SNG-Pension idea to save $2 billion-7-18-16

A proposal to fund state pensions fully—and save $2 billion a year

By Jim Nowlan

A thoughtful friend of mine has an idea that would fully fund Illinois pension obligations—and save more than $2 billion a year in annual state spending.

The State of Illinois will appropriate $9 billion this year, and each year far into the future, for pension funding. This is fully 28 percent of all state general funds revenue of about $32 billion!

Much of this $9 billion is an attempt to "catch up" in pension reserves.

My friend David Eisenman would spend just $6.74 billion.

Policy analyst Eisenman of Champaign has degrees in physics from Harvard and the University of Illinois. As a young man, he served in the initial, and highly respected, Illinois Bureau of the Budget, created by Gov. Richard B. Ogilvie (1969-72).

Background: Over the years, our state has faithfully paid the pensions promised to its retirees.

Illinois has been faulted, however, for failing to set aside an investment nest egg (pension reserve) that would *by itself* be large enough to fund all future pension promises made to current and past employees.

Such "full actuarial funding" is what we require private companies to do—because businesses go out of business. When they do, pension promises fully backed by reserves are necessary to meet those obligations.

Eisenman says we having been thinking about public employee pension fund reserves in the wrong way. He agrees the nest egg for Illinois needs to grow. His disagreement is with how much.

The Illinois pension asset reserve base stands at about $80 billion. Another $120 billion is needed, we are told, to insure all future pension payments.

Eisenman thinks this amount is seriously inflated. He estimates the total reserves should instead be $100 billion rather than $200 billion.

Why struggle to set aside a mountain of assets when in practice they would be needed only if Illinois were at risk of going out of business?

State governments never go out of business.

Eisenman proposes that instead of setting aside so much wealth that will never be used, Illinois fund its pensions on a mixed pay-as-you-go basis, more like Social Security than private company pensions.

It's instructive to look at Social Security more closely.

Few people realize that Social Security is overwhelmingly independent of returns on investment of reserves, though the reserves do serve as an important buffer, available to balance out good and bad times.

Social Security reserves are far smaller, compared to current obligations, than current Illinois pension reserves.

Consider:

- From 1985 through 2008, Social Security pension obligations were *completely paid* from current payroll tax income—and each year some of that income was added to reserves.

- Social Security reserves grew even in 2009-2014, during the worst economic crisis since the Great Depression, despite the need to withdraw some of the interest on those reserves.
- Social Security reserves, compared to its annual obligations, are currently 3.25 to 1. At about 8 to 1, Illinois's pension reserve is far greater. Do we really need 20 to 1, as we are repeatedly told?

Eisenman proposes that Illinois state pension retiree payments of $10.5 billion for the coming year be met as follows:

- $1.56 billion from current employee contributions;
- $3.20 billion from the pension reserve base (a 4 percent return on the $80 billion currently in the pension fund reserves; assets are projected by the five state pension systems to grow on average into the future at 7.5 percent, so the asset base would continue to grow), and
- $5.74 billion from state appropriations.

Eisenman would have Illinois appropriate an additional $1 billion to the pension reserve base, because he agrees the nest egg may need to grow. His disagreement is with how much.

Total: $6.74 billion from the state, not $9 billion.

This proposal would complement efforts currently being discussed in Springfield to trim future state retiree pension pay-out obligations. Both Eisenman and I agree some trimming is necessary.

I can assure you that Eisenman has analyzed this topic deeply over the years and can offer much more support for his proposal than this space can accommodate.

If readers have questions on this important, complex issue, please send them. Eisenman and I will respond.

We believe the State of Illinois can safely pay its annual pension obligations, continue to build its pension reserve, and reduce appropriations for its five state employee pension systems by more than $2 billion a year.