UPDATE: The Illinois Supreme Court on May 8th, 2015 unanimously found that the state's pension reform law, signed by former Gov. Pat Quinn in December 2013, is unconstitutional.

1989 Illinois pension law made one small change that's had a huge effect ever since

> *Eventually, this debt's going to come due, folks. So, you know, realize that in this bill there are all kinds of windows that have been opened for all kinds of people… special situations that everybody around here has asked for. But the fact of the matter is, that doesn't cost much. What really costs the money is the 3 percent compounding. I have no objection to it, if you want to set aside a billion dollars to pay pension benefits, But if you don't, then maybe you'd better back off a little bit.*
> *State Sen. Calvin Schuneman, R-Prophetstown, June 30, 1989*

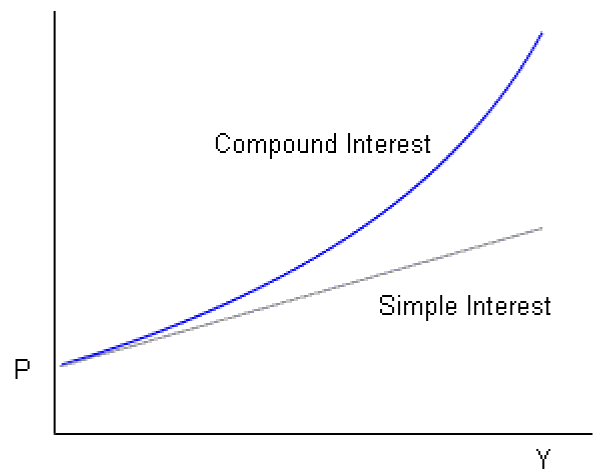
It's been nearly 26 years since Sen. Calvin Schuneman, R-Prophetstown, tried to warn his colleagues in Springfield that what was being treated as an innocuous adjustment in public pension rules was a disaster waiting to happen.

On June 30, 1989, the Illinois Senate debated Senate Bill 95, a mammoth, “omnibus” pension bill that made more than 100 changes to the state pension code. For taxpayers, public employees and the five public pension systems controlled by state government, however, the bill made one change that, arguably, set the course for the pension crisis that plagues the state today.

In an effort to help retirees, primarily teachers, who had low salaries and whose pensions did not keep up with the cost of living, the bill proposed to change the annual cost of living adjustment calculation from 3 percent simple to 3 percent compounded. But the new rate did not apply just to retired teachers with low pensions. It would become law for all Illinois public employees who were members of the five pension funds controlled by state government.

Under the old formula, a $10,000 annual pension would grow to $16,000 over 20 years. With annual compounding, that pension grows to more than $18,000. As retirees lived longer in the decades to follow, their annually compounded pensions grew accordingly.

You don’t need to be a math major to understand the long-term consequences of simple vs. annually compounded increases:



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Schuneman warned his colleagues that computing annual pension increases on a compounded basis would within six years increase the state’s annual pension cost from $500 million to $1.2 billion.

“I mean, this is the kind of liability we’re creating here. Now if this is what we want to do, let’s go do it. ‘Cause it’s sure fun to give away these benefits,” Schuneman said on the Senate floor. “But someday, you know, we’re going to have to pay the price.” (To view the whole transcript of Schuneman’s floor speech, click here and scroll to page 327.)

Fast forward 26 years and we’re paying the price. The state’s pension payment in the budget year that starts July 1 will be $6.8 billion — nearly one-fifth of the state’s General Revenue Fund. When Schuneman spoke out against SB 95 in 1989, the state’s unfunded pension liability was $8 billion. Now it’s $111 billion.

Schuneman, who served in the General Assembly from 1977 to 1993, isn’t gloating over his prescient speech.

“I’m sorry that I turned out to be right on this issue,” says Schuneman, now 88 and splitting time between Naples, Fla., and Prophetstown. “It’s a no-win situation for the people in Illinois.”

Schuneman said his background running an insurance agency made him especially wary of his colleagues’ persistent habit of making bigger and bigger pension promises but never following through with funding. Using life insurance as an analogy, the state wasn’t paying its premiums while promising ever-bigger payouts in the end.

“I kept telling them they were going to break the pension system,” Schuneman says “They just wanted to make promises and kick the can down the road.”

The compounded annual increases have not been the sole factor in creating the current situation, in which pensions gobble up ever-greater shares of the budget while the pension funds move ever closer to insolvency. Failure to consistently pay the state’s share into the funds, economic collapses in 2001 and 2008 and other factors also played roles (though how great is a topic of heated debate).

But mandatory increases to annual pensions have been recognized as the greatest driver of pension costs.

The largest pension fund — the Illinois Teachers Retirement System, which covers public school teachers outside of Chicago — estimates that the current, compounded increase system accounts for 25 percent of its pension payments annually.

That would change under a pension law that currently is the subject of a lawsuit before the Illinois Supreme Court. The new law seeks to end the 3 percent compounded raises and replace them with a formula that ties an annual increase to the rate of inflation. Combined with changes in retirement age and amount of pension-eligible salary, TRS estimates that the new law will reduce the state's payment to TRS in the first year by $860 million.

Whether the new pension law, in whole or in part, survives the lawsuit is now in the hands of the seven Illinois Supreme Court justices.

If the court gives lawmakers the OK to re-work the compounded cost of living adjustments, that in itself would be a sizable victory in the struggle to repair the pension system.

"That's been a great benefit to everyone in the state retirement systems," says Schuneman. "That doesn't mean it was the right thing to do."

(Editor's note: SB 95 contained many other provisions in addition to creation of the compounding formula. Most notably, it allowed lawmakers to substantially sweeten their own pensions. The Chicago Tribune produced a thorough analysis of the bill in 2012. Click here to view.)

https://rebootillinois.com/2015/04/01/rewind-to-1989-ignoring-warning-lawmakers-put-illinois-pension-debt-on-fast-track/