



Illinois Retirement Security Initiative



A Project of the Center for
Tax and Budget Accountability

ISSUE BRIEF

HJRCA 49: A CONSTITUTIONAL AMENDMENT REGARDING THE RULES GOVERNING PENSION BENEFIT INCREASES

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I. INTRODUCTION

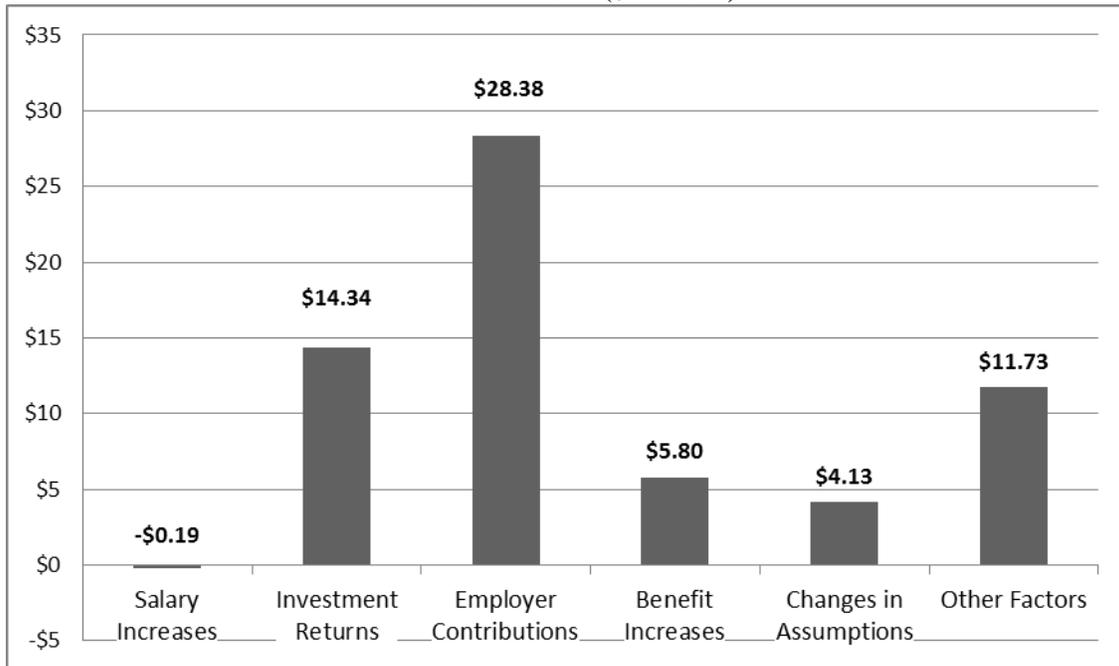
Illinois' significant, unfunded pension liability, which now totals \$83 billion across the five public retirement systems for which the state has responsibility,¹ remains one of the most poorly understood core issues confronting lawmakers. Many assume that, since this \$83 billion deficit exists in state's public retirement systems it must be caused by either overly generous or unaffordable pension benefits. The data, however, clearly show that nothing could be further from the truth. The primary cause of the \$83 billion unfunded liability is the state's now decades-long practice of intentionally borrowing revenue from promised contributions to the retirement systems, in order to subsidize the cost of delivering current public services. Today, the state finds itself faced with an unrealistic repayment plan to the retirement systems and a structural deficit.² Many see the state's yearly pension contributions as crowding out core services like education and human services. The growing pension contributions combined with a limited General Revenue Fund has led many to call for major pension reforms.

II. HOW BORROWING PRIMARILY CREATED THE UNFUNDED LIABILITIES

As shown in Figure 1, insufficient employer contributions, of which the state pays the vast majority, have been the primary source of underfunding for the five state retirement systems. From FY1996-FY2011, unfunded liabilities grew by \$64.19 billion.³ Excluding salaries, which actually caused a decrease in the aggregate unfunded liability, the top two drivers of underfunding were insufficient employer contributions and investment losses during the Great Recession. Insufficient employer contributions account for 44 percent of growth in unfunded liabilities, and investment returns account for 22 percent of total growth. In contrast, benefit increases account for less than ten percent of the growth. Given the small role benefit increases played in creating the problem, it is unfair to target benefits in order to reducing the existing unfunded liability.



FIGURE 1
Growth in Unfunded Liabilities for the Five State Systems
FY1996–FY2011 (\$ Billions)⁴



Source: The Commission on Government Forecasting and Accountability, *Report on the Financial Condition of the State Retirement Systems: Financial Condition as of June 30, 2011* (March 2012).

Borrowing from the pension systems to cover service delivery benefitted taxpayers in the past by artificially keeping the price of those services below actual costs. However, the schedule established for repayment of the debt owed to the pension systems is straining current fiscal resources. Nothing inherent in the pension systems—neither benefit costs nor design—has been the primary cause of either underfunding or the growing strain on current fiscal resources that is “crowding out” services. Borrowing against the pensions was the primary cause of the systems’ underfunding, and repayment of that borrowing is causing the current fiscal stress.

Indeed, the repayment of debt owed to the pension systems is responsible for all the growth in the annual pension payments in FY2013 from FY2012 levels. Consider that, in FY2012 the state’s total pension contribution to the five retirement systems was \$4.135 billion.⁵ Of that amount, only \$1.6 billion—or just about 38.7 percent—was the “normal cost” of covering benefits promised to current workers.⁶ The \$2.535 billion balance—over 60 percent of the entire FY2012 pension contribution— was repayment of pension debt.⁷ In FY2013, the total pension contribution increased by 23 percent from FY2012 levels to \$5.09 billion, all of which is increased debt service.⁸ In fact, the normal cost of covering promised benefits to workers in FY2013 actually decreased by \$100 million from FY2012 levels to \$1.5 billion.⁹

So how did Illinois become subject to a debt repayment schedule that increases so significantly that it not only crowds out funding for services but also is virtually unattainable long-term? The answer is simple: the problem was self-inflicted. Public Act (P.A.) 88-0593, passed in FY1995, created a fifty-year plan for all five state retirement systems aimed at addressing the underfunding of the pension systems that existed at that time. By the end of FY1994, Illinois lawmakers had borrowed so much against the pension systems to fund services that the overall funded ratio of all five systems was just 54.5 percent, and there was a cumulative unfunded liability of \$17 billion.¹⁰ However, the funding plan under P.A. 88-0593 heavily back loaded repayment of the aggregate unfunded liability. Under the design of that repayment schedule, the retirement systems’ aggregate unfunded liability will actually continue to grow through FY2029.¹¹ Unfortunately, most pension reforms introduced to date ignore this reality and focus on reducing retirement benefits rather than solving the debt problem by restructuring the repayment plan.



House-Joint Resolution Constitutional Amendment (HJRCA) 49 is a key example of this misguided approach to dealing with the state's unfunded liability. This legislation would add Section 5.1 to Article XIII of the Illinois Constitution, which covers all public employee retirement systems (state and local) in Illinois. HJRCA 49 would create a constitutional requirement that any pension benefit increases would require three-fifths (3/5) approval by both houses of the General Assembly. This would make it far more difficult for the legislature to enhance retirement benefits for public workers in Illinois. HJRCA 49—itself a Constitutional amendment also requiring a 3/5 vote— passed the House by the required majority on April 18, 2012, and the Senate on May 3, 2012. That means HJRCA 49 will go to the public on November 2012 as a separate ballot initiative.

Advocates justify their support for HJRCA 49 by claiming the proposed amendment represents a positive step towards ensuring the fiscal health of Illinois' public retirement systems. However, this rationale is misguided for two key reasons. First and foremost, while the amendment may prevent future legislatures from passing benefit enhancements without the accompanying and necessary funding, HJRCA 49 does not reduce the state systems' current \$83 billion unfunded liability by even one cent. HJRCA 49 fails to address the real fiscal issue caused by the state's outsized pension debt—how to amortize the \$83 billion debt owed to the five state-sponsored retirement systems in a feasible way. Second, implementing a Constitutional amendment that hinders the ability of legislators to institute benefit increases would make it nearly impossible to rectify the problems associated with the reduced benefit tier that lawmakers created in 2010—Section IV details deficiencies of the second benefit tier.

III. WHAT WOULD HJRCA 49 DO?

Under HJRCA 49, anything that enhances pension benefits (with the exception of salary increases and appropriation bills) would require 3/5 approval by either the General Assembly or a local governing body. This proposed Constitutional change would apply to all levels of state and local governments. Determining which pension enhancements would require the new 3/5 approval hinges on three terms defined in HJRCA 49: “benefit increase,” “emolument increase,” and “beneficial determination.”

HJRCA 49 restricts lawmakers' ability to increase pension benefits, which currently can be done by a simple majority vote. The new requirement would mandate that 3/5 of both houses of the General Assembly would have to approve any piece of legislation that increased pension benefits for it to become law. HJRCA 49 specifies that benefit increases include “but [are] not limited to, any changes that (i) increase the amount of the pension or annuity that a member could receive upon retirement, or (ii) reduce or eliminate the eligibility requirements or other terms or conditions a member must meet to receive a pension or annuity upon retirement.” Any changes that expand the class of persons eligible to join a retirement system would also count as “benefit increases” under HJRCA 49. The legislation specifies, however, that on their own, salary increases do not constitute a benefit increase.

The amendment defines the terms “emolument increase” and “beneficial determination” in an attempt to clarify which pension increases will be restricted under the Constitution. Both terms require 3/5 approval by a retirement system's governing body, which can be the General Assembly or local government depending on the system. An emolument increase is defined in HJRCA 49 as “the creation of a new or enhancement of an existing advantage, profit or gain that an official or employee receives by virtue of holding office or employment, including, but not limited to, compensated time off, bonuses, incentives, or other forms of compensation.” A beneficial determination “means an interpretation or application of pension or other laws by the governing body, or an appointee or employee of the governing body, that reverses or suspends a previous interpretation or application and either (i) results in an increase in the amount of the pension or annuity received by a member of a pension or retirement systems or (ii) results in a person becoming eligible to receive a pension or annuity from the pension or retirement system.” This aspect of the amendment would restrict the ability of retirement systems' board of trustees to amend their respective systems' administrative rules. For example, a change to the definition of “salary” in all likelihood would trigger the aforementioned 3/5 rule. However, a beneficial determination under HJRCA 49 does not include “a beneficial determination mandated by a final decision of a court of



competent jurisdiction.” In other words, if a court decides to interpret a pension law differently and changes it, that would be constitutionally permissible.

Despite the definitions contained in HJRCA 49, ambiguity surrounding what will trigger the 3/5 rule nonetheless exists. For example, it is unclear whether stipends or incentives that would ultimately lead to a salary increase amount to benefit increases, thus necessitating 3/5 approval by both houses of the General Assembly. A specific example of this issue was discussed during a House Committee hearing on HJRCA 49. That hearing considered whether incentives for employees to obtain a higher education degree would constitute a benefit increase, since once an employee completed a graduate degree his or her salary would increase. When asked if that situation would trigger the 3/5 requirement, Speaker Madigan’s legal counsel responded that it would not be possible to know without seeing an employee’s actual contract or collective bargaining agreement. Such a response indicates the complexity and potential legal issues that would flow from HJRCA 49’s implementation. The uncertainty surrounding language used in HJRCA 49 is of extra concern because once passed, changing any aspect of it would require yet another Constitutional amendment.

Given that there are nearly 7,000 local governments in Illinois, the impact of the supermajority-voting requirement could be costly in both the amount of time that will have to spent on pension benefit analysis, and whether those supermajority-voting requisites applied to various changes made to the retirement plans for all units of government. Another related question that remains unanswered is which government entity will be charged with regulation of the amendment—an enormous task given the thousands of public employers and retirement systems affected by HJRCA 49.

Subsection (d) of HJRCA 49 specifies that any governing body—such as school districts, universities, or police stations--may freely impose restrictions on pension benefit increases that exceed the extent of those contained in HJRCA 49. The State Universities Annuitants Association, summed up why this part of HJRCA 49 is especially worrisome, “[it] would grant unprecedented powers to government that will undermine protections contained in the Pension Protection Clause and eliminate the uniform laws that now exist for State employee benefits and obligations in the Illinois Pension Code.”¹²

IV. HJRCA 49 & RECTIFYING TIER-II

Public Acts 96-0889 and 96-1495 passed in 2010, created a reduced benefit tier, commonly known as Tier-II, for all public retirement systems in Illinois. All public employees in Illinois hired on or after January 1, 2011, are automatically in Tier-II.¹³ Key benefit reductions implemented under Tier-II include: increasing the age at which a person is eligible to retire with full benefits; reducing retirees’ cost-of-living adjustment (COLA); creating maximum benefit limitations; and increasing the time period used to determine the final average salary. The total value of the Tier-II benefit for a downstate teacher is, for example, approximately one-third the total value of the Tier-I benefit.¹⁴

Of all the pension cuts implemented under Tier-II, the changes to the COLA are the most troubling from a public policy standpoint. The Tier-II COLA is simple. With a simple COLA, the original pension benefit is increased by a statutorily set percentage.¹⁵ In contrast, a compounded COLA, which is what a Tier-I retiree receives, is one in which the adjustment is made on the previous year’s pension benefit. Figure 2 provides an example of the difference between a compounded and simple COLA. Since a simple COLA is an adjustment on the base pension, a person’s pension benefit does not keep pace with inflation.

FIGURE 2
Compounded vs. Simple Cost-of-Living Adjustment

Years Fully Retired	3% Compounded COLA	3% Simple COLA
0	\$100.00	\$100.00
5	\$115.93	\$115.00
10	\$134.39	\$130.00
15	\$155.80	\$145.00



A more significant impact though is the percentage by which Tier-II retirees' pensions are adjusted. In addition to being simple, the Tier-II COLA is the *lesser* of 3 percent or one-half of the previous year's Consumer Price Index (CPI-U). Unless yearly inflation is above 6 percent, a rare occurrence,¹⁶ the Tier-II COLA will be capped at one-half of CPI-U. From 1913-2011, the average CPI-U increase was 3.3 percent, and for the past twenty years it has been 2.5 percent.¹⁷ In other words, a Tier-II retiree's COLA will likely be less than 2 percent. After adjusting for inflation, the Tier-II benefit will decrease in real value from year to year, resulting in diminished purchasing power and a lowered standard of living for retirees. Approval of HJRCA 49 will make it extremely difficult, if not impossible, to rectify this inadequacy of the Tier-II benefit.

V. CONCLUSION

Ensuring the stability of Illinois' public retirement systems is certainly a laudable goal. That said, the means of ensuring stability should be designed to both redress the true causes of the fiscal problem and constitute sound public policy. HJRCA 49 fails on both counts. Since HJRCA 49 only deals with restricting the ability to institute benefit increases, the legislation does nothing to guarantee that public pension systems are adequately funded, thereby entirely missing the core problem that created the state systems' aggregate unfunded liability. It would also interfere with the legislature's ability to remedy the flaws with Tier II, making it poor public policy. Adequate funding of the state retirement systems is a pressing issue in Illinois. Rather than passing symbolic Constitutional amendments that fail to address the actual cause of the retirement systems' underfunding, lawmakers should concentrate their efforts on redesigning the currently back loaded and unattainable repayment schedule for the debt owed to the five state-sponsored retirement systems.

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ENDNOTES

¹ The Commission on Government Forecasting and Accountability (COGFA), *Report on the Financial Condition of the State Retirement Systems: Financial Condition as of June 30, 2011* (Springfield, IL: COGFA, March 2012), 24.

² A structural deficit means that the appropriations needed to maintain current levels of service do not keep pace the state's projected revenue—adjusting solely for inflation and population.

³ The Commission on Government Forecasting and Accountability (COGFA), *Report on the Financial Condition of the State Retirement Systems: Financial Condition as of June 30, 2011* (Springfield, IL: COGFA, March 2012).

⁴ Figure is based upon using the actuarial valuation of assets, which smoothes investment losses/gains over five years.

⁵ Office of Management and Budget: Executive Office of the Governor (GOMB), *Illinois State Budget: Fiscal Year 2013* (Springfield, IL: GOMB, February 2012), 2-18.

⁶ Center for Tax and Budget Accountability (CTBA), *Analysis of Proposed Illinois FY2013 General Fund Budgets* (Chicago: CTBA, April 2012), 32.

⁷ Ibid.

⁸ Calculation done by CTBA based on pension contribution figures contained in GOMB, *Illinois State Budget: Fiscal Year 2013* (Springfield, IL: GOMB, February 2012).

⁹ Calculation done by CTBA based on pension contribution figures contained in GOMB, *Illinois State Budget: Fiscal Year 2013* (Springfield, IL: GOMB, February 2012) and employer normal cost contributions contained in COGFA, *Report on the Financial Condition of the State Retirement Systems: Financial Condition as of June 30, 2011* (Springfield, IL: COGFA, March 2012).

¹⁰ Illinois Economic and Fiscal Commission, *Fiscal Year 1996 Pension Funding Requirements* (Springfield, IL: Illinois Economic and Fiscal Commission, March 1995), 3-5.

¹¹ COGFA, *Report on the Financial Condition of the State Retirement Systems: Financial Condition as of June 30, 2011* (Springfield, IL: COGFA, March 2012), 95.

¹² This is the opinion held by the State Universities Annuitants Association, and other credible sources disagree on this legal interpretation.

¹³ Tier-II applies only to individuals who are in a defined benefit program.

¹⁴ Information provided to CTBA by the Teachers' Retirement System.

¹⁵ It should be noted that for Tier-II members of the General Assembly's Retirement System and Judges' Retirement System the COLA is compounded.

¹⁶ Out of the past 98 years, there have only been 19 years in which inflation was at least 6 percent. Source: U.S. Department of Labor: Bureau of Labor Statistics, *Consumer Price Index* (Washington, DC: 2012).

¹⁷ U.S. Department of Labor: Bureau of Labor Statistics, *Consumer Price Index* (Washington, DC: 2012); calculation done by CTBA.