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Pension pickle
Illinois lags the rest of the nation in state pension funding. We've tried a few fixes. All fall short. But it doesn't have to be this way.

By James B. Arndorfer

Another first for Illinois: It's the least prepared, among the 50 states, to meet obligations to public workers as they retire, and the state's spend-now-pay-later political system is making matters worse.

As of last June, the liabilities of Illinois' five employee funds ¯ the Teachers' Retirement System, State Employees' Retirement System, State Universities Retirement System, General Assembly Retirement System and Judges' Retirement System ¯ stood at $83.83 billion, compared with assets of $40.72 billion.

That's a funded ratio of 49%. As a rule, public funds are considered healthy if the ratio exceeds 80%. The California Public Employees' Retirement System has a funded ratio of 90%. The Texas Municipal Retirement System is at 82%. The Missouri State Employees' Retirement System: 91%.

The Illinois funds' ratios improved to 57%, but only after the state injected roughly $7 billion of borrowed money into the plans last July. Stock market gains on the funds' investments helped, too.

For instance, the universities retirement system had a funded ratio of 68% at the end of January, compared with 54% before the bond offering, still far below healthy levels.

And state personnel practices aggravated the situation.

An early-retirement program passed in 2002 unexpectedly drove up pension costs. In an effort to reduce payroll, outgoing Gov. George Ryan offered buyouts to state employees, expecting 7,000 to take him up on it. But 11,000 signed up. The program was expected to cost state pension plans $622 million. Instead, it will cost $2.45 billion.

It doesn't have to be this way.

Other states, such as California, have historically had laws requiring governments to put enough money into pension funds to meet future obligations. For the most part, they've stuck with them. Illinois, until very recently, didn't have such a law in place. We're paying the price.

The big state funds aren't the only public funds in Illinois facing shortfalls. The Chicago police and firefighter funds also are underfunded. But others are stronger than the state employees' funds because of their funding plans.

For instance, the Illinois Municipal Retirement Fund, which covers retirement programs of 2,914 local governments, has an aggregate funding level of 99%. That's because it requires participants to put in enough money to achieve 100% funding over a 28-year period.

Other states have put pension funding beyond the reach of politicians with short-term horizons. That's because in up years, politicians tend to count investment returns as money saved. But in down years, they don't make up for investment losses.

"Every chance the budget gives, you should be trying to catch up," says Jeremy Gold, a New York-based pension fund consultant. "You pay off your credit card debt before you go spending again."

When the state pension plans were created more than 60 years ago, there were no guidelines for funding. The state generally put in enough money to cover payouts.

That is, until 1982, when Gov. James R. Thompson began to skimp on contributions to the big state pension funds to balance budgets. The effects of these moves were masked by the funds' investment gains, which exceeded 20% a year in the 1980s.

But by the early 1990s, investment returns weakened, and funding shortfalls began to raise alarms. In June 1994, the funding ratio of the five state plans was 55%; in June 1995, it hit 52%.

Gov. Jim Edgar, elected in 1990, took a stab at a fix.

He pushed a law that went into effect in 1995, designed to boost the state funds' assets to 90% of their liabilities. The target date, however, is 2045. And the annual payments required to get there, drawn from general revenue funds, are gobbling up a growing share of the state budget.

Under the Edgar plan, the state's three biggest pension funds ¯ the Teachers' Retirement System, State Employees' Retirement System and State Universities Retirement System ¯ are supposed to receive a total of $1.95 billion in state funds for fiscal 2005, starting July 1.

In 2010, that annual payment is forecast to be $3.71 billion, according to projections from the funds based on their performance in the year ended last June. By 2020, the payment is projected to be $5.13 billion. And in 2045 ¯ the last year of the plan ¯ the payment is projected to be $15.84 billion.

Gov. Rod Blagojevich's administration is already sidestepping the annual payments required under the Edgar law. Mr. Blagojevich is budgeting $1.33 billion to the three funds, instead of the required $1.95-billion scheduled payment.

'Tough choices'

The big pension plans' funding ratios improved during the tenure of Gov. Ryan, who took office in 1999, due mainly to stock market gains. With its coffers bulging, the state could have put more money than required into the funds during the '90s boom years. It didn't. The Ryan administration stuck to the annual payment schedule laid out in Mr. Edgar's plan.

The stock market crash in 2000 erased the gains seen in the '90s. The state was left without an easy way out. As of June 2002, the funding levels ranged from 52% for the teachers fund to 59% for the universities fund.

Since taking office in 2003, Gov. Blagojevich has yet to come up with a comprehensive solution to the big state pension plans' funding problem. His administration last July floated $10 billion in bonds to inject money into pensions ¯ though it put only $7.32 billion into pensions and used the rest to patch other holes in the budget. The pension funds themselves are on the hook to repay those bonds.

"There are tough choices that have to be made," and the pain likely will "be shared by the taxpayer and by the employees," predicts Gary Anderson, executive director of the Texas Municipal Retirement System. "It's unreasonable to assume just one of them is going to pick up the whole burden."

Eventually, 'taxpayer revolt'

Pension expert Ethan Kra says he expects to see fierce political fights in many states over how much to plow into pensions at the expense of other programs.

"You're going to see some real ugly confrontations (as) pension funds start eating ever-larger shares of state and local budgets," says Mr. Kra, chief retirement actuary at New York-based Mercer Human Resource Consulting LLC. "At some point, you get taxpayer revolt."

Mr. Blagojevich has set up a commission to examine the pension problem and see what can be done to fix it. Findings are expected at the end of the General Assembly's spring session, scheduled before Memorial Day.

"The severity of the pension issue in Illinois can't be underestimated," says state Budget Director John Filan. But administration officials wouldn't comment on what fixes might emerge.

The state could trim benefits for new employees. But the benefits of current plan participants are guaranteed by the Illinois Constitution. Changing them would require a constitutional convention.

Another option is requiring workers to put more money into the funds. Teachers pay 9% of salary into the Teachers' Retirement System. But workers represented by the American Federation of State, County and Municipal Employees don't put in anything.

The only other way to strengthen the funds is to boost revenues ¯ meaning, raising taxes.

Putting off the problem only guarantees that future generations will be saddled with bills being run up today.

"If the generation of taxpayers receiving the benefit of the services of current employees is not putting aside money to cover those (pensions), they are simply passing the debt off to their children and grandchildren," says Gary Findlay, executive director of the Missouri State Employees' Retirement System. That's "a questionable legacy."