SNG-Pension Pullback-Nowlan-4-11-11

Pension pullback unfortunate but necessary

By Jim Nowlan

If I were a current state or local government employee in Illinois, I would be apoplectic with rage about apparent plans in the legislature to reduce my pension benefits and extend my retirement age.

The sad part of this is that the changes are probably necessary to balance the state budget and meet current operating needs for health care, education and other basic state services. Life isn't fair.

Pensions date back to Caesar Augustus in 12 B.C. in the Roman Empire, who formalized pensions for his military legionnaires. And the key features of the Augustan pensions provide the basic parameters for military and other pensions today—20-25 years of service and a payment of 66-75 percent of final full-time pay.

In the late 1800s, major American cities began providing pensions for firefighters, police and teachers. In 1920, the federal government enacted pensions for their civilian employees. In Illinois, teacher pensions predated Social Security; state and public university employees were afforded pensions in the 1940s.

Unfortunately, almost from the beginning, in Illinois anyway, the government failed to provide its promised share of the funding that would build a fund from which later pensions could be paid.

At present, in the state of Illinois, total employee and government funds set aside to pay future pension benefits represent only 38 percent of the amount needed, leaving a hole of about $85 billion in the five state pension funds alone (downstate teachers, state government and university employees, judges and members of the General Assembly).

As a result of this embarrassing underfunding, the state of Illinois in 1995 established a program to build up the funds by "ramping up" state appropriations with ever bigger annual payments, with really big payments not kicking in until now. Unfortunately, the state has not fulfilled this commitment, instead borrowing to make pension payments in recent years, which only kicks the can down the road, as observers are fond of saying about how Illinois has been handling its problems.

The ramp up calls for Illinois to pay $4+ billion in pension payments this year, plus about another $2 billion in principal and interest on the pension borrowing. This represents a big chunk of all general funds dollars. Indeed, required pension payments will represent 60 percent or more of our major tax revenue sources in years to come, which cannot be sustained and still fund basic government services.

If Illinois had made its payments each year as required from the beginning, today's pension payments would be a small fraction of what Illinois now has to pay, and quite manageable. Instead, if I'm right that the legislature will try to reduce current employees' pensions going forward, these current employees will in effect be paying in to rebuild funds that the government itself should have paid!

How did all this happen? Human nature. In government budgeting, there are always more demands to spend this year than there are monies available. When I was on

the appropriations committee in the House decades ago, I never once recall an agency coming before us to request less spending.

Each year, budget-makers were faced with the dilemma of providing limited dollars for *either* a current program like education or a deferred obligation like the pensions. And they always opted to provide dollars for this year's program and put off paying enough into the pension fund.

That is, if the state failed to fund future pensions this year, there was still enough money to make this year's pension payments, out of funds built up by employee payments and some earlier, though inadequate, government payments. In other words, they kicked the can down the road to a future generation—our generation.

What are the present options? As one state pension expert put it, himself a state employee and pension participant, "We have to do something with current state employee benefits, or we'll go bankrupt."

The basic options are to: 1) reduce future obligations by extending the year of retirement, for example, and trim pension payments; 2) shift the program from one in which the state *promises* to make future payments to one in which the state makes a smaller annual payment directly to the employees, who would control the money along with their own payments, or 3) some hybrid combination of promises and direct payments.

By the way, any policies enacted under option 1 will trigger a court contest over the state constitution's protection of pensions as "contractual relationship[s], the benefits of which shall not be diminished or impaired." That is, can the state change the benefits and terms of pensions of state employees going forward?

Based on human nature and the state's track record, I think government employees would be smart in the future to demand payments annually up front, rather than to rely upon promises.