Illinois Retirement Security Initiative

IRSI

A Project of the Center for Tax and Budget Accountability

Illinois lawmakers finally approved a new state budget last month which appeared to fully fund pensions. However, don't be fooled, the pension problem has in no way been solved. While our legislators should be applauded for paying into the system this year, funding the system for 2008 by no way means Illinois has paid off its $40.7 billion unfunded pension liability. It only means that the current budget includes all of the money required under an installment plan that is supposed to result in the pension systems being 90 percent funded by 2045.

This installment plan is commonly referred to as the pension ramp. Instituted in 1994, the ramp was intended to address years of the state not making their contribution to the pension system and the resulting billion dollar unfunded pension liability, by forcing increased allocations to the pension over time. The reform established a 15 year ramp period, during which the newly mandated contributions Illinois had to make for current and past employees increased in gradual increments. Since these make up payments increased annually, they became knows as the 'pension ramp', that is they 'ramp up' over time.

However, locating the necessary millions in the state budget that are required each year under the pension ramp puts an immense strain on the rest of the budget. If lawmakers stick to the payment schedule they will have to find an additional $721 million for pension when they work on a new state budget next spring. The year after that, the increase for pensions is expected to be $759 million. State pension obligations have the potential to swallow almost all of the natural revenue growth the state can expect and will hamper any effort to do anything beyond paying the pensions.

The truth is, the idea of fully funding the pensions is an illusion. The budget is balanced and pensions fully funded this year- only because the state underfunds other costs. Typically, pensions have been underfunded in order to fund those other costs.

Sadly, Illinois suffers from a structural deficit. Unfortunately, Illinois poorly designed tax system does not grow with the economy, and hence generates less revenue than needed to maintain current public service levels and make the required pension payments from year to year. In fact, the source of Illinois $40.7 billion unfunded pension liability stems from decades of Illinois having to borrow against the pension contribution it owes, simply to maintain public services.

The fact of the matter is that before Illinois can actually 'fully fund' the pension system, they must modernize the state's tax system to comport with today's economy. Only then will funds no longer need to be borrowed against others costs to create the illusion of fully funded systems and a balanced budget.

Illinois must then, eliminate the current pension ramp, which irresponsibly backloads costs and effectively defers the problem to future generations and constrains the states ongoing ability to fund services. Illinois should adopt a flat annual payment amortizing the unfunded liability in equal, annual installments over a period of 40 to 45 years. This will make the obligations far less constrictive of state finances, as the real value of the flat annual payment will decrease over time.

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