NASRA Issue Brief:
State and Local Government Spending on Public Employee Retirement Systems

Updated February 2015

State and local government pension benefits are paid not from general operating revenues, but from trust funds to which public retirees and their employers contributed while they were working. On a nationwide basis, pension contributions made by state and local governments account for 3.9 percent of direct general spending (see Figure 1)[i]. Current pension spending levels, however, vary widely among states and are sufficient for some pension plans and insufficient for others.

In the wake of the 2008-09 market decline, nearly every state and many cities have taken steps to improve the financial condition of their retirement plans and to reduce costs[ii]. Although some lawmakers have considered closing existing pension plans to new hires, most determined that this would increase—rather than reduce—costs,[iii] particularly in the near-term. Instead, states and cities have made changes to the pension plan by adjusting employee and employer contribution levels, restructuring benefits, or both. Generally, adjustments to pension plans have been proportionate to the plan's funding condition and the degree of change needed.[iv]

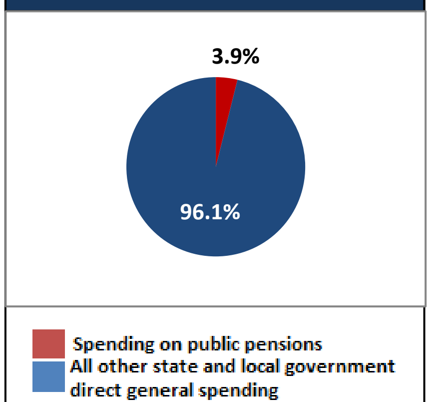
This update provides figures for public pension contributions as a percentage of state and local government direct general spending for FY 2012, and projects a rate of spending on pensions for FY 13.

Nationwide Spending on Public Pensions

Based on the most recent information provided by the U.S. Census Bureau, 3.9 percent of all state and local government spending is used to fund pension benefits for employees of state and local government. As shown in Figure 2, pension costs have remained within a narrow range over a 30-year period, declining from a high point of 5 percent to a low of 2.3 percent in FY02, and reaching 3.9 percent in FY12. State and local governments contributed, in aggregate, an estimated $109 billion to pension funds in FY13, a figure that is projected to equal 3.9 percent of projected state and local direct general spending for that year, as displayed in Figure 2[v].

Although pensions on average do not comprise a significant portion of state and local spending, as shown in Table 1, spending levels for states and political subdivisions do vary widely, from 1.44 percent to more than seven percent. Some municipalities have reported higher pension costs as a percentage of their budget. One study estimates that total required spending on pensions could consume as much as 13 percent of one state's budget,[vi] due mostly to past failures to adequately fund pension costs and assuming a relatively low five percent investment return. The chronic failure by some pension plan sponsors to pay required contributions results in greater future contributions to make up the difference.

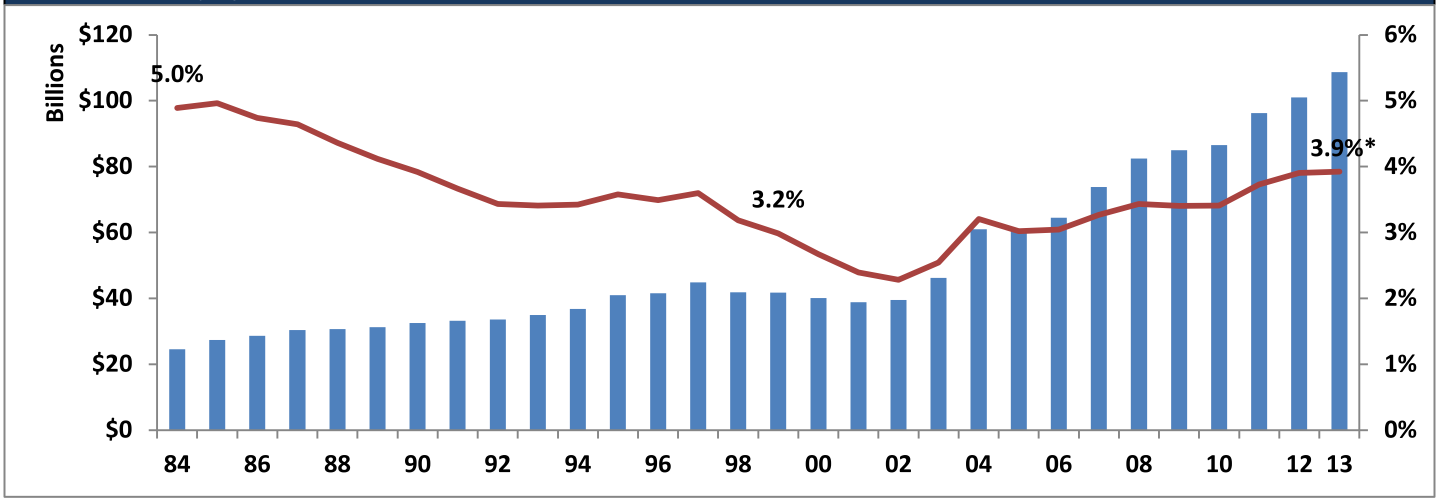
Figure 1: State and local spending on public pensions as percentage of total government direct general spending, 2012



Compiled by NASRA based on U.S. Census Bureau data

Most of the variation in pension spending levels among states is attributable to two factors: differences in benefit levels, and variations in the size of unfunded pension liabilities. As a percentage of total spending, pension costs for cities are higher than states by about 33 percent over the 30-year period spanning 1984-2013[vii]. This is likely due in part to the types of services delivered at the local level and the resulting larger share of municipal budgets that is committed to salaries.

Figure 2: State and local pension contributions, in dollars, and as a percentage of state and local direct general expenditures, 1984-2012 (with 2013 projection)



Compiled by NASRA based on U.S. Census Bureau data
**Projected, based on estimated state and local government spending from National Association of State Budget Officers (NASBO) and U.S. Census Bureau data*

Comparisons of local pension spending can, however, be difficult as the fiscal relationship between a state and its political subdivisions is unique with respect to revenue and spending structure and taxing authority, and varies widely. For example, funding responsibility for K-12 education budgets ranges from primarily a state duty to primarily a local responsibility. Likewise, revenue-sharing arrangements and the authority for local governments to tax and raise revenue also run a wide range. As with states, pension costs for municipalities can vary widely.

Cost and Financing Factors

Public pensions are financed through a combination of contributions from public employers (state and local agencies) and public employees, and the investment earnings on those contributions.[viii] Since 1984, investment earnings have accounted for 62 percent of all public pension revenue; employer contributions, 26 percent; and employee contributions, 12 percent.

Employee Contributions

Because nearly all public employees are required both to participate in the employer-sponsored retirement plan and to contribute toward the cost of their pension benefit—typically four to eight percent of pay—most state and local government retirement plans are, in fact, mandatory savings programs. In recent years, many states have increased rates of required employee contributions. On a national basis, in fiscal year 2013, employee contributions accounted for 29 percent of all public pension plan contributions, with employer contributions making up the remaining 71 percent (see *NASRA Issue Brief: Employee Contributions to Public Pension Funds*, February 2015).

Employer Contributions

A variety of state and local laws and policies guide governmental pension funding practices. Most require employers to contribute what is known as the Annual Required Contribution (ARC), which is the amount needed to finance benefits accrued each year, plus the annual cost to amortize unfunded liabilities from past years, minus required employee contributions.

On a weighted basis, the average ARC paid in recent years has been around 84 percent. Beneath this average ARC experience lies diversity: approximately 60 percent of plans in the Public Fund Survey consistently receive 90 percent or more of their ARC.[ix] This means that although a majority of plans have been receiving their required funding, many plans have not been adequately funded, which will result in higher future costs.

Leading national public sector associations established a Pension Funding Task Force, which in 2013 released its report *Pension Funding: A Guide for Elected Officials* urging policymakers to follow recommended guidelines for an actuarially determined contribution to government retirement systems.

Social Security Coverage

Twenty-five to thirty percent of state and local governments and their employees make contributions to their retirement plan instead of to Social Security. This is the case for most to substantially all of the state and local government workforce in seven states, 40 percent of the nation's public school teachers, and a majority of firefighters and police officers. Pension benefits—and costs—for those who do not participate in Social Security are usually higher than for those who do participate, in order to compensate for the absence of Social Security benefits. This higher cost should be considered in the context of the 12.4 percent of payroll, or an estimated $31.2 billion annually,[x] these employers and employees would otherwise be paying into Social Security.

Investments and Other Parts of the Financing Equation

The largest portion of public pension funding comes from investment earnings, which illustrates the major role this revenue source plays in determining pension costs (see *NASRA Issue Brief: Public Pension Plan Investment Return Assumptions*, October 2014). Other factors that affect pension costs include expectations for wage and general inflation, rates of worker retirement and attrition, and rates of mortality. Expectations for these and other economic and actuarial events typically are based on long timeframes, such as 20 to 50 years.

In addition to the performance of pension fund investments, macro-economic and demographic events also affect the cost of the plan. These events include such changes as retirement rates, attrition and rates of hiring, and wage growth, which is affected by salary cuts and layoffs. Additionally, legislatures in nearly every state have made changes to pension benefits and/or financing structures, in some cases reducing plan costs and long-term obligations.

Conclusion

On average, retirement programs remain a relatively small part of state and local government spending, although required costs, benefit levels, funding levels, and funding adequacy vary widely. Over $240 billion is distributed annually from these trusts to retirees and their beneficiaries, which reaches virtually every city and town in the nation.[xi]

Changes to benefit levels and required employee contributions adopted by states and cities have been diverse, dependent in part on such factors as the legal authority to make changes to benefits or required employee contribution rates, and the plan's financial condition prior to the 2008-09 market decline. Generally, states and cities with a history of paying their required pension contributions are in better condition and have needed more minor adjustments to benefits or financing arrangements compared to those with a history of not adequately making their contributions.

Table 1: State and local government contributions to pensions as a percentage of all state and local government direct general spending, by state, 2012

Alabama	2.87	*Louisiana*	5.25	Oklahoma	4.32
Alaska	4.19	*Maine*	2.45	Oregon[2]	4.43
Arizona	3.42	Maryland	3.99	Pennsylvania	2.65
Arkansas	3.59	*Massachusetts*	4.48	Rhode Island	5.55
California	5.27	Michigan	3.64	South Carolina	2.82
Colorado	2.86	Minnesota	2.00	South Dakota	1.81
Connecticut	5.32	Mississippi	3.32	Tennessee	2.95
Delaware	2.60	Missouri	3.94	*Texas*	2.15
District of Columbia	1.94	Montana	2.77	Utah	3.59
Florida	2.06	Nebraska	2.38	Vermont	1.53
Georgia	2.92	*Nevada* [1]	7.19	Virginia	3.40
Hawaii	4.45	New Hampshire	2.97	Washington	2.18
Idaho	2.67	New Jersey	2.81	West Virginia	5.08
Illinois	7.09	New Mexico	2.94	Wisconsin	1.67
Indiana	3.56	New York	6.52	Wyoming	1.78
Iowa	2.30	North Carolina	1.59	U. S. weighted avg.	3.87
Kansas	2.80	North Dakota	1.44	*Compiled by NASRA based on U.S. Census Bureau data*	
Kentucky	3.68	*Ohio*	3.70		

Percent-of-spending as of publication date. Figures are subject to periodic revisions by the U.S. Census Bureau. States where more than one-half of public employee payrolls are estimated to be outside of Social Security are italicized.

[1] In addition to being a non-Social Security state, one-half of Nevada PERS employers' contribution is attributable to a non-refundable pre-tax salary reduction to fund the employees' portion of the contribution.

[2] Contributions include an annual amount required to amortize the balance of employer side accounts

See also

National Governors Association, National Conference of State Legislatures, The Council of State Governments, National Association of Counties, National League of Cities, The U.S. Conference of Mayors, International City/County Management Association, National Council on Teacher Retirement, National Association of State Auditors, Comptrollers and Treasurers, Government Finance Officers Association, and National Association of State Retirement Administrators, "Pension Funding: A Guide for Elected Officials," 2013, http://www.nasra.org/files/JointPublications/PensionFundingGuide.pdf

Center for Retirement Research at Boston College, "The Impact of Public Pensions on State and Local Budgets," October 2010, http://crr.bc.edu/briefs/impact-of-public-pensions-on-state-and-local-budgets/

Center on Budget Priorities and Policies, "Misunderstandings Regarding State Debt, Pensions, and Retiree Health Costs Create Unnecessary Alarm," January 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3372

National Association of State Retirement Administrators, Issue Brief: Public Pension Plan Investment Return Assumptions, Updated October 2014, http://www.nasra.org/returnassumptionsbrief

National Association of State Retirement Administrators, Issue Brief: Employee Contributions to Public Pension Funds, February 2015, http://nasra.org/contributionsbrief

Contact

Keith Brainard, Research Director, keith@nasra.org
Alex Brown, Research Manager, alex@nasra.org
National Association of State Retirement Administrators, www.nasra.org

---

[i] Prior published versions of this brief calculated pension spending by state and local governments as a percentage of total state and local spending; this brief reflects a revised methodology which substitutes direct general spending for total spending. Direct general expenditures represent all government spending excluding intergovernmental transfers. Included in this category are payments to current and retired employees, as well as government operations and capital outlays. Some state and local government spending is non-discretionary, and therefore not in competition for funds with other programs and services. Including non-discretionary spending would make the effect of pension spending appear smaller. In addition, some states and cities do not contribute the amount determined actuarially to adequately fund the plan.

[ii] Selected Approved Changes to State Public Pensions to Restore or Preserve Plan Sustainability, http://www.nasra.org/files/Compiled%20Resources/nasrasustainabilitychanges.pdf, (updated December 2014)

[iii] NASRA.org, "Costs of Switching from a DB to a DC Plan," http://www.nasra.org/plansdesignchange

[iv] Center for Retirement Research at Boston College, "State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform," February 2013

[v] Projected spending for 2013 derived from actual state expenditures as reported by the National Association of State Budget Officers in the 2012-2014 State Expenditure Report (https://www.nasbo.org/sites/default/files/State%20Expenditure%20Report%20%28Fiscal%202012-2014%29S.pdf) p. 8 and projected increase in local government direct general spending from 2011-2012, as provided by the U.S. Census Bureau http://www.census.gov/govs/local/

[vi] Center for Retirement Research at Boston College, "The Impact of Public Pensions on State & Local Budgets," supra

[vii] Author's calculations using public pension and state and local government finance data provided by the U.S. Census Bureau

[viii] U.S. Census Bureau, http://www.census.gov/govs/retire/ - Table 2a. Revenues of State and Local Public Employee Retirement Systems by State and Level of Government, Fiscal Year 2012-2013

[ix] Public Fund Survey, http://www.publicfundsurvey.org/

[x] Author's calculation based on 30 percent of state and local government employees not participating in Social Security

[xi] U.S. Census Bureau, http://www.census.gov/gos/retire/ - Table 3a. Expenditures of State and Local Public Employee Retirement Systems ; see also "Economic Effects of Public Pensions," http://www.nasra.org/economiceffects