Hidden Education Funding Cuts

Michigan

Pension costs are consuming more than three times as much state education funding today as they were two decades ago

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 steadily been 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 2001–2018, 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 actuarial 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 2001–2018.

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.

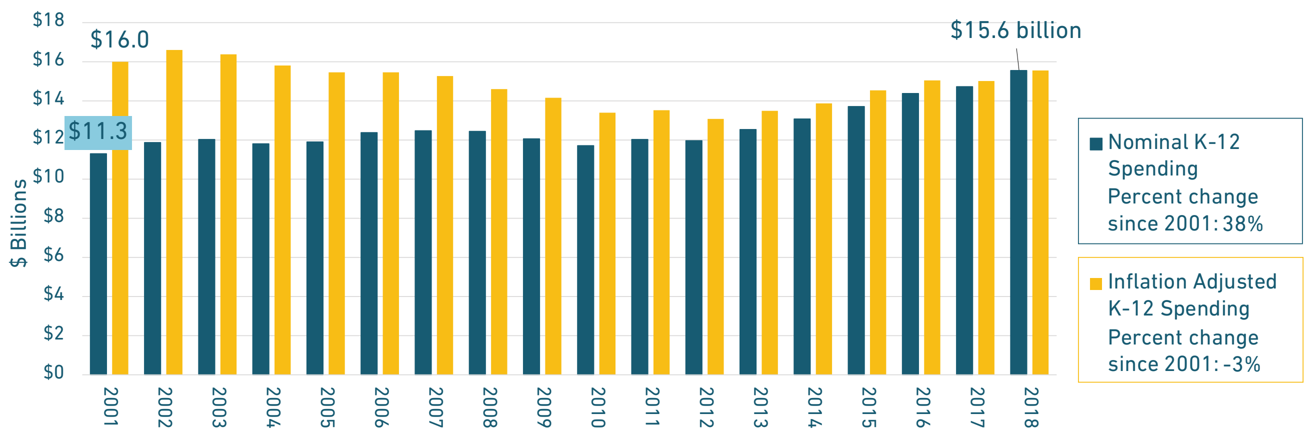
The Great Lakes State is home to nearly 10 million citizens, and almost 1.5 million primary and secondary school students. In 2018, the state's total expenditures exceeded $56.6 billion — funds for schools, transportation, public safety, and other public services. Out of that spending, the state's own-source expenditures — defined as all non-federally supported spending — totaled $35.9 billion.

Michigan teachers hired before 2012 are participants in a guaranteed income plan, known as a defined benefit pension, that is closed to new members. New teachers joining the workforce today have a choice of retirement plans, either a "Pension Plus" plan that combines elements of a defined benefit plan and defined contribution account, or a stand-alone defined contribution only plan. All of the plans available are administered by the Michigan Public School Employees' Retirement System (MPSERS). MPSERS manages retirement benefits for roughly 422,000 active and retired teachers and public school employees.

EDUCATION SPENDING

In 2018, Michigan's K–12 state distributed expenditures totaled $15.6 billion. Out of that total, $13.9 billion came from state own-source funding while the remaining $1.7 billion was from federal grants and other education programs. (Local sources provided additional funding.)

Figure MI1: Michigan's state spending on education has decreased by roughly $400 million since 2001, after accounting for inflation.



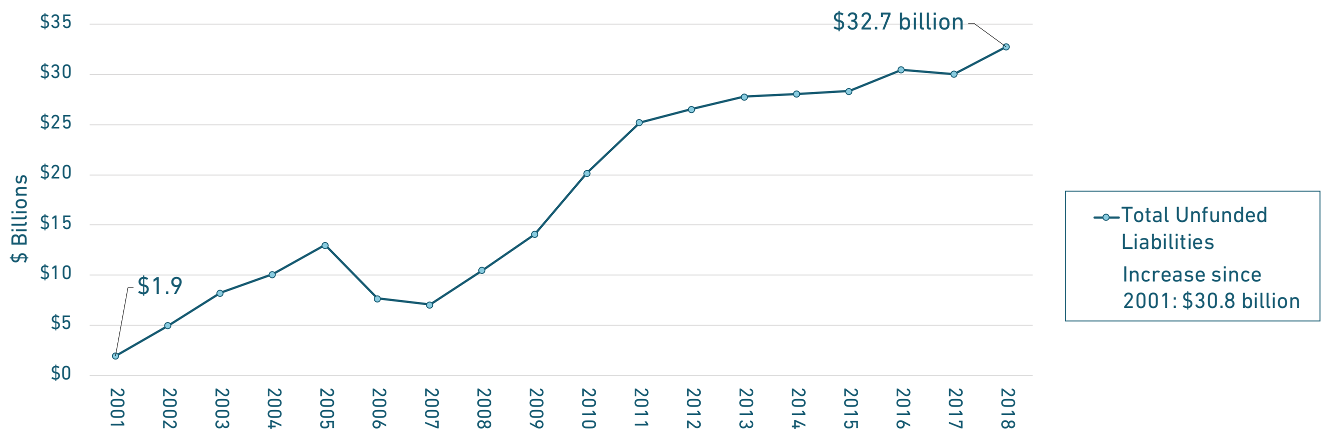
State Own-Source K–12 Spending, 2001–2018

As figure MI1 illustrates, state spending on primary and secondary education in Michigan has increased moderately since 2001 in nominal dollars, but actually declined by $400 million after adjusting for inflation. On a per student basis, the inflation adjusted spending increased 10.8% since 2001 — growing from $9,292 to $10,415. While these various trends may appear conflicting, at least a part of the reason for increased per student funding can be attributed to a decline in enrollment from 1.7 million students in 2001 to 1.5 million in 2018.

PENSION FUNDING STATUS

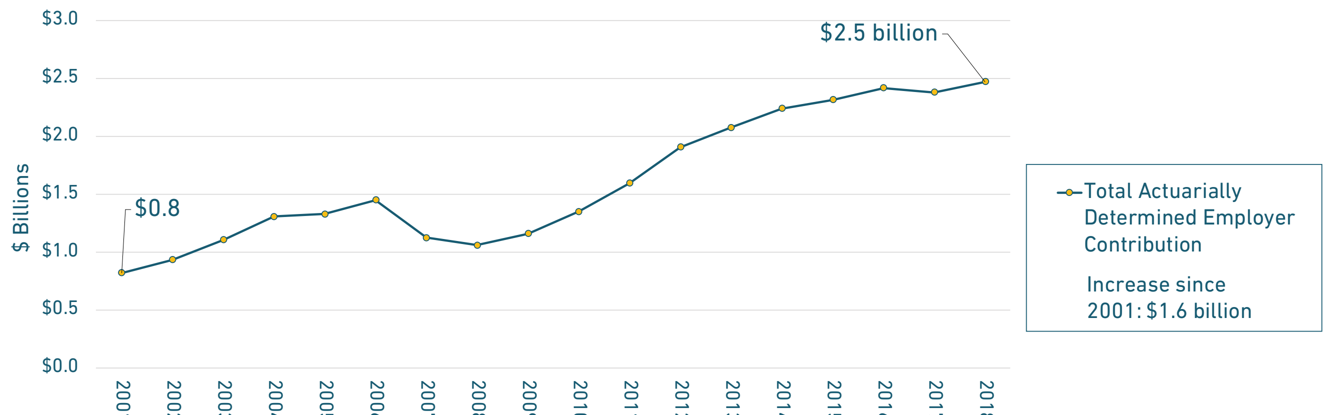
In 2001, MPSERS was nearly fully funded. However, over the past 17 years a combination of underperforming investments coupled with changing demographics have resulted in a $32.7 billion unfunded liability as of 2018. Figure MI2 shows the growth in pension debt and Figure MI3 illustrates the change in what state actuaries have recommended as contributions to MPSERS.

Figure MI2: Since 2001 MPSERS has transitioned from being almost fully funded to having nearly $33 billion in pension debt.



MPSERS Unfunded Liabilities (Actuarial Value), 2001–2018

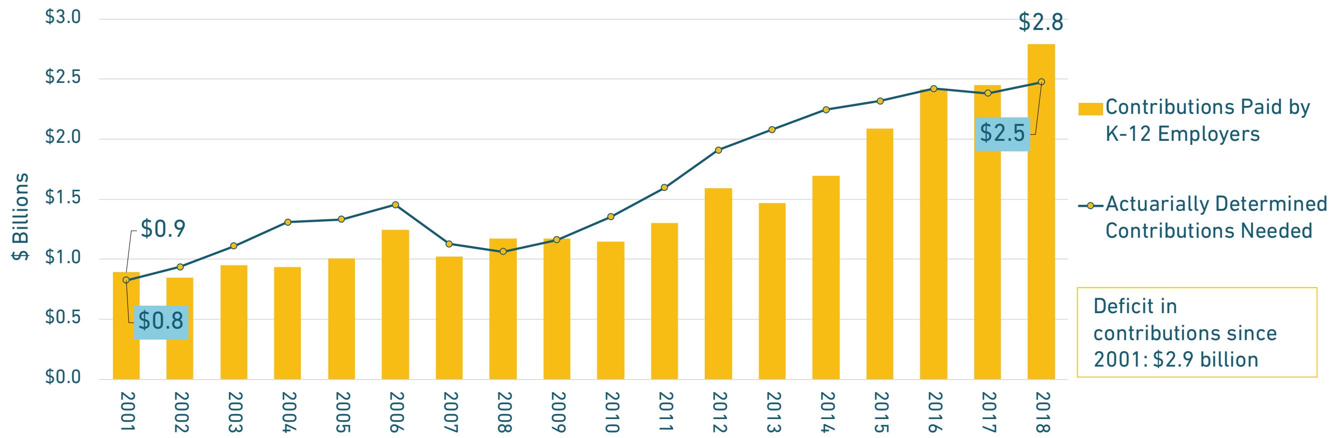
Figure MI3: To address growing pension debt the amount actuaries recommend the state contribute to MPSERS has tripled.



MPSERS Actuarially Determined Employer Contributions, 2001–2018

There are a number of states across the country that do not always ensure that the actuarially defined employer contribution is paid in full to the pension fund each year. Unfortunately, Michigan is one of those states, failing to pay the full pension bill in 12 of the last 18 years, shown in Figure MI4. As a result, the actual contributions paid into MPSERS using education funds have been less than if the ADEC trend displayed in Figure MI2 was paid in full.

Figure MI4: Michigan did not pay its full actuarial bill to MPSERS each year, shorting the plan by $2.9 billion since 2001.



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

Michigan adopted a series of changes in 2017 intended to improve the funding policies for MPSERS, including a steady reduction in the assumed rate of return on investments, increased general fund contributions to MPSERS, and adjustments to member benefits. The remaining challenge for Michigan is its current plan to pay off the $33 billion in pension debt by 2038, which will require increasingly large contributions each year.

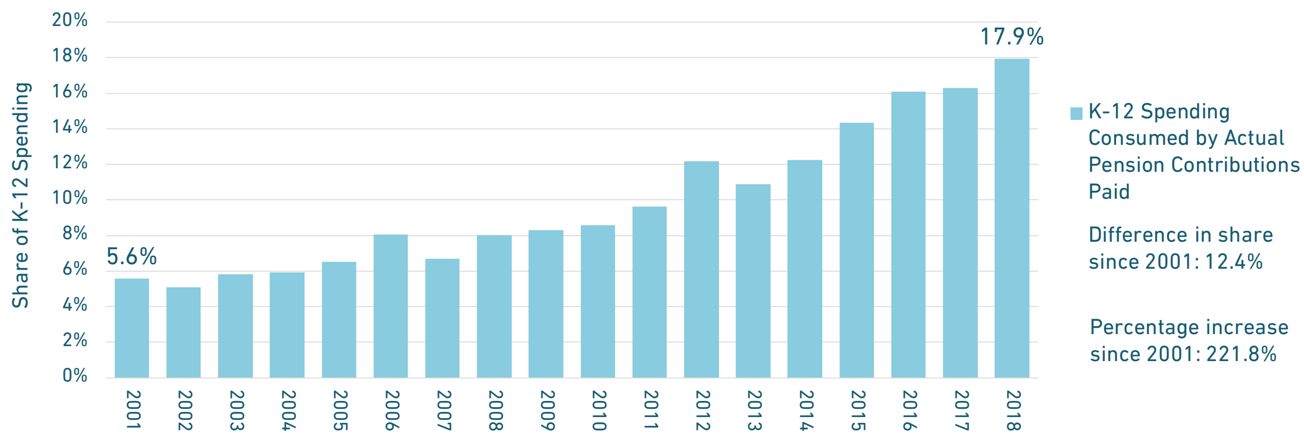
Paying the full required pension bill each year is the bare minimum for ensuring a pension system is fully funded. However, from the perspective of education funding, any increase in pension costs will be viewed negatively if it is shrinking the dollars available for teacher salaries and serving kids. Going forward, Michigan should continue its recent trend of paying the ADEC each year, but it should also budget for those payments in such a way that it avoids the historic practices which have created a considerable hidden education funding cut.

PENSION COSTS CROWDING OUT K–12 SPENDING

The growing costs of funding MPSERS have soaked up an increasing share of Michigan's education spending. This is especially important for teachers, as the growth in MPSERS's costs outpaced the growth in state own-source K–12 spending. In fact, MPSERS' contributions reported as a share of K–12 spending increased from 5.6% in 2001 to 17.9% in 2018.

As Figure MI5 indicates, pension costs have only continued to climb over time, completely offsetting any increase in the state's commitment to education. In fact, the slight decline in education funding since 2001, coupled with the explosion of pension debt and rising costs, has resulted in a sizable hidden funding cut for Michigan schools.

Figure MI5: The hidden cut to Michigan's state education funding is serious. Increasing MPSERS contributions are consuming more than three times as much K–12 funding in 2018 as 2001



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

Michigan has failed to meet its commitments to funding MPSERS by not paying the full ADEC each year. But even the reduced amounts the state has contributed to pay down the system's debt have grown significantly faster than the state's own-source education spending. Unless there is a change that reduces MPSERS's costs and/or adjusts the state's education funding to fully account for pension contributions, Michigan's education funding will continue to suffer this hidden cut in dollars intended for serving the state's children.

An even 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 MI1 shows the UAAL and actual pension contributions on a per student basis compared against state education spending. The per student figures show that the growth in the unfunded pension liabilities and growth in associated contributions have outpaced per student spending by the state. In fact, after accounting for inflation and pension costs, Michigan spent less per student in 2018 than 2001.

Table MI1: While state education spending per student increased, pension debt and contributions have completely offset that growth.

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	$9,292	$1,131	12.2%	$518	$8,774
2002	$9,647	$2,907	30.1%	$491	$9,155
2003	$9,515	$4,788	50.3%	$553	$8,962
2004	$9,164	$5,855	63.9%	$542	$8,622
2005	$8,975	$7,543	84.0%	$584	$8,391
2006	$8,966	$4,456	49.7%	$723	$8,244
2007	$9,007	$4,175	46.3%	$604	$8,403
2008	$8,799	$6,318	71.8%	$707	$8,092
2009	$8,580	$8,530	99.4%	$712	$7,868
2010	$8,429	$12,709	150.8%	$722	$7,707
2011	$8,590	$16,015	186.4%	$827	$7,763
2012	$8,394	$17,061	203.2%	$1,023	$7,372
2013	$8,700	$17,927	206.1%	$948	$7,752
2014	$9,008	$18,244	202.5%	$1,103	$7,905
2015	$9,464	$18,448	194.9%	$1,358	$8,106
2016	$9,827	$19,921	202.7%	$1,580	$8,247
2017	$9,936	$19,881	200.1%	$1,620	$8,315
2018	$10,415	$21,925	210.5%	$1,869	$8,546

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 MPSERS Unfunded Liabilities and Actual K–12 Employer Contributions, 2001–2018

THE DEFINED CONTRIBUTION PLANS IN MPSERS

MPSERS offers Michigan teachers the choice between a stand-alone defined contribution plan and a hybrid "Pension Plus" option that includes a both a defined benefit pension and a defined contribution portion. Under these plans teachers contribute to individual retirement accounts and those funds are supplemented by contributions from their employer. Until 2012, teachers were enrolled in a defined benefit only plan. All of the assets for the defined benefit pension are managed together, and all of the assets of the defined contribution plans are managed through a common third party vendor.

Despite the availability of the defined contribution plans for MPSERS members, complete employer contribution data are not clearly reported sufficiently to allow for their inclusion in these analyses. As a result, the defined contribution plan and defined contribution portion of the hybrid option 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.