A $19 BILLION BLIND SPOT: STATE PENSION SPENDING

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ABSTRACT

In this brief, we examine an important but obscure form of state spending on K-12 education - state subsidies of school district pension costs. In 2018, this exceeded $19 billion across 23 states. To put that amount into perspective, 2018 federal spending on Title I programs was $15.8 billion. This revenue stream is often ignored in analyses of state aid for K-12 and its distribution across districts. Until recently, accounting standards did not require pension plans to report these implicit subsidies to the school districts, so they did not typically know the size of their subsidy. In some important cases, it was missing from state totals for education aid. In the first comprehensive tabulation of these data, we show that this subsidy can be as much as $2,400 per pupil, as it is in Connecticut. In Illinois it comprises an additional 56 percent of state spending on K-12, on top of all formula and categorical aid.

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There is a $19 billion form of state spending on K-12 education that previous analyses have all but overlooked — state funding of teacher pensions. Typically, teachers and their employers — the school districts — each contribute to the pension fund. In a number of states, however, the state provides some or all of the payment that would otherwise be paid by the districts. This seemingly minor distinction in how teacher pensions are funded can have a major impact on how state education dollars are distributed. In this brief, we explore this little known facet of teacher pension finance. First, for each state, we quantitatively answer the important question of who pays the costs of teacher pensions — the state or districts. Second, we explain the significance of new accounting rules (GASB, 2012b) that require public reporting, for the first time, of each district's pension subsidy from the state.

In teacher pension plans, teachers contribute a set percentage of their salary to the pension fund. This is called the "employee contribution" and it is matched, in theory, by an "employer contribution." In most states, local school districts cover the "employer contribution," since they are, after all, the employer. We have identified 23 states, however, where the state — not the school districts — cover some or all of these costs, as "non-employer contributions." This can be a significant subsidy to school districts.

Using publicly available data from pension funds' Comprehensive Annual Financial Reports (CAFRs), and other reports newly required by the Government Accounting Standards Board (GASB), we have calculated the total state subsidy for teacher pensions.[1] In 2018, 23 states made "non-employer" contributions to teacher pension funds for a total of $19.2 billion

[1] GASB issued two new statements on pension reporting in 2012. Statement 67 (GASB, 2012a) requires (among other things) that pension plans report "non-employer" contributions in their annual reports (CAFRs), effective FY14. State contributions were often reported previously, but Statement 67 introduced and standardized the "non-employer" contribution category. Statement 68 (GASB, 2012b), discussed further below, requires plans to provide districts with estimates of the implicit non-employer subsidy, effective FY15.

(Table 1).[2] To put that amount into perspective, 2018 federal spending on Title I programs was $15.8 billion. For each of the 23 states, we present the state pension subsidy in three useful ways: on a per pupil basis, as a percentage of state and district pension contributions, and as a percent of all state K-12 funds.

The size of state pension subsidies varies greatly by state. Half the states provide no subsidy, and other states cover only a partial share of the employer cost, leaving the rest to the districts. In a few cases, such as Georgia, the value of the subsidy is trivial, on a per pupil basis. But in other cases the subsidy is massive. In Illinois and Connecticut, the state spends more than $2,000 per pupil on pension subsidies[3] Connecticut covers the full employer share and Illinois does the same for every district outside of Chicago. Six other states spend more than $1,000 per pupil subsidizing local pension costs. The weighted average, over the 23 contributing states, is almost $800; factoring in the non-contributing states, the national average is over $400.

The amount that states spend on pension subsidies is increasing rapidly, up from $13.0B in FY2014 to $19.2B in FY2018 – a 47 percent rise in the four years since required reporting for state totals began. Colorado and South Carolina have only recently begun subsidizing local pension costs. In Illinois, state pension spending has increased by $3 billion over the last decade, consuming virtually all new state K-12 spending. Indeed, by 2016, Illinois state spending on pension subsidies added an astonishing 56 percent to all other state spending on K-12 education; that is, these subsidies were over half as large as all of Illinois' formula and categorical aid taken together. The subsidies in these 23 states added an average of 10 percent to the rest of their state

[2] Two other states contribute to their teacher pension funds as their legal employer, but we exclude them from our analysis. Hawaii is a single-district state. Delaware is a multi-district state, with two components to their salary scales: a uniform state component and a (smaller) variable local component. The state pension contribution is based on the uniform state component. Thus, in neither Hawaii nor Delaware are the state contributions higher for higher-paying districts – the basis for the equity concern over state pension subsidies. Moreover, public financial statements do not disaggregate state pension contributions for K-12 from other state employees in these two states. For these reasons, they are not included in our tabulations of contributing or noncontributing states. These two states comprise 0.7 percent of national enrollments, so their exclusion is minor.

[3] This does not include the additional state spending to service pension obligation bonds issued by both states.

funds for K-12, likely diverting, at least in part, from other areas of K-12 budgets. For the nation as a whole (including the 25 non-contributing states), the subsidies in the contributing states add 5 percent to total state K-12 spending.

Our tabulation of state pension subsidies is based on careful examination of each plan's standardized financial reports (CAFRs and/or GASB reports). To date, such tabulation has not been possible from NCES data, for two reasons. First, the NCES surveys collect benefit expenditures as a whole, including health, Social Security, unemployment compensation, etc., so pension contributions cannot be separated out (let alone whether they are funded by state or district). Second, the survey of state education agencies underlying NCES data on state revenues for K-12 education (Digest Table 235.20) has not always captured state pension subsidies.[4] This was most notably the case for Illinois and Indiana in the most recent published data (FY16), as well as several smaller contributing states. We estimate about one-third of the nation's state pension subsidies were not included in that year's Digest tabulation of state aid. NCES and the Census Bureau have worked with state fiscal coordinators to secure full reporting in these voluntary surveys, so these omissions should be rectified in forthcoming revenue tables.

Although state pension subsidies can be quite large, they have, until recently, been missing from district financial reports, unlike other forms of state aid. These funds are typically appropriated by the state directly to pension funds, and districts were rarely provided any documentation of the effective value of this subsidy, prior to GASB 68's requirement that pension plans calculate these non-employer subsidies.[5,6] Therefore, data sets built by

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[4] The National Public Education Financial Survey (NPEFS) defines benefit expenditures to include payments made "on behalf of an LEA for retirement contributions." However, some states did not report these payments on the state revenue item (R3) that underlies Digest Table 235.20 (see Exhibit F-1 in NCES, 2018).
[5] As with the NPEFS discussed in the note above, the Annual Survey of School System Finances (F-33) requests districts to report "State Payments on Behalf of the Local Education Agencies," including "amounts transferred by the state into state teacher or public employee retirement funds," but they had no way of credibly complying without estimates provided by the plan.
[6] Pennsylvania is an exception, where the district pays the contribution and the state reimburses half or more.

aggregating district-level expenditures have completely missed this expense. Hundreds of studies in the past have examined how state aid formulas, categorical grants, and other major appropriations are distributed between school districts. This forms the core of the literature on equity in education spending. We know of no scholarly work that has incorporated the use of the new GASB 68 data which breaks out state pension contributions by district.[7]

It is important to note that state pension subsidies are almost always distributed in a manner inconsistent with other state aid programs. Generally, state funding formulas for public education are designed to focus on district and student needs, on the one hand, and ability to pay out of local sources on the other. Indeed, general state aid formulas are often weighted to send more money per pupil to districts with high concentrations of poverty and low property values. Similarly, categorical funds, for purposes such as ELL and severe disabilities, are targeted based on specific student needs. State pension subsidies are not designed in the same way. Rather, state pension subsidies may be allocated in a manner that actually undermines state efforts to increase equity in school finance (Shuls, Hitt, and Costrell, 2019).

Specifically, school districts typically rely on local property taxes as a primary source of K-12 funding. This often means the property-rich districts are able to pay higher salaries than less affluent areas, even after state aid is distributed. Pension contributions are almost invariably calculated as a fixed percent of payroll, so the implicit state subsidies vary across districts by salary, thereby favoring, on average, higher-paying districts. A hypothetical example: if the employer contribution towards the annual cost of newly earned teacher pension benefits is ten percent of salary, then the subsidy to a school district that pays a $70,000 average salary is $2,000 higher per teacher than the subsidy to a district that pays only $50,000. Moreover as in

[7] NCES has a pilot R & D program to request actuarial pension data at the state and district level from a subset of states based on GASB standards. In the meantime, scholars can go directly to the GASB reports themselves.

most states, where the costs have become much higher because the state failed to pre-fund benefits as they were earned, the subsidy becomes even larger – and so do the inequities. Finally, if class sizes are smaller in higher-paying districts, then the per-pupil value of the state pension subsidy is higher yet for the more affluent districts.

A serious unintended consequence might result from state spending on teacher pensions: some states might be offsetting progressive state aid with state pension subsidies that favor wealthy school districts. Given the rapid increase in state pension spending over the last four years, this is creating a rapid and substantial shift in funding patterns. We predict that, in some states, state pension spending now runs completely counter to the progressive purpose of general state aid. Yet this phenomenon has received almost no attention in the scholarly literature. New GASB rules have made new data available to researchers. There are few topics—even in the large fields of funding equity and pension finance—that are more deserving of our attention.

References

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Table 1: State Contributions to Teacher Pensions[1]

State	State Contribution, FY18 ($000)	State Contribution per Pupil, FY18	State Contribution as % of State + District Contributions, FY18	State Contribution as % Add-on to All Other State Funds for K-12, FY16[2]
Alaska[3]	$ 111,757	$ 836	64%	6%
California	$ 2,796,673	$ 443	36%	4%
Colorado	$ 126,505	$ 139	12%	0%[4]
Connecticut[5]	$ 1,272,277	$ 2,409	100%	26%
Georgia	$ 4,416	$ 2	0%	0%
Illinois[5,6]	$ 4,328,117	$ 2,139	87%	56%
Indiana[7]	$ 917,900	$ 876	79%	13%
Kentucky	$ 926,734	$ 1,358	100%	11%
Louisiana	$ 39,550	$ 55	3%	1%
Maine	$ 129,421	$ 723	72%	11%
Maryland	$ 746,354	$ 835	66%	13%
Massachusetts	$ 1,314,783	$ 1,365	100%	20%
Minnesota[8]	$ 46,252	$ 52	10%	1%
Montana	$ 45,006	$ 305	32%	5%
Nebraska	$ 39,339	$ 122	17%	3%
New Jersey	$ 1,514,408	$ 1,077	100%	7%
Oklahoma[9]	$ 318,173	$ 456	44%	10%
Pennsylvania[10]	$ 2,199,500	$ 1,278	52%	17%
Rhode Island	$ 98,121	$ 690	41%	9%
South Carolina	$ 43,822	$ 56	8%	0%[4]
Texas	$ 1,715,785	$ 317	61%	7%
Vermont	$ 110,354	$ 1,273	100%	5%
West Virginia[3,5]	$ 347,322	$ 1,282	72%	18%
TOTAL (23 states above)	**$ 19,192,569**	**$ 797**[11]	**55%**[11]	**10%**[11]
TOTAL (48 states)[12]	**$ 19,192,569**	**$ 414**[11]	**28%**[11,13]	**5%**[11]

Sources: State & District Contributions from Comprehensive Annual Financial Reports (CAFRs) and/or GASB 67/68 reports. Pupil Counts and State K-12 Funds from Digest of Education Statistics (Tables 203.20, 235.20).

[1] States listed provide non-employer contributions to teacher pension funds. Two states not listed (Delaware and Hawaii) contribute as well, but are legally the teachers' employers. See text note 1.

[2] Latest year available for Digest Table 235.20, as of this writing. Some states included the state pension contribution in these figures and some states did not (e.g. Illinois). The percentages here account for this.

[3] Includes DC and DB plans

[4] State contribution did not begin until FY18

[5] These contributions do not include state payments to service debt on pension obligation bonds.

[6] Includes Chicago Teacher Retirement System

[7] Includes pre-1996 Fund and 1996 Fund

[8] Includes St. Paul Teacher Retirement Fund

[9] Dedicated state revenues, but not classified as special funding situation in GASB reports

[10] State reimbursements to the districts, rather than direct contributions to the fund

[11] Weighted average.

[12] Excluding Hawaii and Delaware.

[13] District contributions for the states with no state contribution inferred from estimated national employer contributions using BLS National Compensation Survey.