



## Pensions vs. schools: Higher education

*College funding and tuition aid can't compete with retirement spending*

### THE PROBLEM

Higher education in Illinois is approaching a funding crisis. By fiscal year 2013, the state is set to appropriate more to public university pensions and other retirement costs than it will to support all other higher education programs. Illinois' state pensions, which require a significant increase in state contributions in coming years, are set to drown out spending on core services. When state spending on higher education retirements surpasses all other aid to public higher education institutions, education funding will be turned upside down.

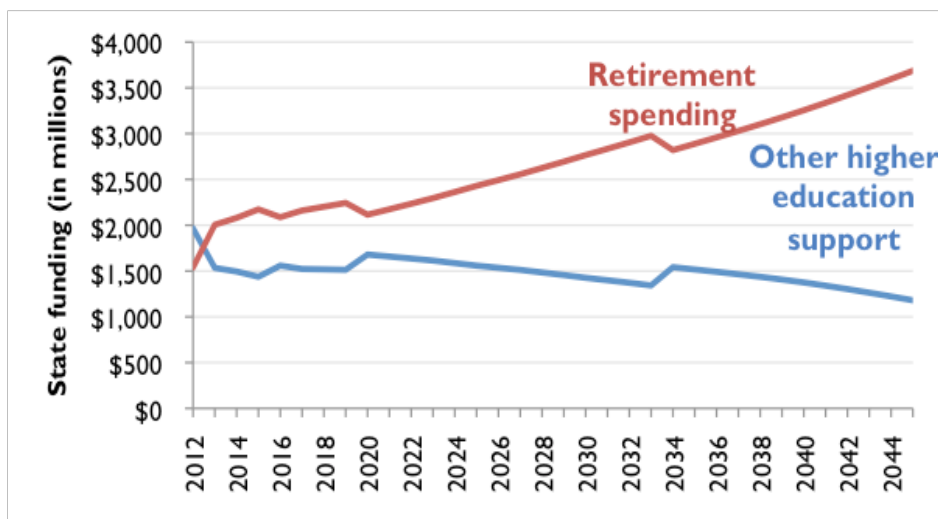
retirement System, or SURS, released updated projections of the state's annual statutory pension contributions through 2045.<sup>1</sup> The numbers were adjusted after the pension system made changes to their actuarial assumptions. The changes increased the state's statutory payment for fiscal year 2013 to \$1,402.8 million from the previous projection of \$1,057.7 million. **This nearly \$350 million jump in payments will almost certainly cause higher education retirement expenditures to eclipse other higher education support next year.**

In November 2011, this problem was put into focus when the State Universities Re-

As decades of fiscal irresponsibility catch up to Illinois' budget, individual programs

**GRAPHIC 1. PROJECTED HIGHER EDUCATION RETIREMENT SPENDING VS. OTHER HIGHER EDUCATION SUPPORT**

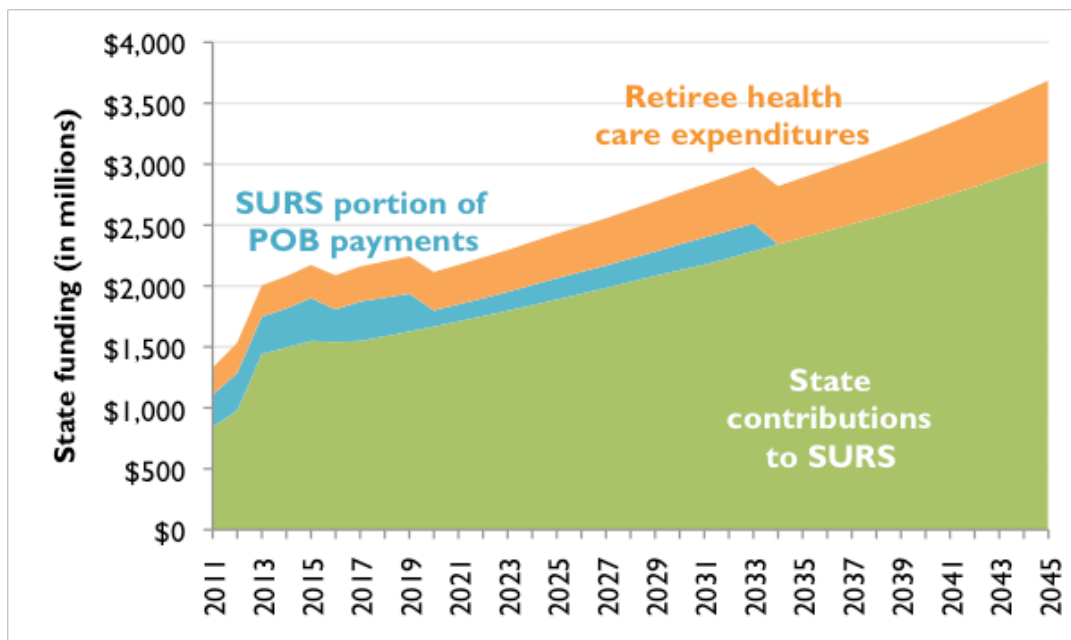
(Assumes total education spending grows at 1 percent annually)



Source: Commission on Government Forecasting and Accountability, State Universities Retirement System and Illinois Policy Institute calculations. Assumes 3 percent retiree health care spending growth. See appendix for more information.

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**GRAPHIC 2. PROJECTED STATE HIGHER EDUCATION RETIREMENT SPENDING BY EXPENDITURE**

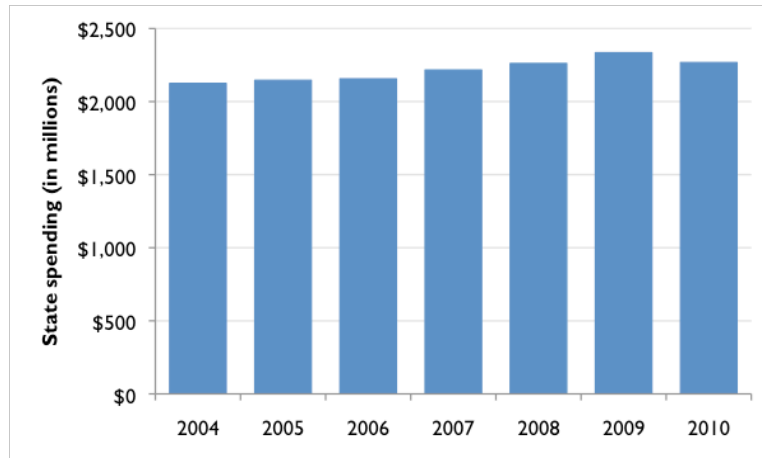


Source: Commission on Government Forecasting and Accountability, State Universities Retirement System and Illinois Policy Institute calculations. Assumes retiree health care costs grow at 3 percent annually.

will compete for funds. An expenditure that will cut into every area of state spending is the increasing liabilities for state employee retirements. To best understand how these retirement expenditures will affect the state's budget, they should be tied to the relevant budget areas where they are incurred. The state's higher education budget, properly conceived, must include all the retirement expenses paid by the state on behalf of

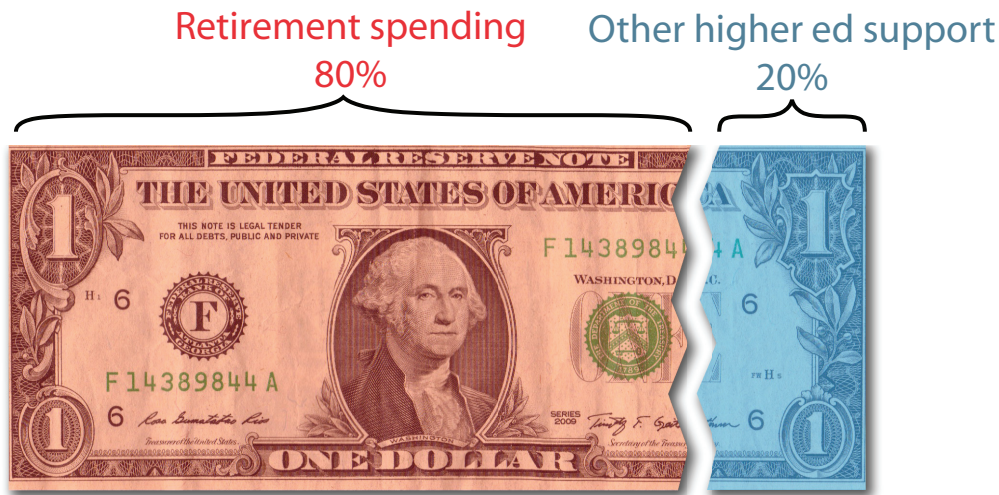
employees of the public higher education system. In addition to pension contributions, the state must also pay for pension obligation bond payments (POB) and retiree health care. The annual pension bond and health care costs can be quite significant, as Graphic 2 shows.

**GRAPHIC 3. NON-RETIREMENT STATE SPENDING ON HIGHER EDUCATION, ADJUSTED FOR INFLATION (FISCAL YEARS 2004-2010)**



Source: Illinois State Budget Books, the Commission on Government Forecasting and Accountability, the Illinois Board of Higher Education, US Bureau of Economic Analysis and Illinois Policy Institute calculations.

**GRAPHIC 4. WHERE NEW STATE DOLLARS FOR HIGHER EDUCATION WERE SPENT (FISCAL YEARS 2005-2010)**



Source: Commission on Government Forecasting and Accountability, US Bureau of Economic Analysis and Illinois Policy Institute calculations.

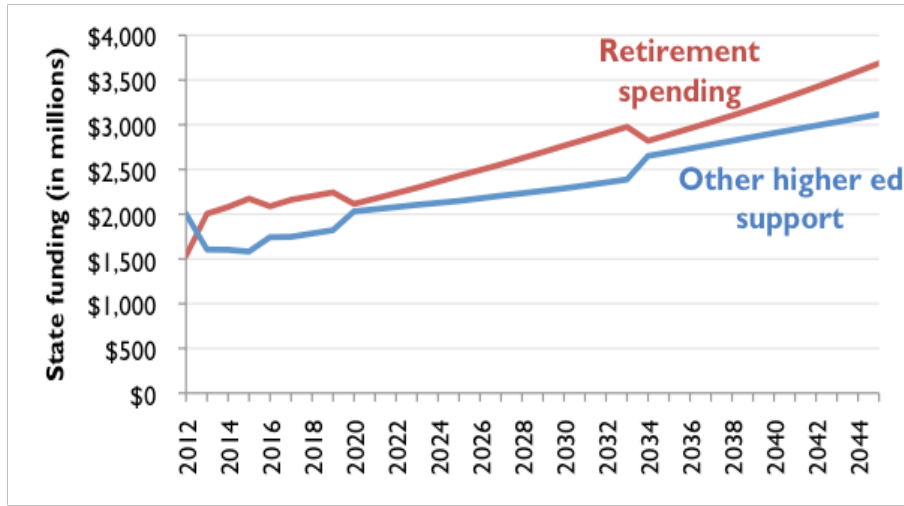
*Even though overall state education spending will grow, the amount allotted to classrooms will be less and less as a percent of total spending.*

In contrast to the steadily increasing retirement expenditures, it is unlikely that total higher education funding will significantly increase in future years. Historical funding trends show that in recent years, other higher education support has remained relatively stagnant (see Graphic 3).

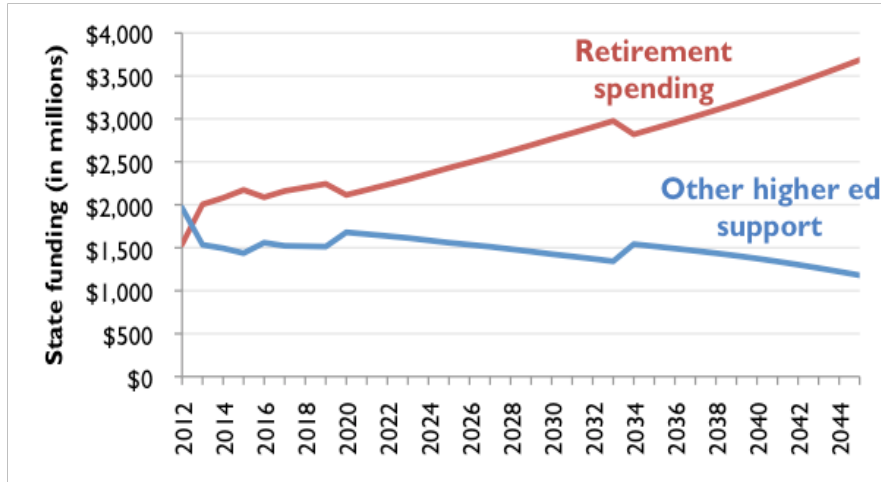
Retirement spending has already started crowding out higher education funding. Eighty cents out of every new state dollar for higher education went to retirement spending between 2005 and 2010 (see Graphic 4). But relief for public higher education institutions won't come soon. In fact, the situation will only worsen.

**GRAPHIC 5. PROJECTED HIGHER EDUCATION RETIREMENT SPENDING VS. OTHER HIGHER EDUCATION SUPPORT AT VARIOUS RATES OF TOTAL GROWTH**

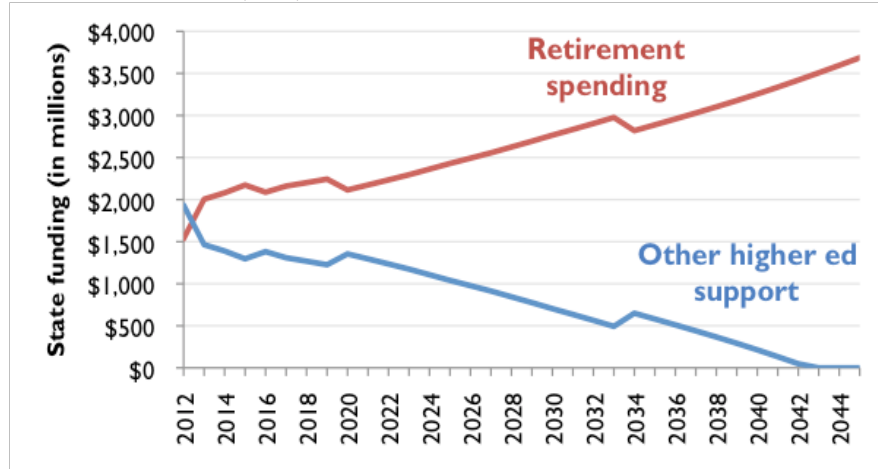
**2% GROWTH IN STATE SPENDING ON HIGHER ED**



**1% GROWTH IN STATE SPENDING ON HIGHER ED**



**NO GROWTH (0%) IN STATE SPENDING ON HIGHER ED**



Source: Commission on Government Forecasting and Accountability, State Universities Retirement Systems and Illinois Policy Institute calculations. Assumes 3 percent retiree health care spending growth. See appendix for more information.

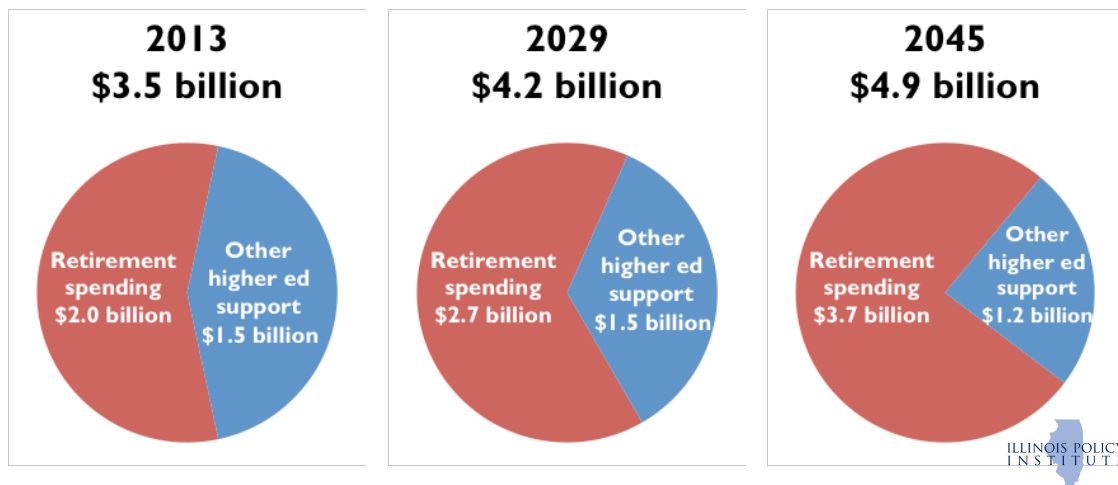
Using pension and bond figures from the State Universities Retirement System and the Illinois General Assembly’s economic and fiscal research commission, the Commission on Government Forecasting and Accountability, it is possible to estimate future state higher education retirement spending. Graphic 5 shows three potential future scenarios based on different rates of growth for total higher education spending (the total of retirement expenditures and other support). For example, if total higher education spending grows at 1 percent annually, retirement spending will account for 76 percent of higher education funding in 2045. If overall higher education funding grows at a faster or slower rate than this, then the share of higher education funding absorbed by retirement spending would adjust as well (see appendix for details). The next decade is going to be extremely troublesome for

Illinois’ state budget. Downstate and suburban PK-12 education funding is facing a similar eclipse from the retirement costs and pension payments to the Teachers’ Retirement System,<sup>2</sup> and the federally mandated expansion of Medicaid through the national health reform will cost Illinois \$10 billion between 2014 and 2019.<sup>3</sup> Significant spending increases in the coming fiscal climate will be unlikely. If historical trends hold true, it may be more realistic for total state higher education funding to hold steady or even decline in future years.

As public universities attempt to make up for the decreased state funding, many will increase tuition and mandatory fees. Higher education officials have often blamed insufficient state funding for the rapid tuition increases in recent years.<sup>4</sup> After adjusting for inflation, tuition and mandatory fees for

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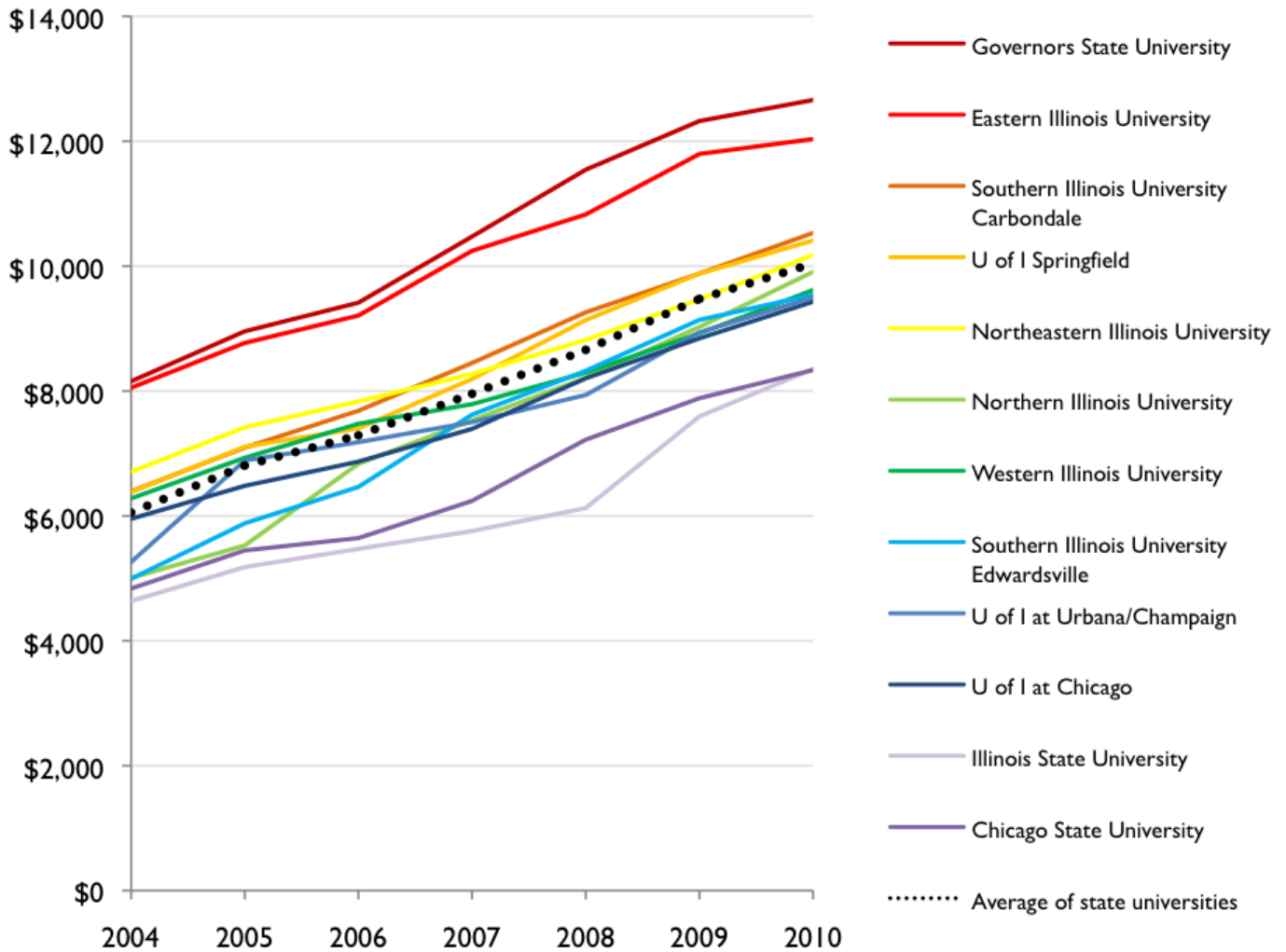
**GRAPHIC 6. PROJECTED STATE SPENDING ON HIGHER EDUCATION: RETIREMENT VS. OTHER HIGHER EDUCATION SUPPORT AT 1 PERCENT ANNUAL GROWTH**



Source: Commission on Government Forecasting and Accountability, State Universities Retirement Systems and Illinois Policy Institute calculations. Assumes 1 percent funding growth for retirement spending and other higher education support combined. Assumes 3 percent retiree health care spending growth. See appendix for more details.

**GRAPHIC 7. ANNUAL TUITION AND MANDATORY FEES FOR ENTERING UNDERGRADUATE STUDENTS AT ILLINOIS PUBLIC UNIVERSITIES, 2004-2010**

**ADJUSTED FOR INFLATION (IN 2010 DOLLARS)**



Source: Illinois Board of Higher Education, the GDP Deflator from the U.S. Bureau of Economic Analysis and Illinois Policy Institute calculations.

incoming undergraduate students increased by an average 66 percent at Illinois public universities between 2004 and 2010.<sup>5</sup> But the irony of this situation is that while officials decry high tuition on one hand, they defend one of the policies making higher education so unaffordable: public employee pensions.

In November 2011, a group of Illinois public university chancellors and presidents sent a letter to Gov. Pat Quinn and legislative leaders urging against a pension reform bill before the General Assembly.<sup>6,7</sup> These university leaders cite pension benefits as a key tool in attracting and retaining talented faculty and staff. Their statement ignores the fact that skyrocketing retirement expenses will devour all other state spending on their institutions and students. The state simply cannot afford to pay for everything: generous pension benefits, financial support for students *and* increasing higher education funding. Unfortunately, it's likely that universities will ultimately push these costs onto students.

#### **OUR SOLUTION**

Legislators have mismanaged the state's public pension funds, while sweetening benefits for retirees and expanding state programs. As it exists now, the pension system is set to cripple state budgets for decades to come. Taxpayers cannot continue to bear the burden of an unsustainable pension system. Instead, the system should be reformed so that politicians are not able to underfund benefits year after year to pay for pet projects or new programs. Retirement benefits should be aligned with private sector practices, and control of individual pension benefits should be in the hands of the employee.

Multiple reform options that would improve the state's fiscal outlook are available to legislators. Future benefits for current employees could be reduced with employees contributing at current levels. Alternatively, employees could contribute more to their retirements

to keep the current benefit level. While these changes would be improvements, the reform that will fundamentally reduce financial risk to taxpayers in the future is to move government workers to a defined contribution system. A defined contribution system would put state employees in direct control over their retirements and reduce liabilities facing taxpayers.

The current system is plagued by irresponsible political behavior and overly optimistic assumptions. The status quo clearly doesn't work. Public university and college employees should not have to rely on politicians who have broken promise after promise. Instead, Illinois should move to a system that takes power out of the politicians' hands and puts it with the employees. Taxpayers and students cannot continue to bear the burden for an overly generous benefit structure. The legislature needs to ensure that retirement benefits match the state's financial reality and start taking steps to regain control of the state's fiscal future. By reducing the cost of pensions, the state can save money for key services – including education.

#### **WHY THIS WORKS**

Illinois' skilled workforce is one of its greatest assets. But the opportunity for educational advancement for the next generation will be severely limited if retirement spending crowds out funding for higher education. Higher education may seem expensive now, but it will only worsen as institutions resort to spiking tuition rates to stay afloat.

Retirement expenditures threaten to strain all of the state's core service areas. Nowhere is this more evident than in higher education. Reform is vital to protecting future generations of students looking to improve their lives and contribute to the state's economy. By creating an equitable and sustainable pension system, the state can protect core services and ensure the financial security of state employee retirement benefits.

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**APPENDIX**

**FUTURE OUTLOOK**

At 1 percent annual education funding growth, the state will spend 75.8 percent of higher education funding on retirement spending in 2045. The following table shows share of higher education spending going to retirement spending versus other higher education support in fiscal year 2045 at various rates of growth for overall higher education funding.

**GRAPHIC 8. SHARE OF HIGHER EDUCATION SPENDING IN 2045 AT VARIOUS FUNDING GROWTH RATES**

Annual higher education funding growth	Retirement Spending	Other higher education support
3.0%	38.9%	61.1%
2.5%	45.9%	54.1%
2.0%	54.2%	45.8%
1.5%	64.0%	36.0%
1.0%	75.8%	24.2%
0.5%	89.7%	10.3%
0.0%*	100.0%	0.0%

\*At no growth (0.0 percent) and lower higher education growth, retirement spending will completely consume overall higher education funding by 2045. This makes it virtually impossible to have flat or negative overall higher education funding growth in future years and maintain the higher education system.

**METHODOLOGY**

This report uses the total of higher education state funds (general and other)<sup>8</sup> from the Illinois State Budget Books as a base for higher education funding. Then the State Universities Retirement System’s (SURS) portion of the state’s annual pension obligation bond (POB) payments<sup>9</sup> and the SURS portion of the State Employee Group Insurance Program (SEGIP)<sup>10,11,12</sup> are added in to determine the state’s “**overall state higher education spending**.”

$$\text{Total higher education state funds} + \text{SURS portion of POBs} + \text{SURS portion of SEGIP} = \text{Overall state higher education spending}$$

To calculate the amount of “**other higher education support**” to higher education institutions, “**retirement expenditures**,” which are the sum of the state’s SURS contribution,<sup>13</sup> the SURS portion of POBs,<sup>14</sup> the SURS portion of the State Employee Group Insurance Program<sup>15,16,17</sup> and the College Insurance Program,<sup>18</sup> are subtracted from the “**overall state higher education spending**” figure. The resulting number is what this report estimates as the state’s “**other higher education support**.”

$$\text{Overall state higher education spending} - \text{Higher education retirement spending} = \text{Other higher education support}$$

Sources for historical information for the following data categories are as follows:

- Total higher education funds total from Illinois State Budget Books<sup>19</sup>
- SURS portion of (POB) payments from COGFA<sup>20</sup>
- SURS portion of the State Employee Group Insurance Program from COGFA<sup>21,22,23</sup>
- College Insurance Program from Illinois Board of Higher Education<sup>24</sup>

For data in fiscal year 2012 and future years, some figures are provided by sources and some are calculated. SURS provides data for the state’s projected contribution to SURS, and COGFA has data on the portion of POBs associated with SURS. Starting with fiscal year 2013, all retiree health care expenditures are grown at 3 percent annually, and the “**overall state higher education spending**” figure, which includes both retirement spending and other higher education support, is grown at 1 percent annually, unless otherwise noted. All other estimates are a result of the previously mentioned calculations.

**ASSUMPTIONS**

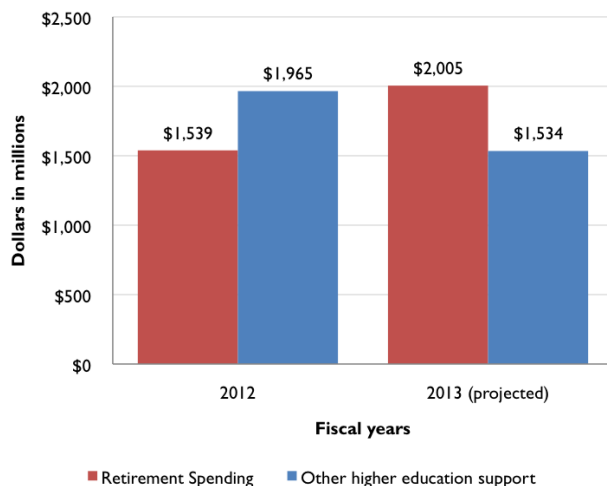
*Total state funding for higher education will likely grow at 1 percent annually*

This report assumes that total state funding for higher education will grow at 1 percent annually, unless otherwise noted. Historically, higher education funding has been stagnating, and the many financial strains facing the state make it unlikely that the higher education budget will be able to grow at a more rapid pace. A number of scenarios are modeled in the table above, ranging from flat funding to a sustained annual increase of 3 percent for total state higher education spending.

*Retiree health care costs will grow at 3 percent annually*

Retired university employees participate in two different group health insurance programs: the College Insurance Program, CIP, and the State Employees Group Insurance Program, SEGIP. Across the nation, health care costs have been increasing rapidly over the last decade, and SEGIP is no exception. Between 2001 and 2010, SEGIP liabilities grew at an average of 7.61 percent annually.<sup>25</sup> In an analysis of CIP, the Commission on Government Forecasting and Accountability grew the program’s cost at 3 percent annually for future years<sup>26</sup>. Although 3 percent annually may likely understate future health care costs, this report uses the more conservative estimate.

**GRAPHIC 9. RETIREMENT SPENDING VS. OTHER HIGHER EDUCATION SUPPORT  
FISCAL YEARS 2012 AND 2013**



Source: Commission on Government Forecasting and Accountability, State Universities Retirement Systems and Illinois Policy Institute calculations. Fiscal year 2013 other higher education support funding projected based on assumptions previously described in the appendix. Assumes 1 percent overall higher education funding growth and 3 percent retiree health care spending growth.

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## ENDNOTES

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- 16 *Commission on Government Forecasting and Accountability*, "Illinois House Bi-Partisan Task Force on Budget Reform and Spending Reductions," 23 February 2010.
- 17 *Commission on Government Forecasting and Accountability*, "Illinois State Employees Group Insurance Program," Gabriel Roeder Smith & Company, January 2010, <http://www.ilga.gov/commission/cgfa2006/Upload/FY2009StateGASBvaluation.pdf>.
- 18 *Illinois Board of Higher Education*, "Data Book: Financial Data – State Appropriations for Retirement and Group Insurance," Fiscal Years 2004-2010, <http://www.isbe.state.il.us/reports/annual10/report.pdf>.
- 19 *State of Illinois*, "State Budget," Fiscal Years 2006-2012.
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