Hidden Education Funding Cuts

Indiana

Teacher pension costs have consistently consumed more than 10% of state education funding for two decades — and that could grow in the future

Teacher retirement systems across the country have seen costs rise over the past two decades, driven largely by growth in pension debt (known as unfunded liabilities). The costs of paying down these shortfalls in teacher pension funds have been steadily cutting into the spending on key education priorities. The effects are felt particularly hard in high-need districts which have fewer local resources to draw on to fill in the gaps when education costs rise, creating less funding for teacher salaries and programs aimed at improving academic and other outcomes.

However, this squeeze has not been felt uniformly across all states, as revenue and education spending experiences have varied. As a result, there are notable differences in the degrees of crowd out that pension debt costs have had on education spending when looking from state-to-state.

This profile provides detailed analysis for your state, supplementing the analysis highlighted in our primary research on Hidden Education Funding Cuts in America. The state profile examines three key elements:

- **State Education Spending:** the state's "own-source" K–12 spending for 2002–2018, both in the aggregate and on a per student basis. This excludes federal funding (which is typically not used to pay pension costs) and local revenues (which also vary as a funding source from state-to-state);
- **Pension Funding Status:** the pension system's unfunded actuarially accrued liabilities (UAAL) and actuarially determined employer contributions (ADEC) for 2001–2018; &
- **Education Crowd Out:** the shares of a state's own-source K–12 spending consumed for the pension contributions paid for 2002–2018.

For each element identified above analyses are from a state budgeting perspective, excluding both federal and local funding. We offer illustrations of trends over time, and a brief analysis of those trends. The last page includes a quick glossary of terms and link to the methodology for all of the data provided.

It is important to note that all charts provide figures adjusted for inflation except for displays of state own-source K–12 spending. This allows for a reference of how much of the increase in nominal education spending is just driven by inflation as opposed to the expansion of education budgets.

The Hoosier State is home to more than 6.7 million citizens, and roughly 1 million primary and secondary school students. In 2018, the state's total expenditures exceeded $33.6 billion — funds for schools, transportation, public safety, and other public services. Out of that spending, the state's own-source expenditures — defined as all state funding that does not draw on federal or local revenue — totaled $20 billion.

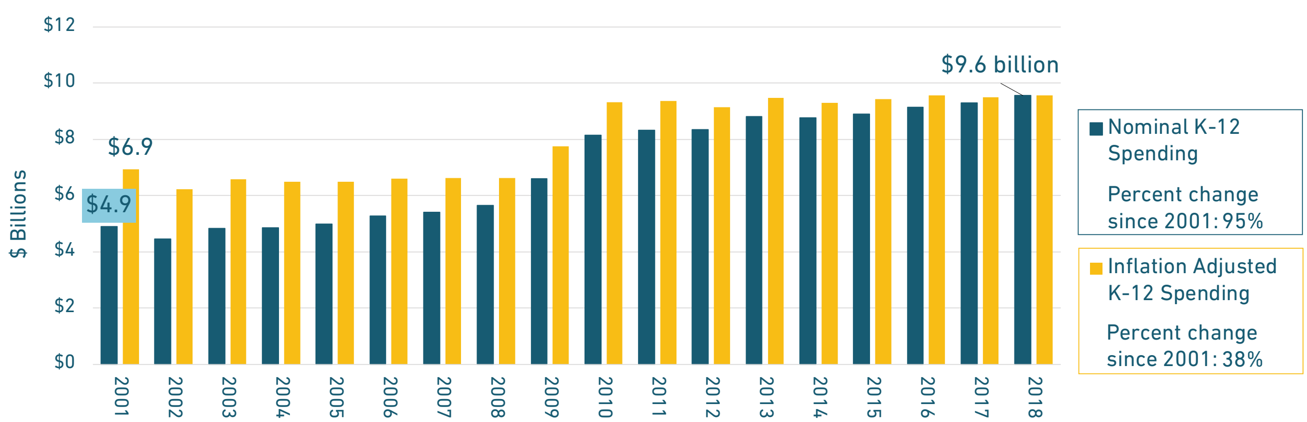
Indiana teachers are enrolled in one of three retirement plans all administered by the Indiana Public Retirement System (IPRS): a legacy guaranteed income plan called the Teachers' Retirement Fund Pre-1996 Account (TRF Pre-96), for those hired prior to June 30, 1995; a hybrid plan that combines the elements of a defined benefit pension with a defined contribution plan, called the Teachers' Retirement Fund 1996 Account (TRF 96); and, an optional stand-alone defined contribution plan, called the "My Choice Retirement Savings Plan."

Across all the TRF plans, IPRS manages retirement benefits for nearly 140,000 active and retired teachers. For these analyses we consider the financials of both the current TRF 96 plan and legacy Pre-96 account but exclude the My Choice plan given the lack of publicly reported employer contribution rate data.

EDUCATION SPENDING

In 2018, Indiana's state distributed K–12 expenditures totaled $10.6 billion. Out of that total, $9.6 billion came from state own-source funding while the remaining $1 billion was from federal grants and other education programs. (Local sources provided additional funding.)

Figure IN1: Indiana's state spending on education only increased by $2.7 billion after accounting for inflation.



State Own-Source K–12 Spending, 2001–2018

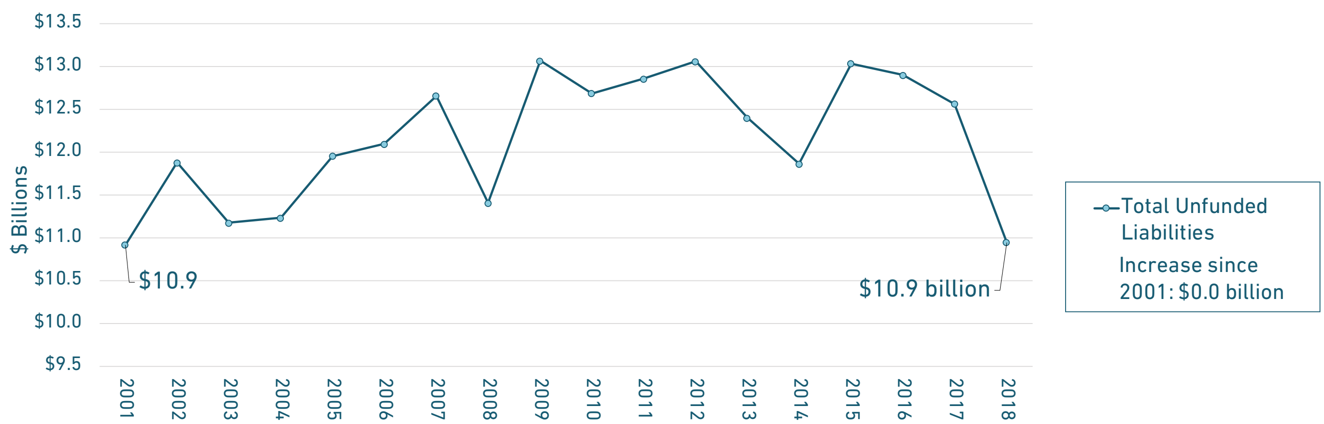
As Figure IN1 illustrates, state spending on primary and secondary education in Indiana has increased significantly since 2001 — growing by $4.7 billion in nominal dollars; however, it increased much less after adjusting for inflation, growing by only $2.7 billion. On a dollars per student basis, spending increased 31.6% since 2001 — growing from $6,945 to $9,140 (inflation adjusted).

PENSION FUNDING STATUS

In 2001, the TRF plans had a combined $10.9 billion in unfunded liabilities. The majority of the pension debt was owed to the effectively insolvent TRF Pre-96 plan, to which the state is paying for pension benefits on a "pay-as-you-go" basis. The Pre-96 plan is steadily shrinking in membership over time as retirees and beneficiaries pass away, but still requires funding each year (including $922 million in state contributions for 2018).

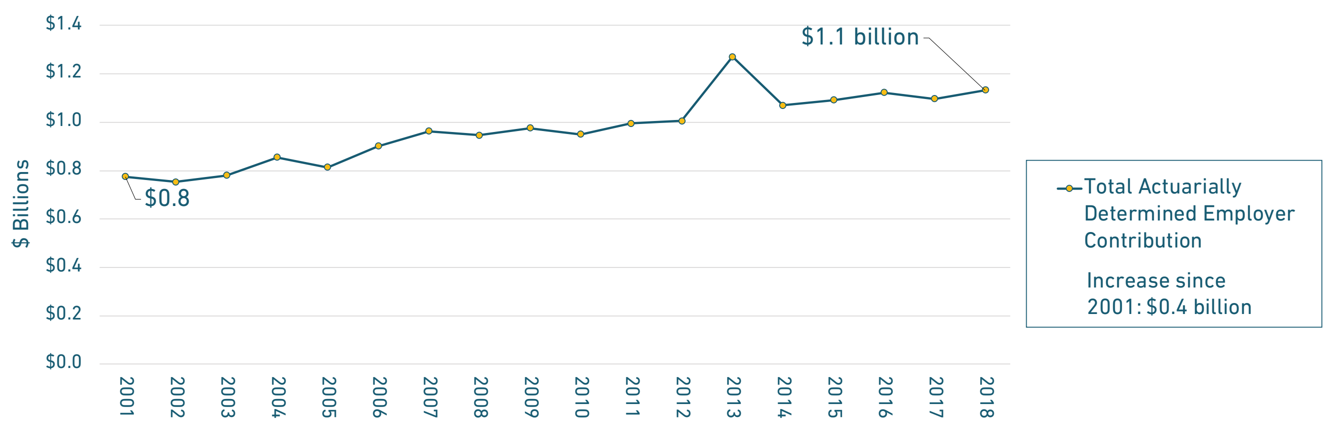
The TRF 96 plan is well funded, with 98.4% of necessary dollars saved, but still has accumulated a small amount of unfunded liabilities due to a combination of underperforming investments coupled with changing demographics. Figure IN2 shows the change in the combined unfunded liabilities of the TRF plans and Figure IN3 illustrates the change in what state actuaries have recommended be contributed from government employers.

Figure IN2: While there were some funding challenges in the 2010s, consolidated Indiana teacher pension debt has returned to 2001 levels.



Combined TRF Unfunded Liabilities (Actuarial Value), 2001–2018

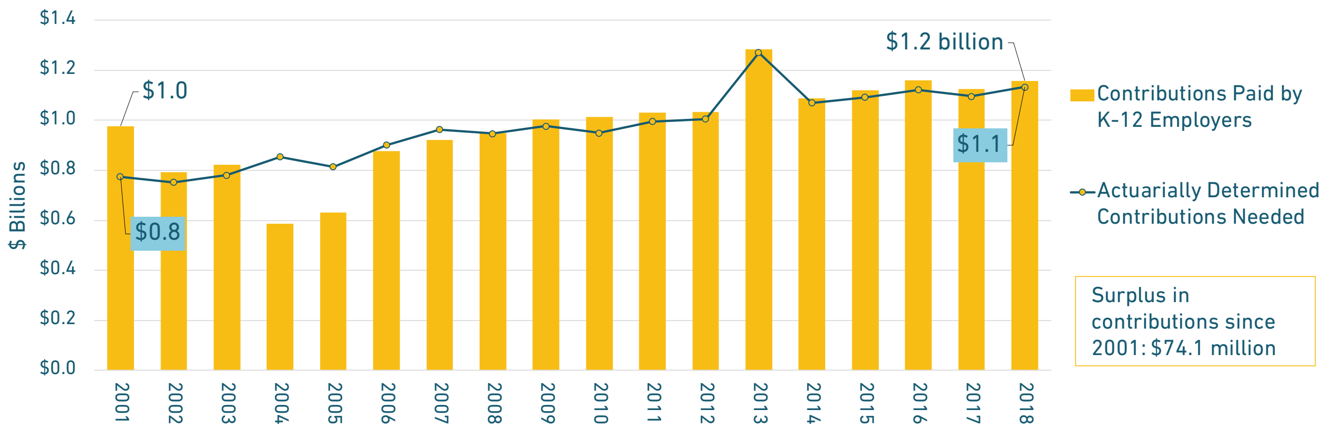
Figure IN3: Pension debt has been kept in check, but the amount actuaries recommend the state contribute to TRF has grown.



Combined TRF Actuarially Determined Employer Contributions, 2001–2018

There are a number of states across the country that do not always ensure that the ADEC is paid in full to the pension fund each year. Unfortunately, Indiana has been one of those states, failing to pay their full pension bill from 2004 through 2007, shown in Figure IN4. However, since 2008 the state has consistently paid more than their required contributions. As a result, the actual contributions paid into TRF using education funds have been more than if the ADEC trend displayed in Figure IN3, growing from $1 billion in 2001 to $1.1 billion in 2018.

Figure IN4: Indiana shorted the pension bill from 2004 through 2007, but has overpaid since, resulting in a $74 million surplus.



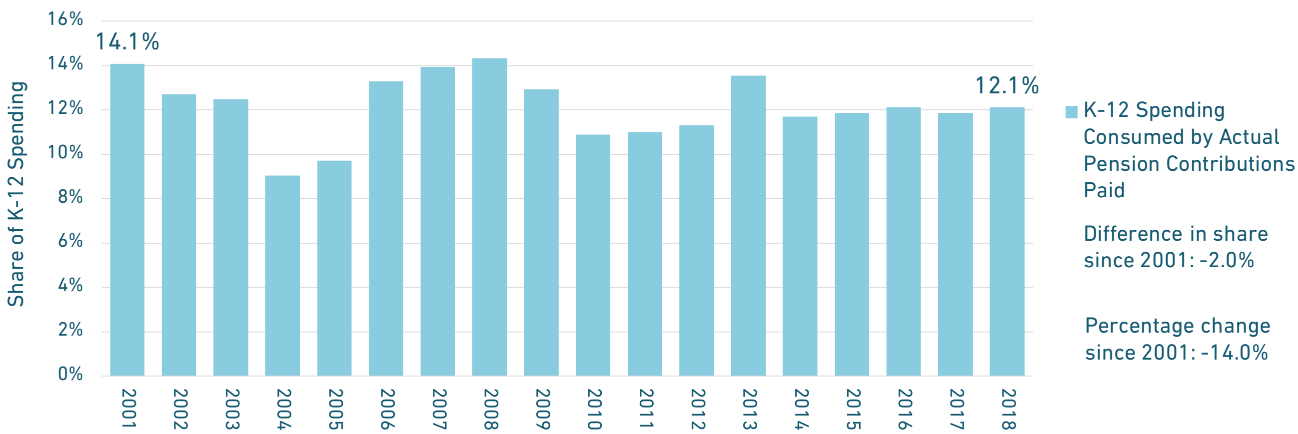
Actuarially Determined Employer Contribution Compared to Actual Contributions Paid to Consolidated TRF, 2001–2018

Paying the full required pension bill each year is the bare minimum for ensuring a pension system is fully funded, an obligation Indiana has upheld since 2008. However, from the perspective of education funding, any increase in pension costs is going to be viewed negatively if it is shrinking the dollars available for teacher salaries and serving kids. In an ideal world, Indiana would have ensured that funding for education expanded at least as fast as the growth in the contributions shown above. As we show in the final chart on the next page, Indiana's state K–12 spending has been able to keep pace.

PENSION COSTS CROWDING OUT K–12 SPENDING

The costs of paying down TRF Pre-96's legacy debt and the debt accumulated by TRF 96 have consistently soaked up more than 10% of Indiana's education spending. TRF's contributions reported as a share of K–12 spending decreased from 14.1% in 2001 to 12.1% in 2018.

Figure IN5: A stable increase in TRF contributions combined with an expansion of state K–12 funding has meant stable pension costs as a share of education spending. This could change if the TRF 96 plan develops pension debt.



Actual Pension Costs as a Share of State Own-Source K–12 Spending, 2001–2018

Indiana's experience over the last two decades has been unique. The creation of a new teacher retirement plan in 1996 was relatively unprecedented and has effectively allowed the state to limit pension cost growth. However, unfunded liabilities have persisted (and will continue to do so) for the TRF Pre-96 plan because it is effectively insolvent, without dedicated participant inflows or investment revenue. Indiana funds these pension benefits on a pay-as-you-go basis and the costs of doing so will not go away until all system retirees and beneficiaries pass away. At the same time, the TRF 96 plan is nearly fully funded and it is critical that the state does not allow unfunded liabilities to accrue, lest they drive up contribution rates.

Over the past two decades state K–12 funding has grown faster than the pension costs associated with both TRF plans, resulting in a slight decline in the share shown in Figure IN5. It is essential that the state does not allow pension costs to grow faster than K–12 spending, lest it runs the risk of a larger hidden funding cut.

All of this said, there still is a cut to education funding from pension costs. A more concrete way to understand how changes in pension debt and pension costs have influenced education resources is to think about them relative to total student enrollment. Table IN1 shows the UAAL and actual pension contributions on a per student basis compared against state education spending. Breaking the numbers down this way shows how unfunded pension liabilities and related pension contributions have grown relative to the increased per student spending by the state. In fact, out of the roughly $2,200 increase in state spending per student from 2001 to 2018, about $200 didn't make it to classrooms. This is not as much of a challenge as many other states face, but it still represents a significant cost in the state's K–12 spending that may not be fully accounted for when the budget is passed each year.

Table IN1: State education spending per student has increased, but pension debt and contributions have also grown.

Year	Total State K–12 Spending Per Student	Per Student Share of Pension Debt	Pension Debt as % of Per Student Spending	Employer Pension Cost Per Student	Per Student Spending Minus Pension Cost
2001	$6,945	$10,933	157.4%	$978	$5,967
2002	$6,188	$11,784	190.4%	$786	$5,402
2003	$6,474	$10,984	169.7%	$807	$5,667
2004	$6,322	$10,939	173.0%	$571	$5,751
2005	$6,266	$11,536	184.1%	$608	$5,658
2006	$6,306	$11,567	183.4%	$838	$5,467
2007	$6,328	$12,094	191.1%	$881	$5,447
2008	$6,337	$10,906	172.1%	$907	$5,429
2009	$7,402	$12,486	168.7%	$958	$6,445
2010	$8,896	$12,116	136.2%	$967	$7,929
2011	$8,998	$12,354	137.3%	$990	$8,008
2012	$8,776	$12,544	142.9%	$993	$7,783
2013	$9,061	$11,842	130.7%	$1,227	$7,834
2014	$8,884	$11,342	127.7%	$1,040	$7,844
2015	$9,022	$12,453	138.0%	$1,071	$7,951
2016	$9,108	$12,292	135.0%	$1,105	$8,004
2017	$9,057	$11,991	132.4%	$1,074	$7,983
2018	$9,140	$10,460	114.4%	$1,106	$8,033

Notes: Values are inflation adjusted dollars spent per student to allow for comparison of spending over time. Figures reflect the K–12 employer portion of liabilities and employer contributions.

Per Student Share of Consolidated TRF Unfunded Liabilities and Actual K–12 Employer Contributions, 2001–2018

THE DEFINED CONTRIBUTION PLANS IN TRF

Following the closure of the legacy guaranteed income plan offered by TRF in 1995, all newly hired teachers are enrolled into either the TRF 96 hybrid plan, that features both a guaranteed income plan and a defined contribution plan, or the "My Choice Retirement Savings Plan," which features only a defined contribution plan. Under both plans teachers contribute to individual retirement accounts and those funds are supplemented by contributions from their employer. In 2018, nearly 95,000 employees were enrolled in the Defined Contribution Plans in TRF. To offer a point of comparison, the DC plans held roughly $2.7 billion in assets, while the combined pension plans reported $9.2 billion in assets.

Despite the fact that defined contribution plans have been among the retirement options for Indiana teachers dating back to 1995, complete contribution data are not publicly reported sufficiently to allow for their inclusion in these analyses. As a result, the defined contribution portion of TRF 96 and the My Choice Retirement Saving Plan are not incorporated into our figures or analyses. This makes the total hidden funding cut figures show more conservative than if we were able to incorporate this data.

ABOUT THIS PROJECT

The growing cost of unfunded pension promises is having direct and immediate influence on the ability of local school districts to serve children. To show how hidden education funding cuts work, we built a dataset of state-level K–12 education spending and combined it with contribution rate data for state pension plans where teachers are participants. Merging these two data types shows how the rate of change in teacher pension costs is growing much faster than education budgets nationally.

To review data at the national level, visit Equable.org/hiddenfundingcuts and check out: "Hidden Education Funding Cuts: How Growing Teacher Pension Debt Payments Are Eating into K–12 Education Budgets." To learn more about our data and how we calculate a state's hidden education funding cut, check out the methodology.

However, the hidden funding cuts to education have not been felt uniformly across all states, as revenue and education spending experiences have varied. For some states, slow growth in K–12 spending has combined with the explosion in pension debt to create a significant threat, potentially crowding other items out of the education budget. In California, for example, a report by Pivot Learning found that rising pension contributions, driven by efforts to repay pension debt, have led to deferred maintenance of schools, larger class sizes, reduction or elimination of after-school programs, and a reduction in educational equity.

But, for other states, K–12 spending itself has grown significantly, even after accounting for inflation, and this has offset part of, or most of, the state's increase in pension costs (though in these cases, it is likely that policymakers were not increasing K–12 spending simply to offset the growth in pension costs). And a few states have even managed to buck the trend entirely. While this profile details the experience of an individual state, we encourage you to explore the profiles of other states to see how their trends compare. A collection of profiles for all 50 states and Washington, DC can be found here.

ABOUT THE AUTHORS

Jonathan Moody is vice president of Equable Institute, where Anthony Randazzo is executive director. Moody has worked on state fiscal policy since 2014 including time as research officer at the Pew Charitable Trusts. Randazzo has worked with over a dozen states on retirement system improvements, and formerly was managing director of the Pension Integrity Project.

QUICK GLOSSARY

Actuarially Determined Employer Contributions (ADEC): This is the money that actuaries calculate should be paid each year by the state and local employers to cover pension benefits earned plus to pay down any pension debt (after accounting for any employee contributions).

Unfunded Liability (UAAL): This is the shortfall in money that a pension fund should have on hand to pay all future promised benefits. Think of this as pension debt owed to retirement systems to pay promised pension benefits. In technical terms, this refers to the Unfunded Actuarially Accrued Liability.

Own-Source K–12 Spending: This is the money spent on primary education using state resources only, excluding any federal funding, local resources, or expenditures on higher education.