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Three Problems With Gov. Rauner's FY2019 Pension And Retirement Proposals

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This week, Gov. Bruce Rauner gave his fiscal year (**FY**) 2019 budget address, revealing his revenue and expenditure proposals for the upcoming year. The governor's proposal relies on $1.5 billion in cost reductions to balance the budget, including:

- A shift of 25 percent of the "normal cost" of pension benefits from the state to local governments for employees covered by the Teachers' Retirement System and State University Retirement System ($363 million), as well as a shift of 100 percent of the normal cost to the Chicago Teachers' Pension Fund ($228 million); and
- The elimination of healthcare support for retired teachers ($129 million).

In addition, Gov. Rauner suggested he would like the state legislature to implement a "consideration model" to reduce pension costs, a longstanding proposal that would allow state workers to trade off lower pension benefits for some other benefit. The governor's budget suggests such a move would save $900 in FY2019, though that is not part of his plan to balance the budget. Rather, it would allow the state to reduce the individual income tax from 4.95 percent to 4.7 percent.

Each of these proposals pose serious problems, however. This brief highlights three of them.

1. ILLINOIS TAXPAYERS ARE ON THE HOOK FOR "NORMAL COSTS" WHETHER THEY ARE PAID BY STATE OR LOCAL TAXES

More than a third of the governor's $1.5 billion in cost savings result from shifting some pension costs to local governments. Specifically, 25 percent of the pension "normal cost"—the amount needed to pay for new benefits earned by current workers each year—for the downstate Teachers Retirement System would be shifted from the state to local school districts. Likewise, 25 percent of the normal cost for the State Universities Retirement system would be shifted from the state to public colleges and universities. Meanwhile, residents of Chicago would be hit hardest by the governor's pension cost shifts, as he proposes that Chicago Public Schools pay 100 percent of the normal cost for the Chicago Teachers Pension Fund.

But while this would make the state's balance sheet look better, these costs would still be paid by Illinois governments—and, therefore, by Illinois taxpayers.

In fact, by pushing additional costs onto local governments, the governor's budget may force local school districts to raise property taxes to cover the difference. For Illinois taxpayers, the governor's savings are no savings at all.

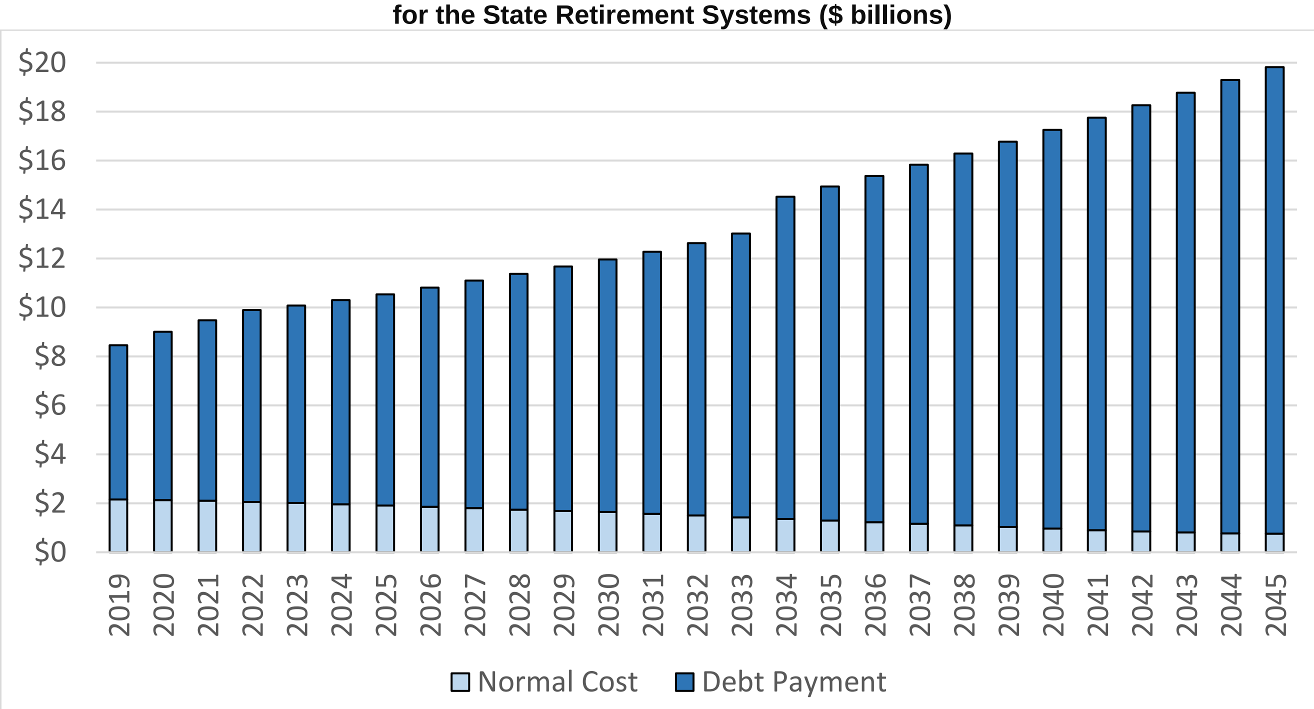
2. SHIFTING NORMAL COST DOESN'T ADDRESS THE LONG-TERM PENSION FUNDING PROBLEM BECAUSE MOST PENSION COSTS ARE DEBT

After shifting 25 percent of pension normal costs to school districts and public college and universities in FY2019, the governor's proposed budget would shift an additional 25 percent in each of the following three years, eventually making the locals pay the full normal costs by FY2022. According to the governor, this is intended to help "rein in" long-term pension costs.

But in fact, this cost shift does not resolve the state's daunting long-term pension funding problem. The reason for this is simple: the costs of new benefits are not the driver of the pension funding shortfall. Instead, Illinois' pension crisis is driven by debt owed on benefits that have already been earned. This debt has been accumulated over decades thanks primarily to deliberate underfunding by the state of Illinois, a practice that has continued to this day. (You can read more background on this in our recent report, "Pension Changes in the FY2018 Budget: Short-Term Savings and Long-Term Costs.")

As Figure 1 shows, the state's normal cost is only about a quarter of total pension costs. More importantly, it is actually projected to decline over time, while debt costs skyrocket. Those debt costs remain unchanged in the governor's plan.

Figure 1: Projected Pension Normal Cost and Debt Payments for the State Retirement Systems ($ billions)



Source: Actuarial Valuation Reports for TRS, SERS, SURS, JRS, and GARS.

3. CUTTING RETIRED TEACHERS' HEALTHCARE BENEFITS IS UNCONSTITUTIONAL

$129 million of the governor's proposed savings would come from cutting healthcare support for retired teachers. But in 2014, the Illinois Supreme Court ruled in *Kanerva v. Weems* that retiree health benefits were covered by the same clause of the Illinois constitution that prevents earned pension benefits from being "diminished or impaired."[1] These savings are almost certainly illusory.

And while the governor's revival of a "consideration" model to reduce already-earned benefit costs is not necessary to balance the budget, it suggests that the governor is moving the state back to a years-long debate over an approach that the Illinois Supreme Court has repeatedly ruled unconstitutional. Each year that debate goes on is a year in which the state's pension debt and the costs of that debt increase. It is irresponsible, and will not move Illinois towards fiscal sustainability.

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ENDNOTES

[1] "Illinois Supreme Court Rules Some Retiree Insurance Benefits Are Protected by Illinois Constitution." Clark Baird Smith LLP, July 7, 2014.