# Straight Talk About Detroit, Illinois Pensions

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**MarketWatch Blog** by Alicia H. Munnell

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*If benefits are to be cut, cut them fairly.*

Detroit and Illinois have both been headline news for anyone interested in pensions. The story in Detroit is that a judge ruled that pensions can be treated like other debt in bankruptcy procedures. The story in Illinois is that the state passed legislation reducing future benefits for current employees and putting in place a plan to pay off the system's unfunded liabilities.

Observers have tried to put these two events together and project their implications for the rest of the country. Unfortunately, the Illinois and Detroit situations are not well-suited to a single sound bite. Here are some general thoughts.

The financial problems facing Illinois and Detroit are among the worst in the country, and have few implications for the nation as a whole. Illinois has systematically not funded its pensions – nor paid any other bills, to my understanding! Detroit's financial crisis reflects the large outmigration of people and industry, as well as fiscal mismanagement. It does not make sense to extrapolate from the nation's most dire situations to the rest of the country.

Pensions play a major role in the Illinois situation, but are less important in Detroit. Although one can always argue about the appropriate interest rate to use in discounting future benefits, Illinois state plans (with the exception of the Illinois Municipal Retirement Fund) vie for last place in terms of funded status.  Both of Detroit's pensions, in contrast, are funded at roughly the national average.  The funded status does reflect the transfer of proceeds from pension obligation bonds issued in 2005 and 2006, which increased the city's *non-pension* debt.  But pensions are not driving Detroit's problems.

The Illinois and Detroit decisions are not the first foray at cutting pension benefits of state and local workers.  In a **recent study** of 32 state pension plans, we found that 29 had cut benefits in the wake of the financial crisis and ensuing recession.  These cuts involved some combination of: a) increased employee contributions and suspensions of cost-of-living adjustments for both current and future employees; and b) dramatic cuts in benefits for new hires.  So most states have already made significant changes to put public plans on a path to sustainability.

American cities are not going to topple like dominoes and declare bankruptcy.  First, most cities do not face the degree of financial challenge faced by Detroit.  Of our sample of 173 prominent cities (the largest few in each state), only 13% had financial problems serious enough to appear in the press.  Second, for those with financial problems, bankruptcy is an expensive route that takes the control away from local officials.

Finally, the goal here is not to hack away at public pensions.  Rather, states and localities need to design compensation packages – commensurate with those in the private sector – to attract talented people to run our states and cities, to educate our children, and to protect our citizens.  Pensions should be part of a human resource dialogue.  Reform is desirable in many

instances as current plans often encourage people to retire in their 50s and provide little for short-term employees.  But the goal has to be that when public employees retire they should have enough to maintain their standard of living.  And whatever is taken away in terms of lower pensions should probably be replaced by higher wages so that the public sector remains competitive.

Try to make a sound bite out of all of that!