GOOD JOBS FIRST

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PUTTING STATE PENSION COSTS IN CONTEXT:

PENNSYLVANIA

SINCE TAKING OFFICE IN 2011, Gov. Tom Corbett has been promoting the idea that the state is facing a public pension crisis, calling retirement costs "a tapeworm eating up the budget."[1] Last year, he presented a plan that included putting all new employees in 401(k)-style defined-contribution plans rather than traditional and more secure defined-benefit ones. So far, the legislature has not gone along.

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 Pennsylvania there are two main plans administered by the state: the Pennsylvania State Employees' Retirement System (SERS) and the Pennsylvania Public School Employees' Retirement System (PSERS). The most recent financial reports indicate annual employer normal costs of $277.5 million for SERS.[2] For PSERS the figure is $1.18 billion.[3] The total is about $1.4 billion.

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.

Many companies benefit from subsidy programs such as Keystone Opportunity Zones, which cost the state $29 million a year; Keystone Innovation Zone Tax Credits, which costs $13 million; the Job Creation Tax Credit, which costs $10 million; and the newer Pennsylvania First program, which costs $37 million.[4] An archaic tax rule that allows retailers to keep a portion of the sales tax revenues they collect from customers costs Pennsylvania about $71 million a year.[5]

The state provides other lucrative tax breaks for business.[6] The research & development tax credit costs $55 million a year. Preferential tax treatment of S Corporations and limited liability companies results in annual revenue losses to the state of $705 million and $513 million, respectively.

Pennsylvania 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 state estimates that the use of single sales factor results in an annual revenue loss of about $202 million.[7]

Another way Pennsylvania has been losing corporate tax revenue is through its long-time failure to adopt a reform known as combined reporting, which is designed to make it more difficult for large companies to export a substantial portion of their Pennsylvania profits to passive investment companies in states such as Delaware or Nevada, thereby shielding a substantial portion of their income from any taxation. In 2005 the state revenue department estimated that the state was losing about $410 million a year in revenue as a result.[8] The state has addressed the problem in part by limiting what is known as the Delaware loophole beginning in 2015, but the Pennsylvania Budget and Policy Center notes that this partial fix will allow the state to recover only about $60 million a year.[9]

Yet 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 Pennsylvania, the estimated cost is $1.78 billion.[10]

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to nearly $3.9 billion per year, as summarized in the table below.

In other words, the annual taxpayer cost of funding the retirement benefits of current Pennsylvania employees belonging to the main state administered public pension systems is only 36 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes.

Keystone Opportunity Zone (KOZ) Program	$29,200,000
Keystone Innovation Zone Tax Credit	$13,100,000
Job Creation Tax Credit	$10,100,000
Pennsylvania First	$37,800,000
Film Production Tax Credit	$60,000,000
Vendor Discount	$71,000,000
Research & Development Tax Credit	$55,000,000
Pennsylvania S corporations	$705,800,000
Limited liability companies	$513,300,000
Sales factor apportionment weight	$202,700,000
Failure to adopt combined reporting (2005 estimate)	$410,000,000
Revenue loss from corporate use of offshore tax havens	$1,780,000,000
TOTAL	**$3,888,000,000**

NOTES:

1 Quoted in Marc Levy, "Corbett wants to confront pension cost 'tapeworm,'" Associated Press, May 5, 2012 (via Nexis).

2 Derived by multiplying the payroll figure on page 69 of the 2012 annual report at http://www.portal.state.pa.us/portal/server.pt?open=514&objID=701628&mode=2 by the employer normal cost rate on page 73.

3 Derived by multiplying the payroll figure on page 60 of the 2012 report at http://www.psers.state.pa.us/content/publications/financial/cafr/cafr12/20121206CAFRComplete.pdf by the employer normal cost rate on page 87.

4 All these amounts come from http://www.portal.state.pa.us/portal/server.pt/document/1320332/2013-14_governors_executive_budget_cd_pdf with the exception of the Pennsylvania First figure, which comes from http://www.portal.state.pa.us/portal/server.pt/document/1346131/2013-14_enacted_budget_line_items_pdf

5 http://pennbpc.org/sites/pennbpc.org/files/Vendor-Discount-Fact-Sheet-2012-Final.pdf

6 The figures in this paragraph come from http://www.portal.state.pa.us/portal/server.pt/document/1320332/2013-14_governors_executive_budget_cd_pdf

7 http://www.portal.state.pa.us/portal/server.pt/document/1320332/2013-14_governors_executive_budget_cd_pdf

8 http://www.taxadmin.org/FTA/meet/05rev_est/sanders.pdf (top slide on page 9).

9 http://pennbpc.org/2013-14-Tax-Code

10 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