



## CIVIC FEDERATION SUPPORTS GOVERNOR BLAGOJEVICH'S LIMITED USE OF PENSION OBLIGATION BONDS

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The State of Illinois is facing an extraordinary budget dilemma. While revenue projections remain debatable, expenditures – especially fixed costs such as pension contributions – are more easily measured. At a December 2002 Civic Federation forum on public pensions, public and private financial experts reached consensus that the State of Illinois faces historic levels of unfunded pension liabilities and that the requisite FY04 pension contribution is expected to total over \$1.9 billion.

A great deal of the pressure to meet the State pension obligations is a result of the 1995 State Pension Reform Law, which established a 50 year schedule of funding requirements to compensate for the State's previous years of under-funding the pension plans. The Civic Federation has traditionally cautioned governments against using long term debt to address budget shortfalls, however, the Federation recognizes the extraordinarily difficult financial position of Illinois and most other state governments. **As a result of the dire budget conditions of the State, past funding inadequacies, and the current historically low interest rates, The Civic Federation supports Governor Blagojevich's proposal to issue long-term debt to meet the State's past pension obligations.**

However, The Civic Federation strongly warns against the practice of debt financing to correct ordinary budget shortfalls or to fund normal operations, which would traditionally include current pension obligations. The Civic Federation's support of the Governor's pension obligation bond proposal is tied to our acknowledgment that the State's pension obligations are compounding dramatically because of past failures to adequately fund the pension plans on a continuing basis. We therefore support Governor Blagojevich's use of pension obligation bonds, but offer the following concerns and suggestions:

- Projecting that the State's pension funds will earn investment returns of 8% or more is optimistic in light of current and foreseeable market performance. However, due to the historically low debt financing rates available at this time, there is a low risk that the average rate of investment returns over the next twenty or more years will not exceed the interest rate on the debt obligation.
- The General Assembly and the public at large should be aware that this financial strategy will not eliminate all the problems associated with the funding of State pensions. Even with this financing strategy, continued market uncertainty, additional benefits granted to employees, or even changes in the assumptions used to calculate pension obligations may require the State to make additional pension contributions in the near term.
- The Civic Federation strongly encourages the General Assembly to be mindful of the benefit levels granted to employees. For example, the current financial crisis was exacerbated because of the State's past agreement to assume the employee's share of contributions to the pension fund. In addition to holding the line on the current level of benefits, the

General Assembly should explore moving to defined contribution pension plans for all new employees, as a more cost efficient means of providing retirement benefits to employees.

- The General Assembly should seriously consider extending the maximum permitted maturity of its debt to match the economic life of the objects secured by its expenditures. In this case, since the unfunded liabilities of the pension funds are mandated by law to be amortized over a period of forty-five years, issuing longer term bonds would be appropriate.
- The State should also consider authorizing cost effective, contemporary borrowing techniques such as variable rate obligations.

**The Civic Federation is an independent, non-partisan government research organization founded in 1894. The Federation's membership includes business and professional leaders from a wide range of Chicago area corporations, professional service firms and institutions. For more information about The Civic Federation, visit [www.civicfederation.org](http://www.civicfederation.org)**

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