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[Fitch Rtgs: Aging Populations Strain State Budgets, Pension Funding Varies]

Link to Fitch Ratings' Report(s): [Demographic Trends and Pension Pressures (Aging Populations and Underfunded Pensions May Present Fiscal Challenges for States)]

Fitch Ratings-New York-25 February 2020: The aging US population poses a range of challenges to state finances, including providing pensions for the swelling ranks of retired public workers. However, a state's demographic profile does not necessarily determine its pension funding, Fitch Ratings says. States with weaker demographic profiles are likely to face slower revenue growth and expenditure pressures but some of these states have maintained an approach to pension funding that alleviates pension pressure.

The population profiles of pension systems are aging, with the number of retirees drawing benefits growing, even as the number of active workers lags behind. For many plans, the number of retirees now exceeds the number of active employees. As states see populations age, revenue growth prospects slow and demand for services climb the concurrent demand for higher pension contributions in order to address underfunding may limit fiscal flexibility.

Fitch's report assesses these pension burdens and demographic trends and differentiates states based on their position relative to 50-state medians, highlighting examples that illustrate the nuances of states' funding considerations and the importance of sustained policy actions in managing the trajectory of pension burdens over time.

States are categorized by their position above or below the median projected labor force growth of 0.12% annually over the 2017-2026 period as projected by the US Census, and the median pension burden, which Fitch defines as the ratio of state net pension liabilities adjusted to a standard 6% discount rate as a percentage of personal income. The median pension burden measured 3.1% in 2018. Quadrants created by this comparison indicate whether states are well placed to manage their pension obligations based on the size of the liability and their active population.

States with the twin challenges of weaker demographics and higher underfunded pensions are arguably more vulnerable to fiscal pressures over time. Dominated by those in the Northeast and Midwest, many of these states are aging faster than the median, with a rising share of the population aged 65 and older, and barely growing or even declining working age populations. Some states within this quadrant, however, have shown commitment to pension funding that has resulted in an improved funding status.

An equal number of states are in the relatively more favorable situation of having both stronger demographic trends and carrying relatively lower pension burdens. Fiscal vulnerabilities stemming from either demographic trends or pension contributions pressures are likely to be lower for states in this quadrant. Pensions are either well funded, or if not, represent a smaller burden relative to the state's wealth base.

The remaining states in the other two quadrants either have solid demographic trends but higher pension burdens, or lower pension burdens, despite weaker demographic trends. While still vulnerable based on weakness that could hamper full pension funding, these states arguably retain more fiscal flexibility than those in the upper left quadrant.

Most governments have taken steps to shore up their pensions by shifting to more reasonable assumptions, increasing contributions to the actuarial level and cutting future benefits for new workers. These corrective actions have less of an effect in the context of maturing pension systems. The problem is magnified for states in which pensions are a material burden relative to the state's resource base.

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