Honolulu Advertiser, Cliff Slater's SECOND OPINION of July 11, 2005.

Hawaii pension fund is stealth debt

Our last column (6.27) dealt with Hawaii's General Excise Tax as a dishonest tax — a stealth tax — that poses as a sales tax, but that actually collects two to three times the revenue that a pure sales tax would yield.

We also have stealth debt. This is debt that is owed and backed by the "full faith and credit" of the county and state governments but which does not appear on the books.

Very quietly, with little fanfare, the taxpayers of Hawaii have acquired another $3 billion debt in the last five years with most taxpayers being unaware of it.

The culprit is the unfunded pension liability of the Hawaii Employee Retirement System (HERS).

Each year the HERS pension fund actuaries calculate the future pension assets and liabilities of the state and counties.[1]

They take into account,

- The likely future growth of the pension fund assets from both earnings and contributions, and,
- The value of future state and county governments' commitments to pensioners.

If the prospective assets are considered insufficient to meet these future pension obligations then the fund is declared to have an "unfunded pension liability."[2]

As of the end of fiscal year 2004, the "unfunded" amount was $3.5 billion, up from only $500 million just five years earlier — a $3 billion increase.

This unfunded liability is the amount that taxpayers will have to make up in future years since the pension fund is guaranteed by the "full faith and credit" of the state and county governments. Since these governments only income of any substance is what it gets from you, the taxpayer, it means that, sooner or later, you have to make up the difference.

To put the $3.5 billion in another perspective, it amounts to $12,000 for each family of four, most of which has been incurred during the past five years. How did we get in that state?

The problem has been that the fund has been managed too aggressively and none too competently. For example, the law requires that four of the eight trustees be union members and the others be "citizens of the state." It turns out that none of these trustees have been in the public eye and, almost by definition, that makes them incapable of doing a great job of handling $10,000,000,000. The losses from the fund are what is primarily responsible for the unfunded liabilility.

In addition, because of retirees living longer, actuaries must allow for continually escalating future pension liabilities. This past year the state was required to pay $330 million into the fund under a method used since 1933. Under this plan, when system was unfunded, the state was required to pay in an amount that would make the fund whole over a 25-year period. State officials seem to have found even that too onerous and changed the law two years ago to a simple percentage of payroll.[3]

According to independent actuary, George Berish, had the old system been in place this fiscal year, the state would have had to contribute $444 million; the change in contribution method will reduce the state's contribution to about $370 million.

We need to bear in mind that using the state's projection of inflation, the fund has to earn, or taxpayers contribute, $417 million this year just to allow for inflation erosion of the fund.

Pension fund problems, including those associated with pensioners living longer, is why most private companies have switched to 401k plans. They can no longer afford the older defined benefit pension plans. Only taxpayers can afford them it would seem.

However, like Social Security, Medicare and other such plans, our children, or even grandchildren, will be burdened with the problem as long as our elected officials continue kicking these cans down the street to avoid dealing with them.

Cliff Slater is a regular columnist whose footnoted columns are at www.lava.net/cslater

---

Footnotes:

[1] **http://www4.hawaii.gov/ers/Financial%20Reports/CAFR%202004.pdf**

[2] The problem with this subject is that while it is boring it is one those huge fiscal black holes that you as a taxpayer have to pay attention to — like rail transit, the Department of Education and also this, the public employee pension fund. So hang in there.

[3] http://www.capitol.hawaii.gov/hrscurrent/Vol02%5FCh0046%2D0115/hrs0088/

§88-123 Amount of annual contributions by the State and counties... Commencing with fiscal year 2005-2006, the contribution payable in each year to the pension accumulation fund by the State and each county, respectively, shall be determined by multiplying the contribution rates in section 88-122(e) by the actual covered payroll in a given fiscal year for each of the two groups of employees in section 88-122(a).

§88-122 Determination of employer normal cost and accrued liability contributions ...

(e) Commencing with fiscal year 2005-2006 ... the employer contributions for normal cost and accrued liability for each of the two groups of employees in subsection (a) shall be based on fifteen and three–fourths per cent of the member's compensation for police officers, firefighters, and corrections officers and thirteen and three-fourths per cent of the member's compensation for all other employees. The contribution rates shall amortize the total unfunded accrued liability of the entire plan over a period not to exceed thirty years. The contribution rates shall be subject to adjustment:

(1) If the actual period required to amortize the unfunded accrued liability exceeds thirty years;

(2) If the actual period required to amortize the unfunded accrued liability falls below the established benchmark funding period of twenty-five years; or

(3) Based on the actuarial investigation conducted in accordance with section 88-105.