EQUABLE

Hidden Education Funding Cuts

States Have Varied Experiences with Pension Debt Payments Eating into K–12 Education Budgets

Contents

About this Project

The growing cost of unfunded pension promises is having a 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.

Our Hidden Education Funding Cuts project finds that pension costs consumed 14.4% of all funding provided by state governments for K–12 education purposes in 2018, up from 7.5% in 2001. That means even as states have added money to their education budgets over the past two decades, pension costs have grown faster. And that's the hidden cut to state education funding.

But while this picture is clear at a national level with all state spending combined, there are a lot of differences in the hidden education funding cuts when we drill down to the state level.

This paper reviews a select set of state profiles to illustrate the various ways that the hidden funding cuts have played out from state-to-state. The main report for this project reviews national trends and summarizes some of the variance in how these trends manifest from state-to-state. A separate supplementary analysis examines the hidden funding cut trends at the school district level by looking deeper across the state of California to see how districts have fared in the face of rising pension debt costs.

For each state, we have also published a stand-alone profile including education spending trends, pension funded status data, and a hidden funding cut chart.

Each iteration of our investigation — national, state, and school district — follows a similar approach, exploring first the trends in education spending and then pension debt and costs. Each concludes with an examination of pension costs as a share of state education spending, allowing for a direct comparison to best illustrate the extent to which the growth of pension costs is outpacing education expenditures.

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.

Introduction

There is a major data point missing from the national debates about teacher compensation: one reason why states and school districts have struggled to provide teachers with adequate raises is because an increasing share of state education funding is going toward teacher pension costs. And those costs are growing specifically to resolve teacher pension debt.

In February 2018, public school employees (mostly teachers) across West Virginia gathered in Charleston to protest stagnant wages and a recent hike in their health care costs. But the first statewide public school employee strike in West Virginia's history didn't happen overnight. The protests grew from a series of walkouts and short work stoppages throughout 2017, as teachers expressed their disappointment with state lawmakers over their refusal to provide any kind of meaningful pay increase. The strike continued until March 6, when then-Governor Jim Justice signed legislation that would re-open West Virginia's schools.

The deal West Virginia teachers ended up getting would provide a 5% pay increase. Yet, during the strike and public debate over teacher salaries, there was little to no discussion of the fact that 24.3% of all state education funding that year was being spent on teacher pension costs — more than $470 million in 2018.

Adjusting for inflation, West Virginia was actually sending less state money to school districts in 2018 ($1.9 billion) than it was at the start of the century ($2.1 billion in 2001). On its own, this was part of the reason that educators in the Mountain State were so upset.

But the state and school districts had additional reasons to pinch pennies when it came to teacher salaries. At the same time as overall state own-source spending on education was stagnating in West Virginia, the costs for their Teachers' Retirement System had increased by more than $100 million a year. The net result was that pension costs in West Virginia were consuming 24.3% of all state education funding in 2018, up from 16.3% in 2001.

This was a massive, hidden education funding cut in West Virginia. It wasn't the only reason teachers hadn't seen a pay raise in years, but it definitely was a contributing factor.

Similar stories to West Virginia can be found in Arizona, California, Illinois, and elsewhere. In each case events tended to play out the same way and rarely are the increases in teacher pension costs discussed in the context of state-level debates over teacher pay.

This is an important omission because the way that hidden education funding cuts work in each of those states was different, as revenue and education spending experiences have varied from state-to-state. Some states have managed to increase education funding as pension costs have increased — meaning depressed teacher salaries could be directly influenced by the growing costs of their retirement benefits. Other states haven't even ensured education funding levels keep up with inflation — meaning depressed salaries for teachers are the result of broad trends in education spending. Understanding these differences between states when it comes to how their pension debt costs have resulted in hidden education funding cuts is important for interpreting both the causes of teacher salary debates, as well as other issues with education funding such as the equitable distribution of resources.

Part 1: Variance in State Trends for Pension and Education Finances

When looking at all state own-source spending on education collectively, the share of funding going to pay for teacher pension costs has grown from 7.5% in 2001 to 14.4% in 2018. But that national average has a lot of variance from state-to-state.

Pennsylvania has experienced the largest increase of any state, with their hidden state education funding cut growing from 2.4% to 34.3% of state education spending. Even New York State, one of the best funded plans in the country, has seen the share of state education funding going toward pensions grow from 1.1% in 2001 to 5.4% in 2018. Oregon, by contrast, has had relatively low and flat pension costs as a share of state education spending, with an 11.1% share in 2001 and 11.8% share in 2018. Alternately, Nevada has kept its pension cost share of education funding relatively flat by doubling state spending on education over the past 18-years — but the share kept stable is more than a third of state spending on education.

The top-line findings of our state analyses reveal that many states had a unique experience over the nearly 20 years from 2001 to 2018. Generally, there are three types of ways that states have been experiencing hidden education funding cuts.

#1 RAPIDLY INCREASING PENSION CONTRIBUTIONS HAVE ONLY EXACERBATED FUNDING PROBLEMS WHERE THERE HAVE BEEN MINIMAL INCREASES IN STATE EDUCATION FUNDING

For some states, slow growth in K–12 spending has combined with the explosion in pension debt to create a significant threat to education budgets. In California, for example, state education funding has increased 12.3% (adjusted for inflation) since 2001, while actual teacher pension payments have more than doubled. A report by *Pivot Learning* found those rising pension contributions, driven by efforts to repay California teacher 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.

#2 MEANINGFUL INCREASES IN EDUCATION FUNDING HAVE BEEN MOSTLY OR COMPLETELY CONSUMED BY GROWING PENSION CONTRIBUTIONS

For most states, K–12 spending has grown, even after accounting for inflation. However, this has been offset partly, or even completely, by 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). In Illinois, for instance, the state has increased its education funding from 2001 to 2018 by roughly $6 billion in nominal dollars, and nearly 40% even after adjusting for inflation. But actual teacher pension contributions have grown from around $1 billion in 2001 to more than $4 billion in 2018, wiping out at least half of the increase in state education funding. On a per student basis pension costs consumed nearly all of the increase: the Illinois state budget provided $1,790 more per-student in 2018 than 2001, but pension costs increased by $1,540 per-student over the same time frame.

#3 EDUCATION FUNDING LEVELS HAVE GROWN FAST ENOUGH TO KEEP PACE, EVEN AS UNFUNDED PENSION LIABILITIES HAVE CAUSED GROWTH IN PENSION COSTS

A few states have managed to buck the trend entirely. In these places unfunded liabilities have increased over the past 18-years, and that has led to an increase in pension costs. But state budgets have managed to keep pace with those changing contribution rate requirements by ensuring state education funding levels increased at similar rates. In Nevada, the statewide retirement system has accumulated nearly $11 billion in unfunded pension liabilities over the past two decades, of which $5 billion is a shortfall for teacher pensions. As a result, actual pension contributions paid have increased by $327 million a year. But education funding levels have also increased. The share of state education funding consumed by pension costs in 2001 was 32.9% and in 2018 it was 35.5% — both numbers are a high share, but the overall trend has been relatively stable.

FIVE SAMPLE STATE PROFILES TO UNDERSTAND VARIANCE

For examples of how various state trends follow or deviate from the broader national trends, we have selected five states to examine and contrast — Arizona, Florida, Kentucky, Nevada, and New York State. These states were selected because they offer considerable variation across multiple criteria, ranging from geographic location, to political affiliation, economic size and activity, and current teacher pension performance.

For instance, Arizona, Florida, and Nevada all mix teachers into statewide retirement systems that provide benefits for employees of other state agencies. Kentucky and New York have separate pension plans for teachers. In fact, New York State and New York City both have entirely separate pension plans for teachers.

To take a detailed look at each of these five states on their own, or any other of the 50 states and Washington, DC, please visit Equable.org/hiddenfundingcuts and download the state profile of your choice.

1.1 Increases in State K–12 Spending Have Varied Considerably Across the Country

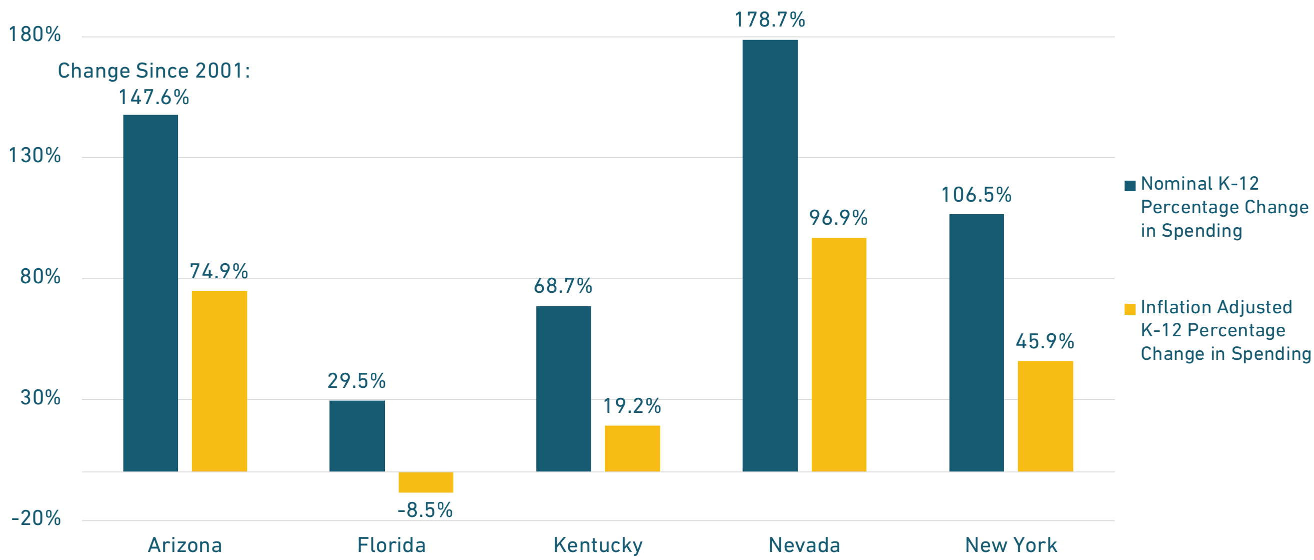
The general trend of state spending on K–12 education nationally has been stagnated growth since 2001. Here are a few top-line findings about K–12 state spending across the country:

- State funding of education, the largest source of revenue for K–12 education, increased in every state on a nominal dollar basis.
- Adjusting for inflation, there were seven states, plus Washington, DC, that saw their own-source education spending decline: Florida, Maine, Michigan, Mississippi, New Hampshire, Oklahoma, and West Virginia.
- Among the remaining 44 states, the average inflation-adjusted increase in education spending was 38%. This means that, on average, state spending for K–12 increased by a little more than 2% a year over the 18-year period measured.

The collective takeaway is that most of the growth in state education budgets has been due to inflation: while the percentage change in nominal K–12 spending went up 78% on average, adjusting for inflation the growth from 2001 to 2018 was just 26% on average. In fact, since 2008, growth in inflation adjusted state K–12 funding has been even more stagnant, increasing only 7.6% nationally between 2008 and 2018 — a trend that holds in most states.

But few states exactly match that national average, as reflected in the variance among the five states we profile in this report. Figure 1 displays the percentage changes in both nominal- and inflation-adjusted state education funding for our sample states.

Figure 1: All five states exhibited growth in nominal dollars since 2001. However, once each state's spending is adjusted for inflation, a much different set of results appears.



Changes in State K–12 Spending between 2001 and 2018 for Sample States

As Figure 1 illustrates, the stronger states are Arizona, Nevada, and New York State. In each of these, inflation adjusted state education funding was about half of the nominal dollar increase from 2001 to 2018. By contrast, Kentucky reflects a change closer to the national average, where the real increase in state education funding is about a third of what the nominal dollars show. Florida, by contrast, represents the handful of outliers where state spending on education in 2018 is actually less than 2001 on an inflation adjusted basis.

(As a reminder to our readers, the data here reflect the state spending on education that state budget officers reported to the National Association of State Budget Officers in their annual survey of state expenditures. NASBO figures typically match closely with state agency spending figures, but occasionally vary based on the categorization of spending. For more information, check out our full methodology.)

There are many reasons why state education funding trends can differ, including political and demographic factors. For example, student enrollment grew by several hundred thousand in Arizona, Florida, and Nevada from 2001 to 2018. In Kentucky, enrollment grew, but only by roughly 12,000 students over the 18 years measured. For New York State, the number of students enrolled in K–12 schools declined by more than 150,000.

Taken alone, these enrollment trends don't mean much, but when they are coupled with the different trends in state K–12 spending, the contrasts between the states become starker. Arizona, Nevada, and New York State saw between 40% and 55% increases in funding on a per-student level; Kentucky's nearly flat growth in enrollment results in a 17% increase in per student funding; Florida's 8.5% decline in K–12 spending, however, is exacerbated by their growing enrollment, such that their education spending per-student declined by 20.9%.

Table 1 (next page) shows how each state's per student spending changed year-after-year from 2001 to 2018, adjusted for inflation.

Education is frequently identified as among the top priorities of most state policymakers, but as shown in Figure 1 and Table 1, the experiences of these five states indicate that the extent to which K–12 education is funded varies significantly across the country. Moreover, the variation across these states underscores the challenges that many lawmakers face when trying to formulate their state budgets, all before we consider the role of increasing pension debt.

Table 1: Differences in student enrollment and state education funding trends have translated to a range of per student spending patterns over the past two decades.

Year	Arizona	Florida	Kentucky	Nevada	New York State
2001	$3,980	$5,722	$6,249	$2,869	$7,046
2002	$4,394	$5,247	$6,231	$3,025	$7,417
2003	$4,222	$4,301	$6,193	$2,987	$7,504
2004	$4,536	$4,451	$6,062	$3,019	$7,392
2005	$4,650	$4,557	$6,280	$2,956	$7,948
2006	$4,769	$4,647	$6,603	$2,899	$8,179
2007	$6,823	$4,844	$6,962	$2,818	$8,930
2008	$6,347	$4,720	$7,068	$3,531	$9,453
2009	$5,998	$4,444	$6,960	$4,250	$10,036
2010	$4,730	$4,084	$6,544	$3,729	$9,630
2011	$4,463	$4,418	$6,555	$3,556	$9,447
2012	$4,012	$3,676	$6,641	$3,796	$9,343
2013	$3,914	$4,000	$6,634	$3,802	$9,451
2014	$4,055	$4,280	$6,520	$3,667	$9,660
2015	$4,277	$4,378	$6,835	$3,675	$10,367
2016	$4,488	$4,375	$6,866	$4,770	$10,584
2017	$4,134	$4,402	$7,497	$3,899	$10,708
2018	$5,184	$4,448	$7,312	$3,838	$10,840

Notes: Values are inflation adjusted dollars spent per student to allow for comparison of spending over time.

Total State K–12 Spending Per Student, 2001 to 2018

1.2 Virtually All States Have Experienced Pension Debt Increases, but Some Are Larger than Others

At the turn of the century, the average teacher pension plan reported they had 99% of the money needed to pay all future promised benefits. But by 2018, state pension plans across the country have a reported $642 billion collective shortfall in their promises to teachers. Here are a few top-line findings about how these unfunded pension liability trends vary from state to state:

- As of 2018, there are only four teacher pension plans with virtually no unfunded liabilities. Each of the following plans has a 95% funded ratio or better: New York State Teachers Retirement System, South Dakota Retirement System, Tennessee Consolidated Retirement System, and Wisconsin Retirement System.
- Most states experienced an increase in unfunded liabilities between 2001 and 2018, but five states have less in pension debt after those 18-years when adjusting for inflation: Maine Public Employees' Retirement System, Oklahoma Teachers' Retirement System, South Dakota Retirement System, Wisconsin Retirement System, and West Virginia Teachers' Retirement System.
- Some states that started the century with little to no unfunded liabilities have experienced larger increases than others. States with the largest increase in unfunded liabilities for pension plans covering teachers were:
    1. California ($104 billion)
    2. Illinois ($59 billion)
    3. Pennsylvania ($52 billion)
    4. Texas ($48 billion)
    5. Florida ($44 billion)

When looking at the five sample states for this paper, we also see significant differences in unfunded liabilities and pension funded status. Kentucky and Florida reported similar dollar levels of unfunded liabilities for teachers in 2018 (between $14 billion and $15 billion), but for Kentucky this means teacher pensions are 57.7% funded and for Florida this means 84% funded. The difference is that Florida's system is larger, so the dollar valued shortfall is a lower share of what has been promised.

New York State's teacher retirement system is one of the best funded in the country, whereas Kentucky's teacher pension plan is one of the ten worst funded. Arizona and Nevada have statewide retirement systems including teachers that are funded at levels around the 71% national average.

What should be done about this challenge? The specifics vary from state to state. Get in touch with Equable Institute's policy team to discuss the range of ways the hidden education funding cut problem can be solved: research@equable.org

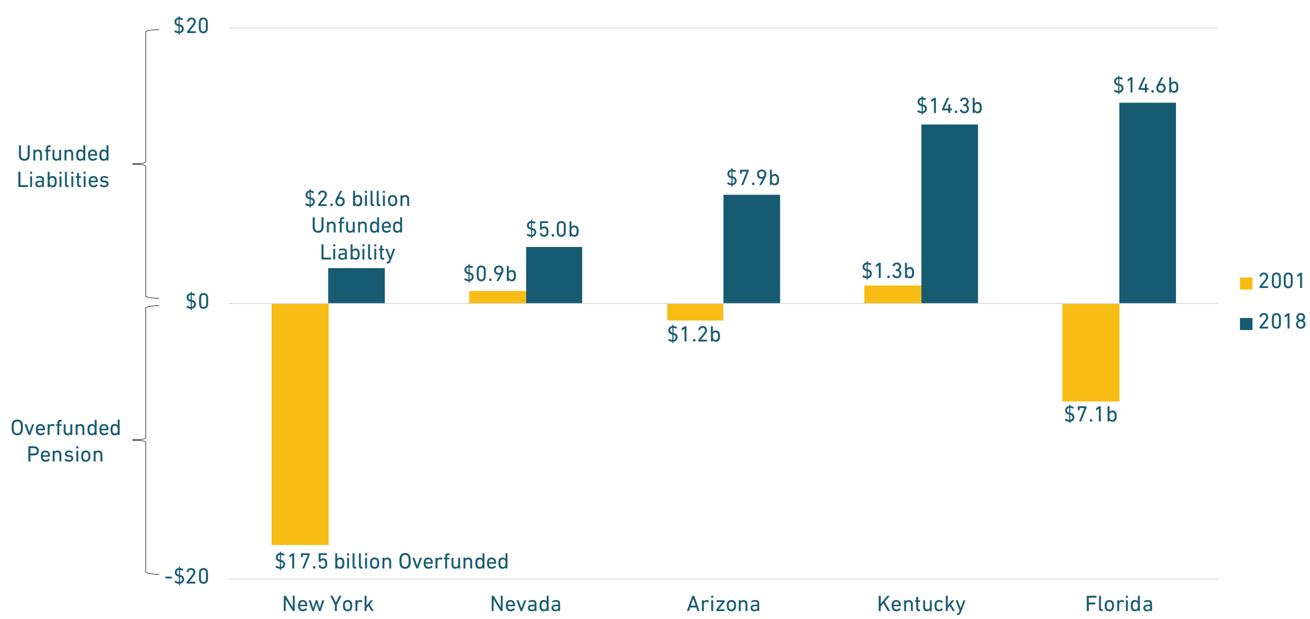
Meanwhile, Kentucky and Nevada started the century with pension funding shortfalls and have seen those pension debt levels rise. But whereas Arizona, Florida, and New York State entered 2001 with a funding surplus, today only the Empire State is still close to being 100% funded.

What matters for analyzing hidden education funding cuts is the relative change in unfunded liabilities over time. This is because growth in unfunded pension liabilities typically means growth in pension debt payments to be made. And higher pension debt payments in certain states can have an outsized effect on that state's ability to provide adequate education funding. For example, Kentucky's economy is roughly 1/5 the size of Florida's. The similar dollar value of unfunded liabilities therefore requires a considerably larger share of Kentucky's revenues to be paid off than the same dollar amount of pension debt does in Florida.

At the same time, just because New York State is close to being fully funded does not mean its underlying pension finances have stayed the same. Back in 2001, New York State was considerably overfunded with a $24.7 billion surplus. But the state's unfunded liability has ranged from $1 billion to $3 billion over the past few years. This suggests there could be hidden funding cut pressures lurking for New York State, even with low unfunded liabilities.

Figure 2 shows the change in unfunded liabilities for each of the five sample states from 2001 to 2018. Some states started out with an overfunded position (New York, Arizona, Florida), but all states have accumulated some level of pension debt.

Figure 2: The growth in pension debt since 2001 has varied from state-to-state, but all five states face some unfunded liabilities.



Change in Share of Unfunded Liability Specific to Teachers (Actuarial Value), 2001–2018, in Billions

1.3 Unfunded Liabilities Mean Pension Debt Payments

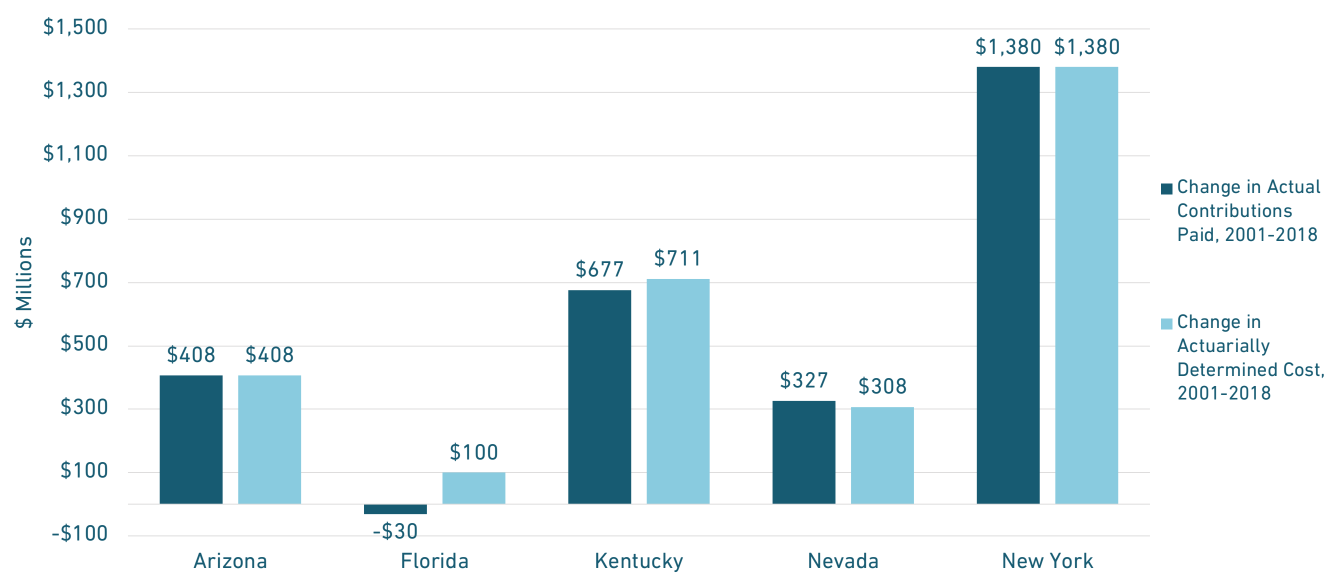
As unfunded liabilities grow, so do pension costs. Unfunded liability amortization payments (for previously earned benefits that have a funding shortfall) are added to normal costs (for benefits earned in the current year), and the total is split between employees and employers. The share paid for by the state and local employers is typically called the *actuarially determined employer contribution* or ADEC.

However, some states fail to consistently pay their share of contributions every year, meaning it is necessary to measure both the change in the ADEC and actual contributions governments paid over time. Top-line findings about state efforts to deal with their pension costs include:

- Only two states have experienced declining ADEC, adjusted for inflation: Maine and Ohio. (Ohio has largely accomplished this by increasing employee contribution rates.)
- For the remaining 48 states and Washington, DC, the median increase in annual pension costs was $311.1 million from 2001 to 2018.
- The average ADEC increased $714 million, but this number is skewed by outsized increases in the ADEC for California, Illinois, Michigan, New York, Pennsylvania, and Texas — all with ADEC growth by more than $1 billion.

Figure 3 offers a comparison of the change in annual pension costs across the five sample states. The dark blue column shows the change in actual contributions paid from 2001 to 2018; the light blue column shows the change in the ADEC.

Figure 3: The growth in teacher pension costs varies across states depending on the size of the state, level of unfunded liability, and degree of commitment to paying the ADEC each year.



Changes in Annual Pension Costs between 2001 and 2018, in Millions

First, it is helpful to point out that Arizona and New York both have fully committed to paying their ADEC each year. Meanwhile, the other three states have struggled to ensure their contributions paid the full pension bill provided. Nevada actually paid more in 2018 than the ADEC, but that was because they were trying to catch up on previous years where they did not pay the full pension bill.

Second, this comparison shows very different sized increases in contributions. Some of the changes are attributable to the size of the state — New York State has a much larger population and budget than Arizona. Some of the changes are the result of low contribution rates in 2001 — both Florida and Arizona had ADEC rates less than 5% of payroll in 2001, but since then have been required to pay in much more.

Third, we see that some states like Florida have been able to avoid a large increase in pension costs even though they've accumulated billions in unfunded liabilities. In most cases, states have simply not paid their full ADEC. In the case of Florida, the state has also sought to reduce overall promises by reducing cost-of-living adjustments and raising retirement ages. The state also increased employee contributions, which further reduced reported state pension costs.

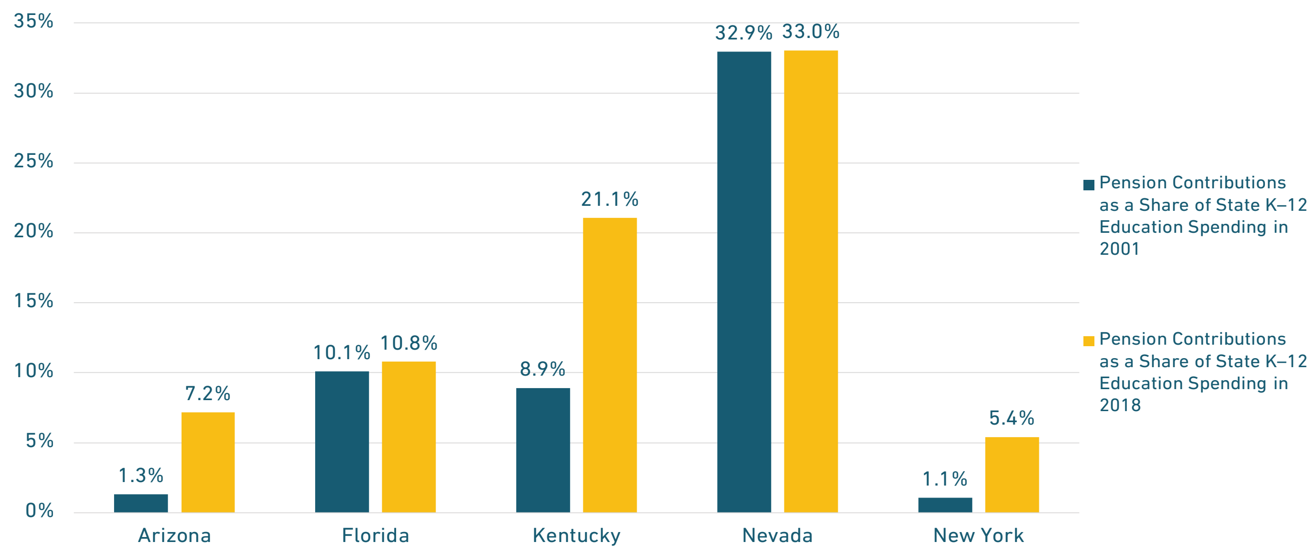
Paying the full required pension bill each year is the bare minimum for ensuring a pension system is fully funded. However, from the perspective of education funding, any increase in pension costs will be viewed negatively if it is shrinking the dollars available for teacher salaries and serving kids. New York State, for example, has managed its pension system well, kept unfunded liabilities to a relatively low amount, and paid the ADEC each year. However, doing all of this has meant an increase of more than $1 billion in annual pension costs. If they didn't match that increase with dollars into their state education expenditures, the state could still have suffered a hidden education funding cut — which we see in the next section.

Part 2: For Most States Growth in Pension Spending Is Outpacing Education Funding

As with our national-level comparisons, we analyze the growth in pension costs relative to K–12 budgets in terms of actual contributions paid by states. This lets us understand how state education budgets have been eroded in real terms, even though the level of funding cuts might be even higher if all states paid 100% of their ADEC every year.

Figure 4 shows that the hidden education funding cuts experienced by individual states do not always follow the national trend, where the share of state education funding has grown from 7.5% in 2001 to 14.4% in 2018.

Figure 4: The five sample states have experienced a wide variety of hidden funding cuts, but the one thing they have in common is that all of them have seen a larger share of state K–12 funding going to pay for pension costs.



Changes in Pension Costs (adjusted for inflation) between 2001 and 2018 as a Share of K–12 Spending for Profile States

Generally speaking, we do not think it is a good idea to put too much weight on the comparison of hidden funding cut levels from state-to-state. Each state has their own story (discussed in section 2.1), and some states have local revenue sources that reduce the magnitude of the hidden cut's overall level (discussed in section 2.2).

As we noted earlier, the reasons why we see differences in the magnitude of those increases are numerous, ranging from Nevada's increased K–12 state spending, to New York State's relatively small amount of pension debt, to Florida's benefit reductions and increase in member contributions. However, it is important to note that there is a common theme across all five of our sample states — all of them saw an increase in the share of state education funding going toward pension costs. This means that more dollars intended for classrooms and teacher salaries aren't making it to their intended destinations as these hidden funding cuts have grown.

2.1 The Divergence in Hidden Education Funding Cut Stories for Each Sample State

For each of our sample states, the story behind their hidden funding cut is one worth telling. In this section we offer some brief insights into how each state has felt the squeeze of their increasing pension costs and, whenever possible, how they have dealt with those consequences. However, if we have shown anything in this report, it's that the experiences of states vary widely and the hidden funding cuts in their state K–12 funding have played out differently. In addition to these short stories from our sample states we invite you to explore a fuller examination of every state and Washington, DC, through our state profiles available here.

ARIZONA: RELATIVELY SMALL HIDDEN FUNDING CUTS HAVE GROWN EXPONENTIALLY AS UNFUNDED LIABILITIES SOARED

In 2001, Arizona's pension costs consumed 1.3% of the state's K–12 budget. The state makes the ADEC payment every year, but failure to adapt to changing markets and demographics has meant a surge in unfunded liabilities. The resulting growth in pension debt payments meant that in 2018, 7.2% of state K–12 spending in Arizona went toward pension costs. The additional 5.9 percentage points' increase is more than five times that of 2001. The increasing costs of Arizona's teacher pension debt are felt particularly hard in the Grand Canyon State, as plan members and employers split all contributions 50/50, meaning that whenever contribution rates go up, teachers' pocketbooks are hit directly. To put this into context, since 2002 teachers have seen their contributions grow from 2.0% to roughly 12.0% in 2018. This increasing squeeze on Arizona teachers' paychecks is in addition to the hidden cuts that trickle down from the reductions in available state K–12 funding.

FLORIDA: DESPITE DECLINING LEVELS OF EDUCATION FUNDING, THE STATE HAS NOT SUFFERED A DRAMATICALLY HIGHER HIDDEN CUT BECAUSE OF STATE REDUCTIONS IN PENSION BENEFITS THAT HAVE REDUCED PENSION COSTS

Florida has had a particularly unique experience over the 18-year period from 2001 to 2018. The state's pension ran a surplus for many years longer than most other states and did not see an unfunded liability emerge until after the onset of the Great Recession. Since then, the state has attempted to keep raising pension costs in check by reducing benefits, increasing employee contributions, and using accounting gimmicks.

Meanwhile, enrollment has increased by roughly 400,000 students, while state own-source K–12 spending has declined. The end result has been a relatively muted increase in pension costs as a share of the education budget.

The unfunded liability for FRS is likely to grow in coming years as the state adjusts the pension plan's assumed rate of return, which will trigger an increase in pension costs. Without a subsequent adjustment to K–12 spending, this could lead to an acceleration of the crowd out effect that Florida has otherwise largely avoided, especially if state K–12 funding does not start growing to keep pace.

KENTUCKY: GROWING UNFUNDED LIABILITIES AND PENSION COSTS HAVE NOT BEEN MATCHED WITH SUFFICIENT STATE EDUCATION FUNDING DOLLARS, LEADING TO A SIGNIFICANT HIDDEN CUT

Kentucky's teacher pension plan is one of the worst funded in the country, with only 57.7% of the money set aside needed to pay for earned teacher benefits. From 2001 through 2018 the state accumulated an additional $12.4 billion in pension debt that translated into an increase of $711.5 million in annual actuarially determined employer pension costs. Budget constraints led to occasional periods over the past two decades where the state did not fully pay the ADEC, and resulted in the state shorting the teacher pension system $2.3 billion from 2007 through 2016. Moreover, it is likely similar fiscal pressures have impeded the state's ability to increase education spending, preventing it from keeping pace. As a result, the share of state K–12 education funding going to TRS pension costs more than doubled to 21.8%. In other words, more than $1 out of every $5 in state funding meant for Kentucky classrooms was being consumed by pension costs.

NEVADA: UNFUNDED LIABILITIES HAVE SPIKED MORE THAN 500%, BUT THE ACCOMPANYING PENSION COSTS HAVE BEEN ALMOST TOTALLY TAKEN CARE OF AS STATE EDUCATION FUNDING LEVELS DOUBLED

In 2001, Nevada's Public Employees' Retirement System had a nearly $2 billion unfunded liability. Over the following 17 years a combination of underperforming investments, changing demographics, and paying less than actuarially recommended have resulted in the continued growth of the unfunded liability — reaching nearly $10.9 billion in 2018. This has led to an increase in annual pension costs of more than $300 million.

However, when compared against our other profile states, Nevada stands out for how much it has increased education spending over the past two decades – total state own-source K–12 funding has nearly doubled even after accounting for inflation (driven in part by the boom in state population during the housing bubble). As a result, the Silver State is relatively unique in that education spending has been enough to keep up with growing pension costs. Whether this pattern will continue is dependent upon the legislature's management of both K–12 budgeting and unfunded pension liabilities.

NEW YORK STATE: PENSION COSTS HAVE INCREASED TO ENSURE A FULLY FUNDED RETIREMENT SYSTEM, BUT THE STATE HAS NOT COMPLETELY MATCHED THOSE COSTS WITH EQUAL INCREASES TO EDUCATION FUNDING

New York State provides an example of how growing pension costs are not inherently a bad thing, if driven by adaptation to changes in markets and demographics. The New York State teacher pension plan started the century over 100% funded, and as of 2018 was 97.7% funded. Effectively maintaining the funded status and keeping unfunded liabilities relatively low has meant paying the ADEC every year and increasing contribution rates to the pension fund. These are all positive signs that show New York's commitment toward the teacher retirement system and its members.

But that does not mean New York State is challenge free. While pension costs have increased to keep the plan fully funded, lawmakers did not always adjust education budgets to account for these increases: In 2001, state teacher pension costs were 1.1% of education spending, whereas in 2018, they are now nearly five times that amount at 5.4% of K–12 budgets. The increased share of funding going to pensions does not present an immediate threat to New York State's fiscal stability or broader education budget, but in practice there have been notable effects on the funding of other education priorities.

2.2 Understanding the Complexity Added by Local Education Funding

The final way that states differ with respect to hidden cuts is the degree to which the share of education funding being measured is supplemented by local revenues for school districts.

Depending on the tax laws and school financing approach of a given state, the majority of education funding could come from state budgets (with local dollars providing some supplement) or local revenues (with state dollars providing a funding equalization effect across school districts). According to 2017 data from the Census Bureau, 47.1% of education funding came from state sources, while 44.9% came from local sources (with federal funding providing the rest).

This balance has been roughly the same for the past 18-years.

In states like Vermont and Hawaii, more than 90% of education revenue comes from the state. But in New Hampshire and Nebraska, more than 60% of education funding is from local sources, such as property taxes.

Ultimately, the state/local balance of education funding does not influence the underlying story of hidden state education funding cuts — states that are not keeping their education funding levels at least as high as growing pension costs have schools with fewer resources each year. However, the magnitude of the hidden funding cut may be different when local resources are added in.

For example, Florida schools get about 50% of their revenue from local sources, and 40% from the state (according to the 2017 Census Bureau data). That means if we measured the state's $1.3 billion in 2017 pension contributions as a percentage of $26 billion in state plus local education spending, the total hidden funding cut would be 5% for 2017.

While complete local revenue data was not available for our analysis, thus requiring us to focus on state funding, we think that the trends from 2001 to 2018 are generally the same even when the local revenue is added. The information for Florida above is still informative as it provides the directional trend of education resources getting pulled away from schools by teacher pension costs.

Part 3: Hidden Education Funding Cuts Should Always Be Examined Locally

The common aphorism that housing prices are always driven by local factors also applies to understanding education funding. While national trend analysis can be helpful in spotting issues to focus on, that focus should then be directed to state-specific examination.

Given the number of factors that could be driving state education funding decisions, contributing to unfunded liabilities, and influencing pension costs, truly understanding hidden education funding cuts requires diving down to the local level.

Such local analysis starts with the state level and ultimately moves on to school district analysis. But even at the state level, some of the differences emerge clearly.

States differ in their levels of education funding, and trends in providing dollars to school districts over the past two decades. Most states have increased K–12 funding on an inflation adjusted basis, but some much more than others. Teacher pension funds have varying levels of success over the past 18-years, though most have accumulated significant unfunded liabilities. That pension debt has translated into growing costs, with some states wrestling with required contributions increasing faster than others.

The net result is that hidden education funding cuts are a real, important challenge for every state to wrestle with, but in different ways.

For states where pension costs are growing faster than education funding, state legislatures need to consider how this might be influencing education outcomes, teacher salaries, and the equitable distribution of resources.

For states where education funding has mostly kept up with pension costs, state legislatures need to continue to monitor their education funding levels so that a large hidden education funding cut does not sneak up on them.

Finally, as we pointed out in our national paper, to solve this overall challenge it is important to recognize that teacher pensions are not inherently the problem. Pensions can offer a pathway for public school teachers to have a secure retirement where they can end their careers with dignity, respect, and the comfort of knowing they earned their benefits while educating America's youth. The real culprit in this story is pension debt — the unfunded liabilities and their costs — that has been allowed to accumulate over years of neglect by lawmakers, administrators, and other policymakers. Without any action, the problem is likely to only grow worse as pension costs increasingly cut into state education budgets.

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.

Appendices, Methodology, And Sources

The analysis reported in this paper is based on two unique datasets compiled by Equable researchers as part of our Hidden Education Funding Cuts project. For more details on the data sources and methodology, visit Equable.org/hiddenfundingcuts and download the methodology.