

## PUTTING STATE PENSION COSTS IN CONTEXT: MICHIGAN

THE RECENT RULING BY A FEDERAL bankruptcy judge approving Detroit's bankruptcy filing and allowing the city to proceed with plans to slash employee benefits landed like a bombshell in the world of public pensions. As the *New York Times* put it, the judge "dealt a major blow to the widely held belief that state laws preserve public pensions."<sup>1</sup> The move by Detroit's emergency manager is expected to open the door to more assaults on pension benefits throughout Michigan and in other states.

While many pension 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 Michigan there are three main plans administered by the state: the Michigan State Employees' Retirement System (MSERS), the Michigan Public School Employees' Retirement System (MPERS) and the Municipal Employees' Retirement System of Michigan (MERS). The most recent financial reports indicate annual employer normal costs of \$95.7 million for MSERS<sup>2</sup>; \$366.2 million for MPERS<sup>3</sup>; and \$124.7 million for MERS.<sup>4</sup> The total is \$586.6 million.

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.

During the past decade, Michigan has been one of the most aggressive states in terms of giving large subsidy packages to corporations. In the *Megadeals* report Good Jobs First published in June 2013, we found that Michigan accounted for more subsidy packages worth \$75 million or more (29) than any other state.<sup>5</sup> Those deals had a total estimated cost of \$7.1 billion.

Since taking office in 2011, Gov. Rick Snyder has de-emphasized big subsidy packages in favor of across-the-board tax cuts for business totaling \$1.4 billion, accompanied by cuts in social safety net programs and education.<sup>6</sup> Yet the financial legacy of those large subsidy deals, as well as smaller ones, lives on. The cost of the Advanced Battery Credit for FY2014 is estimated at \$332 million, while the state's MEGA tax credit, which was at the center of many of those packages, is reducing revenue by \$245 million.<sup>7</sup> The cost of tax increment financing is put at \$280 million and Brownfield Redevelopment Credits have a price tag of \$40 million.

Michigan provides other lucrative tax breaks for business, such as an industrial facilities property tax break that costs \$228 million a year and an exclusion for foreign dividends that costs \$211 million. In 2014 voters will be asked to repeal the \$1 billion personal property tax that corporations pay on machinery and other equipment.

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Michigan is one of the states that allow corporations to apportion their taxable income by methods other than the traditional three-factor (payroll, property and sales) weighting. The Michigan tax expenditure report does not contain an estimate of the revenue impact of single sales factor.

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 Michigan, the estimated cost is \$523 million.<sup>8</sup>

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to more than \$1.8 billion per year, as summarized in the table below.

In other words, the annual taxpayer cost of funding the retirement benefits of current Michigan public employees belonging to the main state administered public pension systems is only 32 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.

Michigan's Advanced Battery Credits	\$332,000,000
Michigan Economic Growth Authority (MEGA) Tax Credits	\$245,000,000
Tax Increment Financing	\$280,000,000
Brownfield Redevelopment Credits	\$40,000,000
Industrial Facilities Development exemption	\$228,800,000
Foreign dividends income exclusion	\$211,800,000
Single sales factor	unknown
Revenue loss from corporate use of offshore tax havens	\$523,000,000
<b>TOTAL</b>	<b>\$1,860,600,000</b>

NOTES:

- 1 Monica Davey, Bill Vlasic and Mary Williams Walsh, "Detroit Ruling Lifts a Shield on Pensions," *New York Times*, December 4, 2013 (via Nexis).
- 2 <http://www.mersofmich.com/MERS/About-MERS/Financial-Report> (derived by multiplying the payroll figure on page 44 of the 2012 report by the employer normal cost rate on page 31).
- 3 [http://www.michigan.gov/documents/orsstatedb/SERS\\_2012\\_CAFR\\_412883\\_7.pdf](http://www.michigan.gov/documents/orsstatedb/SERS_2012_CAFR_412883_7.pdf) (derived by multiplying the payroll figure on page 48 by the employer normal cost rate on page 35).
- 4 [http://www.mersofmich.com/Portals/0/Assets/ActuarialReport/annual\\_actuarial\\_report-2012.pdf](http://www.mersofmich.com/Portals/0/Assets/ActuarialReport/annual_actuarial_report-2012.pdf), p.30.
- 5 <http://www.goodjobsfirst.org/megadeals>
- 6 <http://clawback.org/2011/06/17/michigan-slashes-corporate-subsidies-while-cutting-business-taxes-2/>
- 7 All figures in this paragraph and the next are from: [http://www.michigan.gov/documents/treasury/ExecutiveBudgetAppendixOnTaxCreditsDeductionsAndExempts\\_FY\\_2013and2014\\_394614\\_7.pdf](http://www.michigan.gov/documents/treasury/ExecutiveBudgetAppendixOnTaxCreditsDeductionsAndExempts_FY_2013and2014_394614_7.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://uspirg.org/reports/usp/hidden-cost-offshore-tax-havens>