

## PUTTING STATE PENSION COSTS IN CONTEXT:

# ARIZONA

PUBLIC PENSION COSTS HAVE BEEN A contentious issue in Arizona over the past year. A series in the *Arizona Republic* last May gave the impression that those costs were out of control.<sup>1</sup> In July, the conservative Goldwater Institute published a report stating that “Arizona’s pension systems remain dead men walking.”<sup>2</sup>

While many numbers are bandied about, the central issue is how much of an obligation is being taken on each year to provide benefits for current government employees such as teachers and first responders. The best way to measure this is to use an amount known as employer normal cost. Such costs can be found in the annual financial reports that each public pension plan has to produce. In the case of Arizona, there are two main plans administered by the state: the Arizona State Retirement System (ASRS) and the Public Safety Personnel Retirement System (PSPRS). The most recent financial reports indicate annual employer normal costs of \$295.8 million for ASRS and \$178.7 million for PSPRS, or a total of \$474.5 million.<sup>3</sup>

How should this amount be viewed? One approach is to compare it to the financial costs incurred by the state in supporting business through economic development subsidies and other special tax provisions. While not providing an assessment of the effectiveness of any particular subsidy or provision at achieving targeted policy objectives, such as creating family-wage jobs, this approach does provide an important perspective on public sector pensions.

As for subsidies, Arizona is not one of the biggest giveaway states, having eliminated programs such as enterprise zones. Among the biggest costs is the research & development tax credit, which in the most recent fiscal year cost the state more than \$84 million.<sup>4</sup> To this can be added the cost of an archaic tax rule that allows retailers to keep a total of about \$21 million of the sales tax revenues they collect.<sup>5</sup>

These subsidies and business tax breaks amount to about \$100 million a year, but they don’t tell the whole story. Arizona is one of the states that have responded to pressure from business lobbyists by adjusting the way in which corporations can apportion their taxable income to the state. The main push came from capital-intensive manufacturing companies such as Intel serving national markets, which prefer to pay taxes based only on their sales in the state rather than the traditional formula based on payroll and property as well as sales. Arizona began adjusting the formula in 2001, allowing companies to rely more and more on sales. By 2009 companies could opt for an 80 percent sales factor apportionment. A 2011 report by the Joint Legislative Budget Committee estimated that this cost the state \$63.6 million in revenue in 2008.<sup>6</sup> The committee has issued no subsequent comprehensive cost estimates, but it has calculated that additional enacted increases in the sales factor apportionment (which will reach 100 percent in 2017) will cost another \$24.6 million in FY2015, rising to \$84 million in FY2018.<sup>7</sup>

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Along with sales factor apportionment, another major form of corporate tax avoidance that eats into state revenues is the use of offshore tax havens. In January 2013, the U.S. PIRG Education Fund published a report in which it calculated the impact on this practice on each state. For Arizona, the estimated annual cost is \$360 million.<sup>8</sup>

In other words, the annual taxpayer cost of funding the retirement benefits of current Arizona public employees belonging to the main state administered public pension systems is only 86 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to more than \$550 million per year, as summarized in the table below.

Arizona Competes Fund	\$5,200,000
Accounting credit (vendor discount)	\$21,400,000
Arizona Job Training Program	\$10,700,000
Enterprise Zone Income and Premium Tax Credits	\$6,765,341
Research & Development Tax Credit	\$84,042,870
Sales Factor Apportionment	\$64,000,000
Revenue loss from corporate use of offshore tax havens	\$360,000,000
<b>TOTAL</b>	<b>\$552,108,211</b>

### NOTES:

- 1 The series began with: Craig Harris and Beth Duckett, "The Steep Price of Pensions," *The Arizona Republic*, May 5, 2013 (via Nexis). The full series can be found at [pensions.azcentral.com](http://pensions.azcentral.com).
- 2 Nick Dranias and Byron Schломach, *Recognizing Pension System Insolvency: A Catalyst for Lasting Reform*, (Goldwater Institute Policy Report No. 261, July 23, 2013); online at [http://goldwaterinstitute.org/sites/default/files/GWI\\_Pension%20Policy%20Report\\_NEW\\_r2.pdf](http://goldwaterinstitute.org/sites/default/files/GWI_Pension%20Policy%20Report_NEW_r2.pdf)
- 3 The ASRS figure was calculated from the FY2013 Comprehensive Annual Financial Report at <https://www.azasrs.gov/web/FinancialReports.do> (the total normal cost percentage on page 102 was multiplied by the payroll figure on page 115 to give the total normal cost, from which was subtracted the employee contribution on page 117). The PSPRS figure was calculated from the June 30, 2013 Arizona Public Safety Personnel Retirement System Consolidated Report at [http://www.psprs.com/Admin\\_Investments\\_and\\_Finance/2013%20Actuarial%20Reports%20by%20System/PSPRS%20Annual%20Valuation%202013.pdf](http://www.psprs.com/Admin_Investments_and_Finance/2013%20Actuarial%20Reports%20by%20System/PSPRS%20Annual%20Valuation%202013.pdf) (the payroll figure on page B-3 was multiplied by the employer normal cost figure on page A-2).
- 4 <http://www.azdor.gov/LinkClick.aspx?fileticket=kofgps-m-nl%3d&tabid=108&mid=492>
- 5 <http://www.azdor.gov/LinkClick.aspx?fileticket=kofgps-m-nl%3d&tabid=108&mid=492>
- 6 <http://www.azleg.gov/jlbc/corpsalesfactor0611.pdf>
- 7 <http://www.azleg.gov/legtext/50leg/2s/fiscal/hb2001.doc.pdf>
- 8 U.S. PIRG Education Fund, *The Hidden Cost of Offshore Tax Havens: State Budgets Under Pressure from Tax Loophole Abuse* (January 2013); <http://uspig.org/reports/usp/hidden-cost-offshore-tax-havens>