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Labor Watch

Crisis in Illinois (and Across the U.S.)

Government worker pensions pose a threat to America's future

By Gretchen and Tom Randall

Summary: *Illinois, long famous for scandalous government and powerful unions, leads the country in calamitous sweetheart pension deals, made by politicians and the labor bosses who support them. But the state's near-$100 billion pension shortfall is just the tip of America's trillion-dollar-plus pension iceberg. Every American—and our children and their children—are on the hook for these corrupt bargains.*

While Illinois legislators grappled with the pension crisis, public employees protested the governor's proposed reforms.

When it comes to the crisis in state employee pensions, Illinois is the canary in the coal mine. It's a powerful indicator of the fate that is rapidly approaching that state and that may await the rest of the country.

Illinois, the nation's fifth most populous state and the home of President Obama, has the biggest unfunded liability of any state pension system in the country. Some 24 years ago, the shortfall was only $8.6 billion; 19 years ago, it was $17 billion. Now it's $97 billion, growing by $17 million a day and consuming 22 percent of the state's budget. That works out to an invisible burden of roughly $30,000 on a typical family of four in the state.

Nationally, state and local pensions face a shortfall estimated at $1 trillion—or perhaps $3 trillion or more, depending on the future strength of the economy. (Pension funds are invested, which means that the slower the economy grows, the more money must be put into the funds now to pay for future benefits. Thus, taxes and regulations that slow down the economy now will make the nation's pension problems far worse in future years.)

At the local level, "Unpaid bills from decades of retirement promises made to public workers, combined with a lackluster economy and steep Wall Street losses, have built up a financial mountain that threatens to overwhelm budgets and operations in cities and counties across the country," wrote David Klepper of the Associated Press. "While it hasn't gotten the attention of the 'fiscal cliff' in Washington, the pension crisis at City Hall could have similar effects as mayors are forced to raise taxes, cut government services or renege on retirement promises made to police officers, firefighters, teachers and other public workers."

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The *Las Vegas Review-Journal* in a recent editorial noted: "Credit rating agencies report that states and local governments nationwide have more than $2 trillion in unfunded pension liabilities. In Nevada, depending on how you measure risk, that figure is between $10 billion and $40 billion. Elected officials everywhere, at every level, have promised far more in employee retirement benefits than taxpayers can afford. And those funds—and their unionized beneficiaries—want these promises kept at all cost.

"If bankruptcy courts eventually determine that pension benefits can never be reduced, no matter the hardships to the public, investors will be unwilling to risk putting capital into government bonds. And the voting, taxpaying public, who can barely save for their own retirements, will have a hard time accepting the idea that their governments have to close every school and lay off every cop to continue paying lavish benefits to people who aren't working."

A history of problems

In Illinois, the pension shortfall problem has reached such proportions that much of the state's political establishment—dominated by liberal, Chicago-based Democrats—accepts the need to take action. In the words of the *State Journal-Register* (Springfield), Gov. Pat Quinn "considers himself a progressive Democrat who believes strongly in the labor movement," and union support was critical to his election as governor. The Service Employees International Union (SEIU) contributed $3.2 million to his campaign. He received $575,000 from the American Federation of State, County and Municipal Employees (AFSCME), $458,000 from the Illinois Federation of Teachers, and $256,000 from the Laborers International Union. More importantly, he was the beneficiary of "voter education" and get-out-the-vote campaigns that come with union endorsements.

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Yet Quinn has found himself in the position of adversary to the state's public-sector unions. In the recent legislative session, he joined with House Speaker Michael Madigan (who has held the speakership for all but two of the past 30 years) to propose a reform plan under which public employees would pay more and get less in benefits. The plan passed the House, but was killed in the state Senate by a vote of 42 to 16. A bare majority of Senate Republicans, 10 of 19, supported the measure. Only six of 40 Democrats voted in favor.

The Friday after Memorial Day, Illinois legislators packed up and went home. Following the defeat of reform efforts, the state's general obligation credit rating was lowered by Fitch Ratings and Moody's. (Standard & Poor's had lowered the rating in January.) As this issue of *Labor Watch* was being prepared, the governor called a special session of the legislature to try one more time to deal with the crisis.

Much of the state's problem stems from the way public sector pensions were made into virtual entitlements over 40 years ago; worse, other problems with pensions go back more than a century. In 1902, the Chicago teachers' pension fund was nearly bankrupt, so they cut payouts by half. In 1919, a commission determined that most public employee pension funds were either insolvent or headed in that direction. In 1949, Chicago and Cook County workers were warned that their pension plans were running out of money.

By 1970, politicians throughout the state seemed to realize they had a problem with pensions. Of course, they saw the problem not from the perspective of taxpayers, but from the perspective of big-spending politicians. They saw inadequate pension funding as a threat to their ability to spend more and more on government programs, and to bestow more benefits on unions and even on themselves.

The Illinois Constitution was being rewritten at the time, so the solution, in legislators' minds, was to enshrine a constitutional guarantee that pensions would always be paid, even if there were no money to do so. Thus, Article VIII, Section 5 of the Illinois Constitution was made to read:

> Membership in any pension or retirement system of the State, any unit of local government or school district or an agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefit of which shall not be diminished or impaired.

With that brief statement, pensions in Illinois became much like a federal entitlement program. As with Social Security, Medicare, Medicaid, and food stamps, pensions would be paid out whether the money was there or not. With pensions assuming entitlement status, state legislators felt free to continue spending wildly, adding programs and benefits, just like their counterparts in Washington.

Taking care of number one

In 1989, a bipartisan majority of the Illinois General Assembly worked

together to dramatically enrich their personal retirement entitlements while adding to the state's unfunded pension obligations. At the time, legislators' pensions maxed out after 20 years of service at 85 percent of their final year's pay. This was changed to increase legislators' pensions by 3 percent for each year they served beyond 20 years. Plus, they granted themselves the same automatic "cost of living" adjustments that state employees had, 3 percent a year compounded annually.

Under the first three percent provision, a pension worth a generous $80,000 per year after 20 years of service would have grown to $104,000 after 30 years of service. After just 10 years of retirement, the compounding 3 percent COLA would push that same pension to $140,000 per year.

Some of the biggest names in Illinois politics are the beneficiaries of these provisions. Richard M. Daley (D), the longest-serving mayor of Chicago at 22 years in office, receives a pension from the city of more than $66,000 per year. His pension for serving just eight years in the Illinois Senate nets him an additional amount of almost $118, 000.

Current House Speaker Michael Madigan (D) and Senate President John Cullerton (D) are quick to point out that some of those pension perks for legislators have been ended. But that's true only with regard to later entrants into the system. The constitutional amendment preventing pensions from being "diminished or impaired" means the perks still apply to those already in the systems (pending court challenges). As a result, the 1989 law that Madigan and Cullerton advanced and voted for, had, by 2012, pushed Madigan's prospective annual pension to $131,000 and Cullerton's to $112,000—substantially more than either now earns.

They are not alone. As of 2012, more than a third of all retirees in the General Assembly Retirement System pension fund made more than they did when they were working. Ten percent were receiving more than $100,000 per year. The leading pensioner is former Gov. "Big Jim" Thompson (R), Illinois' longest–serving governor at 24 years in office. He has received over $2 million dollars since retiring, aged 55.

On the other hand, the last two governors before Quinn, George Ryan (R) and Rod Blagojevich (D), won't be getting their pensions. They lost them after felony convictions. Counting Ryan and Blagojevich, four of the past seven governors in Illinois have gone to prison.

By the way, Blagojevich's predecessor in Illinois' 5th district seat in Congress (not counting a Republican who served a single term) was Dan Rostenkowski, who also went to jail. Blagojevich's successor in the 5th district seat was Rahm Emanuel, who was later President Obama's chief of staff and is now mayor of Chicago.

Unfunded liabilities reach $3 million for typical family

Everyone knows that politicians like to buy votes and political support with taxpayers' money. But one of the most pernicious forms of vote-buying is often invisible to the public. It occurs when politicians make promises of future benefits without setting aside the money to pay for these benefits. In effect, they are buying votes today with the wealth of future generations.

These unfunded liabilities aren't included in standard calculations of the national debt, even though these levels of off-the-books debt are so high that the young people of today and their children and grandchildren will be impoverished. They will face ultra-high levels of taxation, and they will be denied government benefits for which they have paid (with tax "contributions") and on which they plan to rely when they get old or sick. Today, the unfunded liabilities of federal, state, and local governments total an astonishing *$3 million for each family of four* in the United States—and with each new government program and each new promise by politicians, that number goes higher.

Those riots in Greece, Cyprus, and Spain over "austerity"? Riots like those are in America's future, unless there is a dramatic change of course. The recognition of this danger led to the rise of the Tea Party movement. When the movement coalesced in 2009, members of the movement seemed to have little in common. They included people of all backgrounds, all ethnicities, and all income levels, from all parts of the country. The only thing they had in common was that they understood the deep danger the nation faces from this debt and from other aspects of Big Government.

A key reason the Left had to ridicule the Tea Party as racists and extremists, and to target them for "special treatment" by government agencies ranging from the IRS to the Department of Homeland Security, is that the Tea Partiers—unlike, say, environmentalists or Occupy Wall Street supporters—are diverse and mainstream. As radio host Chris Plante has noted, the Tea Party movement is, in essence, an association of people who can do math. – SJA

The SEC moves in

After Illinois made public pensions constitutional entitlements, the attitude in the state capitol and in the halls of local governments around the state, was this: "Since pensions must be paid whether funded or not, let's use the money for other spending." (This recalls a famous punchline from the *Doonesbury* comic strip: "But the pension fund was just *sitting* there!")

The most glaring example of this attitude was the state's 67 percent increase in the personal income tax and 46 percent increase in the corporate tax in 2011. The tax hikes were touted as measures to pay debt and fund pensions, and yet pensions still went unfunded.

Prior to the tax increase, Governor Blagojevich (D) pushed the state to issue government bonds to pay pension obligations. As usual, the state promised higher rates of return on the borrowed funds than were actually achieved, and only part of the borrowed money was used as promised for pension funds. Overall, the scheme added to Illinois' unfunded pension liability.

In March 2013, the Securities and Exchange Commission (SEC) took action against the state, charging it with securities fraud "for misleading municipal bond investors about the state's approach to funding its pension obligations." The SEC announced its investigation "revealed that Illinois failed to inform investors about the impact of problems with its pension funding schedule as the state offered and sold more than $2.2 billion worth of municipal bonds from 2005 to early 2009. Illinois failed to disclose that its statutory plan significantly underfunded the state's pension obligations and increased the risk to its overall financial condition. The state also misled investors about the effect of changes to its statutory plan. Illinois, which implemented a number of remedial actions and issued corrective disclosures beginning in 2009, agreed to settle the SEC's charges."

Only once before in history has the SEC ever charged a state with securities fraud in connection with government pensions: In 2010, New Jersey was charged "with misleading municipal bond investors about its underfunding of the state's two largest pension plans."

Five underfunded pension funds

Illinois' unfunded pension liabilities are divided among five major public pension funds, and the best funded of them is estimated to go broke by 2030. Here is where each stands, and some of their incongruous peculiarities:

►*The Teachers' Retirement System* covers about 360,000 public school teachers, excluding those of the Chicago Public Schools who have their own pension fund. As of June 30, 2012 the TRS, the largest of the five plans, was only 40.6 percent funded, with an unfunded actuarial accrued liability of more than $52 billion. At that level, the TRS itself issued a warning to its members saying the fund only has half the assets needed to pay retirees' benefits.

The highest annual teacher's pension ($269,531) is paid to a retired principal of an Illinois high school. The Better Government Association (BGA) claims this was due to the 20 percent raises he received three of the last four years before retirement. More than 3,500 retirees of the TRS receive an annual pension over $100,000.

►*The State University Retirement System* was created in 1941 and today serves 65 employers in Illinois, including state universities, community colleges, and some state agencies. A 2012 actuarial report found it is only 42.1 percent funded.

The largest pension payout goes to Tapas Das Gupta, a retired cancer surgeon and professor at the University of Illinois at Chicago, who receives an annual pension of more than $425,000. Four other retired doctors/medical professors receive approximately $339,000 to $415,000 from SURS. More than 2,100 retirees of SURS receive over $100,000 in annual pension benefits.

►*The State Employees Retirement System* is what could cynically be called a balanced Illinois fund— it has 62,732 members working and paying in, and 62,788 retirees and survivors receiving benefits, as of 2012. It is only 34.7 percent funded.

A key reason for the shortfall is that the state has made unrealistic projections for the rate of return on pension investments. For example, Illinois pension funds have had a targeted rate of return of between 7 percent and 8.5 percent a year, but over the past decade have averaged only 4.5 percent to 6 percent.

►*The Judges' Retirement System* covers judges and certain administrative officers in the court system. As of June 2012, 968 active judges were paying into the pension fund with 1056 retired judges or survivors receiving benefits. The plan is funded at 29.7 percent.

►*The General Assembly Retirement System* is the smallest of the five state pension funds and the least well-funded. It was set up for elected members of the General Assembly as well as the governor, lieutenant governor, secretary of state, treasurer, comptroller, and attorney general and their clerks. As of 2012, 414 retirees and survivors received pensions with only 184 active members contributing to the fund. The funding level: 18.5 percent. While the projected rate of return was 7 percent to 8 percent per year, the actual rate of return was 10 percent total *over three years*.

Opening the box

Solving Illinois' problem of skyrocketing unfunded pension liabilities would seem simple: increase funding and cut benefits. In fact, many have offered a variety of such solutions. But for Illinois politicians, it is not that simple.

They locked themselves in a box with the constitutional amendment of 1970 that made government pensions into entitlements. There may be a way out of the box, though. A top Illinois law firm has concluded that the amendment does allow for change going forward, as long as already-earned benefits are not reduced. Meanwhile, two University of Illinois law professors have come up with an idea for unlocking the box. One of the professors, Laurie Reynolds, told the *Chicago Tribune*, "If the state of Illinois can establish that there are no reasonable alternatives to reducing benefits that have been accrued—and that, for instance, tax increases and spending decreases just can't fill the hole—then I don't think the Illinois Supreme Court is going to issue an opinion that would in essence push the state of Illinois into default."

Ultimately, though, the box is held together by 43 years of promises politicians have made to public-sector employees and their unions. Unlocking it, or breaking it open, will require political courage of a type rarely seen. Illinois is likely to head down the path to insolvency, followed closely by other states with similar political cultures.

Why?

Why is it so easy for states and localities to fall into the trap of huge, unfunded liabilities for government employees' pensions? Because of the imbalance when officeholders negotiate with the unions that represent government employees. Unions hold the keys to victory or defeat for politicians—millions in campaign money, volunteers, voter lists, influence over the media, and so forth. As a result, unions often deal with politicians who are beholden to them, and a "negotiation" is less a contest between adversaries than a sweetheart arrangement that leaves taxpayers out of consideration.

Often, taxpayers have no idea what's happening to them. Consider Minnesota in 1989 (as recounted in *Forbes*). Government employees gave state legislators "a little pressure here, a little hint there" to obtain additional benefits worth a whopping $1 billion, and the general public hardly noticed. This transfer of wealth from taxpayers to union members was accomplished by changing the age when state employees can retire at full benefits (the new formula: age plus years-of-employment equals 90; so a 22-year-old joining the state workforce could retire after 34 years, at age 56). Officials hid the change's cost by adding 10 years to the 20-year period for amortizing the retirement system's unfunded liabilities, and also raising the expectation that the system's investments would earn 8.5 percent annual returns, up from the already high expectation of 8 percent.

Such deception has worked for years. In 1995, former Social Security Advisory Board chairman Sylvester Scheiber told the *Washington Monthly*, "the public is ignorant" about the vast sums which future taxpayers will have to pay to support government pensions. "And there's a reason for that: The people who've made these promises don't want the public to know."

Besides, politicians and unions can spread the cost of their special deals across decades. If the timeframe is long enough, the deals don't have to be accounted for in the short term, and neither politicians nor union negotiators are held responsible. When the bills come due, the negotiators on both sides will be gone—relaxing on a beach, perhaps—and the burden of paying for the pensions and benefits will be someone else's problem.

Jonathan Schwartz, former chief actuary for New York City's pension funds, noted how politicians play games with the funds. "The challenge of being a public-sector actuary," he told *Forbes*, "is that by definition actuaries are concerned with long-range implications, but, for the principals [bosses] you report to, the definition of 'long range' is the four-year election cycle."

As the AP noted recently, "Unions argue workers aren't to blame for poor investments or past failures to fund pension systems. Anthony Martin, a Chicago fire lieutenant and trustee of his public pension fund, said he has seen records going back to 1877 showing the retirement system was underfunded even then. 'You have a dysfunction in government that is hard to overcome. . . . Year after year they kicked the can down the road.'"

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Many thanks,
Terrence Scanlon
President

LaborNotes

Never underestimate the unions' ability to take advantage of tragedy. In the wake of the devastation caused by the storm **Sandy**, unions pushed through the **New Jersey** legislature a measure to expand the use of Project Labor Agreements, which require contractors to pay union-scale wages and benefits on large public work projects. Such agreements increase costs to taxpayers and slow down or eliminate projects that would help New Jersey recover from the storm. The bill to include highways, bridges, pumping stations, and water/sewage treatment plants under PLAs was backed by **State Senate President Steven Sweeney**, who's a paid organizer for the **ironworkers union**, and **State Senator Donald Norcross**, head of the **Southern New Jersey Labor Council**. Ultimately, **Gov. Chris Christie** vetoed the measure.

In the February ***Labor Watch***, we reported on "official time," under which employees perform union duties while on the public payroll. **Sen. Rand Paul** (R-Ky.) has introduced legislation to eliminate the practice entirely, while a less sweeping measure has been introduced in the House by **Rep. Phil Gingrey** (R-Ga.). At the **Department of Veterans Affairs**, at least 250 people work full-time for the union, according to **Nathan Mehrens** of **Americans for Limited Government**.

Colleen Kelly, the head of the **National Treasury Employees Union**, which represents most **Internal Revenue Service** employees, has called the **Tea Party movement** "extreme." She met with the **President** at the **White House** the day before the agency started its "special" treatment of Tea Party and allied groups.

During a three-year period in which his agency was targeting conservative and Tea Party groups, **Doug Shulman**, then the **IRS commissioner**, was cleared for White House visits 157 times, by far the most of any agency or department chief. (His predecessor says that, during his tenure, he visited the White House just once.) Interestingly, Shulman's wife, **Susan L. Anderson**, is the senior program advisor for the organization **Public Campaign**, which seeks to restrict **First Amendment** rights through so-called "campaign finance reform." Public Campaign is able to accept tax-deductible contributions as a 501(c)(3) organization—a status for which few Tea Party-related groups bother to apply. According to the ***Daily Caller***, Public Campaign receives "major funding" from a pro-Obamacare group that includes the **AFL-CIO**; the **American Federation of State, County and Municipal Employees**; the **Service Employees International Union**; the **American Federation of Teachers** (AFT); the **Communications Workers of America** (CWA); the **United Food and Commercial Workers** (UFCW); and other unions and left-wing groups.

Once upon a time, labor unions focused primarily on issues of special concern to their members. Today, they are usually just cogs in the Left's political machine. Case in point: In May, when the **National Gay and Lesbian Task Force** held a celebration of its same-sex marriage victories, sponsors included the AFT, the CWA, and the UFCW, along with the parent company of **NBC**. Who knew same-sex marriage was high on the agenda for the chicken processors, grocery employees, and other workers in the UFCW?

Still, some cracks may be showing in the union/Left united front, as Obamacare threatens union members' healthcare coverage. The head of the **United Union of Roofers, Waterproofers and Allied Workers** has called for the "repeal or complete reform" of Obamacare. And in an op-ed for the **Washington** newspaper ***The Hill***, the president of the UFCW noted that the President's 2009 promise to union members that they could keep their insurance "is simply not true for millions of workers." (Yes, the UFCW is still listed as a member of that pro-Obamacare coalition mentioned above. Such are the ways of Washington.)

Hector Lopez, former president of the **Metal Polishers Local 8A-28A** in **Queens, New York**, pleaded guilty to tax evasion and conspiracy to commit mail fraud and wire fraud, and agreed to make restitution of more than $1.1 million in connection with his fleecing of the union benefit plan. **Cora Carper**, a former clerical employee of the **Heat and Frost Insulators** union in **Lanham, Maryland**, pleaded guilty in connection with the embezzlement of more than half a million from a union Political Action Committee. **Grace Rathke**, a former office manager, was sentenced to 17 months in prison and three years probation and ordered to make more than $200,000 in restitution after she embezzled funds from the **Laborers International Union Local 32** in **Rockford, Illinois**. (Source: the **National Legal and Policy Center**'s ***Union Corruption Update***.)