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
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Pensions Problems

• Overly generous benefits
• Underfunding
  – Deliberate underfunding
  – Inappropriate actuarial assumptions
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

These funded ratios are contingent on meeting current funding policy and 8.5% assumed investment return.

Tier 2 benefits with current funding policy (90% target at 2045) significantly delays funding of current benefits.

Funded ratio target of 90% at 2045.
State Universities Retirement System of Illinois
Comparison of Current Benefits and Tier 2 Benefits

Contribution Savings over projection period
$11.8 billion through 2050

Ultimate Contribution at 2045 as % of payroll
26.9% Baseline
24.6% Tier 2 with Cap (percent of uncapped payroll)

Year


$0 $1,000 $2,000 $3,000 $4,000 $5,000 $6,000

State Contributions ($ in millions)

Debt service remains the same under all scenarios

Baseline  Tier 2 with Cap  Debt Service

Gabriel, Roeder, Smith and Company
March 15, 2010
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