Discussion of
How Do Retiree Health Benefit Promises Affect
Municipal Financing?
by
Betermire, Holland, and Wilkoff

Byron Lutz

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The analysis and conclusions set forth here are those of the discussant and do not indicate concurrence by other members of the Federal Reserve Board research staff or by the Board of Governors.
Question: Do liabilities for OPEB influence muni bond yields

Important question given magnitude of liabilities > $1 trillion

- Approx. $1$ trillion of state and local gov. own source revenue
- Largely unfunded

Very surprising this is first paper to examine question
Question: Do liabilities for OPEB influence muni bond yields

Important question given magnitude of liabilities > $1 trillion

- Approx. $\frac{1}{2}$ of state and local gov. own source revenue
- Largely unfunded

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Empirical methods are sounds

- Panel data approach is sensible
- Variation in effect on yields – e.g. difference by type of gov. contribution – increases confidence in results
- Solid evidence against pension obligations explaining the results
More discussion of why OPEB should affect yields

- OPEB benefits lack strong legal protection
  - Govs. have broad latitude to make changes
- State and localities have been pairing back benefits
  - Reducing/eliminating subsidies, closing to new hires, eliminating completely, etc. (Munnell, Aubry, Crawford 2016; NASRA 2019)
- If a government is under sufficient stress to be unable to make debt payments, is it likely to continue to pay OPEB benefits?
  - If not, how much should liabilities affect yields?
More discussion of why OPEB should affect yields (cont.)

- Paper would benefit from discussion of this
  - E.g. What has happened to OPEB benefits in recent muni bankruptcies?
- There are good reasons why OPEB benefits might affect yields
  - Not all governments could eliminate payments
  - Costs to dropping OPEB even if permissible
Why Do Health Care Costs Matter?

- Greater OPEB effect on yields in states with high health care costs
- But why does market care if size of liabilities arises from costs vs. generosity of benefits?
- Result reflects the price of risk - needs more discussion
Greater OPEB effect on yields in states with high health care costs
But why does market care if size of liabilities arises from costs vs. generosity of benefits?
Result reflects the price of risk - needs more discussion
Future rise in cost of OPEB mostly due to rising health care costs (Lutz & Sheiner 2014)
  ▶ Higher costs today likely implies greater risk from rising health care costs
More explicit discussion of this
Intuition for Size of Effect

- Readers would benefit from discussion of size of effect? Is it reasonable?
Intuition for Size of Effect

- Readers would benefit from discussion of size of effect? Is it reasonable?
- IV result for funding ratio effect on spreads, -3.35, is an order of magnitude larger than the standard estimate, -0.35
- IV results seem implausibly large given sample mean yield spread of 0.25
Empirical Suggestions: OPEB Measures

- Two key explanatory variables explored: liabilities and funding ratio
- Regressions run separately for each of these variables
- But they capture different aspects of OPEB obligations
  - E.g. large liability implies risk even if "fully funded"
  - Accounting rules allow for using risky rate of return
Empirical Suggestions: OPEB Measures

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- Implication: Include both in single specification
- If there is a desire to use a single measure —→ unfunded liability
Heterogeneity in the effect is explored by running separate regressions

- E.g. Separate regressions by OPEB contribution method

Different estimates are taken as evidence of heterogeneity in the OPEB effect

But the estimates often appear to not be different in statistical sense
Empirical Suggestions: Exploration of Heterogeneity

- Heterogeneity in the effect is explored by running separate regressions
  - E.g. Separate regressions by OPEB contribution method
- Different estimates are taken as evidence of heterogeneity in the OPEB effect
- But the estimates often appear to not be different in statistical sense
- Use a single regression and include interaction and main terms

\[
\text{spread}_{i,s,t,m} = \alpha + \beta_1 \times OPEB_{s,t} + \beta_2 \times \text{cont\_method}_{s,t} + \beta_3 \times OPEB_{s,t} \times \text{cont\_method}_{s,t} + \ldots
\]

- Estimate of \( \beta_3 \) indicates if effect meaningfully differs by contribution status
Empirical Suggestions: Instrumental Variables

- Health care cost factors as instruments for OBEP variables
- Instrumental variables approach requires instruments affect bond spreads only through influence on OPEB obligations
  - E.g. role of nurse practitioners must affect state finances only via OPEB
- More needs to be done to establish this
- Does nurse practitioner status affect Medicaid outlays?