

SNG-High taxes, low services explained-8-14-17

State's high taxes, low services explained

By Jim Nowlan

[A reader of a draft of this column said it was as boring as an Amish fashion show. But it's about stuff important to Illinois. Hope you can hang in there.]

With the recent increase in income taxes in Illinois, our state is once again among the top eight or so in state and local tax burden, while our state services to taxpayers are among the lowest.

For example, state financial support for public schools as a percentage of total school spending is lowest among the 50 states.

Why, you might ask? It's all about the pension albatross, Stupid!

Moody's Investor Services reports the state's five public employee pension systems are \$251 billion short of assets adequate to meet guaranteed future obligations. That works out to about \$20,000 in debt equivalent for every person in our state. [By the way, State of Illinois agencies put the underfunding at about half the Moody's figure, but I tend to go with the worst figure when it comes to Illinois fiscal problems.]

The state is paying \$7 billion each year to address the underfunding—and will do so until 2045.

This is more than the revenue generated by 2 percentage points in the rate of the individual income tax. In other words, if our pensions were fully funded, as they are in Wisconsin, we could have an individual tax rate of 2.95 percent or less, rather than the new 4.95 rate.

Or we could spend the \$7 billion to reduce the local property tax big time. Or, my preference, we could use the money to invest in infrastructure, schools, universities, but I guess that thinking is out of fashion right now.

But we aren't Wisconsin. The Badger State can, by the way, reduce pension payouts to retirees if the income from its trust fund is insufficient. Illinois cannot.

Here is the briefest tutorial on pensions from a non-expert:

A bedrock principle for pension experts is that benefits for retirees be generated by contributions made earlier into a trust fund nest egg by those retirees when they were working, matched by their employers. Makes sense.

This principle is, however, honored in the breach more than in fact. Our revered Social Security system is, for example, a prime example of intergenerational, pay-as-you-go coverage of benefits. The US Government uses current payments by workers to cover most benefits often earned earlier by others.

But in Illinois, we are also trying to rebuild our trust funds, which should of course have been funded across earlier decades.

At today's low rates of return on investments, however, I seriously doubt we will ever be able to amass a trust fund adequate alone to fund future obligations. Social Security doesn't even try to do so.

It should be noted that a few years ago Illinois sharply reduced future pension benefits for new employees, but we still have the problem of moving the pig through the python of often large benefits for all other employees and retirees.

The State of Illinois makes its required pension payouts of \$10 billion annually. This comes from \$5.8 billion in investment income (in 2015) from our \$80 billion in pension assets, plus employee contributions of \$1.6 billion, and state appropriations of \$9 billion.

A huge chunk of the excess of state contributions each year go to rebuild the trust funds, so that by 2045 there should, theoretically, be enough in the funds to cover fully the anticipated payouts to retirees.

This excess in state payments over payouts is obviously unavailable for spending on education, social services and infrastructure.

That's why we have high taxes, low services.

Instead of trying to amass gargantuan trust funds, I think we should continue to build the trust funds, but more slowly, and consider them as rainy-day funds to be drawn upon only in the event of a major Depression.

By doing so, we could shave \$2 billion or more off our annual appropriation, make full payments to beneficiaries, and still grow the trust funds. There is no magic in meeting a Year 2045 goal.

The \$2 billion could go toward meeting current needs.

Some retort that would simply be kicking the can of our fiscal mismanagement farther down the road. Wrong. We would be meeting our obligations to retirees fully. And the Illinois Constitution and the state Supreme Court guarantee all pension benefits promised. There is no weaseling out.

It's the pension albatross, Stupid, and we need to rethink it.