THE FISCAL FUTURES PROJECT
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FISCAL PROJECTIONS

Illinois Still Has Serious Fiscal Problems After December 2013 Pension Law Changes

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Illinois has a chronic, structural fiscal problem so huge that it cannot be eliminated by increases in economic growth alone, increases in taxes alone, or—alas—aggressive pension changes alone.[1] In early December 2013 the General Assembly passed, and Governor Quinn quickly signed, a major pension reduction bill. In this brief, we project Illinois' budget gap with estimates of the fiscal impact of the new pension law. The state still has a large structural imbalance after the pension changes.

THE FISCAL FUTURES MODEL

In measuring the fiscal condition of the state, we:[2]

- Use a broad-based budget measure (700+ special funds in addition to the state's General Funds) to provide consistency and eliminate confusion from fund accounting changes;
- Use a long-term perspective that projects budget trends a number of years into the future;
- Focus on sustainable revenue that ignores new borrowing or decreases in fund account balances when calculating the Budget Gap = Total Revenue – Total Spending.

DECEMBER 2013 PENSION CHANGES

The General Assembly passed SB 1 in special session on December 3, 2013. Two days later the governor signed the bill, making significant changes in four of the state's five public employee pension systems.

The intent of the new law is to reduce the state's fiscal burden of paying for future pension obligations. The savings to the state come mostly from reductions in cost of living adjustments for current and future recipients of state pensions.[3]

QUALIFICATIONS

In evaluating the fiscal impact, we assume there are no successful challenges to the new pension law and that there is no delay in implementation of the changes. This assumption may prove not to hold given that the Illinois Constitution states that pension benefits "shall not be diminished or impaired" and that employee unions have already begun to file challenges.[4]

BUDGET GAP PROJECTIONS

Figure 1 (see page 2) shows the difference between the all-funds structural budget gap projections from the Fiscal Futures Model before and after the pension law changes.

- The baseline case of pre-December 2013 pension law is indicated by the solid line. The budget gap is projected to get worse over the next ten years—from -$1 billion in FY 2014 to -$14 billion in FY 2025.

- The dotted line estimates reductions in state spending from actuarial estimates of the new pension law.[5] Note the modest impact of the changes: a reduction in the projected budget gap by $1.0 billion to $1.5 billion in each of the next ten years.

- The pension revision law of December 2013 was a huge step in the direction of fiscal stability for Illinois. Unfortunately, the state's fiscal problems are so great that much still remains to be done. A look at the structural budget gap illustrated in Figure 1 suggests that a gap on the order of $4 billion in 2015, increasing to $12 billion in 2025 still remains. What would it take to close the remaining gap?

Figure 1: Illinois All-Funds Structural Budget Gap Projections to FY 2025 With and Without December 2013 Pension Reforms, Cash Gap with Reduction of Tax Rates per Existing Law

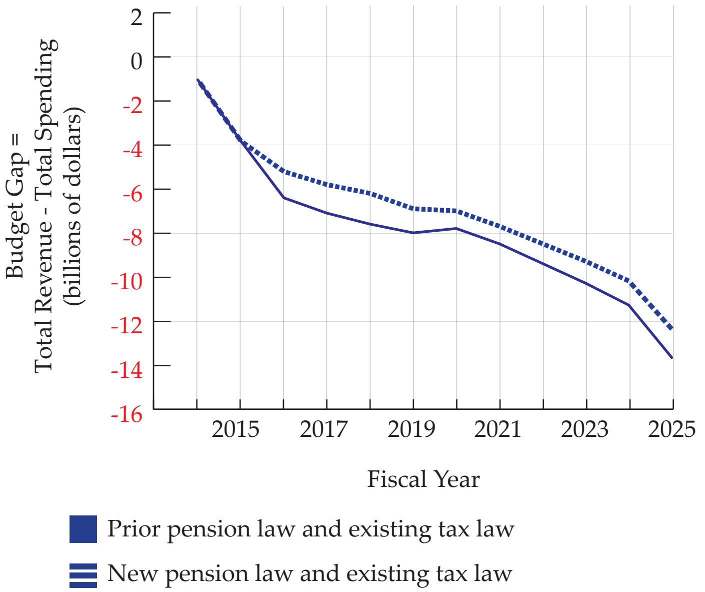
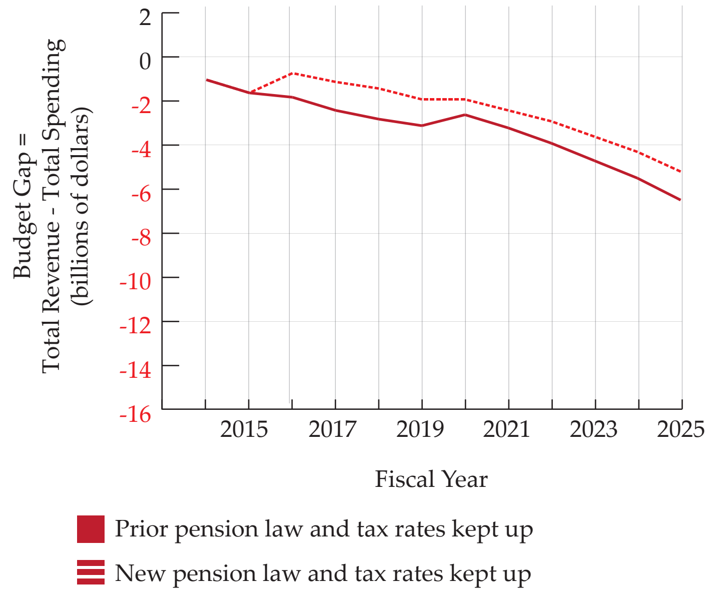


Figure 2: Illinois All-Funds Structural Budget Gap Projections to FY 2025 With and Without December 2013 Pension Reforms, Cash Gap with Tax Rates Kept Up After 2014



HOW ABOUT HIGHER TAXES?

All of the projections in Figure 1 assume current tax law, with temporarily higher tax rates in 2014 declining as scheduled starting in 2015.

One policy option is to eliminate the phase-out and make the higher income tax rates permanent. Figure 2 shows the effects of maintaining higher tax rates before and after pension law revisions.

• The solid line shows the projected gap with higher tax rates and pre-December 2013 pension law. Maintaining higher taxes eliminates roughly half the budget gap compared to the previous figure—reaching only $7 billion in FY 2025.

• The dotted line in Figure 2 shows the extra reduction of $1-plus billion of pension cost savings on top of the tax increase.

• The combined effect of pension law revision and tax increases still leaves a budget gap of $1 billion in FY 2014, which is projected to grow to $5 billion by 2025.

PROBLEMS REMAIN

Illinois has two huge fiscal problems: a large and growing gap between sustainable revenues and projected spending levels; and a largest-in-the-nation unfunded pension liability.

• The December 2013 changes to Illinois pension law (should they survive a constitutional challenge) eliminate the unfunded pension liability problem over the next 25 to 30 years.

• Unfortunately, the pension law changes do not come close to solving the structural budget gap problem. Savings of just over $1 billion per year barely dent a projected gap of $4 billion to $14 billion over the next ten years.

• Even if combined with higher tax rates, pension revisions leave a large projected budget gap.

In the attached appendix, we address the same questions with an alternative measure of the budget gap—the cash gap minus the change in unfunded pension liabilities each year. The pre-pension revision situation looks worse by this measure and the post-pension revision situation looks better. The fundamental take-home message: pension revision does not solve Illinois' fiscal problems.

NOTES

[1] Dye, Hudspeth and Merriman, October 2013, “Peering Over Illinois’ Fiscal Cliff: New Projections from IGPA’s Fiscal Futures Model,” (http://igpa.uillinois.edu/system/files/Fiscal-Futures-Projections-Oct-2013.pdf). Also see the one-page summary of that report (http://igpa.uillinois.edu/system/files/Fiscal-Cliff-Fact-Sheet.pdf).

[2] These are explained in more detail in the paper cited in note 1 and other reports on our webpage: http://igpa.uillinois.edu/fiscalfutures.

[3] State Employees’ Retirement System of Illinois (SERS), “Senate Bill 1 Public Act 98-0599, Effective June 1, 2014 (https://www.srs.illinois.gov/sers/WNpension_FY14.htm).

[4] U of I law professors discuss Constitutional questions: http://www.news-gazette.com/opinion/guest-commentary/2013-12-08/illinois-pension-reform-constitutional.html ; Employee unions prepare lawsuit: http://www.sj-r.com/article/20131204/NEWS/131209783; Rick Pearson, “Retired teachers file first lawsuit against Illinois pension reform law,” December 28, 2013, http://articles.chicagotribune.com/2013-12-28/news/chi-retired-teachers-file-first-lawsuit-against-illinois-pension-reform-law-20131227_1_employee-pension-system-illinois-pension-code-teacher-retirement-system.

[5] SERS: Gabriel Roeder Smith & Company, December 19, 2013, “Illinois SERS – Public Act 98-0599, Baseline 7/1/2013,” (SERS_PA980599_Contribution_UAL_Summary_Values_12192013.xlsx).

SURS: Gabriel Roeder Smith & Company, December 20, 2013, “Illinois SURS, Senate Bill1/Public Act 98-0599 Analysis with Normal Cost Plus Level Percent of Pay Amortization of Unfunded Liability, Baseline 7/1/2013 (excludes SMP and debt service contributions, includes supplemental payments),” (SURS_SenateBill1_Study_Summary_20131220_SendValues.xlsx).

TRS: Buck Consultants, January 17, 2014, “Teachers’ Retirement System of the State of Illinois, Public Act 98-0599 (Senate Bill 1), Comparison of Contributions and Actuarial Accrued Liability,” (2014.01.17 Final Analysis 98-059(SB1) 1-17-2014.xlsx).

GARS and JRS: Commission on Governmental Forecasting and Accountability, November 2013, “Special Pension Briefing: State Retirement Systems Overview,” (http://cgfa.ilga.gov/Upload/1113%20SPECIAL%20PENSION%20BRIEFING.pdf). JRS is not affected by the new law. No actuarial estimates of the impact of the new law on GARS were given, and revision was assumed to have no effect on projected amounts from the above report.

APPENDIX

Adjusting the Budget Gap to Account for Changes in Unfunded Pension Liabilities

The Cash Budget Gap is Total Revenue – Total Spending (with new borrowing and reductions in preexisting account balances not counted as revenue, because they are not sustainable). For decades, Illinois allowed unfunded pension liability to grow each year—a form of off-the-books borrowing that is a major explanation of the state's fiscal crisis. Worse, under the payment schedule in pre-December 2013 pension law, unfunded pension liability is projected to continue to grow by several billions of dollars for each of the next ten years.

An alternative (and arguably more meaningful) measure of the budget gap adjusts for this:

Adjusted Budget Gap =
Total Revenue – Total Spending
– Change in Unfunded Liability.

Figures A1 and A2 repeat Figures 1 and 2, but with the adjusted gap measure, and Table A1 presents the numerical values of projected budget gaps in all four figures.

• The solid line in Figure A1 shows the pre-revision adjusted budget gap projected for the next ten years. Adjustment for the roughly $2 billion per year of new unfunded liability (compare columns 1 and 5 in Table A1 on page 5), projects a gap that grows to $15 billion in 2025.

• The dotted line in Figure A1 shows the adjusted budget gap with the pension revisions.
  - □ The new law offers a large, one-time reduction in unfunded liabilities in the year of enactment, which explains the off-the-chart budget surplus of $19.8 billion in 2014.
  - □ Projected increases in unfunded liabilities make the gap larger in 2016 to 2019.
  - □ After the new law has been in place for a while, unfunded liabilities again decrease and the gap is slightly smaller from 2020 to 2025.

• The solid line in Figure A2 shows the pre-revision adjusted budget gap assuming that tax rates remain at higher levels instead of falling after 2014.

•The dotted line in Figure A2 is the most optimistic of all scenarios—pension revision, higher taxes, and counting reductions in unfunded liabilities in later years. Even in this case, a structural deficit growing to over $3 billion is projected.

More than pension revision and higher taxes are needed to close Illinois' structural budget gap.

Figure A1: Illinois All-Funds Structural Budget Gap Projections to FY 2025 With and Without December 2013 Pension Reforms, Adjusted Gap with Reduction of Tax Rates per Existing Law

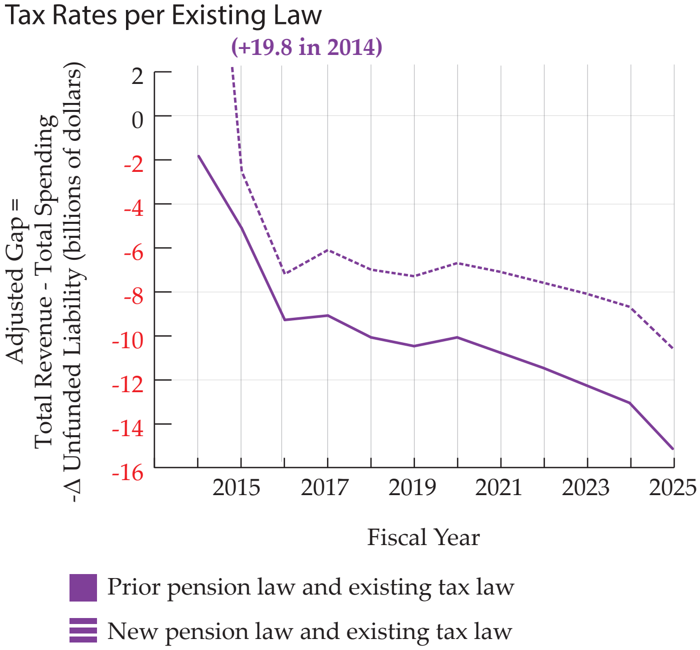


Figure A2: Illinois All-Funds Structural Budget Gap Projections to FY 2025 With and Without December 2013 Pension Reforms, Adjusted Gap with Tax Rates Kept Up After 2014

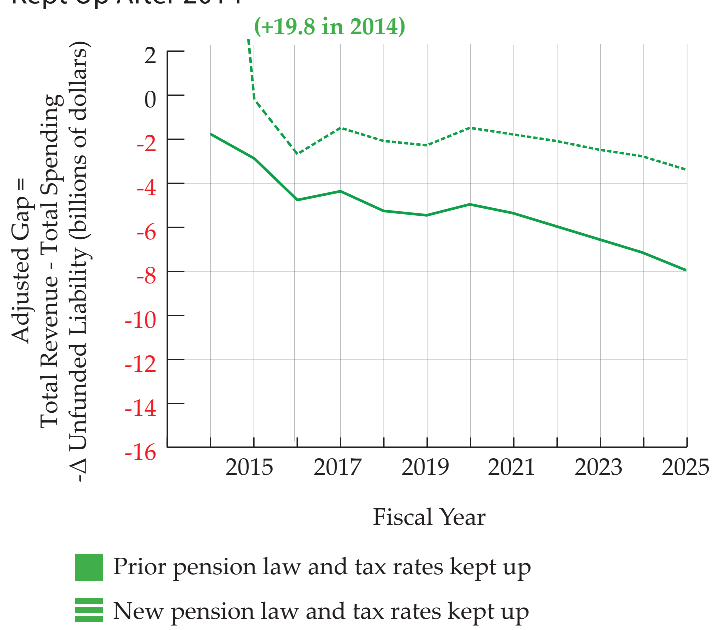


Table A1: Illinois All-Funds Structural Budget Gap Projections to FY 2025 With and Without December 2013 Pension Reforms, With Existing Tax Law and With Tax Rates Kept Up After 2014, With Cash Gap and Gap Adjusted for Change in Unfunded Pension Liabilities (billions of dollars)

Pension Law	Prior	New	Prior	New	Prior	New	Prior	New
Tax Law	Existing	Existing	Rates Kept Up	Rates Kept Up	Existing	Existing	Rates Kept Up	Rates Kept Up
Gap	Cash	Cash	Cash	Cash	Adjusted	Adjusted	Adjusted	Adjusted
Figure	1	1	2	2	A1	A1	A2	A2
Fiscal Year								
2014	-1.0	-1.0	-1.0	-1.0	-1.8	19.8	-1.8	19.8
2015	-3.8	-3.8	-1.6	-1.6	-5.1	-2.5	-2.9	-0.2
2016	-6.4	-5.2	-1.8	-0.7	-9.3	-7.2	-4.8	-2.7
2017	-7.1	-5.8	-2.4	-1.1	-9.1	-6.1	-4.4	-1.5
2018	-7.6	-6.2	-2.8	-1.4	-10.1	-7.0	-5.3	-2.1
2019	-8.0	-6.9	-3.1	-1.9	-10.5	-7.3	-5.5	-2.3
2020	-7.8	-7.0	-2.6	-1.9	-10.1	-6.7	-5.0	-1.5
2021	-8.5	-7.7	-3.2	-2.4	-10.8	-7.1	-5.4	-1.8
2022	-9.4	-8.5	-3.9	-2.9	-11.5	-7.6	-6.0	-2.1
2023	-10.3	-9.3	-4.7	-3.6	-12.3	-8.1	-6.6	-2.5
2024	-11.3	-10.2	-5.5	-4.3	-13.1	-8.7	-7.2	-2.8
2025	-13.7	-12.4	-6.5	-5.2	-15.2	-10.6	-8.0	-3.4

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The Fiscal Futures Project began in 2008 out of concern that the state of Illinois lacked sufficient capacity to project its fiscal demands and revenue streams into the future. A longer term perspective is needed due to:

- The structural deficit: state expenditures have been growing faster than revenue
- The serious consequences of making policy choices while ignoring the impact on the budget in future years
- The relentless pressure on future budgets from an aging population and continuing increases in the cost of health care

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