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Pension Politics: Public Employee Retirement System Reform in Four States

Patrick McGuinn

EXECUTIVE SUMMARY

Massive unfunded liabilities of public sector pensions have become cause for fiscal alarm in many American states, where budgetary crises of varying degrees rage. Political factors have long impeded legislative pension reform, but in recent years, a number of states have succeeded in enacting significant reforms to their systems. This paper provides an overview of the political dynamics around pension reform nationwide as well as comparative case studies of reform efforts in four states with diverse political climates. Two of these states—Utah and Rhode Island—enacted significant structural changes to their pension systems while the two others—New Jersey and Illinois—enacted more limited, less innovative changes.

The nature of any particular state's public pension system challenges—as well as the political environment for reform—varies widely. But the experiences of the four states examined here reveal several lessons that can guide policymakers across the nation. Recommendations drawn from this analysis include:

- **Avoid turning pension reform into an ideological issue** – Do not allow the conversation around pension reform to devolve into a business vs. labor dynamic. Reform leaders must not blame unions for pension issues, but rather focus on the numbers and the need to put the system on a sustainable path. The unions may or may not endorse the final pension

Patrick McGuinn is an Associate Professor of Political Science and Education at Drew University

reform bill, but it is important to give them an opportunity to participate in the process.

- **States need a credible and visible reform champion** – Given the contentious nature of pension reform, the credibility, visibility, and skill of the messenger is very important; having a Democrat lead the effort goes a long way towards countering the charge that reforms are merely a conservative attack on labor.

- **Reform advocates must gather and disseminate accurate data, and clearly communicate the reality of their state's pension liability** – Updated and unbiased information about the status of the pension fund and its projected future health, based on realistic actuarial assumptions, must be collected and disseminated. This data and a simple explanation of what it means can help reform advocates simplify a complex issue and help convey a sense of urgency.

- **Demonstrate pensions' impact on taxes and other state spending priorities** – Reform leaders need to translate the budget data around pensions into opportunity costs to make it clear what the impact of not making pension changes will be on the provision of public services, such as education.

- **Sell the benefits of pension reform to state workers** – Pension changes should be framed as ultimately in the best interests of pension participants relative to the consequences of the pension plans getting to the point where they can't meet their obligations.

- **Sell the benefits of pension reform to school reformers** – Enlisting the support of new teacher voice groups that tend to be comprised of younger teachers who are disproportionately harmed by the structure of traditional pension systems can be an effective tactic, as can making the case that pension reform is necessary not only for fiscal reasons but also to improve the recruitment and retention of teachers.

- **Anticipate and plan for legal challenges** – The U.S. constitution (along with many state constitutions) gives a high level of legal protection to contracts, which can open the door to court challenges to pension reform. Reformers need to be strategic in designing reforms that can survive inevitable legal challenges.

Introduction

Despite increasing concern about the large unfunded liabilities of public sector pensions in many American states and the squeeze they are placing on state budgets, there has been relatively little research on efforts to reform these retirement systems. The political barriers to pension reform are high, but a number of states have enacted significant changes to their systems in recent years. This paper will provide an overview of the political dynamics around pension reform nationwide as well as comparative case studies of reform efforts in four states. Two of these states—Utah and Rhode Island—enacted significant structural changes to their pension systems while the two others—New Jersey and Illinois—enacted more limited changes that were less innovative.

The paper will address the following questions: How are different states approaching pension reform? What are the most important reforms that have been made? How did the legislative negotiations unfold in the different states? Who were the central actors? What were the key compromises? How did the particular political dynamics of each state shape the outcome? In particular, what was the role of the teachers' unions? What has enabled (or prevented) bi-partisan agreement on the reforms? What are lessons that other states can learn from these four states' experiences? The findings are based on a review of scholarly and think tank research on pension reform; analysis of reports and data from state government websites and from organizations such as the National Council on Teacher Quality; a study of media coverage of reform efforts in the case study states; and 21 semi-structured interviews with key players in the reform debates in each case study state and national experts on public sector pensions.

Having identified the purposes of this paper, it is also important to articulate the questions it is *not* intended to answer. There is an intense debate raging nationwide about what constitutes an "adequate" pension for public sector workers, the kind of system that will best serve the interests of retirees and taxpayers (a defined benefit, defined contribution, cash balance, or hybrid plan), and whether changes in benefits to current, retired, or future workers are "fair."[1] This paper will not attempt to answer those questions or identify the one best pension reform, though it does highlight the different views on these issues that have emerged in state legislative deliberations over reform.[2] Some readers may question the use of the term "reform" to describe pension system changes given that "reform" implies progress and some people believe that recent changes and reductions in benefits will harm the quality of life of retired public workers. However, the paper starts from the premise that the pension systems in many states have simply become unsustainable and that significant changes are necessary to protect the retirement benefits promised to workers and to relieve the growing pressure on state budgets due to large unfunded liabilities and increasing annual pension payments. If changes are not made, states will increasingly face the prospect of pension systems becoming insolvent or having to significantly reduce spending on other state priorities, such as education and health care.[3] (While it is possible to raise taxes to pay off pension obligations, this appears politically impossible in most states and, as the case of Illinois demonstrates, tax increases alone do not address longer term fiscal issues around pensions.) There is also growing evidence that the structure of traditional public sector pension systems is ill-suited to attract and retain a high-quality workforce or to permit the kind of worker mobility necessary to better match worker skills and preferences with workplace demands.

The Political Dynamics of Public Sector Pensions

A recent Brookings paper by Johnson, Chingos, and Whitehurst examines the evolution of public employee pension systems in the United States and explains how and why many of these systems have come to be so underfunded. They conclude, "It is obvious that the current situation is unsustainable financially in most states and undesirable in terms of recruiting and retaining the best public employees. Reform will have to come, and it will be far preferable to tackle it creatively before the problem worsens rather than be forced to act hastily down the road."[4] The National Council on Teacher Quality has estimated that U.S. teacher pension systems alone have almost $325 billion in unfunded liabilities, and they note that even that number understates the liability due to unrealistic assumptions in actuarial modeling.[5] However, as Marguerite Roza observes, there is a remarkable degree of ignorance and unwillingness to talk about the pension problem among educators and policymakers. She notes that "There is a complete lack of awareness of how and why they are in the position they are and what it means for them. There is a big understanding gap around pensions and a refusal to engage with the issue—a lot of folks declare it a 'political non-starter' while others don't think it is a part of their job and think it is someone else's responsibility."

Many of the problems of public pensions are symptomatic of broader dysfunction in state budgeting, and the strong temptation for legislators to spend now to please voters and powerful special interests while deferring costs into the distant future.[6] Josh Barro has argued that defined benefit pensions are "basically a structure with which state lawmakers cannot be trusted. They involve making promises over periods of decades. They involve state lawmakers now making decisions for political benefit, and being able to send the bill to people who will be in office far in the future."[7] As a result, as Raegan Miller of the Center for American Progress has observed:

> *"The financial condition of existing defined benefit plans is vulnerable to 'pension holidays,' when employers—school districts—fail to make contributions to their employees' pension plans. Another culprit is imprudent benefit enhancements. Several consecutive years of unusually high returns on a pension plan's investments have been used in the past to justify benefit enhancements or to free up employer contributions for other uses."*[8]

One state policymaker interviewed for this paper called this dynamic the "human/asset liability mismatch" and noted that "The asset is being able to give away a benefit of value now when the bill does not come due until 15-20 years later when you are not going to be around. It is easier to trade a COLA increase now that helps you balance the budget."[9] The *Providence Journal* has observed that:

> *"At the bottom of it all is a political culture that rewarded politicians who made unsustainable promises, working in mutually beneficial tandem with public employee union leaders who extracted remarkably generous benefits without worrying about the long-term costs to the citizenry, especially when the inevitable recession arrived."*[10]

Public employee unions are one of the most—if not the most—powerful political actors in state politics and have used that power to protect and expand the pension benefits of their members, as one would expect.[11] As Healey, Hess and Nicholson have observed:

> *"Public sector unions are often highly involved in raising funds and donating to the campaigns of political candidates, often with the goal of preserving the pension status quo ... As important as it may be to take on the challenge [of pension reform] many lawmakers are still politically incentivized to maintain the status quo for as long as possible."*[12]

Why do union leaders support pension policies that threaten to undermine the ability of a state to deliver promised benefits to their members? Dr. Thomas H. Little from the State Legislative Leaders Foundation noted that it has a lot to do with internal union politics: "Union representatives tend not to look long-term but rather focus on the short-term interests of the current and retired members who elected them and on whom they depend for re-election. These folks tend to be adamantly opposed to cuts in their benefits." As Koedel, Ni, and Podgursky have demonstrated, reforming pensions is also difficult because K-12 education administrators (the "stewards of the pension system") are enrolled in the same pension plans as teachers and actually enjoy the largest net benefits from them. "With such high personal stakes," they write, "there is no reason to expect K-12 administrators or the organizations that represent their interests to support pension reform efforts. Yet it is these administrators who are expected to be the professional voice for the school districts that are bearing the heavy costs of employee pension benefits."[13] In an interview, Podgursky added that:

> *"While management is often on the side of reform when it comes to issues like teacher tenure and performance pay, on the pension issue there is no daylight between them and labor. They are both on the same side of the table, and this creates a serious principal-agent problem. There is a real void between the legislatures and every other actor on pensions and so it's not surprising we have a mess."*

However, the stock market crash of 2008 upended the traditional politics of pensions by dramatically reducing the value of state pension fund investments and concurrently increasing their unfunded liability. This led to a huge increase in annual required state pension contributions at exactly the same time that the broader economic recession reduced state revenue and increased the demand for state social services. (As a recent Thomas B. Fordham Institute report shows, school district budgets are also being squeezed by rising pension costs.)[14] As a result, the Pew Center on the States reports that 35 states made changes to their pension systems in 2010-2011.[15] Most of these changes concentrated on future employees because most states were reluctant to change benefits for current or retired workers due to concerns that courts would classify them as legally protected (and thus unalterable) benefits. In 2010, however, Colorado and Minnesota reduced or eliminated their cost of living adjustments (COLAs), and the moves were upheld in subsequent court rulings, which opened the door for other states to take similar action.[16] Nonetheless, NCTQ argues that:

> *"States pension woes can't be fixed by tinkering with vesting periods or shaving down benefits to teachers, the path most states have taken to date...States are putting their own financial health, as well as the security of their teachers, at great risk by failing to take on a comprehensive approach to pension reform that addresses fundamental problems."* [17]

States vary dramatically in terms of the design and health of their public sector pension systems, as well as in the political context for reform. There are a number of key factors that affect the likelihood that a state will make a serious attempt to reform its pension system, and that impact the likelihood that such an effort, once initiated, will succeed. The first important factor is the size and source of a state's unfunded pension liability, which influences the urgency for reform and the range of contemplated alternatives. States that have the largest shortfalls appear most likely to act and to enact significant reform, though as California demonstrates, having a major pension crisis does not guarantee action will be taken. Another crucial factor is the way in which the pension system interacts with a state's broader fiscal environment. States face different budgetary climates across time and space—and vary in their capacity to tolerate tax or spending increases or service cuts that might ameliorate the need for or severity of pension reform. An additional issue concerns whether teachers and other public employees in a particular state are part of the social security system or not, something which varies considerably across the country. David Draine from the Pew Center on the States observed that "the pension reform conversation is very different when workers do not have social security backing up the pension, because they will require more generous pension benefits to ensure retirement security."

The political environment in a state, not surprisingly, also has a major impact on the willingness of policymakers to embrace pension reform and the kinds of reforms they are willing to consider. Which party controls the governorship and the legislature—and whether there is unified or divided partisan control of government—has important implications for reform, as does the strength and reform posture of the state's public sector unions. Some states have seen the emergence of a political counter-weight to the unions in the form of education reform advocacy groups like Students First, business interests such as the Chamber of Commerce, or civic groups interested in protecting social services. But the actual array and strength of these pro-pension reform groups—and their ability to unite in a single coalition—varies from state to state. The particular regulatory, legal and constitutional context that governs pension systems also varies widely, with some states (such as Utah and Illinois) having very high protections for the retirement benefits of current and former workers. As Howells has noted, "there is a great deal of variation among states' regulation of pensions and benefits," and states have adopted different legal theories for adjudicating changes to them. Some states, she observes, view pensions as gratuities, while others treat them as contracts, property rights, or promissory estoppel.[18]

State Case Studies

Utah

Unlike the other states featured in this report, Utah is a strongly Republican state. It was one of the earliest states to enact major pension reform (in March 2010), and made among the boldest changes by ending its traditional defined benefit plan for new workers and offering them instead a choice between a defined contribution plan and a hybrid defined benefit/defined contribution plan. The changes were precipitated by the 2008 stock market crash, which caused the Utah pension fund to lose 22% of its assets and resulted in a $6.5 billion gap for the retirement system, and a drop from being nearly 100% funded in 2007 to 70% funded in 2009. Interestingly, unlike many other states, Utah's pension liability had not been exacerbated by unsound fiscal practices. The state had never borrowed from the pension trust fund, always made the full annual actuarial payment, and had not increased benefits in over twenty years.[19]

While Utah's constitution provides no "explicit constitutional protection for public pension benefits," Utah's courts have interpreted a contractual relationship on the basis of the "impairment of contract principles." The result is that Utah's legislature "may not provide for the termination of a retirement system unless a substantial substitute is provided."[20] Given these legal constraints, the reforms in Utah focused on changing the pension system for future workers. Republican State Senator Dan Liljenquist, the chair of the Senate Retirement Committee and sponsor of the Utah reforms, noted that:

> *"Utah courts had ruled that the state could only touch benefits of existing workers if a state of financial exigency existed but when Utah was making reforms, the system was still well funded (thanks to 5-year smoothing period) and the state had a AAA bond rating so it was hard to make the case that we were in a position of financial exigency. In addition to the legal constraints, we also felt that that public employees and retirees did not create this problem and that we could make the additional payments this time even as we recognized that if there was another market crash like in 2008 then all bets were off. As a well-run state, changing benefits for current workers was not a 'have to have' at that point."*

Liljenquist's first step was to request comprehensive, long-term modeling from pension actuaries that was used to make the case for reform to his fellow legislators and the general public. He observed that:

"No one understood pensions or how they worked. I took over the pension committee in 2009 and nothing had happened there for twenty years. It became clear that we had a problem but we didn't know how bad—the actuaries were only looking a year ahead. I asked for new modeling that would make pension contribution projections under different scenarios (such as varying rates of return and annual state payments) farther into the future. Their report made it clear that doing nothing was not an option—more realistic assumptions meant employers were going to have to pay $500 million more per year which was just a massive amount."

Liljenquist took that new information and went around the state presenting it to people and arguing that changes had to be made in the name of the state's fiscal solvency. He notes that "We did not make this a partisan issue, or blame our public employees—we tried to show compassion since the situation is a tragedy for them. In the end the unions opposed the reforms and protested against them but we argued it had to be done in order to meet our commitments."

Liljenquist then formulated a legislative proposal that called for an end to the state's defined benefit pension plan for new public employees (those hired after July 1, 2011). His proposed retirement system would have the state contribute 8% of each worker's salary into a defined contribution plan annually. Workers would own these retirement accounts and could carry them to another job but COLAs would be limited to 2.5%. The number of years that a public employee must work before retirement was also increased from 30 to 35 years (and from 20 to 25 years for police and firefighters). Senator Liljenquist remarked that, "Our goals with reform were two-fold: one, to make sure that we could meet every penny of the commitment that we had already made to current employees and retirees and two, to reduce and eventually eliminate the pension-related bankruptcy risk to the state." Two other companion bills would have eliminated the state's 1.5% matching contribution to existing 401(k) plans and ended "double dipping" by prohibiting public employees who retire and are rehired after July 1, 2010 from collecting a pension and a salary at the same time.

The plan passed the Senate in February 2010 by "comfortable margins."[21] (The bill to suspend the 401(k) payment was not put up for a vote in the Senate, however.) Union leaders continued to oppose Liljenquist's plan and shifted their focus to amending or defeating it in the House. They held rallies against the bill and threatened to defeat legislators who voted for it. Union leaders believed that they had the votes to kill the bill in committee and prevent it from coming to the floor for a vote. House leaders publicly lobbied committee members to support the bill and succeeded in flipping two votes. House Majority Whip Brad Dee argued that "Pensions are a contagion. They affect everything we do in government. They affect every financial decision we make as a legislature. If we do not change the direction, we are going to go broke."[22] In what observers called "an extraordinary move," House Speaker Dave Clark and two other House leaders attended the committee vote where the bill ultimately passed 6-3.[23]

Nonetheless, labor groups were able to secure a number of significant amendments in the House. As Kory Holdaway, the Director of Government Relations for the Utah Education Association (UEA), observed:

> *"From where Senator Liljenquist started to where we ended there were some significant compromises that were achieved. When he first started his crusade he wanted to completely eliminate the defined benefit but as he got into it he realized that was more than he could get through the legislature. Liljenquist's original proposal passed largely intact in the Senate but we were able to make some big changes in the House."*

One amendment made the retirement benefit more generous by increasing the state's contribution to 10% of salary from the 8% in the Senate bill, and expanding service credit per year from 1 to 1.5%. The biggest change came in the form of giving new public employees a choice between a 401(k) style defined contribution plan or a hybrid plan that combines a limited defined benefit and a smaller 401(k). In both the DC and hybrid plan, the state's contribution is capped at 10% of salary. Under the defined benefit portion of the hybrid plan, if the markets perform poorly then the worker has to make up the difference in the required actuarial contribution and it automatically comes out of the employee's paycheck. Existing workers are not affected by the reforms but have the option of participating in one of the two new pension plans if they would like.

The House ultimately passed the bill 46-26 and the amended version passed the Senate on a party line vote with all but one Republican in support and most Democrats opposed. Public opinion polls showed that a majority of Utah voters supported the reforms and not a single Republican who voted for the reforms lost their re-election bid in 2010.[24] (After a unanimous vote in the House and Senate the following year, lawmakers made a significant change that would allow the legislature to reduce or even eliminate the defined benefit for current employees and retirees if the defined benefit became unstable with contribution rates above 12%—2% from employees.)

While hybrid pension plans have become common, the structure of Utah's is distinctive. The employing agency deposits any amount of the 10% contribution not needed for the DB portion into the DC portion. As the Fordham Institute has observed, "In effect the state subsidizes the employee's DC plan when the DB plan is exceeding expectations; otherwise the employee is the only contributor to the DC plan."[25] In addition, employees, rather than the state, are on the hook for the market risk connected to the defined benefit plan. (Liljenquist reports that the retirement system is set up so that employees default into the hybrid plan, and that half of those who make an active choice are choosing the hybrid over the 401k.) Pew's Draine noted:

> *"While the pension reform conversation nationwide usually focuses on either DB or DC plans, the Utah reforms demonstrate how retirement plans can take pieces of one and aspects of the other that has a combined set of characteristics. You can shift risk in different ways with different plan designs—there is a lot more flexibility to meeting employer and employee needs than is often assumed."*

Observers declared that as a result of the reforms, "Utah's public retirement plans are now in less danger of becoming insolvent, and its public workers' retirement benefits are more secure."[26] While Utah's reforms have been widely praised for creating a new, more financially sustainable pension system for future workers, it is important to note that the changes did not apply to current workers and retirees, or reduce the state's unfunded liability for those already enrolled in the DB plan. As Mike Lafferty has noted, "Cutting future liabilities and reducing the state's investment risk by passing it to employees are positive steps for state budgeters and taxpayers alike. But how well those steps work to reduce Utah's unfunded pension liability for its original DB plan depends very much on future investment returns."[27] Holdaway from the UEA also argues that the pension reforms will have a deleterious effect on the quality of public workers in the state. He notes that:

> *"In Utah the salaries for teachers and other public employees have historically been low and the retirement benefits provided the incentive for people to work in those sectors. … These pension reforms will ultimately affect the quality of employees and the number of employees who choose to go into public service in the state."*

Rhode Island

Rhode Island's 2011 pension reforms are significant because they have been widely described as the most comprehensive in the nation to date and because—unlike in Utah—they were enacted in a strongly Democratic and pro-union state. The political environment in RI in 2011 did not seem hospitable for major pension reform—the new governor, independent Lincoln Chafee, had been endorsed by the state's public sector unions in the 2010 election in large part because of his declaration that the pension system could be made solvent without benefit cuts for current workers or retirees. And a 2011 study found that Rhode Island's state public unions were among the strongest in the country, with 62% of all state workers members of a union.[28] The Rhode Island legislature at the time had large Democratic majorities—65-10 in the House and 29-8-1 in the Senate—and had historically been very responsive to union interests. Dr. Little of the State Legislative Leaders Foundation noted, however, that the fact that RI was a one-party state also helped it get pension reform passed, because it became an intra-party debate rather than the kind of partisan and contentious inter-party fight that we have seen in states with divided government. And because the effort in RI was led by Democratic politicians who went out of their way to avoid vilifying the unions and gave them a seat at the table, it was harder for opponents of reform to question the motives of reformers.

The large and growing unfunded liabilities of the RI pension system had been well known for years and legislators enacted reforms during every session between 2004 and 2010 (with the sole exception of 2008). But these changes were relatively minor—such as the 2005 reform which raised the retirement age and reduced benefits for new hires and non-vested employees—and did not address the system's underlying structural problems and growing liabilities. In 2008, the then-Speaker of the RI House William Murphy warned that the state was "on a collision course with some bad times" and created a special commission to study the retirement system. The Murphy Commission recommended raising the retirement age from 59 to 65 and creating a hybrid DC-DB plan for new workers but the proposals were met with "fierce resistance" from public employee unions and were never even brought up for a vote. Commission chair Rep. Timothy Williamson observed that "The business sense says to look at the vested workers, perhaps even go after people who are already retired. But the political sense is that if you do, be ready for a backlash and non-support and even though you're doing the right thing, the group you're going after may not agree and you may not be re-elected."[29]

In the end, the legislature enacted a few smaller changes in 2009 that saved only $58 million and seemed more focused on plugging that year's state budget than addressing the long-term challenges of the pension system. As a result, by 2010, Rhode Island's pension system was widely considered to be in the worst shape in the country on a per-capita basis.[30] The state had more public sector retirees than public sector workers and the pension fund had—in each of the previous ten years—paid more money to retirees than it collected from state employees and taxpayers combined. As a result, the *New York Times* noted that "the fund is shrinking even though the benefits coming due are growing."[31] The Pew Center for the States calculated that the system was only 49% funded and faced a $7 billion funding gap in 2010.[32]

In 2010, however, elections brought new leadership into the state in the form of a new governor (Chafee) and a new treasurer (Gina Raimondo), who joined the new Speaker of the House (Gordon Fox). Raimondo in particular would play a central role in driving pension reform, relying on her experience as a venture capitalist and her credibility as an outsider to state politics. A Yale-trained lawyer and Rhodes Scholar, this was her first elected office and she made pension reform the central issue in her campaign. Dr. Little of the State Legislative Leaders Foundation observed that "Raimondo was the willing hero—the story starts and ends with her. You could not argue with her pedigree and she came in without having held office before so did not have the political baggage of her predecessor." Jon Duffy, the spokesman for EngageRI, a pension reform advocacy group, concurred noting: "You need to have a champion to do this work and Raimondo brought a lot of credibility and independence to the work as a first time politician coming from the financial sector. She was very smart about educating folks, and depoliticized the issue by focusing on the numbers."

While the state had been making its required annual payment into the pension fund every year (as required by law), it was clear that the payments were not adequate to meet the fund's long-term obligations. Raimondo's first step was to work with the state Retirement Board to adopt a more realistic rate of return and actuarial assumptions for the state's pension system. These changes (most significantly a shift from 8.25% to 7.5% rate of return and longer life expectancies) resulted in a dramatic increase in the system's unfunded liability, from $4.7 to $7 billion. (Interestingly, six of the seven union representatives on the board voted against the changes.) As Ted Nesi, a reporter from WPRI observed, this shift created a new climate for reform: "Suddenly the state faced a much larger pension contribution—Raimondo basically blew a three hundred million dollar hole in the budget. It created an urgency around pension reform that just would not have been there absent those actuarial changes." It was also a surprising move for a pension board that had a long history of succumbing to political pressure to make changes not to enhance the integrity of the pension system but to ease pressure on state budgets. Why did the Board act at this point? Raimondo made a persuasive argument to the board that these were necessary steps to take. In addition, and more controversially, the day of the vote she also brought a lawyer in to speak to the board about their legal fiduciary responsibility to ensure that the pension system was on sound ground.

Armed with the new numbers from the Retirement Board, Raimondo then commissioned and disseminated a high profile report, "Truth in Numbers: The Security and Sustainability of Rhode Island's Retirement System," in May 2011, which laid out the large and growing problems in the pension system with stark clarity. It documented how benefits had been steadily increased by the legislature over time without a corresponding increase in funding. In 1960, for example, when average life expectancy was 70 years, a RI public employee could retire at age 60 with a pension equal to about 50% of their salary with no COLA. By 1990, however, despite longer life expectancy, the retirement age had been dropped to 50, the maximum initial pension had increased to 80% and retirees were entitled to an annual COLA.[33] The report noted that as a result of these changes, "retired public employees can routinely earn retirement benefits that exceed 100% of their final average earnings."

The Truth in Numbers report argued that the path the pension system was on was unsustainable and would get much worse over time. It declared that:

> *"Today Rhode Island's pension plans provide neither retirement security nor financial sustainability and are in dire need of re-design…Each year that the state delays action to address its fundamental structural pension issues, the more risk the system faces and the harder it becomes to fix… [W]e all suffer if the state has to make severe cuts to vital public services to maintain the current pension system."*[34]

The report noted that the state was already paying ten cents of every dollar of revenue into the pension system and emphasized that number would double within the next decade, significantly reducing the amount of funds available for other state needs, including those such as education and social programs that were priorities for the Democratic party. This point helped to convince legislators—as well as the general public—that the pension problems would not remain isolated but instead would threaten the fiscal health of the entire state, and that absent reform, the state would inevitably be faced with raising taxes or cutting funding for popular programs. Treasurer Raimondo remarked that:

> *"I rang the alarm bell in my fiduciary duty to say this system is broken and if we don't fix this cities and towns in RI are going to go bankrupt and people aren't going to get a pension 15-20 years down the road. We ran a public education campaign for about a year and put the problem to the people directly without sugar-coating it. We made it real for people and explained to the typical Rhode Islander and to the social service and non-profit sectors why they should care about pension reform and before you knew it a pretty broad coalition of folks came forward to support reform and the General Assembly began to hear from their constituents."*

Significantly, this approach avoided the kind of contentious labor vs. business fight that has emerged in other states. Speaker Fox remarked that, "We got a lot of support from social services because they finally realized that if nothing happens, there will be a billion dollars going into pensions and that money had to come from somewhere. … Who wants to go out and say because we did not do this, we can't educate your children?"[35]

Treasurer Raimondo also worked hard to persuade Governor Chafee that the pension problems were more serious—and required more serious changes—than he had initially thought. Together they created a 12 member Pension Advisory Group to gather information and craft a proposal for the legislature's consideration. The group was comprised of four public union representatives, three state and local government representatives, two business leaders, and three academic experts and worked for two months. The group held a number of public meetings (often in public libraries so that they were accessible), heard expert testimony, and encouraged interested citizens and groups to submit their ideas and concerns. Raimondo also endeavored to sell reform to the public, speaking to about 50 different groups across the state during 2011, and the treasury department created a special online clearinghouse of information about pension reform called Secure Path RI.

The Rhode Island Retirement Security Act (RIRSA) was introduced on October 18, 2011.[36] The most important provisions of the proposed legislation were a suspension of Cost of

Living Adjustments (COLAs) until the pension system reached a healthy 80% funding level; a new defined contribution plan to work in conjunction with the traditional defined benefit pension; an increase in the retirement age for current employees; and, a plan to work closely with local governments to stabilize their own pension plans. Raimondo commented that "We wanted a lasting solution and there was no way we could have found a solution without sharing the risk across all stakeholders, including creating a defined contribution component and re-amortization. If you didn't do this then the next time the stock market crashed or you had budget problems you would be back at the drawing board." This policy design was also seen as better balancing risk between the state and workers as well as offering a political compromise of sorts between those who wanted to preserve the defined benefit plans without modification, and those who called for a complete shift to a defined contribution plan. Politically, this approach promised to establish a secure minimum pension for retirees, which made it more palatable to unions and democratic legislators.

Speaker Fox and Senate President Paiva Weed called the General Assembly into special session in the fall of 2011 to debate the pension bill, an important strategic choice which brought additional media attention and accountability to the issue and allowed legislators to focus on pension reform without the pull of other issues. In order to have a transparent process and build public trust, the House and Senate Finance Committees held four public hearings and heard 29 hours of public testimony, all of which was covered live online and on public access television. At a crucial moment in the legislative deliberations, when it appeared that the opponents of reform were having success in arguing that the pension crisis was overblown, the town of Central Falls, RI declared bankruptcy on August 4, 2011. The timing of this event could not have been more fortuitous for pension reform supporters, because it dramatically underscored the danger that unfunded pension liabilities posed to state and municipal governments. It also highlighted the dangers of doing nothing for union members, as the Central Falls unions had rejected proposed reforms prior to the declaration of bankruptcy and ended up seeing their pensions slashed by significantly more (50%). This high profile event made it easier for legislators to sell the pension changes to their constituents, and make the case that small cuts were needed today to prevent larger cuts in the future.

The pension bill also received important and timely support from the largest newspaper in the state—the *Providence Journal*—which ran regular coverage in favor of the bill. A sample headline from the *Journal* during the legislative negotiations over the bill, for example, was "Union Leaders are Just Special Interests with their Hands Out," while after the reforms passed the headline was "Rhode Island Rescued."[37] The media attention was supplemented by the efforts of EngageRI, a single-issue advocacy group 501(c)(4) created to persuade citizens and legislators to support pension reform. EngageRI's spokesman Jon Duffy noted that it

> *"was founded by folks in the business community who saw that the state's budgets were way out of whack and that taxes were going to continue to increase and the business community was going to continue to get squeezed unless reforms were made. We understood that there was a need to help make the case for Raimondo's proposal and to counter the union opposition."*

While it is hard to estimate precisely the influence which EngageRI had on the reform debate, Duffy believes that "Without our group the legislators would have worked in the dark and we would have gotten some watered down kick-the-can kind of pension reform. It is unlikely we would have gotten real reform, but we made the choices stark: large tax increases and draconian budget cuts." The group spent more than $740,000 (a considerable amount in a small state like RI) over two months on lobbying, direct mail solicitations, phone banks, television and radio commercials, and online and newspaper advertisements calling on the public and legislators to support the Raimondo-Chafee proposal.[38] (See the appendix for a sample of some of these materials.) They also conducted targeted hyper-local campaigns in key districts where there were swing legislators who were on the fence about pension reform.

Duffy observes that:

> *"We got out there fast and first and big and gained a lot of momentum and I don't think the unions ever had time to catch up. It's like a political campaign—you have to fund-raise, plan, and execute and the legislative fight over pension reform happened very quickly—something like 73 days from the creation of EngageRI to the final legislative vote. We knew we needed to have a broad coalition so we recruited over a hundred groups to sign on—including a bunch of social services groups which made it hard to characterize us as just a business group—and used an advocacy tool to let citizens send messages directly to their representatives."*

A survey conducted by EngageRI helped to convince wavering legislators by showing that public opinion was overwhelmingly supportive of pension reform, with more than nine out of 10 in favor of it. In addition, the group promised to defend lawmakers who supported the pension reform bill from the attacks that unions promised at election time. On the day the bill passed, EngageRI fulfilled this promise by creating a new group, EngageRI PAC to raise and contribute campaign funds to pro-reform lawmakers. Significantly, none of the Democratic legislators who voted for the bill were denied re-election. As Dr. Little noted, "this sent the important message that you can support pension reform over the opposition of the unions and still survive politically."

The final bill passed by overwhelming majorities in both chambers, by a vote of 57-15 in the House and 35-2 in the Senate (overall 77 of 94 Democrats in the legislature voted for it). On November 18, 2011 Governor Chafee signed the RIRSA into law, and the final legislation bore a strong resemblance to his and Raimondo's initial proposal. COLAs were suspended for both current and future retirees, but in a compromise, will be revisited every five years and could be reinstated depending on the performance of the fund. The retirement age will be raised gradually to mirror that of social security (from 62 to 67). And it created a hybrid DB-DC plan in which all employees will get a diminished guaranteed pension supplemented by a defined contribution plan similar to a 401(k). Along with a reduction in the vesting period from 10 years to five, these changes were intended to make working in the public sector in RI more attractive to prospective employees who would now receive earlier and more portable pension benefits.

According to the Pew Center for the States, these reforms made RI the first state to change core benefits for current workers. Another (less noticed) provision in the bill outlines a series of steps that have to be taken if the pension fund gets underfunded again and reaches a "critical status" of only 60% funded. It requires the Retirement Board to come up with a list of potential solutions to fix things and present it to the General Assembly to choose from. The final legislation has proven popular, and a poll taken in December revealed that six out of 10 Rhode Islanders supported the reform bill.[39] The reforms were estimated to reduce that state's unfunded pension liability by \$3 billion (from \$7.3 billion to \$4.3 billion), and the annual state and local pension payment by \$275 million (from \$690 million to \$415 million)—in both cases a savings of about 40%.[40] The Pew Center for the States called the RI reforms "the most extensive public pension reform in U.S. history,"[41] while Fitch Ratings stated that "The reform is unusually expansive [and] the sweeping nature of the reform may inspire similar efforts in other states."[42]

However, three criticisms have emerged. First, union leaders and liberal advocacy groups believe that the legislation will not produce the savings advertised and that it unfairly places the costs of pension reform on public workers and retirees by cutting their benefits and increasing their investment risk. An analysis by the Economic Policy Institute concluded that "The shortfall in RI's pension plan…is largely due not to overly generous benefits, but to the failure of state and local government employers to pay their required share of pensions' costs…RIRSA will result in an average benefit cut of 14% for future full-career employees."[43]

Second, despite some resistance from Raimondo and the business community, the state's pension debt was re-amortized—which increased the overall debt (through borrowing costs) but enabled the state to pay off the debt over a longer time frame (over 25 years instead of 19) and with more manageable annual payments. (Several observers called the refinancing a necessary political compromise in order to gain final passage of the reforms.)

Third, a major omission from the final legislation was the lack of a solution for the problems of the municipal pension systems—like the one that helped drive Central Falls into bankruptcy. Providence Mayor Angel Taveras has remarked that "The future will show that Rhode Island did not achieve comprehensive pension reform because we failed to address the problem where it presents its most pressing threat to our financial future—in our cities and towns."[44] Insiders say that there was concern that adding this enormous issue to an already complicated and controversial bill might have endangered its passage. In addition, unlike the state pension plan, the municipal plans are negotiated through collective bargaining which makes it harder—and less legally defensible—to change benefits for current workers and retirees. The new state law does, however, create new requirements for municipal pensions that are intended to create greater transparency and to push them to undertake needed reforms.[45]

The RI experience offers several lessons. One of the most important factors in the success of comprehensive pension reform in RI was the political courage and effective leadership of the state treasurer, governor and legislative leaders. As one study of the RI reforms put it: "The story of pension reform in Rhode Island is about public servants who risked considerable political capital to overcome difficult and often emotional challenges to achieve their goal of comprehensive pension reform."[46] It was very important that this reform effort was led by a Democratic treasurer and supported by the Democratic leaders in the state legislature. As the *Wall Street Journal* noted, this "undercuts the narrative that pension reform is merely a cause célèbre for conservatives who want to stick it to unions."[47] The Democratic leaders based their argument on the numbers and went out of their way to make it clear that this was not an ideological or anti-union effort and avoided blaming union workers for the problems of the pension system.

In fact, reform supporters argued passionately that they were acting in the best interests of the unions by shoring up a system in danger of insolvency and preserving benefits for both current and future workers. Perhaps the most effective appeal to Democrats—both inside and outside of the legislature—was that reform was necessary to permit spending on other state policy priorities such as education, health care, and social services. The tactical decision to call a special session of the legislature to focus policymakers' and citizens' attention on pension reform also proved important. Finally, the RI case demonstrates the importance of having an outside advocacy group to fund and coordinate a public relations campaign that can educate citizens and pressure legislators. As Nesi, notes, "Engage RI gave Raimondo a political campaign around her message and gave political cover to legislators to support the bill."

In the end, however, the state's public sector unions vehemently opposed the final version of the legislation and filed a lawsuit against it. In December 2012, a Superior Court judge ordered the unions and the governor/treasurer's office into mediation to resolve the dispute—an extremely unusual (and perhaps even unconstitutional) move. As of early February 2014, the mediation talks were ongoing and since all parties involved are subject to a gag order, no details of the negotiations are available.[48] Any negotiated settlement to the case would require the approval of the judge as well as both chambers of the state legislature even though much to their chagrin, legislators have not been part of the mediation process. House Majority Leader Nicholas Mattiello (D-Cranston) has said that any changes to the pension reform law would be "a very difficult thing to consider" and that he wouldn't be surprised if the legislature simply ignored any settlement that emerged from the mediation.[49] It also seems likely that the case would be appealed to the state Supreme Court even if a deal survived those hurdles. One important factor that may help to defeat the unions' legal challenge to pension reform at this stage is that the RI pension system is set out in state statute rather than in the constitution as is the case in other states (such as IL), which makes it easier to argue in court that it is not a binding, unalterable contract.

Even if the state's argument that pension benefits should not fall under contract law is rejected by the courts, the state intends to argue that the state's broad police powers and the existence of a "legitimate public purpose"—the need to resolve a financial crisis—necessitate that they make the pension changes contained in the legislation.

New Jersey

Following the RI model, New Jersey enacted a number of significant reforms to its pension system in 2011, including a suspension of COLAs, a later retirement age, increased worker contributions, and a requirement that the state make its annual pension payment. However, the state did not make the kind of structural changes—such as moving to a defined contribution or hybrid plan—that some observers believe are necessary to ensure the sustainability of pension plans over the long-term and better adapt it to the needs of the workforce. And there is considerable skepticism (and precedent) that the state will be unable or unwilling to make the large payments it will need to make at the end of the seven-year ramp up schedule mandated in the reform legislation. As a result, there is some debate over whether the state's reforms should be considered a "success story" or not, and only time will tell. NJ's reforms are also interesting because (like RI and IL) it is a strongly Democratic and pro-labor state with a Democratic-controlled legislature; unlike those other two states, however, NJ had a Republican governor (Chris Christie) in office when the reforms were enacted. It thus offers a rare example of bipartisan pension reform.

New Jersey's pension system is unusual compared to other states because it combines all of the different state public sector employees (as well as some municipal government workers) into a single pension system. Approximately 200,000 of the 500,000 public workers in NJ are teachers and the state's seven public employee pensions cover more than 780,000 working and retired teachers, police officers, and government workers. By 2006, there was widespread recognition that the state's pension system was broken and in need of major repair. Efforts by the legislature to enact reforms in 2006 and 2008 were blocked by then-governor Jon Corzine, a Democrat who was seen as being strongly aligned with public sector unions. Corzine supported the union's view that any changes to pensions and benefits for state workers should be negotiated rather than legislated.

By 2010, New Jersey had the third largest unfunded pension liability in the nation at $34.4 billion, behind only California and Illinois. It got to this point due to a combination of factors but most important were the following: the state stopped making its full contribution to the pension system in the 1990s (and in many years made no contribution at all); it granted a nine percent increase in pension benefits that was approved by Republican Governor Donald DiFrancesco and the GOP-controlled legislature on the eve of the 2001 election; the fund relied on overly optimistic investment return projections that were not met; and the system saw an increase in the life-span of retirees.[50]

The initial push to reform the system came from Senate President Stephen Sweeney, a Democrat and former president of the International Association of Ironworkers union. He formed an unusual alliance with Republican Governor Chris Christie on pension reform, despite their very rancorous and public fights on other policy issues. At first blush it seems strange that a union leader led the effort to reform (and in several ways reduce) pension benefits for union members, but there were three reasons it happened. The first is that Sweeney is a member of a private sector union and there has long been a split between private and public sector unions in NJ. Sweeney embraces the "business unionism" model that views unionized government workers—and their generous taxpayer-supported benefits—with healthy skepticism. Second, Sweeney recognized that the pension system was in serious danger of becoming insolvent and that unless major changes were instituted, the state would not be able to meet the pension commitments it had made to retirees. Third, he also understood that when the bill came due on the state's ballooning unfunded pension liabilities, the fiscal mess it would create would impair the legislature's ability to allocate resources to other policy priorities and/or would require unpopular tax increases.

Sweeney remarked that "I got in a big fight with the unions—it wasn't pretty but it had to be done. I don't want people who were promised a pension to face not having one and we were only a couple of years away from us blowing the whole thing up and saying it's dead." He added that:

> *"Pensions are really, really simple. They are numbers—the more you want the more you've got to put in. The market drives the pension—if your return assumptions don't come in you've got to make that up. I am chair of a pension fund and they are really not hard to figure out. Over the past decade we were only making a return of two percent on average but our assumption was six and a quarter percent so every year there was a big gap. And then you had the state government not putting in its share so together the fund was being shorted ten*

percent a year which is a lot of money when you are talking about billions of dollars."

Understanding the story of NJ's pension reforms requires some context about the state's notoriously idiosyncratic politics. Several powerful Democratic political machines—particularly that of George Norcross in the southern part of the state and Joseph DiVincenzo, Jr. in the north— wield enormous influence over the legislature and the selection of its leadership. Rutgers professor and pension expert Mark Magyar observed that "NJ reforms stemmed from a very unique political situation with a handful of bosses controlling 30% of the Democratic caucus and willing to hand a Republican governor some major victories." In 2010, Norcross and DiVincenzo installed a new president in the Senate, Sweeney, and a new speaker in the Assembly, Sheila Oliver—both of whom (unlike their predecessors) supported pension reform. Christie also supported pension reform on the campaign trail as part of a broader push to rein in public spending, reduce taxes, and fix the state's longstanding budgetary problems. When Christie was elected governor in 2010, the leadership of the executive and legislative branches of state government was thus poised to move forward on the issue.

In 2010, Christie signed into law a number of small changes to the state's pension system that included banning future part-time workers from the system and requiring that pensions be-based on a single salary. Most of the reforms were for new rather than existing workers. In February of 2011, Governor Christie and his Republican allies in the legislature introduced a proposal that called for much more significant pension reforms, including an increase in employee contribution to 8.5% of wages; a raise in the retirement age from 60 to 65 (and in early retirement eligibility from 25 to 30 years of service); a shift from three to five year salary average for calculating pensions; the rolling back of an unusual 9% benefit increase for new workers that had been enacted in 2001, and the elimination of cost of living adjustments.[51] Democrats criticized Christie's plan as "simply more of the same that got us to where we are now" and offered their own proposal which called for: joint labor-management boards to administer the system; forcing employees to pay more if the fund's fiscal health declined; rolling back the 2001 pension boost; and eliminating COLAs for new and recent hires.[52]

Despite the wide gulf between their initial pension reform proposals, Christie and Sweeney ultimately were able to make a deal based on two key compromises. First, Sweeney reluctantly agreed to Christie's requirement that health benefits reform be combined with pension reform into a single bill. The other key compromise centered on employees paying more for their pensions in exchange for Christie's promise—after years of the state not making any payment to the pension system—to make an immediate (partial) payment and to ramp up to its full contribution (estimated at $5 billion) over seven years. Sweeney commented that "If it wasn't for this legislation this governor would not have made a single pension payment—he would have let the fund go bankrupt and I could not allow that to happen." There was a recognition—even among Democrats—that there was a genuine need to reform the system in order to save it and that NJ public employee union members paid less for their pensions than private sector union members in NJ, and less than public workers in other states. Magyar observed that "Most Democrats supported the pension side of the bill and would have voted for it had it been separate from the health benefit reforms," which most Democrats opposed because it suspended collective bargaining over health care for the first time. (It is also important to note that because the unions viewed the health benefit reforms as more threatening than the pension reforms they focused their advocacy efforts on that side of the legislation.)

Christie rallied most Republicans to vote for the bill and Sweeney was able to bring along about a third of Democrats to pass the bill on June 20.[53] The Democrats who supported the bill mostly had ties to political bosses Norcross and DiVincenzo, fiscally conservative Democrats who came from a background in private sector unions and had disdain for the generosity of public sector benefits.[54] On June 28, 2011, Governor Chris Christie signed Senate Bill 2937 into law (Public Law 2011 Chapter 78). The legislation repealed or amended over eighty different laws and made significant changes to the retirement, pension, and healthcare plans of the state's public employees (including teachers). These changes included raising the retirement age from 60 to 65, increasing the number of years of service before eligibility for retirement from 25 to 30 years, increasing teacher contribution rates by 2% (to 7.5% of salary), moving to a three-year average for calculating the pension amount, and suspending cost-of-living adjustments for both current and future retirees until the system is 80% funded. In addition, the state will now be contractually required to make an annual pension payment and unions can sue to force payment. The final bill contained several other compromises from Christie's initial proposal. The employee contribution was increased to 7.5% of wages rather than the 8.5% Christie wanted; and COLAs were suspended rather than eliminated completely.

Most of the changes (except for the COLA) apply only to new employees and do not affect employees who have already earned their benefits. The bill also created a labor-management pension board and Sweeney remarked that “We have given the unions the ability to have more say in the management of their pension. It is their responsibility to see that it is funded right.” The state’s largest teachers' union, the NJEA, nonetheless strongly opposed the final bill and paid for TV advertisements against it.[55] Executive Director Vince Giordano stated that Democrats who supported it made “a very, very dangerous mistake” and would pay a price at the ballot box. Sweeney responded by saying that “the NJEA is fiddling with our teachers’ money while Rome burns. This $1 million attack ad won’t do a thing to save the pensions of hundreds of thousands of teachers and retirees, or give property taxpayers any relief from the ever-increasing weight of health benefits that hangs around their necks.”[56] Despite the widespread perception that the NJEA is the most powerful interest group in the state, Magyar notes that “The unions just got hammered on pensions—there was no compromise with them at all.” Ginger Gold Schnitzer, Director of Government Relations at the NJEA, acknowledged that Sweeney told them early on in the process that they were going to have to pay more and get less and she said "once the bill was introduced there was not a lot of negotiation. It appeared as though a deal had been struck by some legislative leaders and the Governor and it happened very fast.”

If Senator Sweeney’s leadership was crucial inside of the legislature, Governor Christie’s leadership was crucial outside of it. Christie “went public” with speeches and 38 town halls, successfully creating a sense of crisis around the pension system and shifting public opinion in the state. Robert Grady, the Chair of the NJ State Investment Council, remarked that “the governor did a good job of educating the taxpaying public and beneficiary groups that there was serious risk and that the state might wake up some years down the road and not be able to pay for the pensions.” This was part of a broader effort by Christie to criticize unions and connect them to budget deficits, high taxes and dysfunctional policies. His message received a lot of media coverage and clearly resonated with voters in the state, many of whom were experiencing economic hardship and/or unemployment due to the recession and were envious of and irritated by the generous benefits and job protections enjoyed by public sector workers. (In 2010, public favorability of the unions on polls declined, and an unprecedentedly large number of school budgets were voted down—with Christie’s encouragement.)[57] The relationship between Democrats and the teachers’ unions—historically very strong in the state—also appeared to be shifting more broadly which facilitated pension reform. Democratic Senator Teresa Ruiz, the chair of the Senate

Education Committee, for example, led the legislature's successful 2012 effort to reform the state's teacher evaluation and tenure systems in the face of significant opposition from the teachers' unions. (It is important to note in this regard that both Sweeney and Oliver were subsequently re-elected by the Democratic caucuses to their leadership positions despite breaking with their party on the pension and benefits bill.)

The NJ pension system's unfunded liability dropped from $54 billion to $35 billion after the reforms were passed and the Christie administration claimed that the changes would save state and local taxpayers $121 billion over 30 years. Grady stated that:

> *"There is no question that by any measure the pension system is more healthy for the long term—the changes were not that jarring but they have bent the cost curve and made the problems more manageable over time...Did we go far enough—I think we've gone further than just about any other state. Did Governor Christie propose to go even further? Absolutely but he had to negotiate with the legislature."*

Some observers nonetheless consider the state's reforms to be inadequate to address the long-term fiscal challenges of the pension system. Fred Beaver, the former state pension director for example, remarked that "while admirable, this was paper reform. The state is going to need a big shovel to get out of the hole they are digging themselves by not making the [full] payments."[58] Joshua Rauh of Northwestern declared that "New Jersey moved itself from the top of the list of most-troubled states to a state in the top third, but not a standout."[59] The pension system remains significantly underfunded and due to the seven year phase-in plan, the state will not make its full contribution until 2018 at the earliest. As a result, the total unfunded liability is projected to grow significantly and swell to $58 billion (past its pre-reform levels) by 2019.[60] Governor Christie acknowledged that "the unfunded liability, even under the reforms, is going to increase because of the way we're staging our pension payments." But, he argued, "we're falling behind by a heck of a lot less than we were in the years before I got here when we made no pension payments."[61] A 2014 analysis by Richard Dreyfess and Steven Malanga found that the condition of the NJ pension system had improved "only marginally" since the 2011 reforms and declared that "absent additional reforms these pension plans will remain unsustainable with the only question being by how much and when insolvency will occur."[62]

The ultimate impact of the NJ reforms—and the future viability of the state pension system—depends on the state making its full annual contribution, something that it has rarely done in the past. As Brian Volz of the NJEA stated, "You can make all of the changes that you want but if you are not going to fund the pension system to where the actuaries say it needs to be funded then you're going to continue to hit this crisis—really just kicking the can down the road." While the 2011 reforms committed the state to making these payments, it will undoubtedly prove very difficult to do so, given the fiscal and political dynamics. The state made the smaller partial payments called for during the first three years of the ramp-up (Fiscal Years 2012-2014), which—after so many years of making no payment at all—is clearly a big improvement. However, by 2018, the required state payment for pensions is projected to reach $5 billion or more per year, and it is unclear where such a large sum of "new" money will be found, particularly if Governor Christie maintains his pledge not to raise taxes. Magyar observes that:

> *"[The] pension system clearly was insolvent with the path the state was on of not making contributions, and this has locked in the state's contribution and locked in higher employee contributions. But the state contribution number in 2018 may end up being much higher than people think right now—rather than $5 billion it may end up being $7 billion or more depending on the impact of new federal accounting standards from the [Governmental Accounting Standards Board] (GASB). What happens if this number is so high that the state can't swing it? Normal revenue growth is not likely to be adequate to cover it so where are you going to make your cuts in the state budget?"*

The NJEA indicated that it is going to keep the pressure on the state to make the pension payments, in part with a media campaign and by hiring independent actuaries to explore new ways of raising and allocating state revenue.

Fitch and Moody's responded to these projections by downgrading the state's bond rating in 2013 and observing that "only making partial payments until 2018 will force'sizable' increases in taxpayer contributions 'likely to conflict with other long-term challenges, such as property tax relief, school funding, and infrastructure needs.'"[63] The size of even the partial payments is already creating budgetary challenges—Christie's proposed $33 billion budget for fiscal year 2014 included a $1.67 billion pension payment, which is the largest in state history, but less than half of what actuaries say it should be. Nonetheless, Sweeney noted that virtually all of the new money that has come into the state budget over the past three years—about 85 cents of every new dollar—has gone towards the pension payment. But Magyar cautions that "with the pension contribution eating up such a substantial chunk of normal revenue growth, it is precluding the state from doing anything else in another policy area that it may want to do until after the ramp up is completed in 2018." In addition, the unfunded liability in health benefits is even larger than in pensions—and may complicate efforts to make pension payments. Sweeney, meanwhile, has promised to sue Governor Christie if he doesn't make a payment. But he cautions that "I am concerned that people will try to undo the state's pension obligation when I am not there. I tried to pass a bill that would have made a constitutional amendment to mandate that the state make the pension payment every year but the union leadership fought against it."

The fear of another skipped or partial pension payment was heightened in January 2014, when Christie suggested in his State of the State address that the money might be better spent on other priorities and that there was a "need to have the conversation now about further changes to our pension system."[64] Sweeney and the other Democratic leaders in the legislature responded by emphatically declaring that they would not permit a pension holiday or demand further concessions from public employees. As governor, Magyar points out, Christie has the ultimate power over pension payments because the state's annual budget law supersedes other laws and Christie can use his line-item veto to shape the budget. And Democrats do not have the votes to override his veto in either chamber.[65] Sweeney, however, declared that he would shut down the state government if Christie does not agree to make the full pension payment. Christie backed off his threat in early February, declaring in a radio interview that he would make the actuarily required pension payment of about $2.4 billion required for Fiscal Year 2015.[66]

Even with the immediate impasse resolved, a further problem is that the state (like many others) may be relying on overly optimistic rates of return for the pension fund investments. In 2012, for example, the state treasurer projected a 7.95% rate of return but the investments only grew 2.5%.[67] There is concern that the state's flawed actuarial model will lead to additional unfunded liability in the system in the future. (Grady from the state investment council notes, however, that the 20-year annualized rate of return for the fund as of 9/30/13 was 7.96%.) NJ also did not make the kind of structural changes (such as a shift to defined contribution plan) that might have put the state pension funds on a stronger long-term fiscal path. (A provision in the 2011 legislation to permit full-time workers with fewer than ten years on the job switch to a 401(k) style plan was removed in the Assembly due to fears that it might undermine the stability of the system.) Sweeney acknowledged that "There have to be more long term solutions. We really have to recognize that there is going to have to be a move from a defined benefit to a defined contribution or some kind of hybrid for workers that are not vested." He noted, however, that he does not have any plans to introduce additional legislation on pension reform in the near future. As a result, New Jersey can be viewed both as a positive example of how reforms can be enacted despite the opposition of powerful interests, and the significant barriers to major structural reform.

In addition, there is some question about the legal sustainability of the pension changes, as NJ public employee unions initiated litigation against the state in August 2011 to stop the reforms. The NJEA argued that "the state has illegally taken away promised and earned contractual benefits" by eliminating the COLA and requiring future retirees to make a larger contribution to pay for their health insurance and pensions and has made the unfunded liability of the pension system "substantially worse" by phasing in the state contribution over seven years rather than paying the full amount immediately.[68] The COLA challenge was later pulled out into a separate lawsuit but in May of 2012, a judge ruled that public workers are not entitled to cost-of-living adjustments on their pensions, upholding the changes to the COLAs enacted in the reform bill.[69]

Central to the rest of the unions' legal challenge is language included in the 1997 pension refinancing plan that "confers on a public employee a non-forfeitable right to pension benefits established by law after the employee has served for five years."[70] In testimony before the Joint Legislative Committee on Public Employee Benefits Reform on August 23, 2006, Peter Kelly, the counsel for the Office of Legislative Services, noted that the law made it clear that the legislature intended to establish pension benefits as contractual rights and give them protection under provisions in the NJ and U.S. constitutions that prohibit the impairment of contracts. One observer has declared that "the 'non-forfeitable right' language in the 1997 law is so strong that it is not clear that the state's public employee labor unions would have the right to agree to pension benefit givebacks even if they wanted to."[71] Howells, on the other hand, notes that the state courts have consistently ruled that the legislature is free to revise the management of pension plans despite the fact that employees have a contractual right to some sort of payment.[72] A lower court judge dismissed the case on procedural grounds in December 2011, but the unions appealed to the NJ Supreme Court and as of February 2014, it had yet to issue a decision in the case.

Illinois

Illinois is an important case to examine because like Rhode Island and New Jersey, it is a strongly Democratic and pro-labor state that came to possess an enormous unfunded liability in its public employee pension system but was ultimately able to enact reform. Pew estimated that the state had $95 billion in pension debt as of July 2013, and projected that without reform, the state could wind up spending 40% of its revenue on pension costs by 2045.[73] As noted above, states vary widely in the level of statutory and constitutional protection that they have granted to public pension benefits and perhaps the greatest barrier to reform in Illinois had been that the state—along with New York, Alabama, and Arizona—has adopted a contract theory approach to pensions and benefits that has provided a high bar of constitutional protection for past and future benefit accruals. Howell notes that states with this legal and constitutional framework face a particular challenge in successfully reforming pension rights.[74]

Illinois has five different pension funds, of which the Teacher Retirement System is the largest. Another unique feature of Illinois' pension system is that the state is required to make the entire share of the employer contribution for teacher pensions (except in Chicago). Chicago has its own separate pension fund—which predates the state pension system—that is paid for through city property taxes, though it was created by state statute and is governed by rules established in the legislature. Laurence Msall, President of the Civic Federation of Chicago, noted that:

> *"Changes to the state pension system in 1995 established a back-loaded 50-year payment plan designed to get the state system to 90% funded. This was too long a time horizon, so early payments were actuarially unsound and unrelated to the actual costs of the program. The situation was made worse over time as the legislature added a 15-year ramp up to the 50-year payment plan, granted pension benefit enhancements, took payment holidays, and borrowed money to make pension contributions. The legislature's focus with the pension system has been on budget relief mechanisms rather than sound funding policies and this has resulted in extraordinary growth of the unfunded liability. We have kicked the can down the road repeatedly and now the can is a 50-gallon drum that doesn't even roll but there are still some people attempting to push it beyond the immediate crisis."*

Nick Yelverton, the Director of Government Relations for the Illinois Federation of Teachers, observed that:

> *"Really from the inception of these pension funds they have never been actuarially funded [and] the 1995 bill really just legalized systematic underfunding. Legislators could say every year that they were complying with the law but the payments that were being made were nowhere near what was necessary... Retirement benefits are not out of the norm in Illinois compared to other states—particularly when you consider that the majority of public employees in the state (and especially those in state pension plans) are not part of the social security system. Despite that, the legislature has taken the approach that cutting benefits is the answer. The underlying problem all along has been that no one wanted to fund government by raising taxes and so instead they just used the pension fund and contribution as a piggy bank to pay for other programs. The annual payment has been ever increasing and is now in excess of $6 billion per year even though the normal cost is only $1.7 billion."*

Senator Daniel Biss concurred, noting that "Illinois has a proud history of not making pension payments." Unlike some states (such as New Hampshire which has a constitutional requirement), Illinois does not have a strong mandate to make its pension payment each year. As Biss explains, the Illinois legislature routinely passed benefit enhancements without making any attempt to discern their long-term cost or ensure that the system would be able to pay for them. "It comes down to simple politics," says Biss. "People enjoy the pleasure of getting stuff without the pain of paying for it and there is always a strong temptation in state and local government to imbalance spending and taxation and use the pension fund to hide debt. The bill doesn't come due until well after the legislators who wrote the check have left office," he concludes.

The increasing unfunded liability and escalating annual state pension payment has put increasing pressure on the state budget, particularly after the 2008 recession led to a dramatic drop in state revenue and a deep decline in the value of pension fund investments. Because lawmakers have obfuscated the true costs of the pension system for so long, however, Illinois taxpayers are only now beginning to realize the true fiscal implications of underfunding. Despite this growing awareness, Msall notes, "The benefits of pension reform are longer term but the political pain of reform—and the reaction of the employee groups—is immediate. As a result it is hard to get the political will to reach a consensus on reform." Due to these factors, by 2010, Illinois had the second largest unfunded pension liability in the nation, at $54.4 billion.[75] That year, in an effort to curb pension costs, the state created a two-tiered system in which teachers hired after January 1, 2011 pay the same annual contribution (9.4% of salary) as teachers hired before that date but receive significantly lower pension benefits. The changes raised the age at which a public employee can receive full benefits to 67, capped annual pension payments at $106,800 and prohibited double dipping. Since the changes only applied to new employees, however, they did not address the state's current pension liability, only its future growth.[76] As Costrell and Podgursky have noted, this approach unfairly shifts the cost of past pension promises onto future workers and undermines their retirement security, and may harm the state's ability to attract and retain a high quality workforce.[77]

Even these changes proved inadequate to solve the pension system's longer-term problems, however, and the overall health of the system—and of the state's fiscal situation—continued to deteriorate. The legislature passed a large tax increase on individuals and corporations in 2011, but virtually all of the new revenue raised went to pay that year's pension payment and debt service. The share of the Illinois state budget that was devoted to its annual pension payment continued to grow, increasing from 6% in 2008 to 16% in 2013. As one observer noted, "the multi-billion-dollar Illinois pension crisis [is] continuing to wreak havoc with the state budget, siphoning cash away from areas such as education, public safety, and human services and jacking up the cost of borrowing money for the state and its cities, counties, and school districts."[78] Democratic Governor Pat Quinn projected that a $400 million cut in education spending for the coming fiscal year would be necessary absent pension reform and Moody's gave Illinois the lowest credit rating of any state in the country. As a result, 2013 saw increased pressure on the legislature to act and greater movement on pension reform than the state had ever seen.

By this time, thanks to the passage of reforms in Utah, Rhode Island, and New Jersey (among others), the thinking about the political and legal boundaries to pension reform began to change. Sen. Biss notes:

> *"Until 2011 the near-consensus interpretation of the Illinois Constitution was that pensions are a contract and that benefits for current and retired workers are untouchable. But we have seen a change in attitude out of necessity—my constitutional theory about pension reform is that we are in a state of emergency*

and cannot meet our other constitutional obligations—such as in education—without pension changes."

Nonetheless, two very different approaches emerged in the Illinois House and the Senate and they were unable to produce compromise legislation that could pass each chamber during the 2013 session. Speaker Michael Madigan—who is seen as more conservative than the Senate leader—drafted a proposal in the House that received the support of the business community. It called for unilateral changes in pension benefits that would cut $30 billion from the state's unfunded liability and make the system fully funded after 30 years. It set a cap on salaries used to determine pensions, limited COLAs for future retirees, increased the retirement age to 67, hiked worker contributions an additional 2% (of salary), and made actuarial changes in calculating the annual state pension contribution intended to bring it closer to projected costs. The Madigan plan also contained a provision requiring the state to make timely and adequate annual pension payments and exempted pension changes from collective bargaining.

Democratic supporters of the House bill believe that the state needs to take major steps to shore up the pension system and that action cannot wait any longer. Rep. Elaine Nekritz (chair of the Assembly Pensions Committee) for example, remarked that:

> *"My reasons for doing this are very similar to Raimondo's in RI. Cutting other parts of the budget in order to sustain the current pension system is not healthy for the state in the long run. And it does not allow for funding of other Democratic priorities—aid for the mentally ill, K-12 education, higher education scholarships, the list goes on and on."*

Yet other legislators don't see the pension system to be in crisis and take a more near-term view of just making the annual payment, even if it is well short of what is actuarially required and does not address longer-term fiscal challenges. Part of the challenge in Illinois apparently stems from the lack of a high-profile champion—such as Raimondo in RI and Sweeney and Christie in NJ—who is willing and able to invest political capital to make the case for pension reform to the legislature and the general public. Governor Quinn (who rose to the office when Rod Blagojevich went to prison) in particular has been widely criticized for his lack of leadership on the pension issue, with some observers saying that he does not know how to place an issue on the public agenda and sell it.

In response to passage of the House pension reform bill, Senate President John Cullerton developed an alternative plan—which was negotiated with labor union officials and received their endorsement—that offered current workers a choice in how reductions in pension would affect them.[79] The changes were predicted to reduce the system's unfunded liability by $15.7 billion and bring it to a 90% funded level in 30 years. The proposal was crafted with the explicit intent of being able to avoid a court challenge, or at least survive one should it arise. The thinking was that having state workers agree to the changes in exchange for a "consideration"—some other benefit—would permit the proposal to pass constitutional muster despite the restrictive language about benefits changes in the state constitution. Current workers could choose among several different options, including COLA changes, higher worker contribution rates, and how future salary increases counted in their pensions. The primary choice for workers would be to keep their COLA and forgo participation in the state retiree health care plan or to keep retiree health care and forgo the COLA. Health care benefits are not covered by the state's constitution provision that protects pension benefits and thus can be legally reduced or eliminated. (The projected savings in this bill are based on an assumption that 50% of workers and retirees would choose to give up health care in order to keep their COLA, but the actual savings could be very different if this assumption proves off-target.)

While the bill passed 40-16 in the Democratic-controlled Senate, most Republicans voted against it. The bill was criticized for not going far enough to reform the pension system and for generating much lower short- and long-term savings than Madigan's bill in the House. Republican Senator Matt Murphy stated, for example, that "This bill doesn't do enough to change the trajectory of our pension funds and you will be back here reliving this nightmare."[80] In addition, while Cullerton had hoped that the unions would not file a lawsuit against his proposal, a group that represents retired teachers nonetheless signaled their intent to do so if the measure became law.[81] Like the Madigan plan, the Cullerton plan also contained a provision requiring the state to make timely and adequate annual pension payments and exempted pension changes from collective bargaining.

The House leadership refused to even bring up the Cullerton plan for a vote, believing that it did not generate sufficient budgetary savings or go far enough in addressing the state's pension problems. The Madigan plan was voted down twice in the Senate—the second time on a 16-42 vote on May 30, the day before the legislature was set to adjourn, which left little time for the two chambers to craft a compromise.[82] Observers report that each chamber apparently believed that the other would eventually cave and accept its pension proposal, but that did not happen. The legislature then adjourned but Governor Quinn called a special session during the summer and set a deadline of July 9 for them to produce an agreement (which was not met). In addition, in a move that angered legislators, the governor used his line-item veto power to suspend lawmakers' salaries until they reached an agreement on pension reform. A conference committee was created and charged with coming up with a compromise between the two bills, a "third way" that could receive sufficient support to pass both chambers of the legislature.[83] A pension bill written by the Institute for Public and Governmental Affairs at the University of Illinois was apparently the starting point for the conversation (though details of the negotiations remain confidential).[84] Legislators were reluctant to move forward until the salary freeze issue was resolved with the governor since the governor's action was viewed as a violation of separation of powers and an attempt to blackmail the legislature into making policy. Ironically then, the governor's attempt to push legislators to speedy action on pensions appears to have delayed a reform push that had gained considerable momentum.

One of the most interesting things about Illinois' pension reform effort is that it is being led by Democrats in a very pro-union state. Yelverton notes that because it is essentially a one-party state,

> *"The Democratic party has become a broad party that incorporates a range of ideological perspectives, including a number of Reagan Democrats who in any other state would probably be Republicans. Democrats have co-opted the business community in the state and embraced a lot of its agenda, in order to prevent an alliance with Republicans that could threaten Democrats' power in the legislature."*

This dynamic has led many Democratic legislators to be receptive to the call for pension reform from the business community, and particularly to their argument that the pension problems are consuming state funds that could be going to other priorities. But Rep. Nekritz believes that the Illinois pension reform effort has struggled due to a lack of leadership and willingness to compromise on the part of different interests. She commented that "In some states public officials step forward to really educate the public or union leaders are willing to compromise and get it done but in Illinois we have struggled with that." Sen. Biss added that "I tried very hard to change the public discourse but failed—I am a low guy on the totem pole and the leaders in the state that had the platform either tried and failed or didn't try at all."

Some observers believe that the state struggled to enact major pension changes because it adopted an "ideological, right wing approach to reform" that featured a battle between business and labor, and blamed "greedy" unions for the problems of the pension system. Yelverton observed that:

> *"There has been a concerted effort by the business community and the* Chicago Tribune *editorial board to demonize these benefits and basically say that teachers and public employees get these benefits that you don't get and creating an 'us versus them' kind of situation. We have been particularly successful in reminding people that public employees don't get social security and this changes the conversation. But reformers have argued that the pension system is a tax-eating monster and highlighted scandals and corruption in the system and instances where people were able to join the system—or get a higher pension or second pension inappropriately."*

A group called Illinois is Broke, for example, was created to disseminate information about the need for pension reform, but was criticized for being too sensationalistic and ideological in their appeals.[85] The business versus labor approach—and the inflamed rhetoric—in Illinois stands in stark contrast to the more pragmatic and numbers-based approach taken by Raimondo in Rhode Island. Sen. Biss remarked that:

> *"[Raimondo's] approach was to educate people about the nature of the problem and build a broad constituency for pension reform before talking about what the specific reforms should be. That is the opposite of what we have seen here in Illinois where we have not educated people in an open way, not engaged stakeholders in a respectful way, and disrespected public employees. This has turned off even people who otherwise appreciate the need for pension reform—it has poisoned the debate and made it hard for Democrats to align themselves with these folks."*

In addition, Illinois legislators disagreed about the severity of the pension problem and the need for reform, with Senate President Cullerton remarking in October that "People really misunderstand the nature of the whole problem—quite frankly, I don't think you can use the word 'crisis' to describe it at the state level."[86]

Nonetheless, the state's ongoing budget problems eventually pushed the legislature to act and the conference committee hammered out the outlines of an agreement by late November. In December, the committee handed off the bill to minority and majority leaders from each chamber who met six to eight times behind closed doors to hammer out the final details. On December 2, 3013, the Illinois legislature voted to approve the deal that was put together by party leaders who claimed that the measure would save an estimated $160 billion and erase the state's debt over the next 30 years.[87] Biss described the final legislation as a "solid compromise," and observed that while House Democrats and House and Senate Republicans were in agreement for the most part, Senate Democrats "had to come a long way." This was reflected in the final (close) vote in each chamber, as the bill relied more on Republicans in a 30-24 vote in the Senate but had stronger Democratic support in a 62-53 vote in the House. (In the Senate Democrats voted 20-15 and Republicans voted 10-9 in favor, while in the House Democrats split 47-24 and Republicans 15-32.)[88] Democratic Rep. Nekritz remarked that "I don't take any joy in this action today. But it is the responsible thing to provide a pension system that gives workers retirement security without bankrupting the state."[89]

The central components of the reforms were: curtailing of cost-of-living increases for retirees; capping the salary level used to calculate pension benefits; and raising the retirement age for workers under the age of 45 on a graduated scale (by as much as five years for some workers). In exchange for these cuts in benefits, workers will see their pension contributions drop by one percent and the state commits to increase its payments into the system by $60 billion to $70 billion (by putting an additional $1 billion per year into the system by 2020). Biss observed that compared to what emerged from the legislature in August, the final version of the bill "saves more money and asks more of workers but did it in a way that is more surgical and less indiscriminate and shelters people with small pensions and those who have worked the longest in public service." The new law also contains an optional 401(k) plan for those willing to leave the pension system, but according to Biss, it is structured in such a way that few public employees are likely to utilize it. The plan is only available to a maximum of five percent of workers hired before 2011, for example, in order to ensure sufficient enrollment in the traditional pension plan to cover payments to current pensioners. Biss called the 401(k) plan "unimportant as policy but politically important (especially for Republicans)."

There are three streams of money that the new law creates to go into the pension system. First, the new law mandates that the state make the actuarially required payment in year one—which would be the first time in Illinois history that happens. (Unlike in New Jersey, the Illinois reforms do not include a ramp-up to making the full pension payment.) Second, beginning in year one, 10% of all savings from the pension reforms has to go into the pension system. The third stream starts later, in 2019, when the state's debt service payments begin to drop and 100% of money that is saved has to be put back into the pension system. Biss notes that Illinois is one of only a few states that have enacted far-reaching changes to benefits for current workers and retirees, similar to Rhode Island.

Critics argued the law includes too little structural reform to the pension system and takes too much from state employees and teachers, with the Illinois Federation of Teachers President declaring "we call it theft."[90] And Bruce Rauner, a Republican candidate for governor, cautioned that "the truth is that the savings in this bill are both insufficient and will make true, comprehensive reform more difficult."[91] Others—including Chicago Mayor Rahm Emanuel—criticized the law for not addressing the pension problems facing local governments across the state or for dealing with the fragmentation of the system in which 628 separate public systems exist. The law's harshest critic was the *Wall Street Journal* editorial board, which decried "Illinois' Fake Pension Fix" and remarked that "the most dysfunctional state government lives down to its reputation." It declared that the reforms "merely delay the fiscal reckoning ... [because they] merely tinker around the edges ... [and] shave the state's unfunded liability by at most 20%."[92] A study by the University of Illinois Fiscal Futures Project concluded that while "the pension revision law of December 2013 was a huge step in the direction of fiscal stability for Illinois," the state still has a projected budget gap of $3 billion in 2015 and will grow to $13 billion over the next ten years.[93]

Union leaders in Illinois have filed suit in state court to have the legislation declared unconstitutional, and Senate President Cullerton himself remarked upon passage that "the bill has serious constitutional problems."[94] The ability of the law to survive the court challenge is unclear, though Senator Biss believes that the inclusion of a "consideration" for public workers in the form of reduced pension contributions increases the likelihood that it will pass constitutional muster. Msall added that:

> *"Illinois Supreme Court judges are elected and they could decide pension reform passes legal muster if reforms are presented as 1) the most equitable way to*

continue providing essential services while maintaining the pensions and 2) a last resort after a lengthy effort to try other fixes (including tax increases). The argument that would be before a court is that the pension system is broken and the 'consideration' being given to public employees is a choice between pension reform or an insolvent system that results in a reduction or elimination their pension."

The fate of Illinois' pension reform effort will thus likely depend on how the court weighs the state's unusually high level of protection for pension benefits against claims that the state is in financial crisis and needs to make cuts both to make the pension system solvent and to pay for other state priorities. The court's ruling will likely have national ramifications given similar legal challenges in other states.

Lessons and Recommendations

The nature of any particular state's public pension system challenges—as well as the political environment for reform—varies widely. But several lessons and recommendations emerge from the four state case studies above that can guide policymakers in this work.

States should make their complete actuarial payment every year

This is an obvious point but nonetheless crucial; making the full annual required contribution (ARC) is a necessary (if often not sufficient) condition for having a sustainable pension system. Employees make steady contributions to their pensions throughout their careers—in fact, it is deducted from their paychecks. States need to meet their obligations with the same regularity—when payments are skipped or made only in part the unfunded liability in the pension system can grow quickly, especially if the market declines. Alicia Munnell has found that in many states, pension problems did not result from union lobbying or inappropriate discount rates, but from a lack of fiscal discipline. "The Shenanigans in Illinois and New Jersey," she writes, "have more to do with politicians behaving irresponsibly than with understating liabilities or with union power."[95] Schnitzer from the NJEA argues that "the problem is not that the benefits are too generous, but instead that the failure to make regular payments over time causes pension payments to be a budget buster. Too many states are not making payments and then complaining that 'the system is broken.'"[96] Laurence Msall of the Chicago Civic Federation added that:

"Illinois has been dealing with the pension crisis for decades but it is painfully

obvious that the longer you wait to address your pension problems the more expensive it is and the harder it gets. Illinois has seen our unfunded pension liabilities double in less than ten years. When that happens, the size of the solution has to be that much larger and more painful. Allowing yourself payment ramps, focusing on short-term budgetary relief or counting on increased state revenues/taxes in the future to solve the problem is a bad idea."

For political reasons, there is a strong temptation for for legislators to look only at the short-term and make quick pension fixes that resolve that year's budget problem rather than address longer-term structural issues in the retirement system. The longer that the unfunded liability continues to grow, the harder it will be to get the pension system back to a healthy place. Conversely, by bending the cost curve, you can make it much more manageable over the long term; the earlier a state enacts pension changes the better off it will be. Reformers should seek to make it a legal (or even constitutional) requirement that their state make its full actuarial pension payment every year and that the state retirement board and legislature have to act if the pension fund gets severely underfunded again. Public sector unions should be prepared—and empowered—to sue in court to force the state to make its required payment when it fails to do so.

Need for a credible and visible reform champion

Given the contentious nature of pension reform, the credibility, visibility, and skill of the messenger is very important. Sweeney in NJ (because of his history as a union leader) and Raimondo in RI (because of her experience in the financial sector) were uniquely positioned and qualified to deliver the message of pension reform. While having a high profile champion of reform to provide leadership is crucial, this leadership may emerge from different places. In some states, the effort has been led by the governor, while in others it was led by a legislative leader or the treasurer. While pension reforms are supported by many Republicans, having a Democrat lead the effort goes a long way towards countering the charge that reforms are merely a conservative attack on labor. In states where Democrats have large legislative majorities (such as RI, IL, and NJ) Democratic support for reform is of course a necessity.

Gather and disseminate the hard data

Would-be reformers need to start by collecting updated and unbiased information about the status of the pension fund and its projected future health. This data and a simple explanation of what it means can bring transparency and clarity to an opaque and confusing issue. Policymakers should request more accurate cost projections using more realistic actuarial assumptions. These changes are likely to result in a larger unfunded liability than previously thought, creating a sense of urgency around reform. Treasurer Raimondo's work with the actuarial board in RI and the publication of her "Truth in Numbers" report is a great example of this. The report was written in an accessible style and widely disseminated and framed the reform conversation in a clear, data-driven manner. New federal Governmental Accounting Standards Board rules that began in summer 2013 required changes in the way public pension plans account for their portfolio gains and losses and may help the cause of pension reform. As *Governing Magazine* notes, these new rules "will likely have the effect of making a plan's unfunded liability appear higher than it did in prior years. Coupled with announcements from credit rating agencies that they will downgrade state with high unfunded liabilities, the pressure on public pension reform is mounting."[97]

Communicate and educate

It can be difficult to convince the public and political leaders that pension problems that may not fully hit until many years in the future need to be addressed today, particularly when doing so requires political and financial sacrifice. The amount of unfunded pension liability in states varies greatly and the less severe the situation, the less sense of urgency to fix it. Only when it gets really bad and the state's pension contribution begins to consume a large share of the annual budget does political momentum develop for reform. Rebecca Sibilia, the Chief Operating Officer of Students First noted that:

> *"Pensions are like a leaking oil well and there are two very different fixes that are needed—how to clean up the oil (paying off current unfunded liability) and how to stop the source of the leak (the underlying structural problems of the pension system). This hasn't been communicated effectively to politicians or by politicians."*

Reform advocates need to simplify complex issues for policymakers and the public alike and convey a sense of urgency, to bring immediacy to problems whose greatest impact may be far down the road. As Little, Morton, and Lakis have observed: "From a political perspective, pension reform is a hard sell. It is technical and complex, bringing to the forefront such enticing issues as 'rate of return,' 'actuarial assumptions' and 'long-term unfunded liabilities.'"[98] It is important to take the issue directly to the public by investing time and resources in implementing a multi-faceted communications strategy utilizing social media, town halls, television, newspapers, radio, and mailings. NJ Senate President Sweeney, Utah Senator Liljenquist, and RI Treasurer Raimondo devoted a tremendous amount of time to convincing citizens around their states of the need for reform, often one small group at a time.

Avoid turning pension reform into an ideological issue

Reform leaders in successful states emphasize the need to run a positive campaign that does not seek to blame unions but rather focuses on the numbers and the need to put the pension system on a sustainable path. The NJEA's Schnitzer remarked that:

> *"How you do something is almost as important as what you do. Conversations about pension changes are best done between lawmakers, their staffs, and affected constituencies outside of the media frenzy. I think unions see trouble on the horizon for some of these pension systems and might be willing to come to the table to work on how these issues ought to be addressed. In New Jersey, that conversation was often not started until a lawmaker held a press conference or introduced a bill. This puts unions and their members on the defensive. We have to start working on these problems—not making political hay of them—and that means talking first, coming to some mutually agreeable solutions, and having a press conference later. Demonizing employees (whether intended or not) makes these battles bloodier than they have to* be."

Utah State Senator Liljenquist, concurs, noting that politically it is important to let the numbers drive the conversation about fiscal realities and budgetary trade-offs and to avoid making the issue ideological.[99] The unions may or may not endorse the final pension reform bill, but it is important to give them a voice and an opportunity to participate in the process.

Demonstrate pensions' impact on taxes and other state spending priorities

How pension reforms are framed and presented to the public and state workers will have a major impact on how the politics of the legislative negotiations unfold. Illinois Senator Biss observed that "You have to demonstrate how pension cuts are part of a broader package of steps to address state budget problems that will reasonably and equitably distribute pain—ultimately it's about fairness." Utah Senator Liljenquist added that “reform leaders need to translate the budget data around pensions into opportunity costs to make it clear what the impact of not making pension changes will be on the provision of public services. In Utah we spoke about how the increase in unfunded pension liability was equivalent to the salaries of 8,000 teachers over a 25-year period.”

Sell the benefits of pension reform to state workers and school reformers

Most of the debate about pension reform focuses on the negative financial impact of changes on retiree benefits. But pension changes should be framed as ultimately in the best interests of pension participants relative to the consequences of the pension plans getting to the point where they can’t meet their obligations. Grady of the NJ Investment Council observed that “The NJ case offers a real leadership lesson for other states. The Governor made a very specific proposal and went around the state to educate the public about the situation and the real risk that pensions would not be there unless changes were made.” In addition, recent research has demonstrated convincingly that the structure of compensation and benefits for teachers and other public employees has a major impact on labor market dynamics and that existing pension systems impair states’ ability to recruit, retain, and deploy a high quality workforce.[100] As Rick Hess has observed, the debate over pension reform is “an opportunity for strategic teacher union leaders who would like to recalibrate the balance of spending between benefits and salary, between retirees and practicing educators, and between more senior and less senior teachers.” Hess has spoken with “a number of union officials and local leaders who quietly acknowledge the challenge posed by expensive factory-style health and pension obligations for retirees, and who are intrigued by the chance to revisit existing arrangements.”[101] Enlisting the support of new teacher voice groups like Teach Plus and Educators for Excellence—which tend to be comprised of younger teachers who are disproportionately harmed by the structure of traditional pension systems—can also be an effective tactic. As Chad Aldeman from Bellwether Education Partners observes:

> *“Pension tweaks like those in NJ that changed COLAs and retirement ages help the current financial state of the plan—but only shore up a fundamentally outdated system that doesn’t match the needs of the workforce. States should also make benefits more portable and attractive to younger prospective teachers and those who may not plan on spending their entire career in education.”*

Making the case that pension reform is necessary not only for fiscal reasons but also to improve the recruitment and retention of teachers can be a powerful two-pronged argument.

Build a diverse coalition and a statewide advocacy campaign

Public sector unions have large memberships and extensive resources and typically deploy their extensive political influence to oppose pension reform. In order to be successful, reformers need to build a counter-weight to the unions, a pro-reform coalition that can work to persuade policymakers and the general public of the need for pension changes. It can provide direction and communication across groups supportive of reforms and direct resources at lobbying the legislature and public engagement. It can also conduct polls to demonstrate public concern about pension problems and support for particular reforms. It is important, however, that the conversation not simply evolve into a business versus labor dynamic. Ideally, the pro-reform coalition will be diverse and broad-based and include groups from across the political spectrum—not just conservative and business groups but also social services groups who are concerned about how pension costs may affect their own state spending priorities. This coalition may be led by a new single issue advocacy group (such as EngageRI), or by an older group that has a broader agenda, as with the Civic Federation of Chicago. Given the unions' threats of electoral retaliation to politicians who support pension reform, it is important that pro-reform groups promise to defend/support them at election time and then stick around to do so when the time comes. Another potential resource for the pro-pension reform coalition are advocacy organizations that focus on school reform more broadly such as Students First, 50Can, Stand for Children, and Democrats for Education Reform.[102]

Adapt legislative strategy to particular state political environment

The legislative strategy reformers adopt can have an important impact on the outcome, but there is no single "best" approach, rather it depends on the particular political context in a state. RI emphasized a lengthy, transparent process with extensive engagement from a large number of legislators and the general public. NJ by contrast, achieved pension reform largely through a closed process of negotiations between Senate President Sweeney and Governor Christie's office. Calling a special session of legislature (as was done in Rhode Island and Illinois) can be an effective tactic because it forces legislators (and the media) to focus on a single issue within a short time window and creates a more hospitable environment for reform. In addition, the timing of a pension reform push can be significant in that elected officials may have more political capital to spend at the beginning of their terms and be more willing to make politically difficult decisions than when an election is approaching.

Anticipate and plan for legal challenges

The U.S. constitution (along with many state constitutions) gives a high level of legal protection to contracts and this has opened the door to court challenges to pension reforms in many states (including Colorado, Minnesota, Rhode Island, South Dakota, and New Jersey). The outcome of these cases depends on a state's specific statutory and constitutional language and the interpretation of the courts. As a result, significant pension reform may be delayed or even prevented unless these state and federal legal barriers are removed. Reformers also need to be strategic in designing reforms that can survive inevitable legal challenges.[103]

Endnotes

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push harder for pension payments in the state budget bill. We always include it in our testimony and statements but rarely have we withheld our support for the state budget bill over a skipped pension payment. It is hard for school employee unions who care so much about education as a whole to take a pass or rally against a budget that shortchanges or totally stiffs their pension if it fully funds or increases funding for the school aid formula or includes other important programs for kids."

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Interviews Conducted for this Project

Chad Aldeman, Senior Analyst at Bellwether Education Partners. August 8, 2013.

Senator Daniel Biss, Illinois Senate (D-9th District), Licensed Activities and Pensions Committee. Member of General Assembly Pension Conference Committee. August 7 and December 18, 2013.

David Draine, Senior Researcher, States' Public Sector Retirement Systems, Pew Center on the States. July 29, 2013.

Jon Duffy, Spokesman, Engage RI, August 5, 2013.

Ginger Gold Schnitzer, Director of Government Relations; Kevin Kelleher, Director of Research and Economic Services; and Brian Volz, Lobbyist, New Jersey Education Association. July 16, 2013.

Robert Grady, Chair of New Jersey State Investment Council. July 17, 2013.

Kory Holdaway, Director of Government Relations & Political Action, Utah Education Association, August 29, 2013.

Sandi Jacobs, Vice-President and Managing Director of State Policy, National Council on Teacher Quality, June 20, 2013.

Daniel Liljenquist, former Utah State Senator, Chair of the Retirement and Independent Entities Committee, and author of Utah pension reform legislation. August 29, 2013.

Dr. Thomas H. Little, Director of Curriculum Development and Research, State Legislative Leaders Foundation. July 24, 2013.

Mark Magyar, Editor-at-Large for NJ Spotlight, President of Community Informatics Inc., and Lecturer, School of Management and Labor Relations, Rutgers University. July 11, 2013 and January 31, 2014.

Laurence Msall, President, Civic Federation of Chicago and former Senior Advisor for Economic Development for Illinois Governor George H. Ryan. August 14, 2013.

Rep. Elaine Nekritz, Illinois Assembly (D-57th District), Assistant Majority Leader and Chair of Committee on Personnel and Pensions. August 6, 2013.

Ted Nesi, Reporter, WPRI 12, Rhode Island, August 2, 2013.

Michael Podgursky, Professor of Economics, University of Missouri-Columbia. July 19, 2013.

Gina Raimondo, General Treasurer of Rhode Island. August 7, 2013.

Sarah Rosenberg, Education Policy Analyst, Center for American Progress. July 29, 2013.

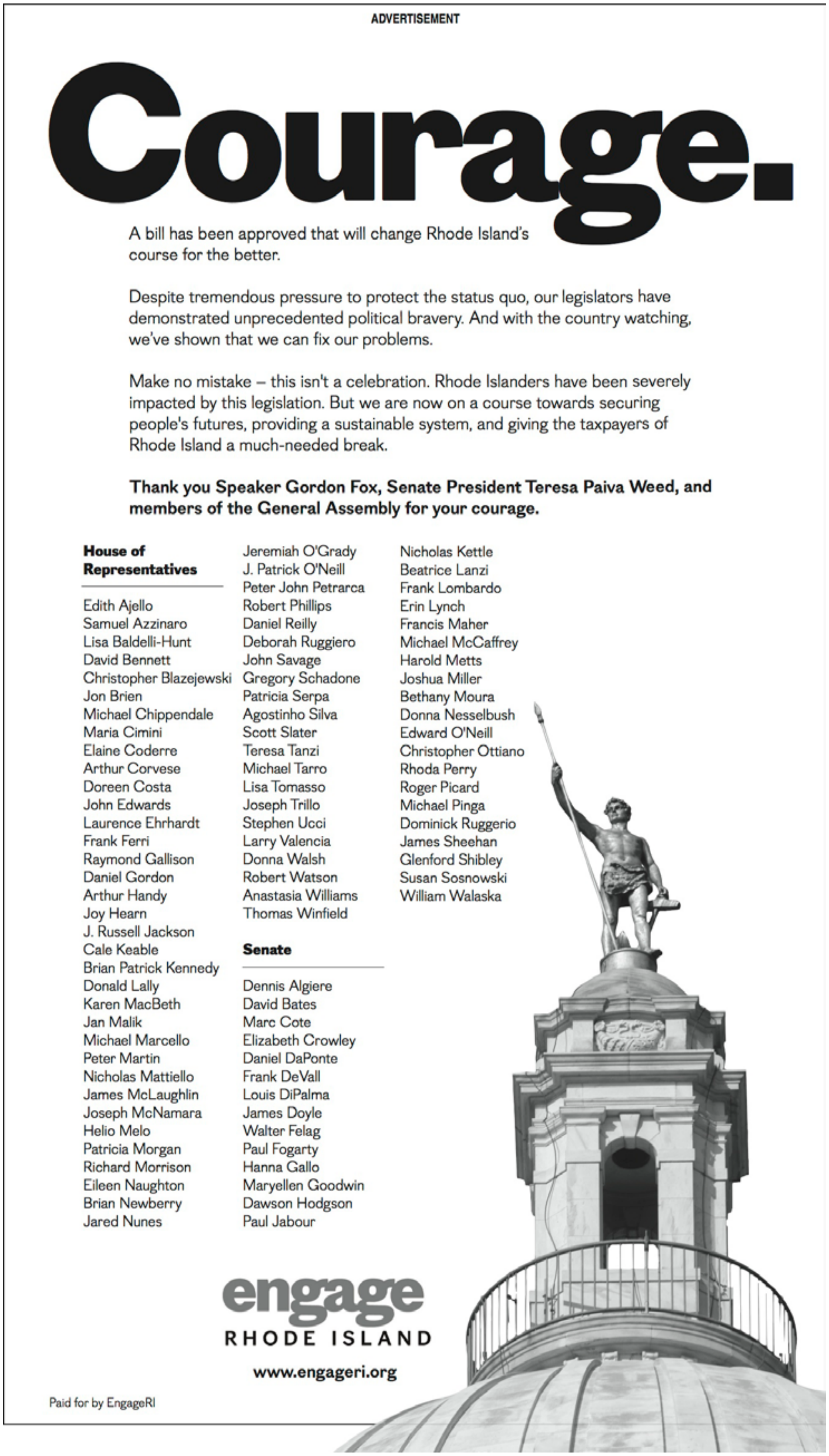
Marguerite Roza, Director of the Edunomics Lab at Georgetown University and Senior Research Affiliate at the Center on Reinventing Public Education. July 19, 2013.

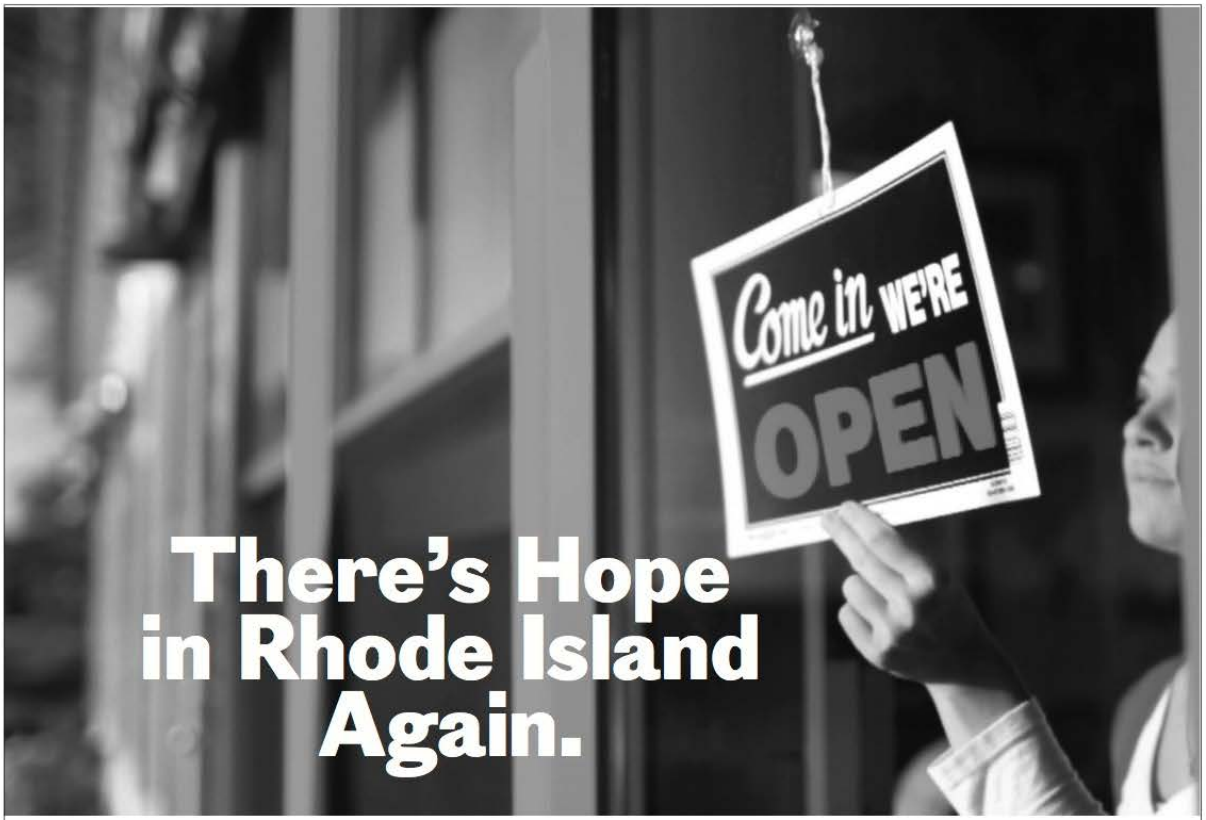
Rebecca Sibilia, Chief Operating Officer and Vice-President of Fiscal Strategy, and Eric Lerum, Vice-President for National Policy, Students First. August 28, 2013.

Steven Sweeney, New Jersey Senate President and author of NJ pension reform legislation. July 17, 2013.

Nick Yelverton, Legislative Director, Illinois Federation of Teachers, August 12, 2013.

Appendix A: Advertisements and Website from EngageRI Advocacy Campaign





The Governor and Treasurer recently introduced the Rhode Island Retirement Security Act of 2011 (RIRSA), a comprehensive pension reform bill that creates an affordable sustainable and secure retirement system for workers, taxpayers and retirees.

Comprehensive pension reform is an enormous step forward for Rhode Island and we cannot let this historic opportunity slip away. A recent poll indicated 92% of Rhode Islanders are in favor of fixing the pension crisis, so now it's up to the General Assembly to pass the bill – and they need to hear from YOU.

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Rhode Islanders want pension reform. You want a fair, sustainable system for workers, without having to pay more taxes. And you believe the state system will go bankrupt without changes.
You voted for your legislators to represent you. Don't let them ignore your voice.
Call your legislators today and urge them to pass the RI Retirement Security Act.
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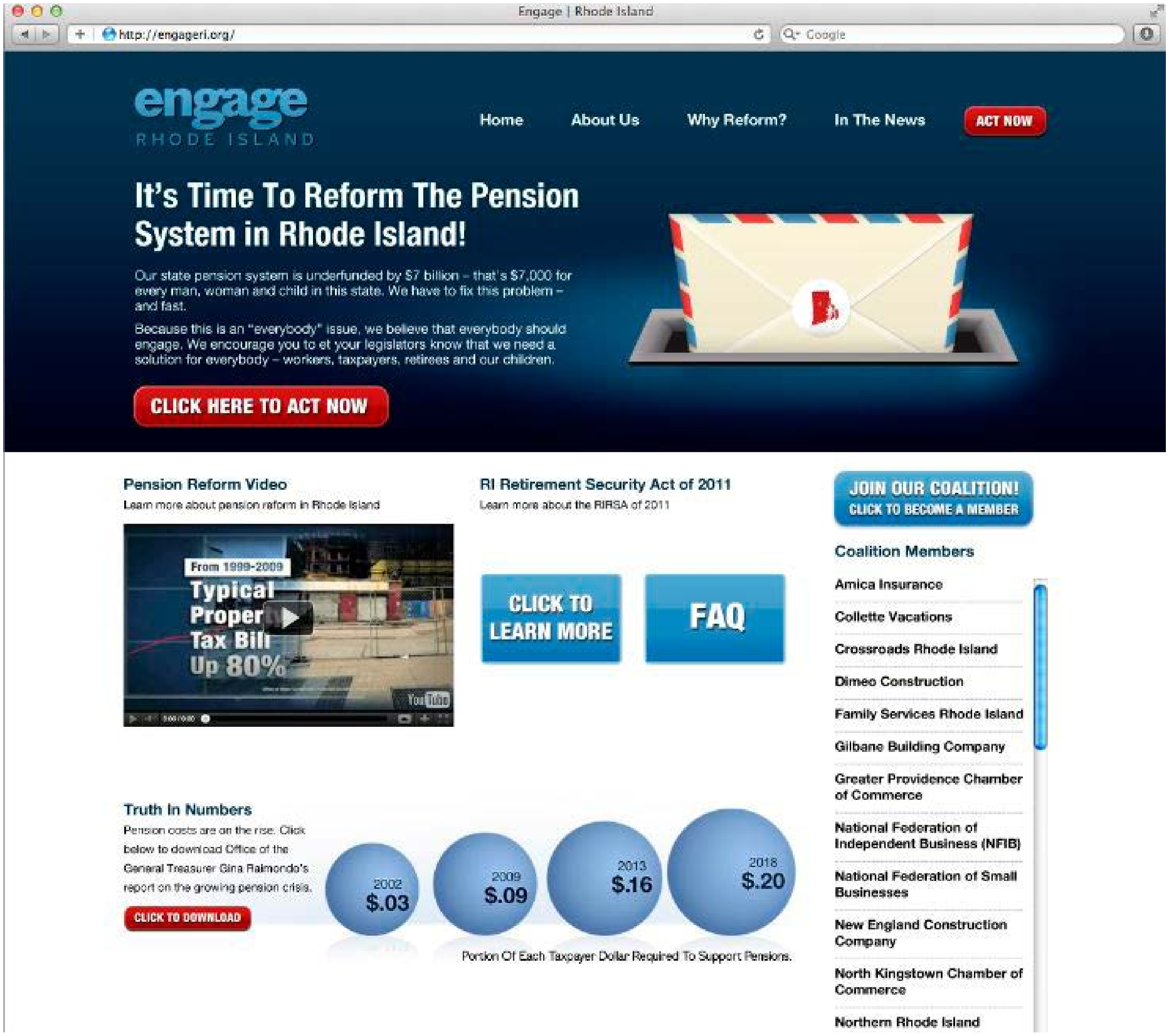
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Our state pension system is underfunded by $7 billion – that's $7,000 for every man, woman and child in this state. We have to fix this problem – and fast.
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Liz Sablich

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