



The 800 Pound Gorilla That Got (??) Us into This Problem – Pensions and OPEB

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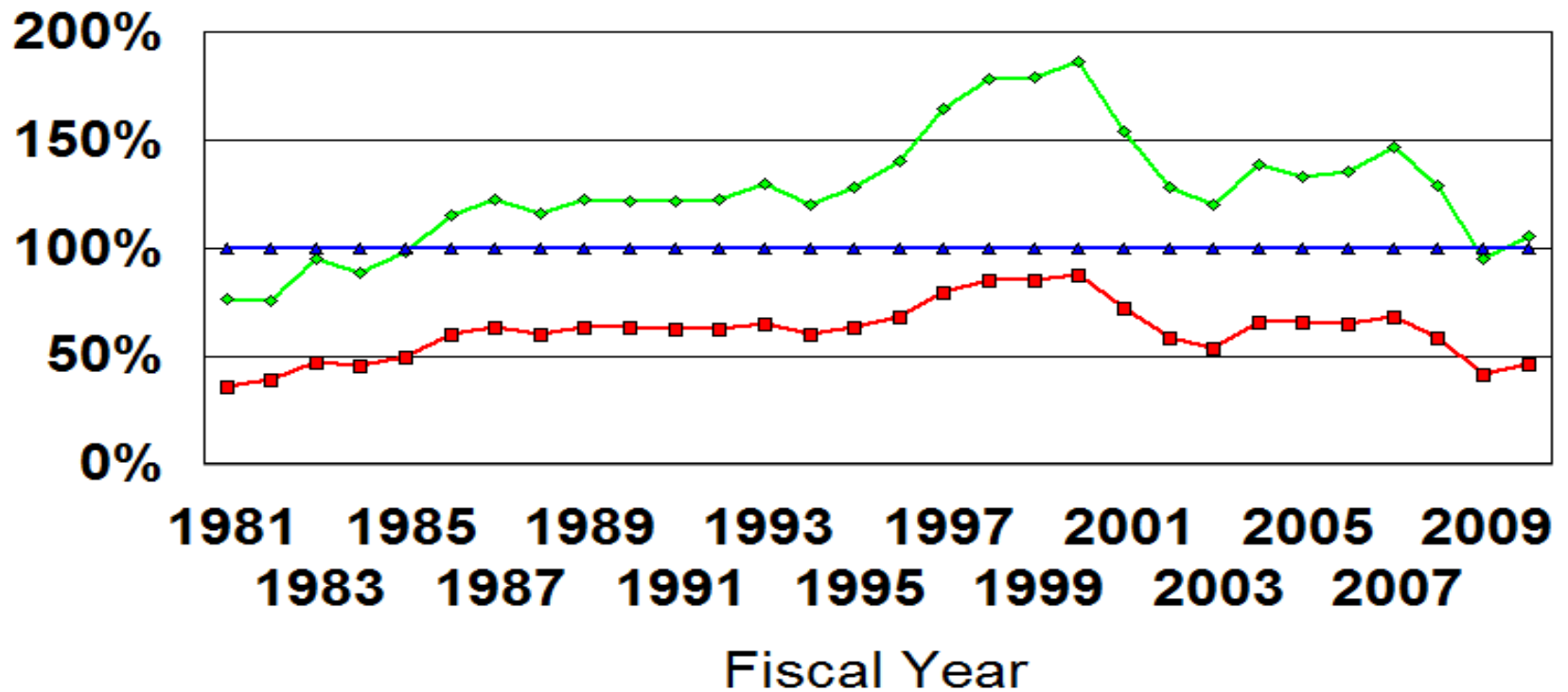
**Charting Illinois's Fiscal Future: Dealing with Structural Deficits
and the Implications of High Levels of Future Debt**

Federal Reserve Bank of Chicago
June 17-18, 2010

Pensions Problems

- Overly generous benefits
- Underfunding
 - Deliberate underfunding
 - Inappropriate actuarial assumptions

SURS Funding Ratio



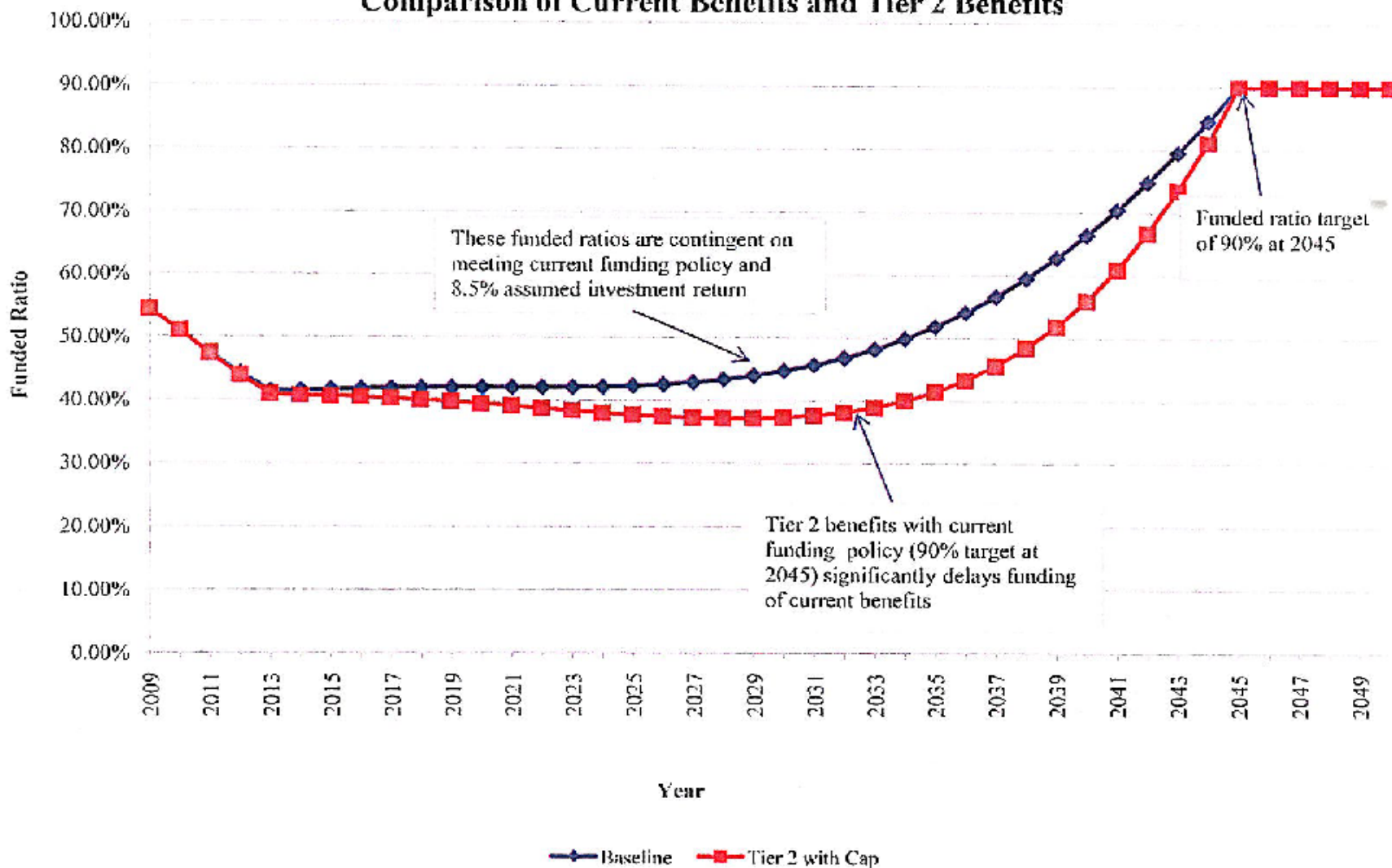
—■— Actual Contribution —▲— 100% Funding
—◆— With "Normal Cost" Contribution

SURS Staff

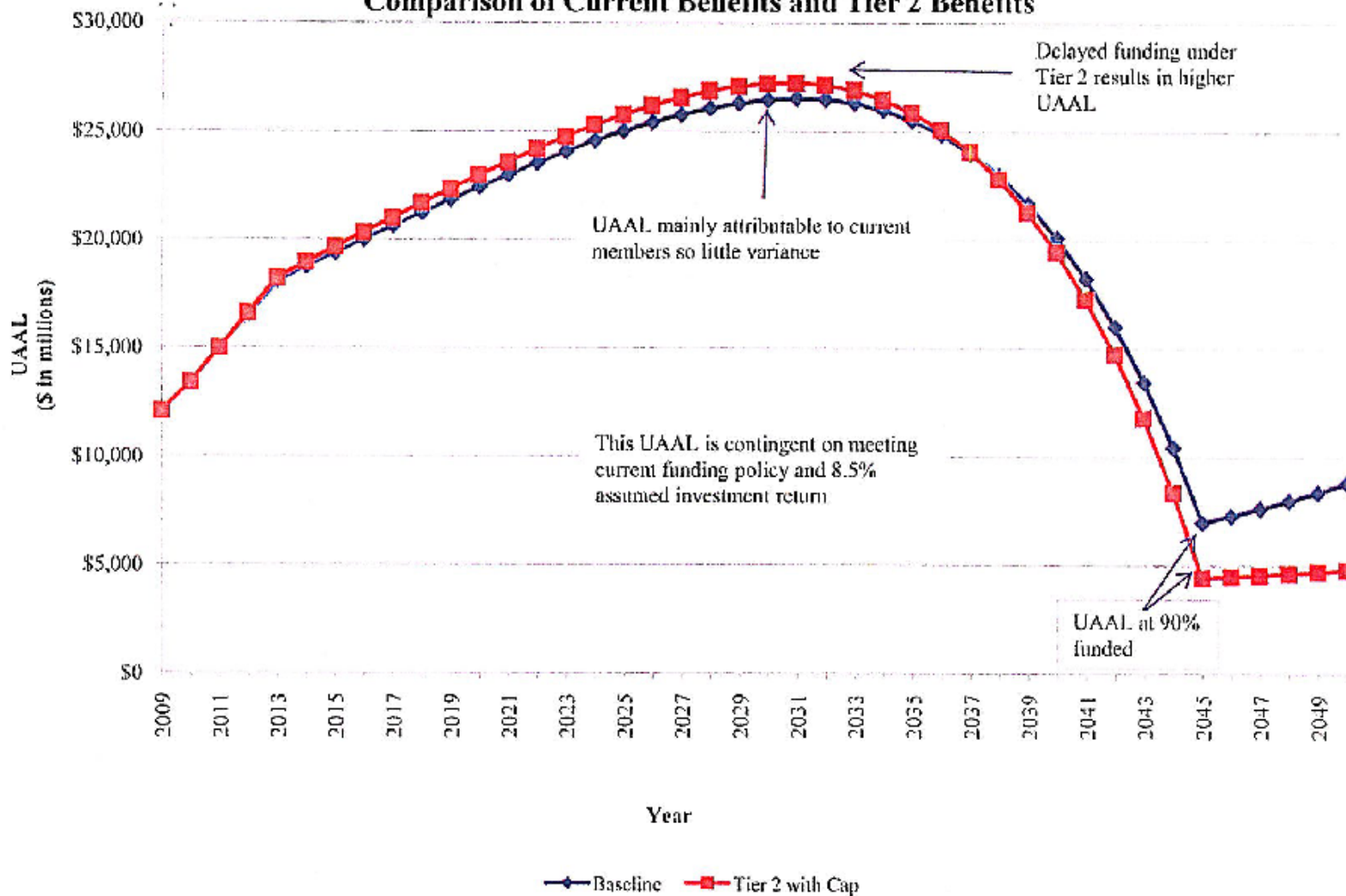
Pension “Reform” in Illinois

- Recent Accolades for the Changes
 - *Wall Street Journal* Editorial Page
 - *Chicago Tribune* Editorial Page
 - George Will
 - Abner Mikva
 - Gov. Pat Quinn
 - Speaker Michael Madigan
- When they all agree, beware.

State Universities Retirement System of Illinois Comparison of Current Benefits and Tier 2 Benefits

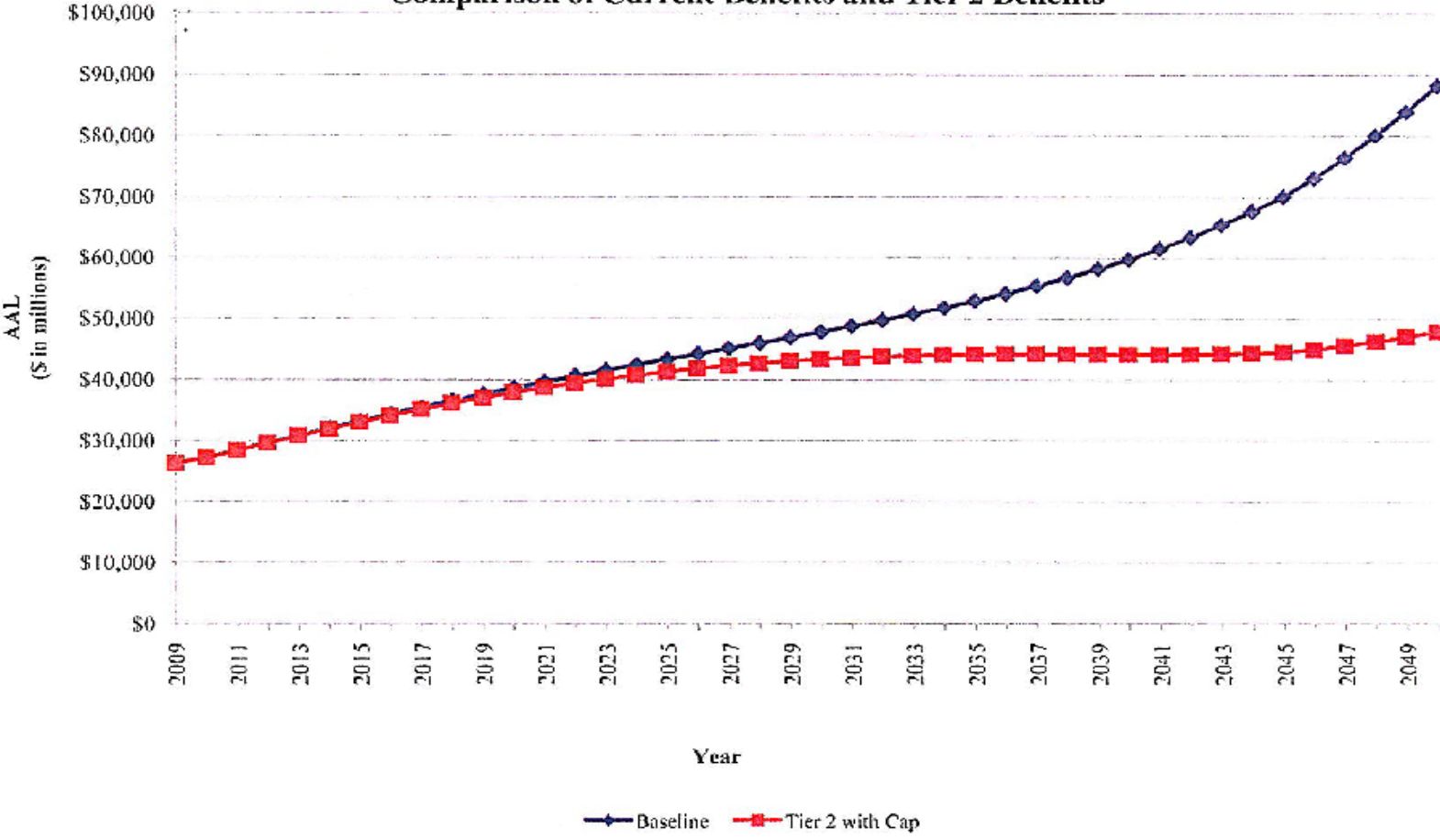


State Universities Retirement System of Illinois Comparison of Current Benefits and Tier 2 Benefits



State Universities Retirement System of Illinois

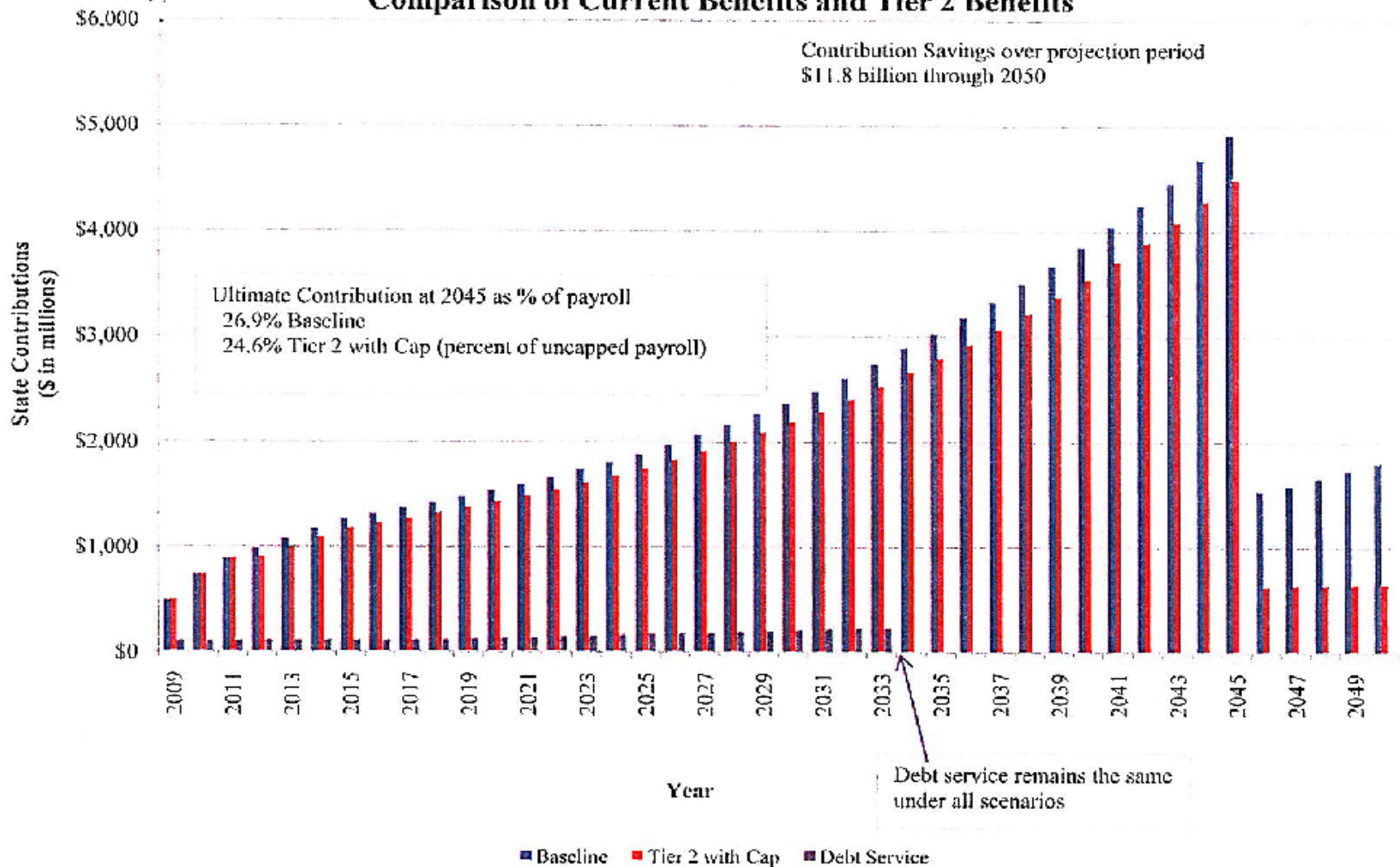
Comparison of Current Benefits and Tier 2 Benefits



State Universities Retirement System of Illinois

Comparison of Current Benefits and Tier 2 Benefits

Contribution Savings over projection period
\$11.8 billion through 2050



Pension Issues

“To alcohol: the cause of, and solution to all of life's problems.” Homer Simpson

Are pensions the cause of, and solution to all state fiscal problems?

Metaphors are misleading:

“Ticking time bomb?”

“Pension train wreck?”

“The 800 gorilla” **who was invited for dinner**

Future Prospects and Options

Rules from Douglas Holt-Eakin (former CBO Director) about dealing with social security and health care at federal level (which applies to Illinois as well)

- A reasonable response will inflict pain
- All programs and revenue sources must be on the table

Option 1: General Solutions

- The basic answer—Deal with the state’s long term structural deficit
 - Stop the temporizing
 - Continuing revenues must be increased and/or
 - Significant cuts must be made in many programs
 - Pension reforms (both benefits and revenues) must be part of this
- This is the preferred approach, but it is unlikely to be politically viable in Illinois
 - Does Illinois have the political will to do any of these appropriately?
 - Will the state revert to similar bad behavior in the future?

Option 2: Pension-Specific Options

- Move to DC from DB
 - Will not solve short term problems
 - Might be considered for dealing with longer term issues
- Giving up—moving to a pay-as-you go system
 - Extremely costly—20+ percent of payrolls vs. 10 percent
- Pension-related changes
 - Revenues enhancements and benefit reductions and the non-impairment clause
 - Current retirees
 - Post retirement non-pension benefits
 - Taxation of (some) retirement benefits
 - Current employees
 - Restraints on wage growth
 - Post retirement non-pension benefits
 - Taxation of (some) retirement benefits
 - Future employees
 - Reduced future benefits (already done)
 - Taxation of (some) retirement benefits

Will this work?

- How can prudent behavior be encouraged?
- Experience suggests that savings generated by these changes would not be used to deal with the pensions problem
- How can maintenance of effort be promoted?
- The Dave Ramsey approach
 - Earmarking
 - Enforcing creditable commitments
 - Maintenance of effort, not replacement of effort