Budget Solutions: End Illinois' pension crisis

The problem

Illinois is home to the worst pension crisis in the nation, according to Moody's Investors Service. Pension funding requirements currently eat up a quarter of the state's budget, crowding out vital services on which the state's most vulnerable residents depend.

The system does not work for pensioners, who worry about retirement security. The system does not work for young government workers, who are trapped in an unfair scheme. And the system does not work for taxpayers, who pay more and more each year while pension funds fall deeper and deeper into insolvency.

This crisis is the result of overpromising, not underfunding. In fact, Illinois' pension systems would be more than fully funded if growth in benefits had simply matched that of Wisconsin, Indiana or Missouri over the last 30 years. Instead, Illinois' funds have less than 38 cents for every dollar they need to pay out future benefits.

Asking taxpayers for a pension bailout year after year without reforming the foundation of Illinois' failed defined-benefit pension system is unconscionable.

The solution

The Illinois Policy Institute is proposing a constitutional pension reform plan that spells the beginning of the end for Illinois' pension woes. This plan will secure worker retirements while reducing and eventually eliminating defined-benefit pension plans.

The core of the Institute's reform plan is the self-managed plan, or SMP, that the state has offered to university employees for nearly 20 years. Nearly 20,000 workers have opted into this retirement plan, which functions similarly to a 401(k) – the employee and employer contribute to a retirement account that is portable and transferable from job to job.

Under the Institute's retirement plan, new state workers and current workers who opt in would enroll in a hybrid SMP plan that also includes an optional Social Security-like benefit.

The Institute's plan would bring stable and predictable costs, a significant reduction in accrued liabilities, a path to ending the unfair Tier 2 pension system, a way to wind down the unsustainable defined-benefit system, and protection for both social services and taxpayers. No other plan does this.

The Institute's reforms allow the plan to begin with a contribution toward state worker retirements that is $1 billion less than the current pension systems require in 2018, and phasing in the cost of actuarial changes will reduce pension costs by $650 million.

Illinois Policy Institute plan vs. Senate proposal

Senate Bill 11 contains the pension reform component of a larger budget package introduced by Senate President John Cullerton and Senate Minority Leader Christine Radogno in early January. This package also includes a bailout of the Chicago Teachers' Pension Fund in the form of Senate Bill 5, as well as a multibillion-dollar income tax hike.

Senate plan does not end the failed defined-benefit model

The reforms in SB 11 don't end Illinois' broken defined-benefit pension system. That means the bill perpetuates the crisis.

This factor alone should disqualify SB 11 from serious consideration, as failing to modernize the state's pension systems will result in even more suffering for retirees, workers, taxpayers and people dependent on social services.

Under the Institute's plan, at least half of all workers will be on a defined-contribution plan by 2030, and almost all workers will control a defined-contribution plan by 2047. Over the past two decades, more than a dozen states have enacted some form of 401(k)-style retirement plan. Nearly 85 percent of private-sector workers are enrolled in some sort of defined-contribution plan.

Senate plan relies on flawed consideration model

The reform plan uses Cullerton's consideration model as a basis for pension reform for lawmakers, university workers and teachers in Chicago as well as downstate. Under the consideration model, workers choose between freezing their pensionable salary or receiving a smaller cost-of-living adjustment in retirement. Either way, they lose.

Given that the court has struck down more modest reform efforts in the past, it would not be surprising if the Illinois Supreme Court ruled these efforts unconstitutional. That means taxpayers will be asked to pay billions more in taxes for reform that does not seriously address the state's $130 billion pension crisis and that may be blocked by the courts.

Senate plan still allows pension spiking

SB 11 also ends the General Assembly Retirement System for new workers going forward, creates a 401(k)-style plan for workers (but enrollment is restricted to 5 percent of total employees), and lowers the ceiling for pension spiking penalties for teachers and university workers to 5 percent from 6 percent.

That means taxpayers will still be on the hook for pensions spiked by a series of 5 percent raises in the final years of a worker's career. It is unfair to ask Illinois families to continue bailing out a system that allows this practice.

Under the Institute's plan, pension spiking would vanish over time, as more workers enroll in defined-contribution plans.

Senate plan bails out Chicago pensions

Senate Bill 5 would force the state to "pick up" Chicago's employer contribution to the Chicago Teachers' Pension Fund in perpetuity, costing state taxpayers an extra $215 million in fiscal year 2017 alone.

This is unfair to state taxpayers for three major reasons.

First, it bails out the behavior of Chicago Public Schools officials, who have wildly mismanaged district finances over the past 15 years. Second, it's insulting to ask state taxpayers to pay hundreds of millions of dollars more to CPS when the state's own teacher pension fund is in even worse shape.

And third, CPS officials want the state to pay for the district's yearly pension costs because that's what the state does for every other school district in Illinois. But the fact is that the state should not be in the business of paying for the pension promises of any local school district. This arrangement encourages districts to dole out higher pay, end-of-career salary hikes and other pensionable perks, knowing the state will pay the cost of the resulting higher pensions.

This is why the Institute's comprehensive property tax reform plan (see "Budget Solutions: Giving Illinoisans the property tax relief they deserve") calls for all local governments to pay the annual (normal) cost of pensions.