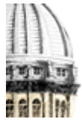

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Ralph Martire: Cutting benefits won't fix state's pension crisis

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If you want to believe that "unaffordable" pension benefits promised to public-sector workers in Illinois like teachers and social workers caused the state's outsized, $83 billion unfunded pension liability, stop reading now. This column will only make your head hurt by disproving that canard with facts. If instead you'd rather understand both the true cause of that underfunding and how it actually strains the state's budget, then by all means continue reading.

Start with the single most important fact: Illinois' ginormous unfunded pension liability was no caused by any inherent aspect of the pension systems. That's right, neither the benefits promised nor the cost of paying for those benefits are to blame. Here's proof.

The current unfunded liability is $83 billion across all five state systems because Illinois only has $63.6 billion in pension assets to cover $146.5 billion in pension liabilities. The result is an aggregate funded ratio — i.e., the portion of promised benefits covered by existing assets — of just 43.4 percent. To be considered sound, public sector pension systems should be at least 80 percent to 90 percent funded. That's scary, but here's the eye-opener: If retirement benefits and salary increases were the only drivers of the unfunded liability, the state's retirement systems would be about 94 percent funded today. In other words, there'd be no pension crisis.

What Illinois really has is a debt crisis. Here's why. For decades, Illinois' antiquated, poorly designed tax policy created an ongoing structural deficit. That means adjusting solely for inflation and population growth, tax revenue hasn't grown at a rate sufficient to cover the increased cost of delivering the same level of services from one year into the next. This is somewhat amazing, given that despite having the fifth-largest population of any state, Illinois annually ranks in the bottom 10 in spending on services.

To paper over — without resolving — the fact that its tax policy is so poor (pun intended) Illinois literally can't afford to be one of the lowest-spending states in the nation, decision makers opted to fund public services by borrowing against what they owed the pension systems. In effect, the state racked up a ton of debt by using the pension systems like a credit card to pay for public services for which there was not enough tax revenue. By 1994, lawmakers had borrowed so much against pensions that the funded ratio was just 54.5 percent.

Sure, this benefited taxpayers in the short run by allowing them to consume public services without having to pay the full cost of those services, but the ever growing debt ultimately had to

be paid. Purportedly to rectify the problem, Public Act 88-0593 was passed in 1995. Known as the "Pension Ramp," it established a repayment schedule to get the pension systems 90 percent funded by 2045.

Unfortunately, the Pension Ramp was fundamentally flawed, because it both continued the practice of borrowing against pension contributions to fund services for 15 more years, effectively tripling total pension debt, and it was so back-loaded that the installments of debt that had to be repaid in out years jumped at annual rates that were unrealistic and unaffordable. For instance, last year in FY2012, the state's pension contribution was $4.1 billion, of which only $1.6 billion was the cost of funding benefits, while more than half, $2.5 billion, was repayment of debt. In FY2013, the contribution jumps by 23 percent to $5.1 billion — with all the increase being debt repayment under the goofy Pension Ramp.

The implications of all this are clear: The problem won't be solved by cutting benefits, because benefits aren't the problem, the Pension Ramp is. Indeed, if the state had incurred this debt with a bank rather than the retirement systems, Illinois couldn't even try to make the bank's workers repay the state's debt and couldn't have forced the bank to accept an unrealistic, unaffordable repayment schedule.

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