First things first with the public pension crisis

Everyone, but especially media commentators, has discovered that the Illinois public pension systems are in a fiscal crisis.

Some in the media and civic/business community claim that the crisis is due to the legislature’s failure to fund the systems and its excessive generosity to greedy public employees.

Let me offer my own view. Full disclosure: I used to be a participant in the State Employees Retirement System (SERS), but cashed in my contributions when I left government employ. So I have no skin in this game.

Instead of decrying how much certain people are getting and insisting that public employees “start making sacrifices for the state,” let’s go back to certain “first principles.”

First, the public pension systems must be run honestly. That should be a given, but we recently learned that Illinois-style corruption has found its way into at least one pension system. That is the Teachers Retirement System, which funds the retirement of public school teachers outside the Chicago Public Schools. Most of the board members who run TRS are gubernatorial appointees.

Three former TRS board members are awaiting sentencing for defrauding TRS. Rumor has it that the U.S. Attorney is holding them as possible witnesses against Rod R. Blagojevich in his second trial.

Second, the public pension systems must be administered according to the highest fiduciary standards. Fiduciaries should be more then honest; they should also make the best possible investments for the beneficiaries of the systems. Even in the 1970s, legislators sometimes told the systems where they may, must, and must not invest funds. One can sympathize with the idea of prohibiting investments in foreign dictatorships or in businesses that have contracts with them, but at some point the legislature is interfering with decisions best made by fiduciaries.

Need I add that the boards of these funds should be held to the highest standards of accountability in investing funds that will support the elderly and their survivors?

Third, there must be an examination of the administrative efficiency of the funds. Perhaps some of the funds could be combined under one investment umbrella in order to obtain the greatest leverage in investing. Let’s take an example from private institutions of higher learning, most of which have pensions managed by TIAA-CREF. This is one of the wealthiest private pension funds in the country, partly because it is huge. It leverages its power to get good deals for its thousands of members.

Even since about 1950, when public pensions became a significant factor in state and local budgets, legislatures have been reluctant to fund them properly. Illinois is a particularly egregious example of head-in-the-sand tactics. The Illinois Pension Laws Commission reports dating from 1950 show that funding has been as low as 40 percent of what is “recommended,” which is very dangerous, and only as high as 60 percent, which is still below the “80 percent level” suggested by experts. I remember hearing legislators say, even in the 1970s, “Oh, well, we can shift general funds to the pension systems when we need to.”

That was fine as long as the economy was humming along, investments were earning high returns, public employees didn’t live so long after retirement and the state wasn’t enamored of incurring debt. Now the funding level is at a shocking 38.5 percent, probably the lowest level of funding in Illinois history.

The pension payouts are about 3 percent of the state budget, which is still less than half of the 7 percent of the state budget devoted to debt service.

A few weeks ago TRS decided to sell 10 percent of its $30 billion plus of assets in order to meet pension obligations. Talk about a sacrifice! TRS is reducing the base upon which interest can be earned in the future in order to pay pensions to retirees today.

Worse, TRS was the fifth of the Illinois pension systems to sell off assets to meet current payments in this fiscal year. Will there be more sales?

I would have advised these boards to let the system run out of money to make current payments and encourage the retirees who don’t receive their pension checks to file a lawsuit, as the Illinois Supreme Court suggested in People ex rel. Sklodowski v. State, 188 Ill. 2d 220 at 233 (1998). If the retirees can prove their case, which I think they can, then a court will issue a judgment in favor of the retirees who don’t receive their pension payments and encourage the system to run out of money.

In Illinois, state and local budgets, legislatures have been reluctant to fund them properly. Illinois is a particularly egregious example of head-in-the-sand tactics. The Illinois Pension Laws Commission reports dating from 1950 show that funding has been as low as 40 percent of what is “recommended,” which is very dangerous, and only as high as 60 percent, which is still below the “80 percent level” suggested by experts. I remember hearing legislators say, even in the 1970s, “Oh, well, we can shift general funds to the pension systems when we need to.”

Eduard Viersen in 1893. But there is no question that the judgment would cause the state’s financial rating to plummet to rock-bottom, making it impossible to borrow more money.

I am now convinced that only a rock-bottom financial rating and the ensuing fiscal disaster will get the attention of Illinoisans and their legislators. We’ll have to find the revenue (probably through raising taxes) to pay the claimants.

And then we can start restructuring. We can discuss what makes a good pension system — who gets what when. And who makes sacrifices. Not before.