GOVERNING
THE STATES AND LOCALITIES

The Week in Public Finance: Trump's Infrastructure Plan, Risky Pensions and NYC's Surprising Fiscal Health

A roundup of money (and other) news governments can use.

By Liz Farmer

January 13, 2017

How Will Trump's Infrastructure Plan Affect the Economy?

Economic impact estimates are all over the map when it comes to how much of an affect President-elect Donald Trump's 10-year $1 trillion infrastructure proposal will have on the economy. To that end, two reports came out this week that come to completely different conclusions.

The first, by Georgetown University, says that Trump's plan could create as many as 11 million jobs. However, it cautions, the additional spending in combination with proposed tax cuts and other economic policy shifts could "overheat the economy" by increasing inflation and setting the stage for further interest rate hikes.

The Tax Foundation had a much more modest take. This is partly because the report assessed the varying degrees of economic impact the proposal would have depending on what other policy measures are implemented. The foundation looked at the impact of a theoretical $500 billion investment by the federal government through five funding mechanisms: borrowing, cutting government spending, raising excise taxes, raising the top tax rate on individual income and raising the corporate income tax.

The foundation concluded that either borrowing money or reducing government spending to pay for the increased investment would slightly boost GDP and increase employment by 21,400 full-time jobs. The other methods of funding would have a more reduced economic impact.

The Takeaway: A lot depends on how much the federal government will invest and how it will pay for it. Lawmakers in Washington will have to walk the fine line of putting up enough capital to get things going, but not so much that paying for it threatens to depress economic growth.

Meanwhile, many believe that most of the infrastructure investment would flow to toll roads and other projects that generate revenue.The Court Street Group's George Friedlander and Joseph Krist recently predicted that the toll-free status of highways could be threatened. "We expect a significant portion of any new funding to target transportation," they wrote, "and would not be surprised to see Congress permit tolls on Interstate highways as a way to support desperately needed maintenance and repair of these arteries."

Surprise (Or Not)! It Turns Out High-Risk Pension Investments *Are Risky*

A new analysis by the Rockefeller Institute of Government has found that the common pension practice of choosing more high-risk, high-reward investments to increase returns significantly increases the

chance that taxpayers will be left paying for a pension shortfall.

As interest rates have fallen over the last 25 years, pension plan investments have shifted from stable bonds to stocks and alternative investments like hedge funds. This shift was done as a way for plans to still hit their target rates of return, which is typically between 7 and 8 percent.

The institute's analysis took this practice and projected it onto the finances of a prototypical pension fund over 30 years. The result was that the pension had a 17 percent chance of falling below 40 percent funding after three decades. Such a low level of funding means the government would face a risk of sharp contribution increases.

The Rockefeller analysis also looked at what happens if pension plans lower their target investment rate of return to 3.5 percent, which is roughly what long-term bond interest rates are now. In this case, the pension fund "had almost no risk of severe underfunding over the 30-year period," but government contributions would likely triple.

The Takeaway: **Some of the country's worst-funded pension systems are already an example of this high-risk simulation at work. Dallas, for instance, was downgraded this week by S&P Global Ratings, largely because of its pension crisis caused by extremely risky pension investments that failed.**

All of this has led to a few pension plans seeing the writing on the wall and lowering their investment rate of return. One of San Jose, Calif's pension funds voted to lower its target rate of return to 6.875 percent. The city's other fund is considering doing so too. CalPERS, the state-run pension fund, also recently voted to step down its target rate to 7 percent by 2020. Such moves "make public pension funding safer," the institute's report said, "but unfortunately will increase stresses on already-strained state and local governments."

Sneaky Debt

New York City has been ranked as the nation's second-worst in terms of its fiscal health in a newly released analysis of 116 U.S. cities with populations greater than 200,000. That's obviously surprising because the Big Apple's economy has been soaring — total revenue has gone from $60 billion in 2009 to $81 billion in 2015. "But," notes Public Sector Credit Solutions' Marc Joffe, who worked on the rankings, "the city has been spending the money almost as quickly as it has been coming in."

New York's per capita bond debt also greatly exceeds that of all other large U.S. cities, and is even 50 percent higher than that of Chicago, which was ranked first in the analysis. It's retiree health-care liabilities ($85 billion) double its long-term debt total.

On the other end, California cities dominate the top of the cities with the best fiscal health — another surprise as the state is home to the most municipal bankruptcies in the modern era. Southern California's Irvine ranks No. 1 thanks to relatively low debt levels and high reserves.

The Takeaway: A key factor here is that, while the analysis considers annual pension costs, it doesn't include pension liabilities in its long-term debt tally. Pension debt has been a big factor in California's bankrupt cities, for example. Looking to New York City, it's pensions are by no means well-funded but they are in far better shape than Chicago's.

Still the city's outsized retiree health-care liabilities signal a major vulnerability that should be managed. "High-debt burdens and insufficient general fund reserves are associated with episodes of fiscal distress, which are marked by employee furloughs, layoffs, and, in extreme cases, bond defaults and bankruptcy filings," warns Joffe. "Still, if New York City continues to record strong revenue growth, it can shoulder its sizable obligations."