THE PEW CHARITABLE TRUSTS

NCSL Forecast ‘23: Budget Working Group

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Greg Mennis, Director

State Fiscal Policy, The Pew Charitable Trusts

Long-Term Liabilities

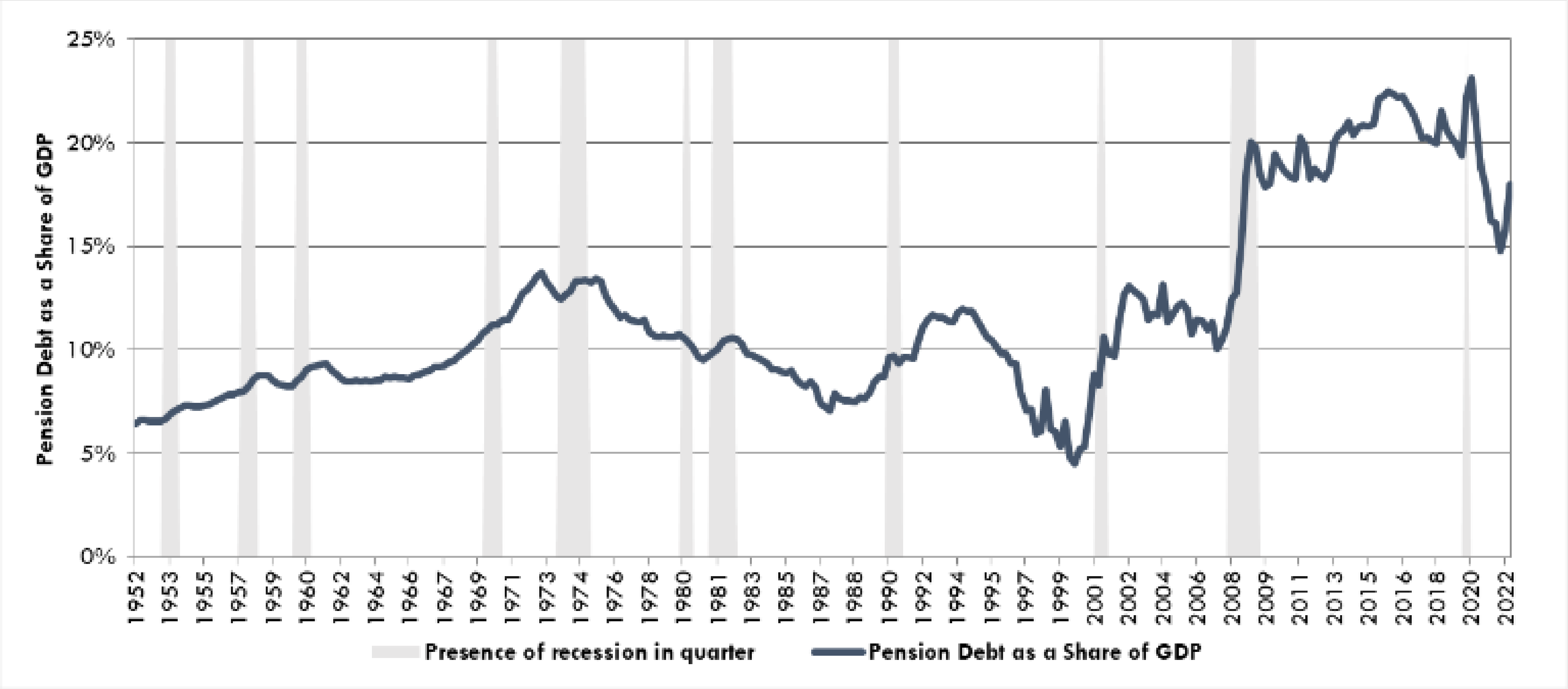
- State and local government (SLG) obligations for long-term debt, unfunded retirement benefits, and deferred infrastructure maintenance exceed $6 trillion. Pew estimates the annual cost of adequately funding these obligations equates to 25%-30% of SLG own source revenue (OSR).

- These deficits are likely to increase with slower economic growth and higher inflation; although the overall outlook for pensions has improved, due in part to past reforms.

- Current Research Questions:
  - Are SLGs positioned to bend the cost curve on pensions?
  - How large is the liability for deferred infrastructure maintenance and what is the expected impact of increased federal funding from IIJA and ARPA?

State and Local Pension Debt as a Share of Gross Domestic Product

A decade after the Great Recession, aggregate pension debt remains at historically high levels

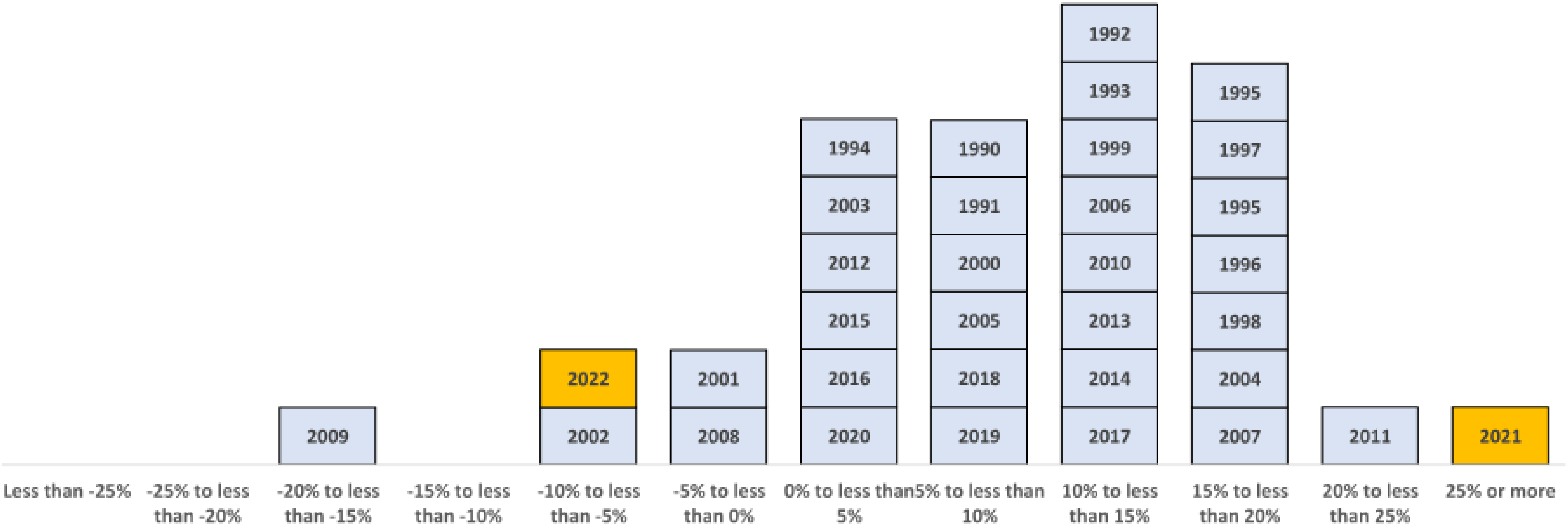


Note: Data reflects Federal Reserve data as of Q1 2018, prior to a change in the Fed's methodology for calculating pension liabilities.
Source: Federal Reserve Board

Volatility of Pension Fund Investment Performance

Once-in-a-generation gains in 2021, followed by losses in 2022

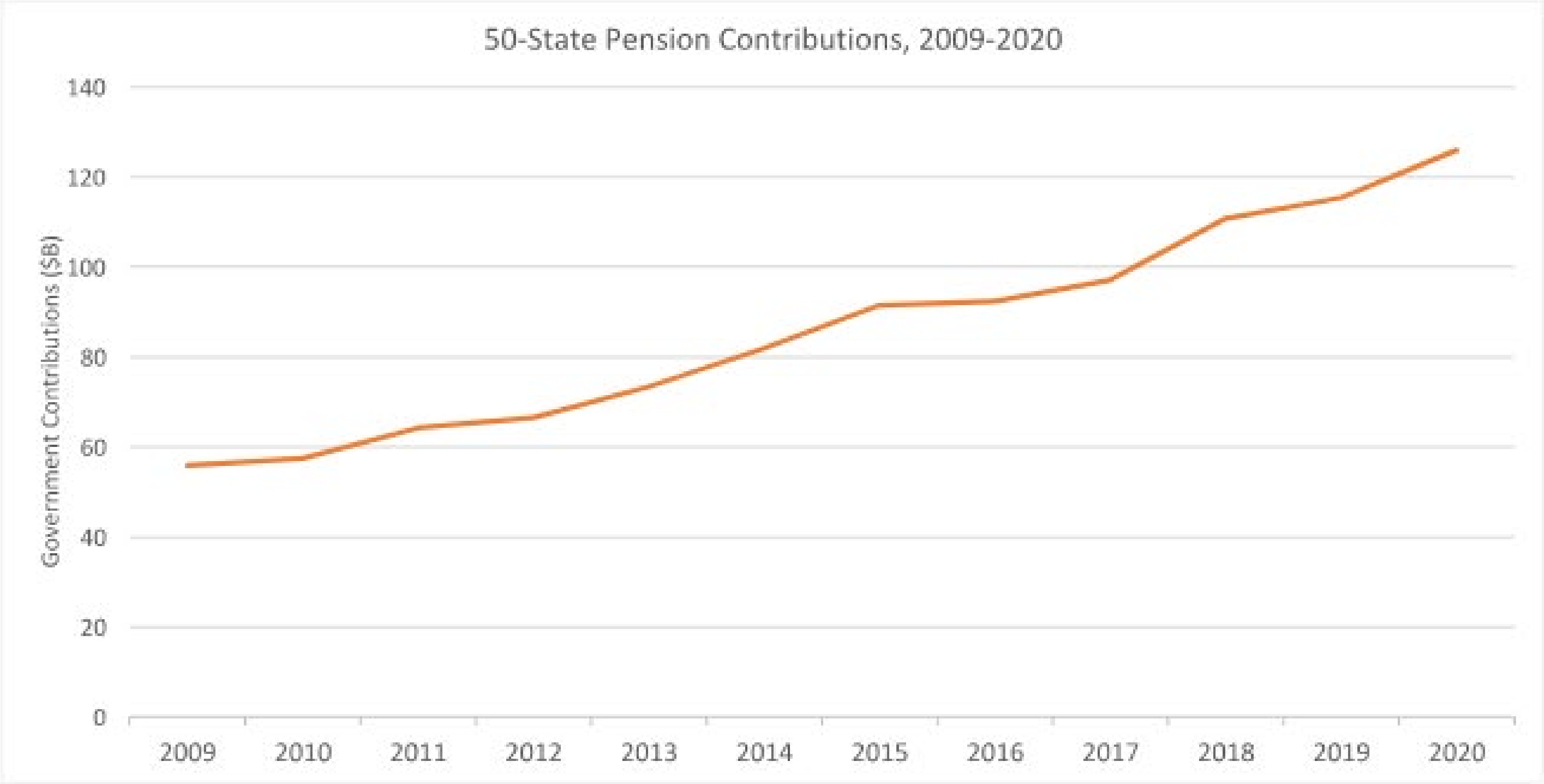
Median annual returns, fiscal years 1990-2022



Source: Analysis by The Pew Charitable Trusts using data from Wilshire Trust Universe Comparison Service

Pension Contributions Since the Financial Market Crisis

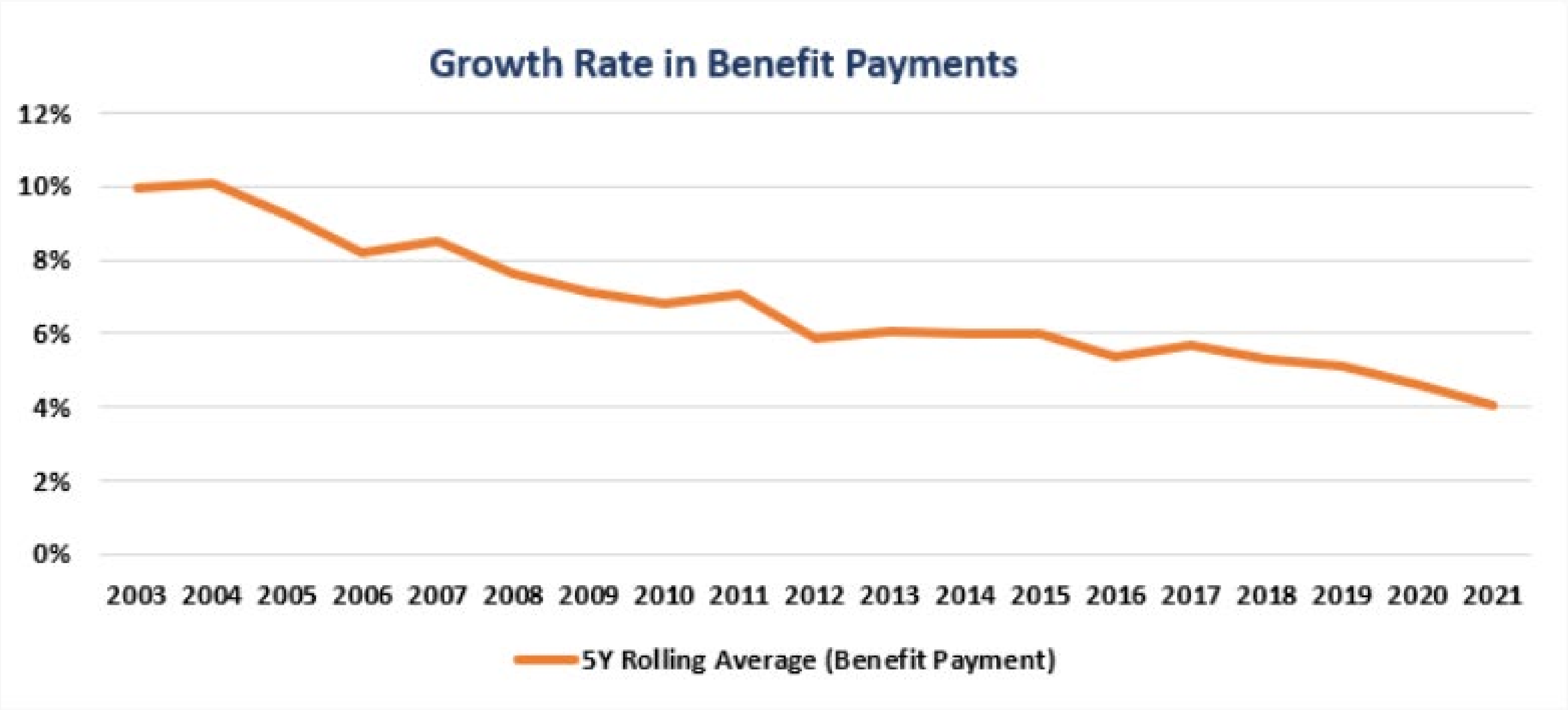
Cash inflows have increased by over 7% annually since 2009, nearly twice the rate of revenue growth



Sources: Comprehensive annual financial reports, actuarial reports and valuations, other public documents, or as provided by plan officials.

Pension Benefit Payments – Annual Growth (US Census Data)

Growth in cash outflows is slowing, due in part to past reforms



Pension Trends

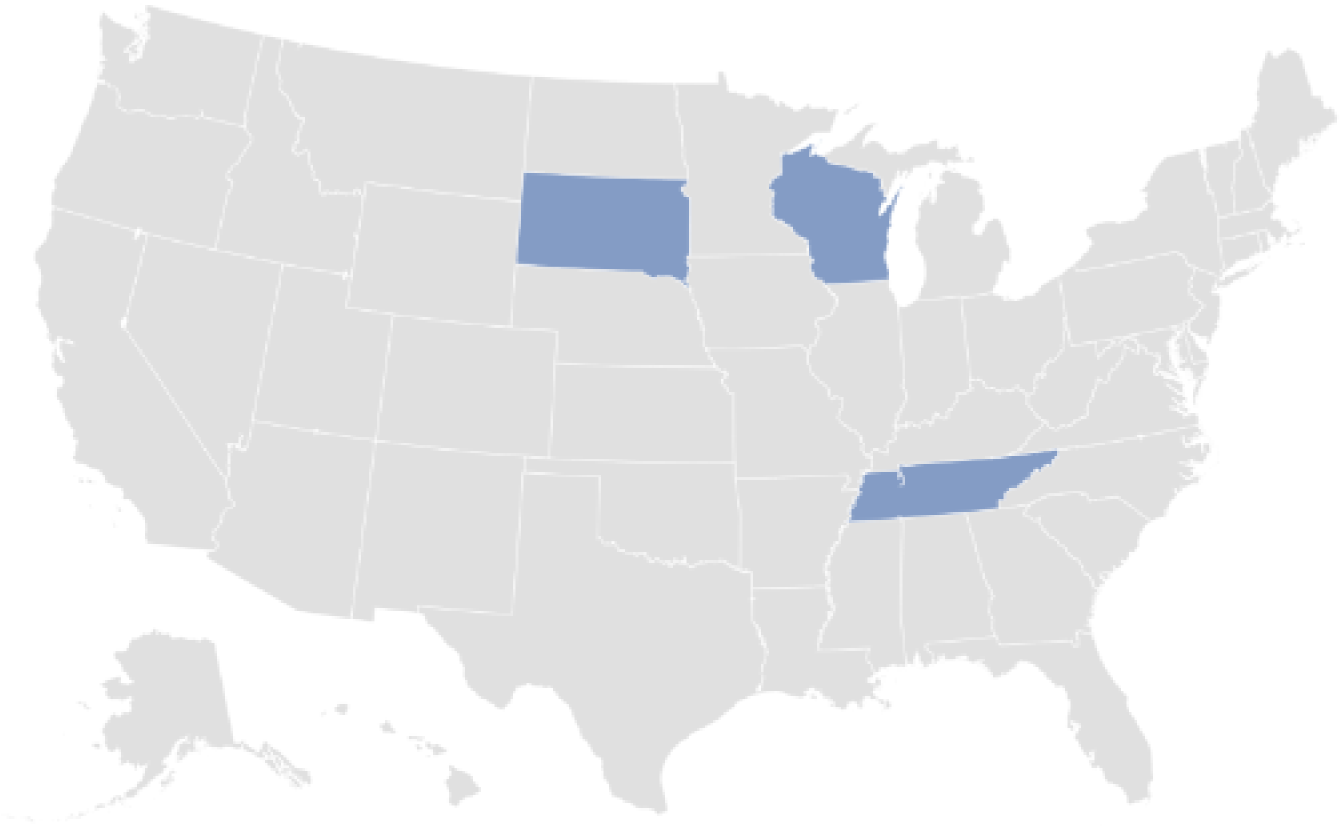
- Over the long-term, lower economic (GDP) growth likely means lower returns on pension investments and growth in government revenue.

- However, the outlook for pension finances and cash flow has improved markedly, due in part to the impact of past reforms.

- As a result, US public pensions are financially better prepared to navigate a hard-landing recession scenario than they were 5-10 years ago.

- Measurement and Management: **Pew's research and technical assistance focuses on risk-assessment (stress testing); and the proven practices of model retirement systems.**

Model Retirement Systems – Spotlight on Three States

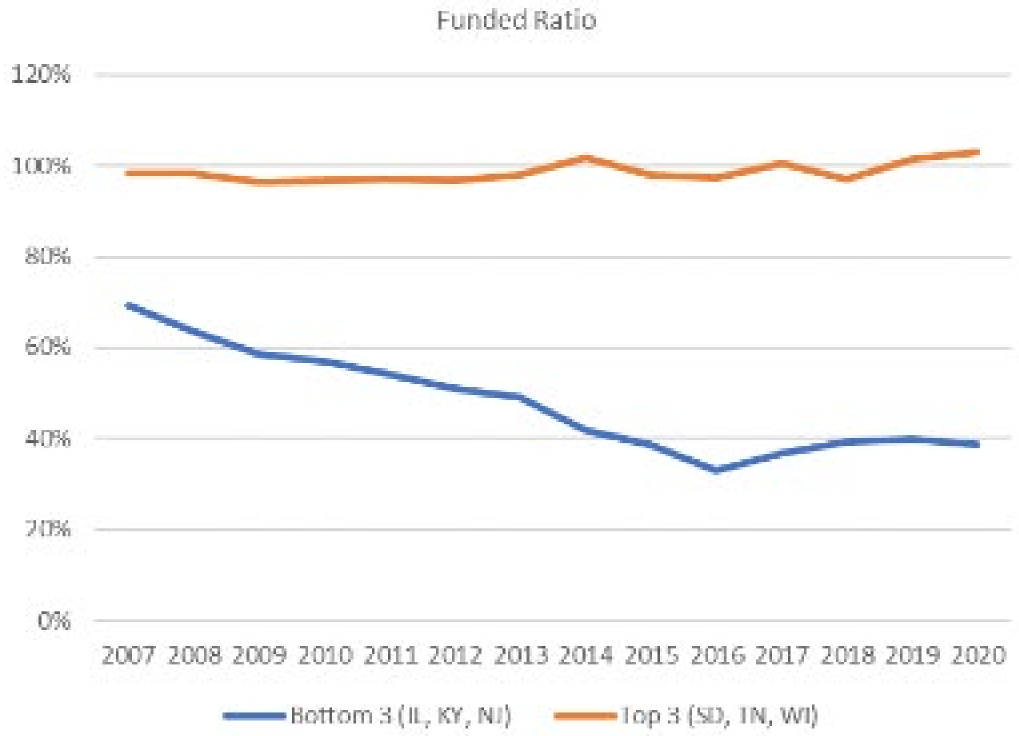


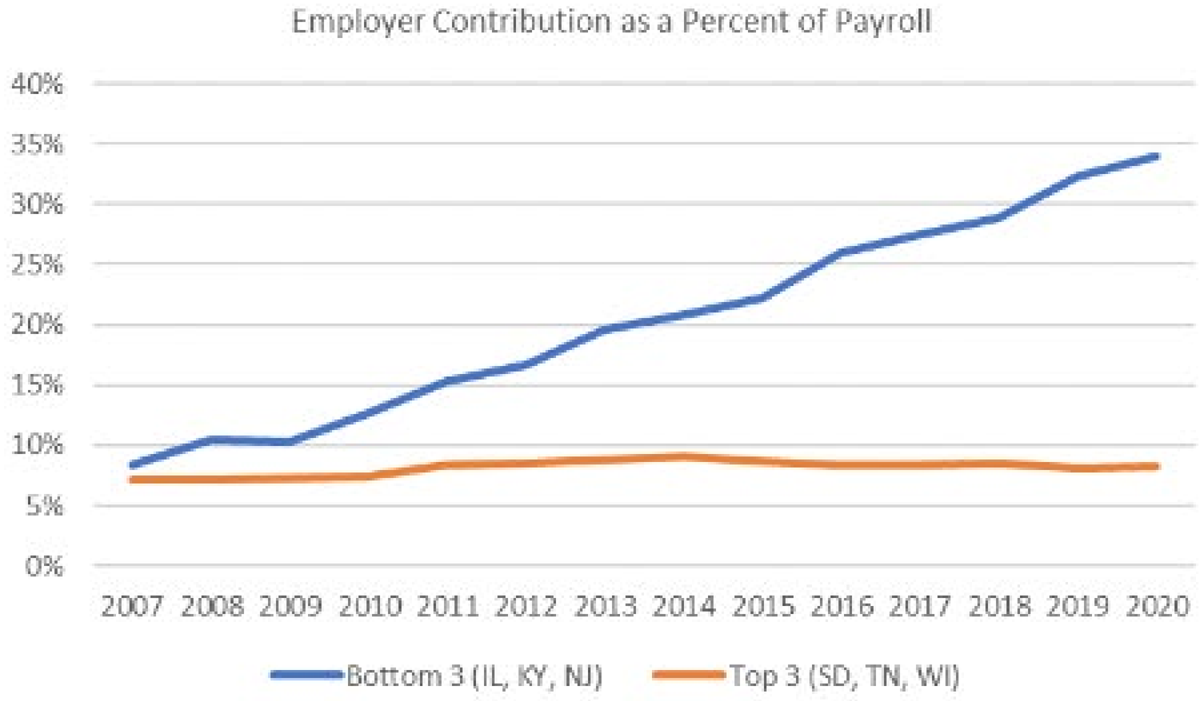
- **Wisconsin Retirement System** Principles in Practice since 1946
- **South Dakota Retirement System** Intentional and Transparent
- **Tennessee Consolidated Retirement System** Raising the Bar on Readiness

Note: Other high performing states include Nebraska, Utah and Washington. States that have made significant improvements through reforms include Colorado, Maine, Pennsylvania, Rhode Island, and Virginia.

Funded Status and Contribution Rates Vary Across States

South Dakota, Tennessee, and Wisconsin have maintained full funding while keeping costs low





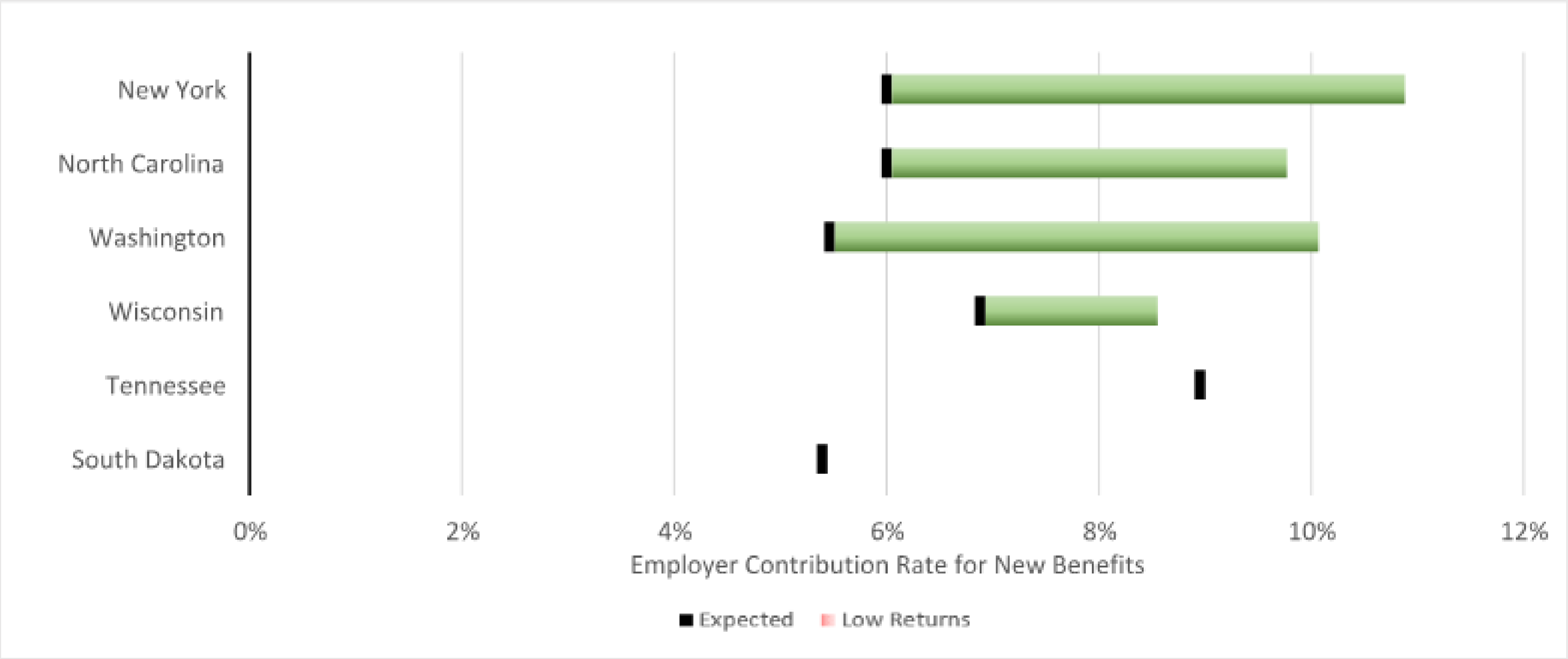
Sources: Comprehensive annual financial reports, actuarial reports and valuations, other public documents, or as provided by plan officials.

5 Practices of Highly Successful Retirement Systems

- Provide a Path to Retirement Security
- Maintain Fiscal Sustainability
- Preserve Inter-generational Equity
- Plan for Uncertainty
- Govern Transparently

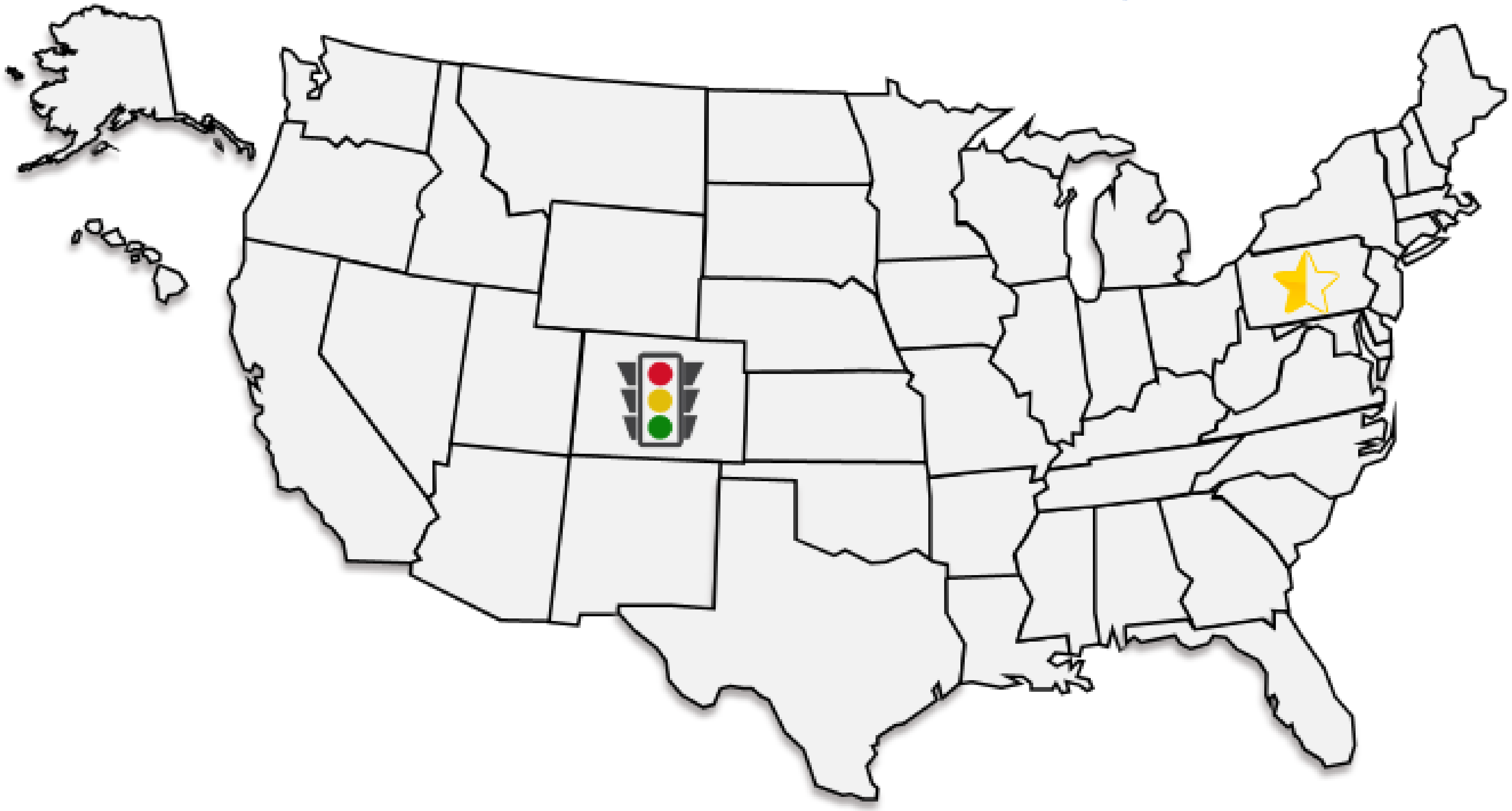
Plan for Uncertainty - Cost Predictability of Best Funded States

Model retirement systems employ variable-benefit and hybrid models to help keep costs stable



50 State Stress Testing Map

7 states conduct forward-looking risk assessments in 2012
Increases to 25 states today



Essential Elements of a Risk Reporting Policy

Routine and Transparent

Stress testing is done on a regular basis and published in a public-facing manner

Target audience includes plan fiduciaries AND governmental plan sponsors

Forward-Looking

Assesses the effects of low or volatile investment returns on plan funded levels and contributions

Provides a framework that can be tailored to plan circumstances and relevant economic scenarios

Policy Relevant

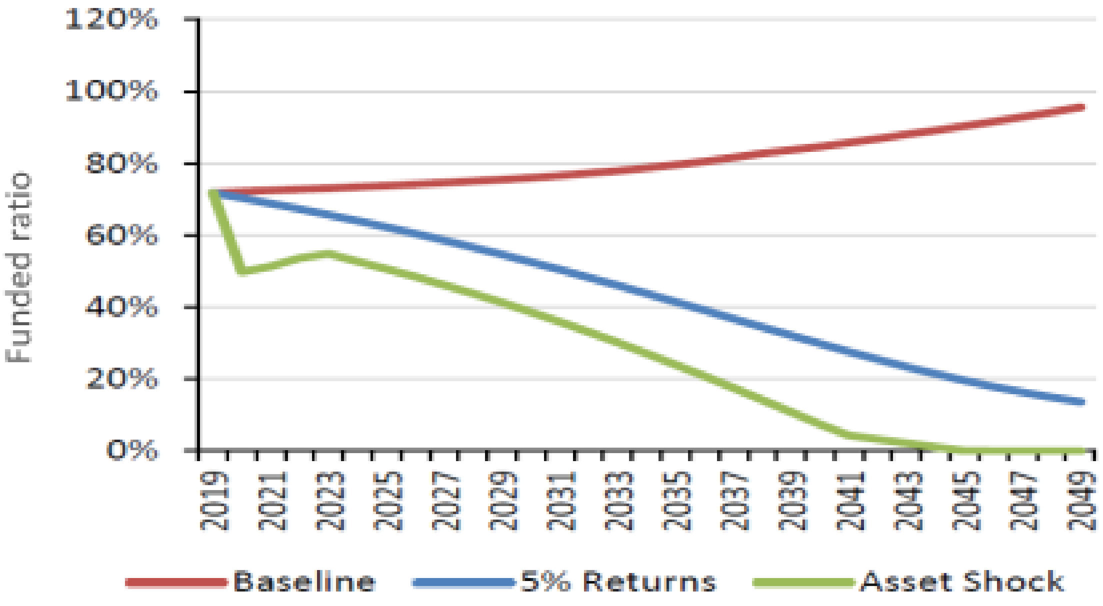
Includes analysis of potential plan costs in a budgetary context

Designed to inform long-term decision-making

Stress Testing in Action

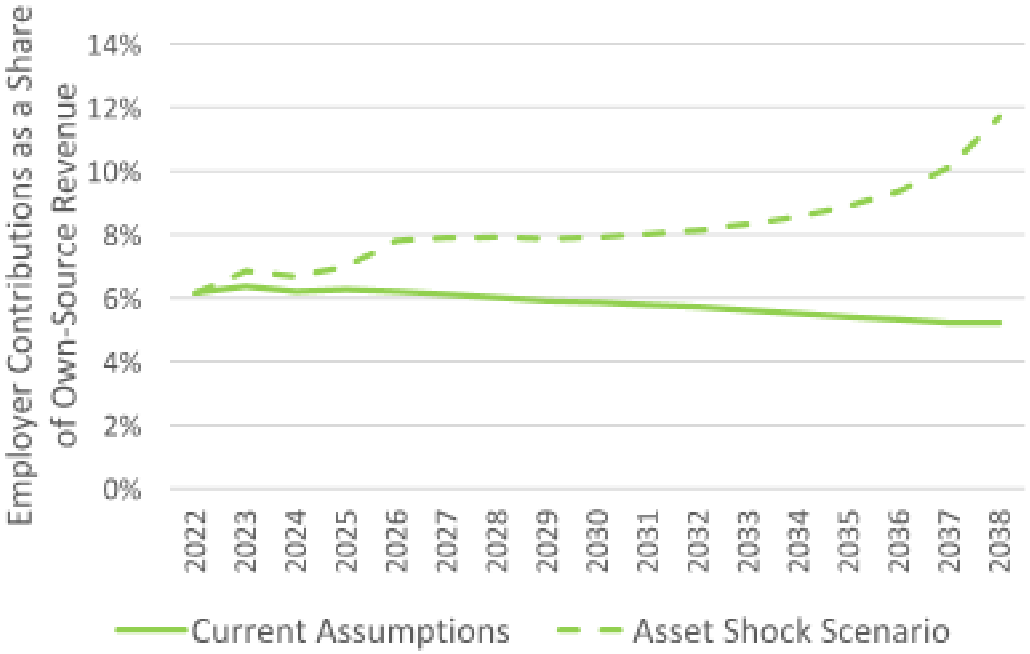
Forward looking analysis to test both solvency and budget risks in downside economic scenarios

Montana Risk Analysis



Source: The Terry Group and The Pew Charitable Trusts

Vermont Risk Analysis



Public Infrastructure – State and Local Governments

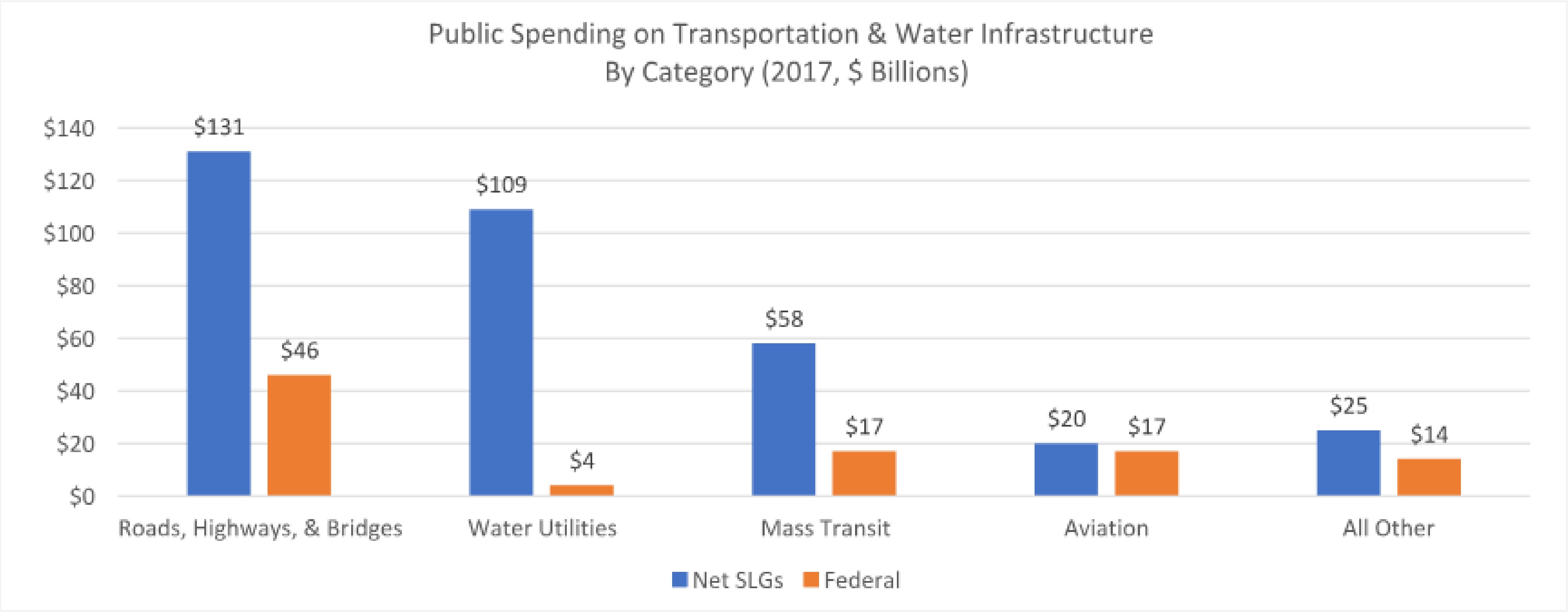
- Total annual spending of roughly $400 billion on transportation and water assets that are owned, operated and primarily paid for at the state and local level.

- Deferred maintenance **estimated** at ~$1T, due in part to declining federal investment beginning in the 1980's.

- IIJA (and ARPA) provide needed resources and attention. And potentially a down payment on the infrastructure debt.

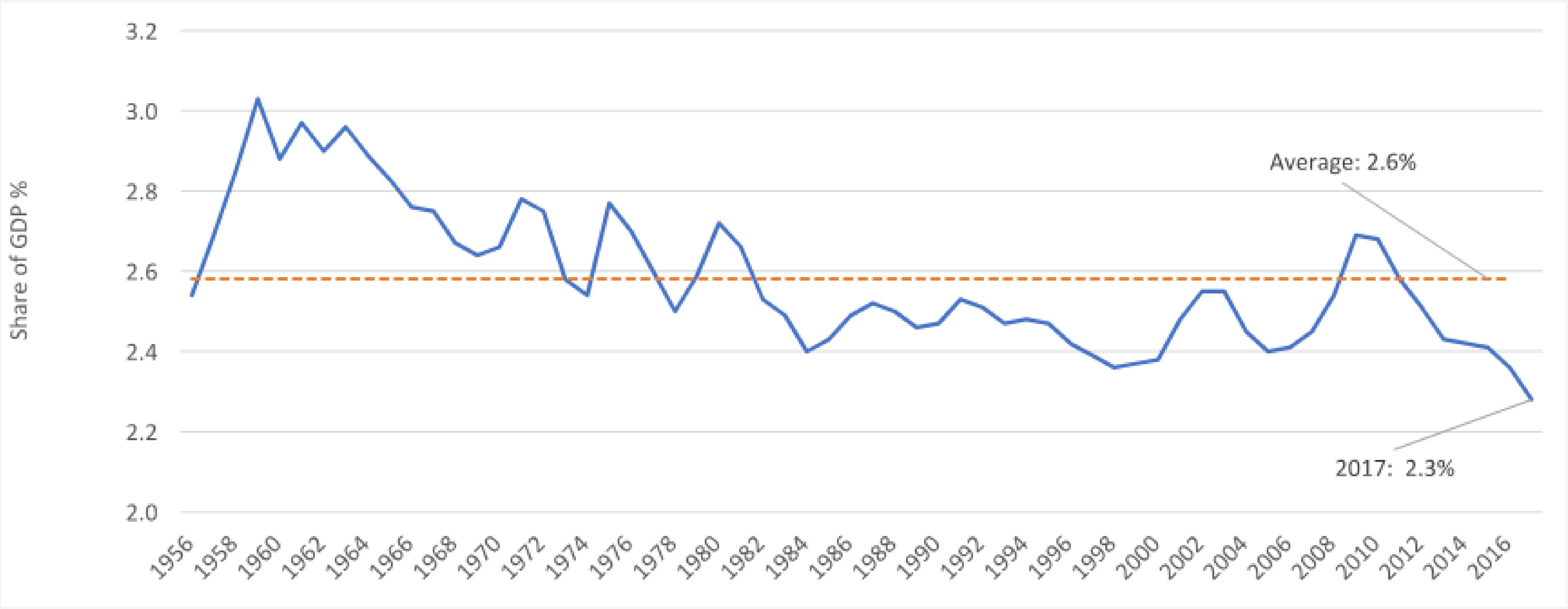
State and Local Governments Account For ~80% of Government Spending on Transportation and Water Infrastructure

Roads & Bridges, Mass Transit, Water infrastructure account for most spending



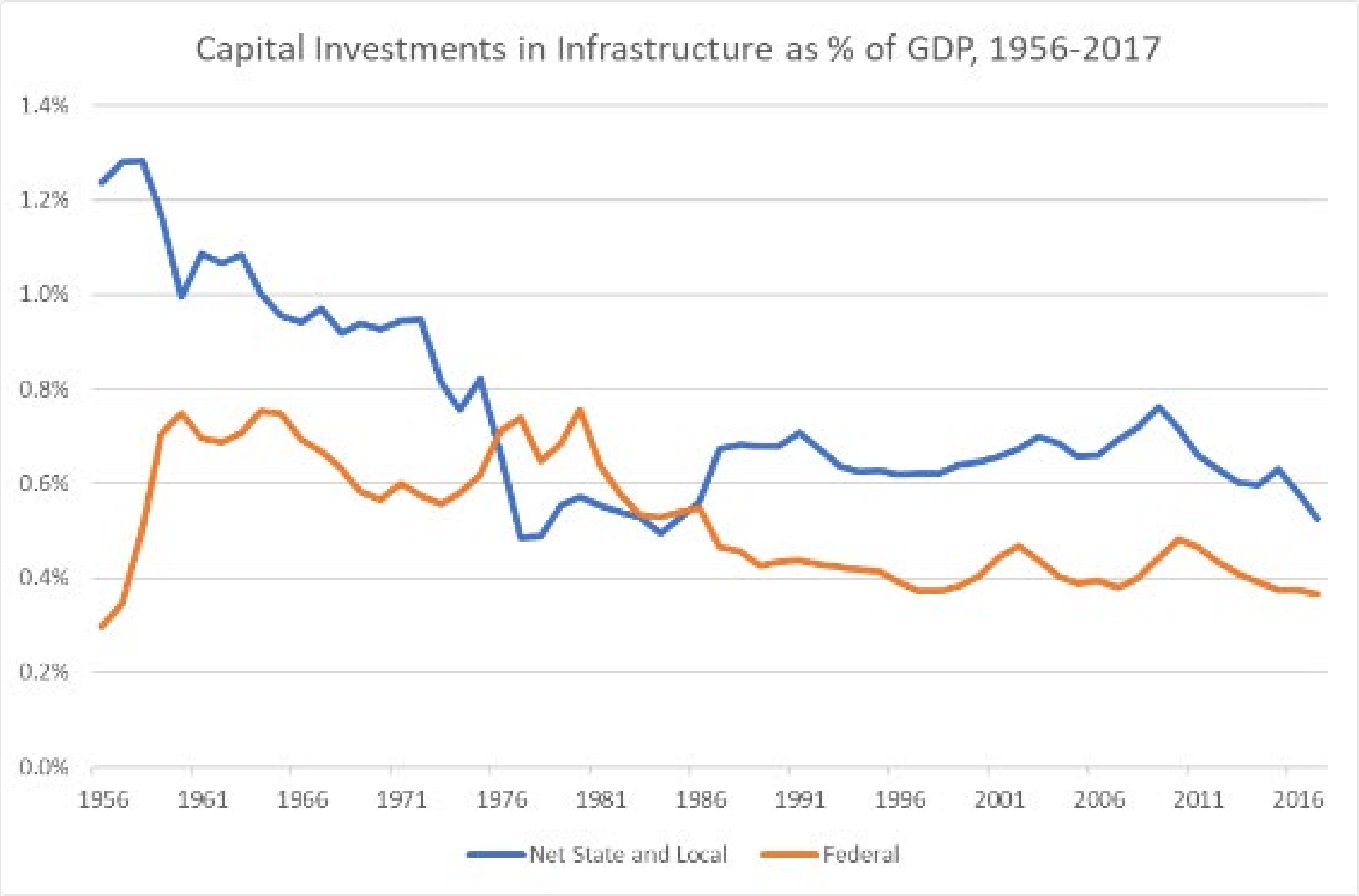
Source: Congressional Budget Office

Public Spending on Transportation and Water Infrastructure as a Share of GDP 1956 to 2017

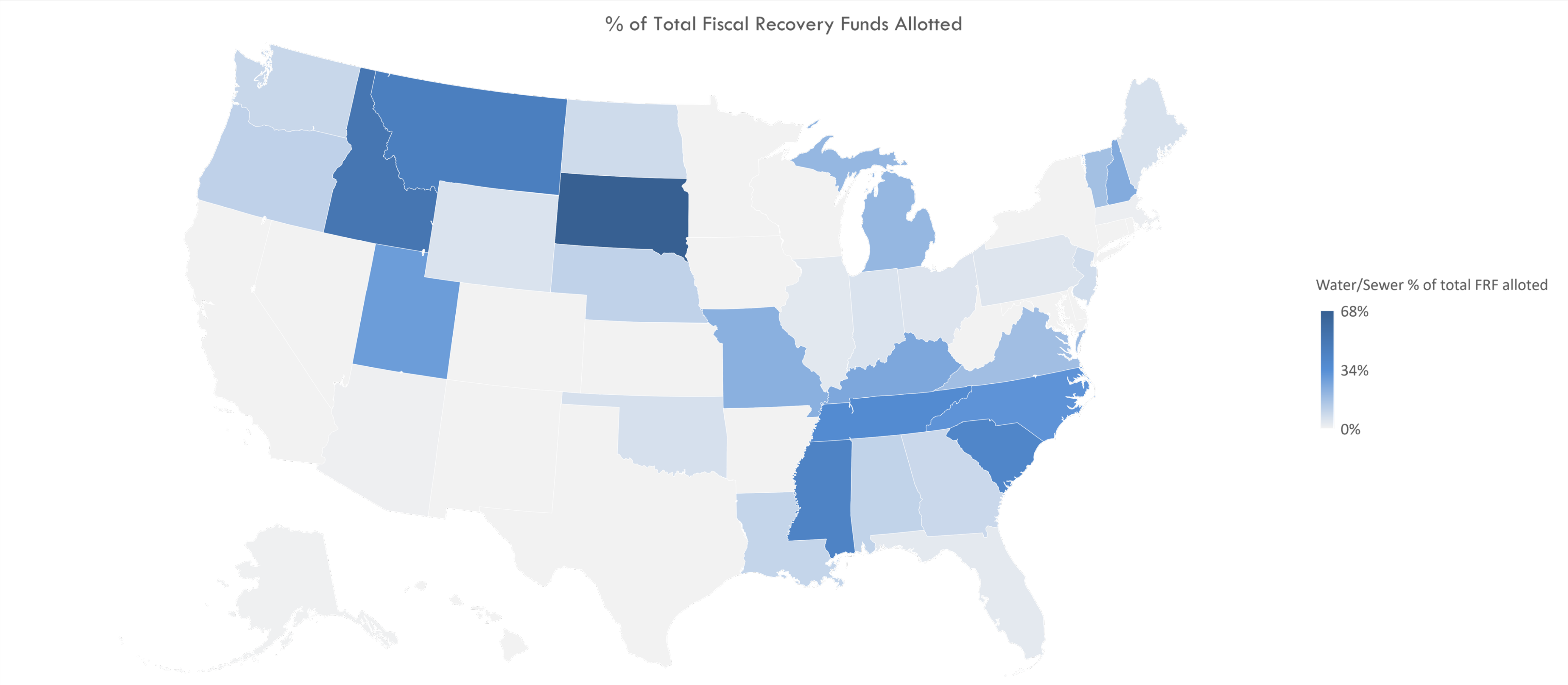


Source: [Congressional Budget Office (2018)]

Infrastructure Investment – Declining Federal Government Support



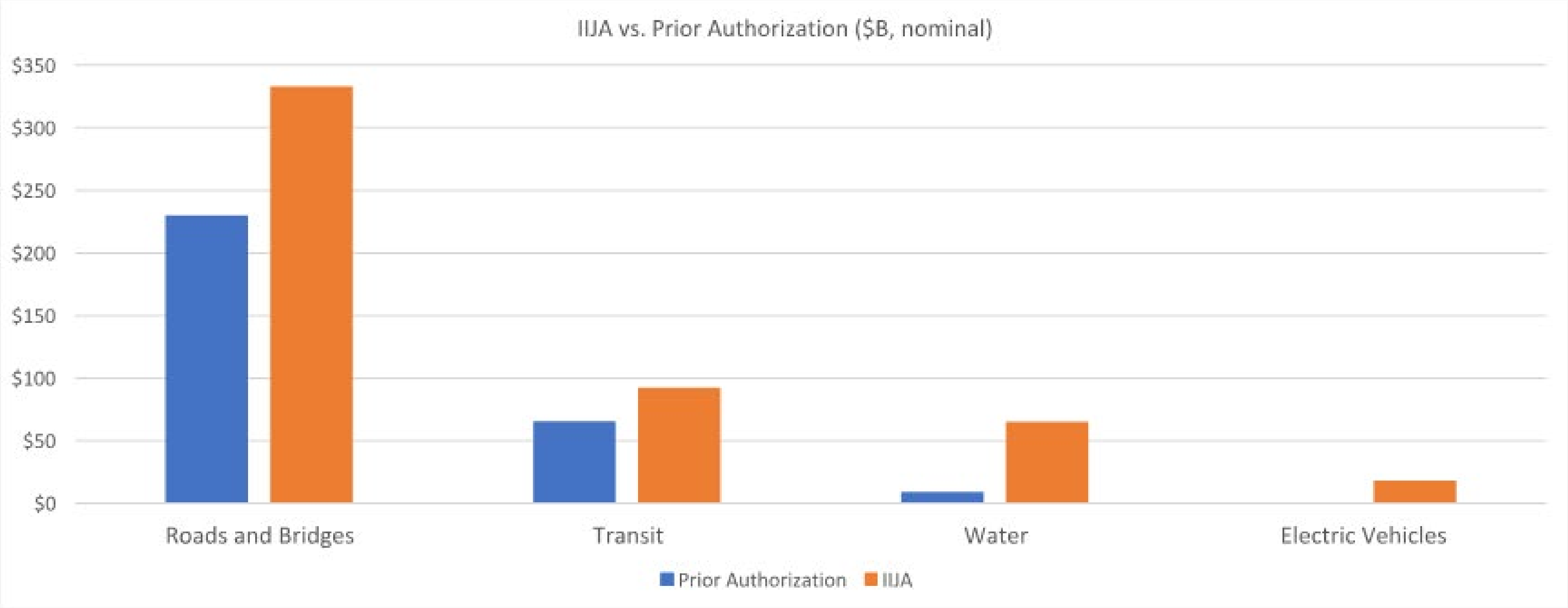
State Uses of Fiscal Recovery Funds for Water Infrastructure



Source: Pew analysis of data published by the Center on Budget and Policy Priorities

Infrastructure Investment – IIJA as Down Payment

Largest increases for Bridges, Water, and Electric Vehicles



Takeaways

- Long-term fiscal resiliency calls for attention to both the operating budget **and** the balance sheet.

- In theory, issues related to long-term liabilities are connected:
  - Opportunity to better manage costs for pensions and other retirement benefits
  - Need for investment in public infrastructure
  - Overall debt capacity to address emerging, long-term risks

- In practice, measurement standards vary and management responsibility (i.e. for pensions, debt, and infrastructure) is diffuse.

Discussion Questions

- What is your view on pensions as an ongoing fiscal challenge, versus an area where past reforms have helped to stabilize retirement system finances and their impact on the budget?
- Which areas of public infrastructure (e.g. roads, bridges, transit systems, drinking water, other water utilities) are most in need of increased investment in your state?
- Which do you expect will benefit the most as a result of increased funding through IIJA and ARPA?
- How has thinking evolved on the use of current budget surpluses to help address long-term liabilities?