



PUTTING STATE PENSION COSTS IN CONTEXT: ARIZONA

2015 Normal Cost of Arizona Public Employee Pensions:	\$334,230,649
2015 Cost of Arizona Subsidies and Corporate Tax Breaks:	\$575,319,266
Percentage of Pension Costs to Subsidy Costs:	58.1%

Last year, Arizona Gov. Doug Ducey signed pension reform legislation that offered new police and firefighters a choice between traditional pensions and defined contribution plans (like 401(k)s). The reforms also required equal sharing of costs between workers and employers and capped government contributions per employee.¹

While many numbers are circulated in public discussion, 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 \$162.7 million for ASRS and \$171.5 million for PSPRS, or a total of \$334.2 million.²

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 good paying 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 Environmental Technology Manufacturing tax credit, which in the most recent fiscal year cost the state more than \$19

million.³ To this can be added the cost of an archaic tax rule that allows retailers to keep a total of about \$17 million of the sales tax revenues they collect.⁴

These subsidies and business tax breaks amount to about \$36 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 2017 report by the Arizona Center for Economic Progress estimated that this costs the state \$132 million in lost revenue, an amount that has doubled since our 2013 report.⁵

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 November 2016, 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 \$261 million.⁶

The total of these corporate subsidies, official tax breaks and unofficial tax dodging amounts to more than \$575 million per year, as summarized in the following table.

Arizona Competes Fund	\$5,583,807
Accounting credit (vendor discount)	\$17,415,320
Arizona Job Training Program	\$6,997,769
Enterprise Zone Income and Premium Tax Credits	\$1,738,020
Quality Jobs Tax Credits	\$9,102,000
Research & Development Tax Credit	\$100,068,204
Rural Economic Development Grants	\$1,680,119
Qualifying Facilities Tax Credit Program	\$18,173,929
Environmental Technology Manufacturing credit	\$19,393,017
Single Sales Factor Apportionment	\$132,000,000
Angel Investment Tax Credits	\$1,898,749
Revenue loss from corporate use of offshore tax havens	\$261,268,332
TOTAL	\$575,319,266

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 equals about 58 percent of the cost to the state of economic development subsidies and corporate tax breaks and loopholes. All signs point to growth in the public costs associated with these

programs. During the 2017 legislative session, Gov. Ducey signed a \$10 million angel investor tax credit bill, expanded eligibility rules for subsidies to small business, and extended a job creation tax credit for big companies, most especially Intel which recently laid off workers at facilities throughout the U.S.

¹ “Arizona Pension Reform is Signed by Gov. Doug Ducey, But Voters Will Have a Say” (Arizona Republic, 2/16/16) <http://www.azcentral.com/story/news/arizona/politics/2016/02/16/arizona-pension-reform-signed-gov-doug-ducey-but-voters-have-say/80471656/>

² The ASRS figure was calculated from the FY2015 Actuarial Report on the Valuation of the Plan at <https://www.azasrs.gov/sites/default/files/pdf/Actuarial%20Valuation%20of%20the%20Defined%20Benefit%20Plan%20-%20June%2030%2C%202015.pdf> (the normal cost on page 32 less the member contributions on page 9.) The PSPRS figure was calculated from the June 30, 2015 Arizona Public Safety Personnel Retirement System Consolidated Report at [http://www.psprs.com/Admin Investments and Finance/2015 actuarial reports by system/June%2030,%202015%20PSPRS%20Annual%20Valuation.pdf](http://www.psprs.com/Admin%20Investments%20and%20Finance/2015%20actuarial%20reports%20by%20system/June%2030,%202015%20PSPRS%20Annual%20Valuation.pdf) (the employer normal cost rate on page A-2 was multiplied by Covered Payroll in Appendix I-3).

³ The Revenue Impact of Arizona’s Tax Expenditures, Fiscal Year 2015-2016 (Arizona Dept. of Revenue, 11/15/16) https://www.azdor.gov/Portals/0/TaxExpenditures/FY16_PreliminaryTaxExpenditureReport.pdf

⁴ The Revenue Impact of Arizona’s Tax Expenditures, Fiscal Year 2015-2016 (Arizona Dept. of Revenue, 11/15/16) https://www.azdor.gov/Portals/0/TaxExpenditures/FY16_PreliminaryTaxExpenditureReport.pdf

⁵ Q&A Arizona’s State Budget and Taxes (Arizona Center for Economic Progress, January 2017) <http://azchildren.org/wp-content/uploads/2016/12/QA-Budget-and-Taxes-002.pdf>

⁶ U.S. PIRG Education Fund, *Picking Up the Tab: Small Businesses Bear the Burden for Offshore Tax Havens*: (November 2016); <http://www.uspirg.org/sites/pirg/files/reports/USP%20PickTab%20Nov16%201.0.pdf>

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