VIEWPOINT
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State Government Up to Its Eyeballs in Pension Debt

By James M. Hohman

Summary

Michigan taxpayers shoulder several kinds of debt. The most troubling obligation is pension debt, or the sum of promises made less the money that has been set aside to make good on on those promises.

Main text word count: 616

Unlike Washington D.C., Michigan's state government is constitutionally prohibited from spending more than it takes in each year and borrowing to make up the difference. Yet state taxpayers are still liable for large amounts of state debt, for purposes both practical and problematic.

The debts of greatest concern to residents are general obligation bonds, backed by general taxpayer dollars. Payments come right out of the general fund tax revenue the state uses to support the rest of what it does.

Michigan's recently passed budget includes $137 million to make payments on this debt, paid from the general fund. (Most of the money in that fund comes from the state income tax.)

But not all taxpayer debt is general obligation debt. Some $3.1 billion borrowed to build or improve state offices and college buildings is also of concern because it will take another $247 million from next year's budget — money that won't be available for other uses.

Taxpayers won't have to worry so much about some portions of the state's $26.6 billion official debt. The Michigan State Housing Development Authority, for instance, borrowed $2.0 billion and then lent it in turn to housing developers. But taxpayers will not be liable as long as developers make their payments.

The major threat to taxpayers in Michigan and around the country is the semi-off-the-books debt — and pensions are exhibit No. 1.

Michigan state and local governments have promised their employees far more in pension benefits than can be supported by the amount set aside for that purpose. There may be no official mortgage or bond offering for this debt, but every taxpayer is on the hook for it nonetheless.

The state-run school pension system is largest pension system in Michigan. Lawmakers have promised teachers and other school employees $67.7 billion in pension benefits, but have set aside and invested only enough to cover $41.0 billion. Taxpayers carry the burden for the $26.7 billion difference, and it is a heavy lift: $2 billion of the amount paid in state and local school taxes goes to fill this hole. Given the complexities of estimating the obligations of pension systems and the continued annual increases in stated unfunded liabilities, the actual numbers are likely higher.

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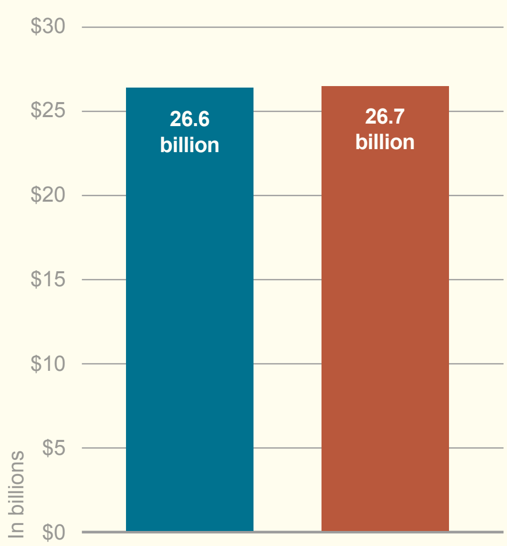
Michigan Bond and Pension Debt



Official state debt
School pension debt

Source: Office of Retirement Services and Senate Fiscal Agency

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How did the school pension system become significantly underfunded? It came about in two ways. As auditors have noted, state officials and lawmakers made overly optimistic assumptions about how quickly payrolls would increase and how much the pension funds would earn on their investments. So the actual debt owed to retirees in this system may actually be higher than $26.7 billion.

It was problematic enough for officials to base the system on imprudent predictions. Equally damaging, though, was their failure to make full payments recommended by the financial experts. For 2015, for example, actuarial accountants said the state should put away $2.18 billion to help fund teacher retirements. But it deposited only $1.97 billion, or $210 million less. That marked 2015 as the sixth consecutive year in which the state failed to make what actuaries call the "annual required contribution" for the pension system.

Moreover, the pension figures ignore billions of quasi-liabilities represented by health insurance benefits that have been promised to school and government retirees. Unlike its treatment of pensions, Michigan's Constitution does not prohibit trimming those insurance benefits, or even eliminating them altogether.

Because the pension underfunding has gone on for decades, more money is owed to government employees and retirees than to any other class of creditor. That is a bad situation for those workers and for taxpayers alike. To prevent the problem from getting worse, governments should stop providing pension benefits that can and have been underfunded and instead offer employees defined contribution benefits.

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