Pension Reform

With so much of the state deficit due to unfunded pension liabilities (over $114 billion), this is a huge issue for the State of Illinois. Technically, while the City of Chicago pensions, including its teachers, are not the responsibility of the state, the fact that Chicago needs to spend so much on pensions that it relies on increased property taxes and additional state funding for those and other obligations, I will discuss them here as well.

First, an overview of the system. There are five state government worker pension programs: teachers (except Chicago) (TRS), State university workers (SURS), other State workers (SERS), judges (JRS) and politicians (GARS). All but SURS plan are Defined Benefit Plans, where a monthly retirement pension amount is promised at retirement for the lifetime of the participant. In addition, this benefit is guaranteed to increase by 3% annually, regardless of inflation, and this increase is not means tested. This benefit is due irrespective of the performance of the underlying "fund" set aside to meet these obligation. In other words, the employer takes all the risk of the fund performance as well as any missed contributions.

The Chicago Teacher's Plan assumes a 7.75% annual rate of return on its investments, and state plans use similar assumptions. When the market is flat, as it was in 2015, the pension liability increases due to missing the projected return.

Since 1996, the funding gap increased by more than $16 billion due to returns less than estimated. Career politicians ignore these gaps because they will antagonize the general public with tax hikes or public sector unions with benefit cuts. Again, all of this falls on the employer, who in this case, are the taxpaying citizens of Illinois!

SURS, with its 189,000 participants, uses a Defined Contribution Plan model, whereby a certain amount of money is contributed each year, including employee and employer contributions, and the participant walks away with whatever the fund grows to at retirement. The participant takes on the responsibility of managing the underlying funds in his/her account.

HISTORY

A little history of our politicians' utterly irresponsible behavior will show what led to the awful mess the Chicago Public School (CPS) pension finds itself in today. It is not dissimilar to the malfeasance on the part of state politicians as well.

In 1981, In exchange for no salary hike, the Chicago Board of Education paid the 7% of salary that teachers normally contribute to the pension. This is known as a pension pick up, and teachers, who are obligated to contribute 9% of their salary as a pension contribution only added 2%. This pension pickup has cost city taxpayers nearly $170 million annually, and over $1.3 billion since 2006.

In 1995, at the request of the Chicago Board of Education, the Illinois General Assembly let Chicago Public Schools quit paying into the teacher's pension for ten years. Since 1996, contributions to the pension were $2.7 billion vs the $5.2 billion that was required.

From 1995-2011, CPS granted teachers 3-4% annual pay increases PLUS step hikes for experience, degrees, etc. By 2005, the pension was only funded at 79%.

In 2011, the Illinois General Assembly, consistent with the kicking the can down the road policies of the majority party, voted a pension holiday to allow the Board to fund $200 million vs. the $600 million it should have. This, combined with bad investment results, caused the funding level in 2011 to drop to just under 60%.

By 2024, the CPS will be spending more on retiree benefits than current teacher wages. Current retirees should have $15b set aside. The current plan assets are

$10b, so it doesn't have nearly enough for them. And it has nothing set aside for active workers!

Recently, the City of Chicago passed a budget that included a $544 million property tax hike to pay down the unfunded CPS pension liability. This property tax hike will hit individual residences as well as commercial property, with some tax bills increasing by as much as 45% over the next four years. This will force some residents out of their homes, force home sales at depressed prices, and increase rents for apartment dwellers and business owners.

Chicago Police and Fire pensions are under 30% funded, and some lawmakers, including our 47th Ward Alderman, have suggested imposing yet another $300 million property tax hike to deal with some of these other issues. Fortunately, cooler heads have prevailed, at least for the time being.

Our state pensions are only 41.9% funded as of 2015, the worst funded pension plans in the nation. Pension costs now consume more than 25% of the state's general fund budget, up from 8 percent in fiscal 2005. Illinois unfunded liabilities have risen in ten out of the last eleven fiscal years.

TRS

In a recent poll of 93 suburban school districts, in more than half of them, at least a quarter of the retirees were making more than the average of their highest salaries. Statewide in 2015, 30,357 of the states 100,689 retired teachers and administrators got pensions that were higher than their average highest pay when they were working.

Illinois penalizes districts who give end of career pay bumps of more than 6% in order to increase pensions. Then, in 2010, it created a separate tier for new state workers with annual COLA tied to inflation, and full benefits only at age 67. It also limited how much of their salary can be counted towards their pensions.

GARS

Taxpayers pay once for a state politician's salary and another 1.5 times for their bankrupt pension. In 2017, taxpayers will contribute nearly $123,000 of each lawmaker just to keep the General Assembly Retirement System afloat. The average legislative salary currently equals $82,000 for what is legally a part time job. The current average pension for a General Assembly retiree is about $58,400.

More than 12,000 participants receive over $100,000, and average $3 million over their lifetime. Pensioners begin drawing benefits in their 50s, far earlier than private sector workers.

GARS is currently only 16% funded. In fiscal 2017, the state will contribute $21.7 million while lawmakers will put in just $1.28 million towards their own pensions (17 times more).

Since there are no unions to oppose reforms for this plan, why haven't the lawmakers done so? Is it the best interests of the State or of themselves that they really have at heart?

SERS

AFSCME worker salaries grew at twice the inflation rate and five times faster than an Illinois average worker's earnings from 2005-2014. Illinois would have saved $3.5 billion had these salaries increased by the rate of inflation. According to a memo form the governor's office in 2015, AFSCME leaders were pushing for four year raises ranging from 11.5 to 29%. This would increase salary and pension costs by $1.6 billion.

Conclusion and Recommendations

We can no longer afford politicians who recognize the financial problems of the state yet continue to preach that more tax and spend policies will solve the problems.

The Pension Protection Clause was added in 1970 as an amendment to the state constitution. In 2015, the Illinois Supreme Court rejected the 2013 restructuring that took six attempts over 16 months to pass, despite one party rule, saying that you could not take away benefits that had already been promised. The restructuring was projected to save $145 billion over 30 years by limiting out of pocket COLA and raising retirement age. While this would have eliminated only one-fifth of the unfunded liability, yet it was still challenged in court.

With a 60% majority of both houses, a referendum could be placed on the ballot to repeal the Pension Protection Clause, then a majority of voters could pass it. While it is possible that a Federal lawsuit would be filed against the state, many suggest that the case law is favorable that the repeal would not be overturned.

The current solution under negotiation of just forward looking is less likely to be challenged, but the effect would be to reduce our unfunded liability by less than the 20% of what the 2013 bill would have accomplished. Estimates of the current talks between Governor Rauner and Senate President Cullerton would save about $1 billion annually. (Unfunded liabilities currently $111 billion)

There is NO combination of tax increases that would solve Illinois' state and local fiscal crises without also including drastic reforms including cuts in pension benefits and growth in the tax base. It doesn't matter what's fair, and at this point is doesn't matter who's to blame, although the answer to that question is obvious. It doesn't matter what party you are in. Tax rates would have to be so unrealistically high, that Illinois would be a ghost state in a few years. The only people left would be the public pensioners collecting their monthly checks, and the politicians who for decades caved in every time their public worker support complained.

Local governments, most of which are already in worse shape than the states, have already tried this. Higher property taxes lower property values, and the slippery slope is built. Check out Chicago's south suburbs to see what has happened. It's probably pride that keeps many of these towns and cities from declaring bankruptcy right now. And inevitable for Chicago if serious changes are not made.

Our system is broken. We can no longer keep the promises we made. The number of jobs, growth and revenues simply aren't there.

So, here are some suggestions of reforms that I would like to see put in place on the pension side. But keep in mind, reforms need to be made in many areas in order for our State to survive.

Start with the politicians. They don't have a union so there shouldn't be a court appeal. Transition the current GARS Defined Benefit pensions into a Defined Contribution plan similar to a 401(k).   Depending on the cost savings to the state, have some matching by the state of employees' future contributions.

As long as Defined Benefit Plans are still in place for teachers, stop all pension pick-ups by school districts, and have teachers contribute the entire 9% that they are required to by law. Make it illegal for the state or any school district in the future to negotiate pension pickups in exchange for wage concessions. Similarly,

make it illegal for the state or any school district to negotiate away or postpone any current year contributions to retirement plans of any form.

Draft a constitutional amendment to repeal the Pension Protection Clause, get it passed by 60% of both Houses, and put to a referendum vote by the citizens of the State. While this may be unpopular, if the alternative is no available jobs or money to pay salaries, perhaps it can pass. At that point, begin to transition all public pensions to the 401k model (take a look at the State University Retirement System Plan which is self-directed). Teachers who are now contributing 9% to their pension (under item #2) can now decide how much they want to contribute to their 401(k) account. Have the State match employee contributions to some extent, as in Item # 1.

Duplicate what the State did in 2010, when it created a separate tier for new state workers with annual COLA tied to inflation, and full benefits only at age 67. It also limited how much of their salary can be counted towards their pensions.

To the extent that there are employee matches or other contributions made to employee accounts for teacher pensions, have the school district be responsible for those costs. While it is assumed that the state would provide funding for this, it would be up to the individual districts to properly manage this expense, just like any other expense.

Determine if there is a way to get these employees into the Social Security system, and if not, make provisions to fund such a benefit at retirement after taking into consideration the benefits earned and accrued under the old pension that will still follow the employee.

Put a cap on cost of living increases for both salaries and pensions to no more than the appropriate Consumer Price Index increases on an annual basis.

Have all employees covered by State retirement plans contribute to the cost of their health care benefits commensurate with what private sector employees pay for their coverage.