pension liabilities.

I. The problem

A. Debt Service



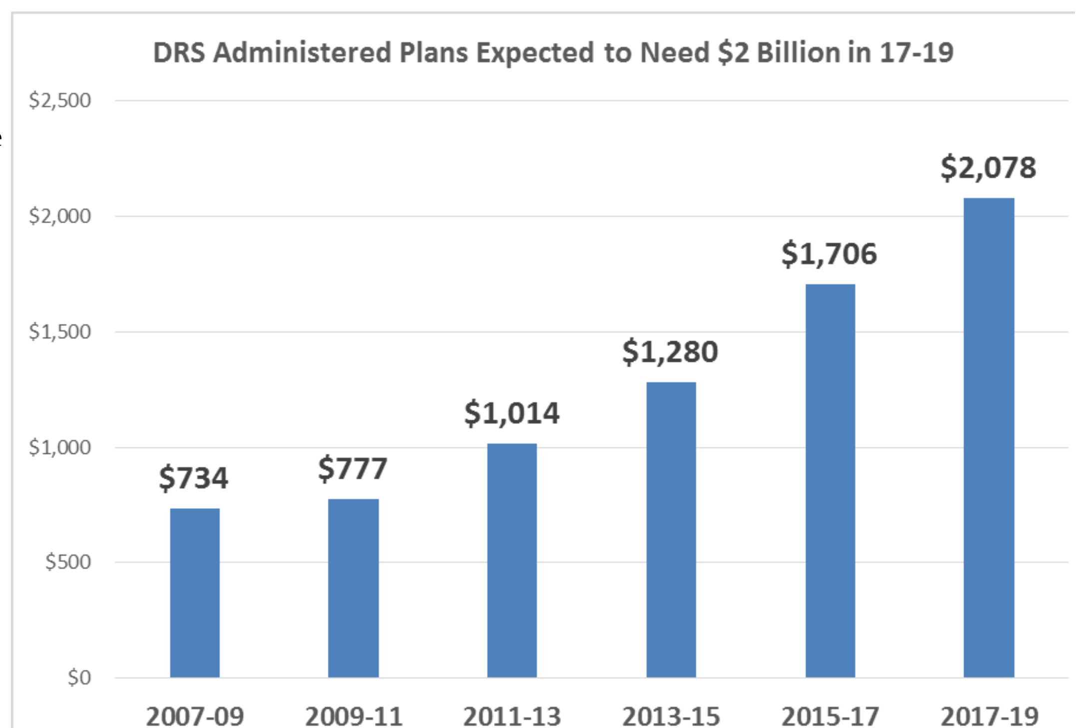
When the state invests in capital projects such as buildings or infrastructure, the projects are usually funded by borrowing money. Just as with a mortgage or car payment, retiring our loans require payments that cover both the interest and principle. Those payments are referred to as debt service. The state's debt service is expected to cost over $2.2 billion in the upcoming budget, and in the long-term, it is projected to be the fastest growing functional area of the budget, with percentage growth rates exceeding the rate of revenue growth[1].

The Treasurer's Office issues an annual debt affordability study[2]. Washington ranks:

6th highest state government debt per capita ($2,924 per person vs. $1,054 for the national average)
5th highest debt as % of personal income (6.4% vs. 2.6% national average)
5th highest debt as share of gross state product (5.4% vs. 2.4% national average)

B. Pensions

Data supplied by the Office of State Actuary shows that the state experienced a dramatic increase in tax payer support for pensions over the last decade. The state's contributions are expected to rise by almost $800 million over the next four years.



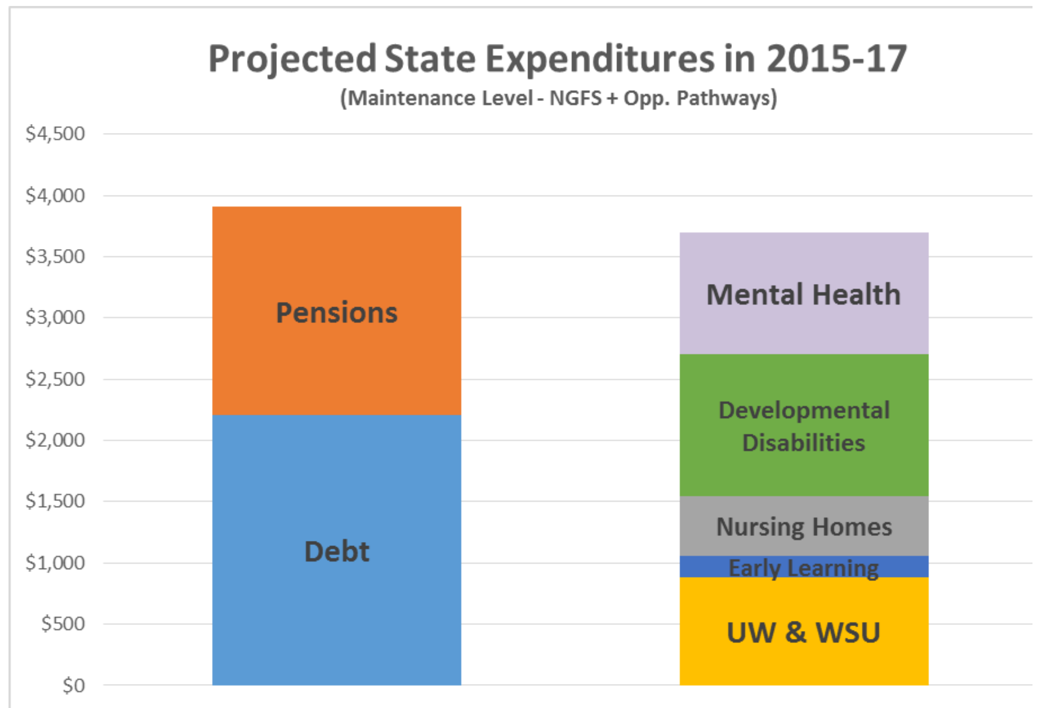
There are two major reasons for the dramatic increase:

First, from 2007-11, the state underfunded the pension system, choosing to ignore the actuary's recommended funding level. Pension liabilities must be covered eventually and delaying payments by underfunding drives costs up.

Second, people are living longer than previously projected. This past year, the actuary concluded that the state's pension system had underestimated life span by roughly two years. While longer life spans is good news, this means that more taxpayer funding needs to be put in the system in order to fund public employee pension benefits. This is a significant cost driver for state and local governments, so much so that the actuary's recommendation is being "phased in" over six years[3]. This phase-in will ultimately increase the state's future cost just as the underfunding between 2007-2011 did.

C. Budget Context

In the upcoming budget, pension liability and debt service are expected to cost more than the combined state spending on the mentally ill, elderly in nursing homes, those with developmental disabilities, early learning and the UW & WSU.



II. Options for Reform

A. Debt Service

1. Limit Bond Issuance to a Share of Biennial Appropriations (SB 5981)[4]

This bill replaces the statutory debt limit with a simple limit that caps debt issuance to 5% of the operating budget appropriation level. Debt can be issued in a higher amount only if approved by voters.

This proposal offers two primary benefits:

a. Stability in Debt Issuance

The debt issued in the Capital Budget currently varies significantly with each biennium, as there are numerous "games" budget writers can engage in to authorize more debt. This unpredictability would be reined in under SB 5981 since the only number that would matter in terms of debt issuance would be the operating budget spending level.

b. Lower Debt Expenditures over time in the Operating Budget

If this limit had been in place during the last 10 years, the state would have issued about $2 billion less in bonds over that time period.

This policy would have translated to $277 million less in debt service in the current biennia than what we are paying today. It would have freed up a quarter of a billion dollars in the current budget and every budget thereafter. That is enough money to reduce tuition by 30% for every student attending a four year public higher education institution in our state.

B. Pensions

1. Adjust Retirement Age by 2 Years for New Employees (SB 5982)[5]

Most of the current retirement ages for state pension systems were put in place in the late 1970s. The retirement age for full unreduced benefits are as follows:

Firefighters & Police	—	53 years old
Public Safety Employees (Mostly Dept. of Corrections)	—	60 years old
State employees & K-12	—	65 years old

Note: There are "early retirement" options for state employees, K-12, and public safety employees that allow retirement at 10 years earlier with a reduced benefit.

Since these retirement systems and ages were put in place, the life expectancy has increased by over 5 years (from 74 year old life expectancy in 1980 to 79 years old in 2010; and, for those who reach age 65, their life span is expected to be 86 years old).

During this time, the federal government has adjusted the age from which individuals could collect social security from age 65 to age 67 (for those born after 1959). Yet the state's retirement age has remained unchanged, despite this increase in life span. As a result, pension benefits must now be paid out over a longer period of time, costing more than was expected when they were first enacted.

SB 5982 makes one simple change in the law: for employees hired after July 1, 2015, the retirement age for full benefits is pushed back by 2 years in recognition of the actuary's recent adjustment of increased life spans. This change is projected to save taxpayers over $3 billion over the next 25 years, with over half of that savings accruing to local government[6].

2. Tie Pension Contributions to State Average Wage (SB 6005)[7]

SB 6005 returns to the analytical premise of a pension benefit: namely, that it is supposed to be a foundational benefit rather than, in some instances, a benefit higher than what most people in the state are making.

For new employees, SB 6005 establishes a contribution cap much like social security. The state and employees would contribute for pensions up to the state's average wage. Thus, if an employee made $100,000 a year, rather than contributing the 17% (employer & employee) on the full amount of that salary, there would be contributions only up to the state's average wage ($52,000).

Employees making less than the state average wage would see no change in their pension benefit. Employees making more than the state average wage would see a reduced benefit compared to current law, but—and this is important—they would also see an increase in take home pay from which they could contribute to a deferred compensation supplemental benefit if they desired.

Taxpayers would no longer guarantee a retirement benefit that far exceeds what the average worker in the state is making. The actuary estimates the taxpayer savings at $8.7 billion over the next 25 years ($5.3 billion state & $3.4 billion local)[8].

III. Conclusion

Current spending on pensions and debt service is unsustainable, exceeding the budget amount spent on the most vulnerable members of our state. The reform bills proposed in this policy paper would stop the trends in state debt and pension liability that are consuming larger shares of the state's budget every year, freeing up significant resources to be spent on the state's highest priorities like delivering essential services and investing in our state's future.

Footnotes

1. 2015-17 Debt Service is just over $2.2 billion at maintenance level. Future debt service is projected to grow at 6% per fiscal year: http://www.erfc.wa.gov/forecast/documents/bo_20140416_Methodology.pdf
2. 2015 Debt Affordability Study, http://www.tre.wa.gov/documents/debtAffordStudy-2015.pdf
3. Office of State Actuary, http://leg.wa.gov/SCPP/Documents/2014/06-17/5.PrelimRptPPT.pdf
4. SSB 5981: http://wsldocs/2015-16/Pdf/Bills/Senate%20Bills/5981-S.pdf
5. SB 5982: http://wsldocs/2015-16/Pdf/Bills/Senate%20Bills/5982.pdf
6. State Actuary Estimate, 3/16/15.
7. SB 6005: http://wsldocs/2015-16/Pdf/Bills/Senate%20Bills/6005.pdf
8. State Actuary Estimate, 2/6/15.