



Don't redirect pension funds

Lawmakers should be wary about lowering pension debt payments

By James M. Hohman | February 2024

Gov. Gretchen Whitmer wants to take \$670 million out of the state's pension debt payments and spend it elsewhere. Michigan legislators should be careful. Underfunded pension debts have a long history of wreaking havoc with state budgets. Lawmakers, employees, unions and citizens should all want to catch up on what taxpayers owe to public retirees.

All public school employees are required by state law to be part of the state-managed pension and retiree health insurance system. Michigan public schools send money to the state to pay for their employees' pensions, and the state pays out pension checks to employees when they retire.

The system is supposed — and required by the state constitution — to be prefunded. That is, when employees work and earn their pensions, their employers set aside enough cash to pay for their monthly pension checks. After they retire, they can be sure the state will pay off their pension benefits regardless of how many new employees enter the

system. When you earn a dollar in pension benefits, your employer sets aside a dollar to pay for them.

Unfortunately, Michigan lawmakers have not lived up to this requirement. Instead of putting in the dollar to pay for what was earned, they set aside just 64 cents of what they needed, according to the state's most recent actuarial valuation.

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It's a big problem. The state owes pensioners in this system \$35 billion more than lawmakers have saved. The state accidentally made school employees the state's largest creditors. This hurts teachers and taxpayers alike.

Underfunding pension debt is bad for teachers. School resources now go to pay down school debt, money that could otherwise be spent on take-home pay. Current retirement contribution rates cost 48% of payroll. The bulk of payments do not go to prefunding

pensions but to paying extra rates that are assessed to pay down the pension debt of past workers.

It is also bad for taxpayers, because pension debt has interest costs, \$2.1 billion a year at current underfunding levels. Michigan taxpayers are spending more on pension debt than on the entire annual budget for the Department of Corrections.

Lawmakers have done a lot to contain additional pension debts. They now give employees the option to be in a 401(k)-style plan that doesn't let lawmakers underfund benefits. They also use better pension funding assumptions and have decided not to lower pension contributions until debts are paid.

This is what Whitmer wants to change. The 2025 executive budget proposes "statutory changes to adjust the...floor" of the unfunded actuarial accrued liability for retiree health benefits, according to the State Budget Office. Michigan has saved roughly enough to pay benefits, according to recent assessments. The full funding is only on the retiree health care side, not the pension side. And the requirement to keep contribution rates up until debts are paid applies to both. The governor wants to take the money meant to catch up on these debts and spend it elsewhere.

That means putting \$670 million less into the pension system each year. This would defer further pension debt payments and put the state further away from the point where pension debts are fully paid off. As with any case where people defer their debts, it would mean taking up more in interest costs.

Taxpayers are not supposed to be in this position. School employees are not supposed to have their pensions underfunded. Lawmakers have done a lot to limit pension debt. They should reject the governor's attempt to undo that progress.

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