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WHY U.S. STATES NEED PENSION WAIVER CREDITS

Randall K. Johnson*

I. INTRODUCTION

The U.S. public pension crisis, which arose when “[public] . . . employees, taxpayers, and investors . . . became concerned about the underfunding of [public] . . . pension plans,”¹ has led to a profound change in state budgetary priorities.² Some U.S. states, for example, have raised taxes to ensure that public pensions are adequately funded.³ Others have offered fewer public services, in order to reduce their unfunded pension liabilities.⁴ A third group has made better use of scarce public sector resources, especially because Chapter 9 bankruptcy is not available to any U.S. state.⁵

Making better use of public sector resources may be the single best way to deal with the U.S. public pension crisis, because it is a more politically viable alternative to tax increases and spending cuts.⁶ This approach also has lower opportunity costs, which are defined as the “amount of other goods and services [that] . . . could have been obtained instead [of the selected option].”⁷ Lastly, it helps to identify government failures,⁸ such as spiking.⁹ In other words, this approach is a cost-justified response to the U.S. public pension crisis.

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1. Julie Roin, *Planning Past Pensions*, 46 LOY. U. CHI. L.J. 747, 750–51 (2015).
2. See generally Iris J. Lav & Dylan Grundman, A Balanced Approach to Closing State Deficits, Ctr. on Budget & Pol’y Priorities 2 (Feb. 25, 2011), <http://www.cbpp.org/sites/default/files/atoms/files/2-16-10sfp.pdf>.
3. *Id.* at 7–8.
4. *Id.* at 2.
5. While Chapter 9 bankruptcy is not available to U.S. states, it may be used by local governments and other non-state entities. See U.S.C. § 109(c)1 (2012).
6. See Lav & Grundman, *supra* note 2, at 1–2.
7. John Black, OXFORD DICTIONARY OF ECONOMICS 332, *Opportunity Cost* (2d ed. 2002).
8. See Clifford Winston, *Government Failure vs. Market Failure: Microeconomics Policy Research and Government Performance*, BROOKINGS (Sept. 2006)), <http://www.brookings.edu/research/papers/2006/09/monetarypolicy-winston> (“[Government failures arise] . . . when

By presenting a detailed case study, which focuses on the public pension crisis in a single jurisdiction, Illinois,¹⁰ this article describes one way to make better use of public sector resources. It does so by critically assessing the case of Illinois,¹¹ which is the worst funded public pension system in the entire country.¹² Despite its last-place standing, Illinois still “provides a reasonably good illustration of the public pension problems facing many U.S. states”¹³ because it adheres to the majority legal rule, i.e., that public pensions are valid common law contracts.¹⁴ As a result, this article also explains how other U.S. states could address their own public pension issues.

Specifically, this article focuses on one of the primary sources of public pension inefficiencies: defined-benefit pension plans.¹⁵ Defined-benefit pension plans operate by awarding public employees a fixed amount of money, and other fringe benefits, upon retirement. The cost of

government has created inefficiencies because it should not have intervened [in a particular market] . . . in the first place or when [that government] . . . could have solved a given problem . . . more efficiently . . . by generating greater net benefits.”)

9. “Spiking” refers to the practice of “artificially inflating pensionable salary.” See Civic Federation, *Illinois Pension Primer: A Plain-English Guide to Public Employee Pensions in the State of Illinois* 9 (April 22, 2015).
10. See Honor Moore, *The Public Pension Reform Problem*, 22 ELDER L. J. 249, 251 (2014) (“The complexity and severity of the pension crises in Illinois puts the state in a unique position to serve as an example for other [U.S.] . . . states that are experiencing pension crises.”).
11. *Id.* at 251 (“In Illinois, strict legal requirements and intense political pressures forces legislators to be very careful and creative in developing ways to reduce the state’s liabilities while upholding the contractual rights of public employees.”).
12. Martin Z. Braun, *State Pension Funding Levels In U.S. Improve For A Second Year*, BLOOMBERG, Oct. 12, 2015, <http://www.bloomberg.com/news/articles/2015-10-13/state-pension-funding-levels-in-u-s-improve-for-a-second-year> (“Illinois with a pension shortfall of more than \$100 billion, remains the state with [the] . . . worse funded retirement system, with a ratio of assets to liabilities of 39.3 percent.”)
13. Roin, *supra* note 1, at 751–52.
14. See Eric M. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, 27 ABA J. LAB. & EMP. L. 179, 181-2 (2012):
 Most [U.S.] . . . states follow the contractual approach . . . In Illinois, . . . by joining a pension system, public employees obtain absolute ‘vested’ rights in the pension plan, including later benefit increases added during their service. These rights cannot be unilaterally changed by the legislature under any circumstances, but the rights may be modified via legitimate contract principles (an offer, new consideration, and voluntary employee acceptance).
15. The author uses the term “defined-benefit pension plans” to describe one way to deliver “retirement annuity benefits.” This mechanism for delivering retirement benefits has been around for a long-time and remains a very popular option. See Robert Clark, *Evolution of Public-Sector Retirement Plans: Crisis, Challenges, and Change*, 27 ABA J. LAB. & EMP. L. 257, 262 (2012) (“By the middle of the twentieth century, virtually all [U.S.] . . . states provided . . . define benefit plans . . . to their employees.”).

administering defined-benefit plans, traditionally, was borne by public employers.¹⁶

Despite their popularity, defined-benefit pension plans are a relatively inefficient way to deliver retirement annuity benefits,¹⁷ at least in conventional economic terms,¹⁸ for a variety of reasons.¹⁹ One such reason is that many defined-benefit pension plans generate unfunded pension liabilities due to “the mismatch between the assets in [these] defined-benefit pension plans (primarily equities) and [their] . . . liabilities (deferred fixed annuities).”²⁰ This mismatch therefore should be avoided, in order to limit unfunded pension liabilities. A simple way for U.S. states, such as Illinois, to achieve this goal is to move away from defined-benefit pension plans.²¹

Among the biggest obstacles to moving away from defined-benefit pension plans, at least in cases where both parties agree to modify a valid public pension contract, is the common law requirement of fresh consideration.²² This requirement assumes that any subsequent modification to a valid common law contract will be unenforceable, unless both parties receive additional consideration.²³ This fresh consideration

16. See Civic Federation, *supra* note 9, at 5 (“In Illinois [almost all public pensions are defined-benefit pension plans, which]. . . are funded through employer and employee contributions and investment earnings.”).
17. See Zvi Bodie, *Mismatch Risk, Government Guarantees, and Financial Instability: The Case of the U.S. Pension System*, 8 INT’L J. OF CENTRAL BANKING 273, 274–5 (2012), <http://www.ijcb.org/journal/ijcb12q0a15.pdf>.
18. In comparison, moving away from defined benefit pension plans may be economically efficient because public employers, state taxpayers and public employees are all better off by sharing the risk of loss. See Richard Posner, *ECONOMIC ANALYSIS OF LAW* 1.2 *Value, Utility, Efficiency* (9th ed. 2014) (“The social goal most emphasized in modern economics is not happiness or utility, but the efficient allocation of resources in a somewhat special sense. . . . A Pareto-superior transaction (or ‘Pareto improvement’) is one that makes at least one person better off and no one worse off.”).
19. See, e.g., Civic Federation, *supra* note 9, at 6. For example, the fact that the risk of loss is placed solely upon public employers raises the possibility of moral hazard or “the danger that if a contract promises people payments on certain conditions, they will change their conduct so as to make these conditions more likely to occur.” Black, *supra* note 7, at 308–09. An example of how some public employees change their conduct in order to make it more likely that their public pensions grow is the practice of spiking.
20. Zvi Bodie, *supra* note 16, at 273.
21. In fact, there may be some non-economic benefits that result from using defined-benefit pension plans such as increased loyalty to public employers. In cases where U.S. states choose to continue using defined-benefit pension plans, for whatever reasons, it may be prudent to employ the use of legal lists. Legal lists describe the types of investments that public pension funds should make. See *Legal Lists*, INVESTOPEDIA, http://www.investopedia.com/terms/l/legallist.asp?adtest=term_page_v14_v2 (“A selection of eligible companies and investments, determined by . . . state governments, for institutions such as insurance companies and pension plans [to invest in] . . . These [legal lists focus on] . . . low risk, low [volatility options that] . . . insure the well-being of investors . . . where safety of principal is of concern.”).
22. The requirement of fresh, or new, consideration was imposed in response to the common law pre-existing duty rule. See Joseph M. Perillo, *CONTRACTS* § 5.14 (7th ed., 2014) (“Under the pre-existing duty rule, a binding agreement to modify a contract requires consideration.”).
23. *Id.*

must be provided, in keeping with the pre-existing duty rule, except in situations when “changed circumstances” or another valid exception is raised by a party.²⁴

Within this context, a fresh consideration dilemma may arise because one, or both, of the parties cannot offer additional consideration. This dilemma, however, may be overcome by using Pension Waiver Credits.²⁵ This new tax expenditure concept,²⁶ which is described for the first time in this article,²⁷ achieves its goal by providing fresh consideration for each of the parties. This additional consideration takes two forms: a new tax credit allocation (i.e., this tax expenditure provides early access to retirement benefits, which would otherwise be accessible upon retirement, and thereby provides fresh consideration for public employees) and the right to discontinue offering defined-benefit pension plans (i.e., the waiver of this legal duty, which would otherwise need to be discharged, serves as fresh consideration for public employers). Because this fresh consideration is not tied to any pre-existing duty, and meets every other requirement,²⁸ Pension

24. See Jason Scott Johnston, *Default Rules/Mandatory Principles: A Game Theoretic Analysis of Good Faith and the Contract Modification Program*, 3 S. CAL. INTERDISC. L. J. 337, 366–71 (1993).

Insofar as the ultimate purpose to be served by a legal rule on modification is to enforce modifications that are based on actual changed circumstances not already accounted for in the contract price, and not to enforce those modifications that are simply extortionate hold-up attempts, the pre-existing duty rule was both underinclusive and overinclusive.

Other potentially valid exceptions to the pre-existing duty rule may include mutual rescission, reliance and waiver. See Corneill A. Stephens, *Abandoning the Pre-Existing Duty Rule: Eliminating the Unnecessary*, 8 HOUS. BUS. & TAX L.J. 355, 366–71 (2008).

25. The term “waiver” is defined, at least for purposes of this article, as “the release of claims pursuant to a private agreement between a person and his or her current or former employee.” Daniel P. O’Gorman, *A State of Disarray: The ‘Knowing and Voluntary’ Standard for Releasing Claims Under Title VII of the Civil Rights Act of 1964*, 8 U. PA. J. LAB. & EMP. L. 73, 73 n.4 (2005).

26. See Stanley S. Surrey, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679, 679–80 (1976):

Essentially, the tax expenditure concept . . . regards such a tax as composed of two distinct elements. The first element contains the structural provisions necessary to the application of a normal income tax. . . . These provisions compose the revenue raising aspects of the tax. The second element consists of the special preferences found in every income tax. These special preferences, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favor a particular industry, activity or class of persons.

27. The author of this article, Randall K. Johnson, initially developed the concept of “Pension Waiver Credits” in 2012.

28. A valid common law contract, and any subsequent modification of such a contract, requires an offer, an acceptance, consideration on both sides, no defenses to contract formation and no defenses to contract performance. See generally Williston, *CONTRACTS* § 1.1 (4th ed. Lord 1990).

Waiver Credits resolve the fresh consideration dilemma for public pension contracts.²⁹

The article proceeds in four parts. First, this article describes the applicable law for U.S. public pensions.³⁰ Next, it explains how to limit public pension inefficiencies, at least on a prospective basis, by moving away from defined-benefit pension plans. Third, the article describes one way to move beyond defined-benefit pension plans by calling for the creation of a new state tax expenditure program (specifically, a Pension Waiver Credits Program). Finally, it explains how U.S. states could implement this tax expenditure program in order to partially address the U.S. public pension crisis.

II. APPLICABLE LAW

For the last forty years, U.S. states were not legally “required to fund their [public] . . . pension promises.”³¹ This lack of regulation gave public employers an implied legal right to withhold information, to use questionable practices and to not insure public pensions.³² The 1974 Employee Retirement Income Security Act (ERISA) enabled each of these implied legal rights.³³

Subsequent federal regulation impaired these implied legal rights, so as to encourage the disclosure of more public pension information.³⁴ This regulation required every U.S. state “to disclose the difference between the present value of accrued pension benefits and the fair market value of the assets . . . set aside to pay them.”³⁵ These state disclosures had to be made by 2010, as required by the 2004 rules that were issued by the Government Accounting Standards Board.³⁶

29. This dilemma is resolved, at least with respect to the modification of public pension contracts in Illinois, because Pension Waiver Credits provide an opportunity to gain early access to vested public pension benefits (the fresh consideration for public employees) as well as to discontinue offering defined-benefit pension plans to public employees (the fresh consideration for public employers).

30. This description of the applicable law includes a series of recent state court decisions, which expressly focus on public sector pensions. *See, e.g.,* Heaton v. Quinn (In re Pension Reform Litig.), 2015 IL 118585, 32 N.E.3d 1 (Ill. 2015) (holding that enacted legislation that sought to unilaterally modify public pensions was void and unenforceable because it violated the Pension Protection Clause of the Illinois Constitution of 1970).

31. Roin, *supra* note 1, at 748.

32. *See id.* at 748–49.

33. *Id.* at 748 (“In 1974, Congress made a calculated decision to exclude governmental plans from the strictures of its landmark pension legislation, the Employee Retirement Income Security Act (ERISA).”); 29 U.S.C. § 1003 (2012).

34. *See* Roin, *supra* note 1, at 750–51.

35. *Id.*, at 751.

36. *Id.* at 750.

These mandatory disclosures were just the start of a broad reform effort, which sought to assure the payment of unfunded pension liabilities.³⁷ Additional public pension reforms were enacted under state and local law.³⁸ A representative example of a state reform was Illinois Public Act 98-0599.³⁹

Public Act 98-0599, which was enacted by the Illinois General Assembly in 2013,⁴⁰ operated in several ways.⁴¹ First, the statute eliminated guaranteed cost-of-living increases.⁴² Public Act 98-0599 also increased the minimum retirement age for public employees.⁴³ Lastly, it limited the computational basis for determining future retirement benefits.⁴⁴ Public Act 98-0599, in other words, ensured that most costs were borne by both parties to a public pension contract (i.e., public employers and public employees).

This statute was subsequently challenged in an Illinois Supreme Court case, *In Re Pension Reform Litigation*.⁴⁵ This state court case resolved three legal issues.⁴⁶ The first issue was whether “Public Act 98-0599’s reduction of retirement annuity benefits owed to members of [Illinois’] . . . retirement systems violate the pension protection clause [of the Illinois Constitution of 1970?]”⁴⁷ The second issue was “if [the statute violated the

37. *Id.* at 750–51.

38. *Cf.* Paris Schulz, *Plan to Fund Chicago Police, Fire Pensions Surfaces in Springfield*, Chicago Tonight, CHICAGO TONIGHT (May 29, 2015 7:23 pm), <http://chicagotonight.wttw.com/2015/05/29/plan-fund-chicago-police-fire-pensions-surfaces-springfield>:

A much anticipated plan to shore up Chicago’s . . . pension plan funds has finally surfaced in Springfield. The measure would double the city’s payment into the fund next year and triple it in the next five years The bill does not call for benefit reductions or increased contributions But city officials say they are still negotiating with unions to achieve some level of reform to go along with the new projected revenue.

39. *See* Pension Reform—Public Employee Benefits, 2013 Ill. Legis. Serv. P.A. 98-599 (S.B. 1) (WEST).

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *In re* Pension Reform Litigation, 2015 IL 118585, 32 N.E.3d 1 (Ill. 2015).

46. *Id.* at 2015 IL 118585 ¶ 43, 32 N.E.3d at 16:

Three issues are presented for . . . review: (1) does Public Act 98-599’s reduction of retirement annuity benefits owed to members of the GRS [General Assembly Retirement System] . . . , SERS [State Employees’ Retirement System] . . . , SURS [State Universities Retirement System] . . . , and TRS [Teachers’ Retirement System] . . . retirement systems violate the pension protection clause set forth in article XIII, section 5, of the Illinois Constitution of 1970 (Ill. Const. 1970, art. XIII, § 5); (2) if so, can the law’s reduction of those benefits nevertheless be upheld as a proper exercise of the State’s police power; and (3) if not, are the invalid provisions of Public Act 98-599 severable from the remainder of the statute?

47. *Id.*

Pension Protection Clause] can the law's reduction of those benefits nevertheless be upheld as a proper exercise of the State's police power [?]"⁴⁸ The third issue was "if [there is no proper exercise of Illinois's police power] . . . , are the invalid provisions of Public Act 98-0599 severable from the remainder of the statute?"⁴⁹ As each of these issues were resolved in the plaintiffs' favor, Public Act 98-0599 was held to be unconstitutional.⁵⁰

The first issue was the most relevant for the purposes of scholarly discussion because it underscored the fact that unilateral modifications are not an option in Illinois. This issue also was important because it focused attention on the legal status of public pensions. Furthermore, it established that public pensions are valid common law contracts, which are protected under Illinois law. Lastly, the issue helped to explain why public pensions may not be unilaterally modified (or even bilaterally modified by agreement of the parties, at least without a showing that fresh consideration will be provided on both sides of the proposed deal).

In undertaking its analysis, the court found that the language used in the Pension Protection Clause of the Illinois Constitution was essential to the resolution of *In Re Pension Reform Litigation*. This language states, in relevant part, that: "membership in any pension or retirement system of the State . . . shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."⁵¹ The Pension Protection Clause went into effect with the Illinois Constitution of 1970.

The Illinois Supreme Court also found "that the clause means precisely what it says: if something qualifies as a benefit of the enforceable contractual relationship resulting from membership in one of the State's pension and retirement systems, it cannot be diminished or impaired."⁵² In making this finding, the court emphasized that: "retirement annuity benefits are unquestionably a 'benefit of a contractually-enforceable relationship resulting from 'membership' in the four State-funded retirement systems' Indeed, they are among the most important benefits provided by those systems."⁵³ In other words, "Public Act 98-0599 . . . would clearly result in the diminishment of the retirement annuities to which . . . [plaintiffs] . . . became entitled when they joined those systems."⁵⁴

48. *Id.*

49. *Id.*

50. *See id.*, 2015 IL 118585 ¶ 98, 32 N.E.3d at 30 ("For the foregoing reasons, the judgment of the circuit court declaring Public Act 98-599 to be unconstitutional and permanently enjoining its enforcement is affirmed.")

51. Ill. Const. 1970, art. XIII, § 5.

52. *Pension Reform Litig.*, 2015 IL 118585 ¶ 45, 32 N.E.3d at 16.

53. *Id.*, 2015 IL 118585 ¶ 47, 32 N.E.3d at 17.

54. *Id.*

For these reasons, the Illinois Supreme Court ultimately held that: “there was simply no way that the [retirement] . . . annuity reduction provisions of Public Act 98-0599 can be reconciled with the rights and protections established by the people of Illinois when they ratified the Illinois Constitution of 1970 and its pension protection clause.”⁵⁵ Stated simply, the court held that: “the General Assembly overstepped the scope of its legislative power. This court is therefore obligated to declare [Public Act 98-0599 to be constitutionally invalid as to this first issue].”⁵⁶

In the wake of *In Re Pension Reform Litigation*, and other recent cases,⁵⁷ Illinois has been presented with a number of viable public pension reform options. Some reforms, for example, called for better use of public sector resources to limit unfunded pension liabilities.⁵⁸ Others relied on market-based reforms, which are prospective in nature.⁵⁹ A third group of options called for Illinois to fully comply with its own laws.⁶⁰

The preceding discussion indicates that Pension Waiver Credits may be an especially useful reform option because of their ability to address a range of potential issues. For example, this tax expenditure encourages each party to a public pension contract to fully comply with the applicable

55. *Id.*

56. *Id.* at 2015 IL 118585 ¶ 47, 32 N.E.3d at 18.

57. See, e.g., Mary J. Jones et al. v. Municipal Employees’ Annuity and Benefit Fund of Chicago, 2014 CH 20027, Circuit Court of Cook County, Chancery Division (July 24, 2015), <http://chicagotonight.wttw.com/sites/default/files/article/file-attachments/Chicago%20Pension%20Ruling.pdf>; See Laura-Ann Wood, *City Loses Effort to Change Pensions*, CHI. DAILY LAW BULLETIN (July 24, 2015), <http://www.chicagolawbulletin.com/Archives/2015/07/24/City-Pensions-Effort-7-24-2015.aspx>:

A Cook County judge Friday rejected the city’s attempt to scale back its worker pension contributions to create a more sustainable retirement fund. Holding closely to the Illinois Supreme Court’s *In Re Pension Reform Litigation* ruling issued May 8, Associate Judge Rita M. Novak held the Chicago plan is unconstitutional.

58. See Tom Kacich, *Want to Fix the State Budget? Here’s How, Says One Expert*, NEWS GAZETTE (Feb. 28, 2015), <http://www.news-gazette.com/news/local/2015-04-28/want-fix-state-budget-heres-how-says-one-expert.html> (“Illinois can solve its multibillion-dollar fiscal problem, balance the budget within two years and add billions to education funding in four steps [by changing its budgetary approach].”).

59. See Gregory G. Katsas, Brian J. Murray and Anthony J. Dick, *The Skeptics Are Wrong: Rauner’s 401(k)-style Pension Idea Will Work*, CRAIN’S CHI. BUS. (May 12, 2015), <http://www.chicagobusiness.com/article/20150512/OPINION/150519943/the-skeptics-are-wrong-rauners-401-k-style-pension-idea-will-work>:

[Governor Bruce]. . . Rauner’s proposal operates entirely on a going-forward basis: it guarantees that workers will keep every cent of every pension benefit earned for past service under current law, and it thus leaves current retirees unaffected. At the same time, his proposal saves the state budget by slightly modifying the formula used to calculate benefits based on future service.

60. See Sheila Weinberg, *Do the math: Pension Crisis was Created – and Fueled – by Politicians*, CRAIN’S CHI. BUS. (Aug. 12, 2015), <http://www.chicagobusiness.com/article/20150812/OPINION/150819935/do-the-math-pension-crisis-was-created-and-fueled-by-politicians> (“The state balanced budget requirement must be strengthened to prevent the accounting gimmicks that have been used to balance the budget, while incurring \$104.6 billion of pension debt.”).

law. Pension Waiver Credits also help each party to a public pension contract to access their “dead capital,”⁶¹ so as to realize efficiency gains that may close the gap between equities and annuities. Finally, in helping to bring about efficiency gains that limit unfunded pension liabilities, the tax expenditure reduces public pension inefficiencies.

III. DISCUSSION

A. Positive Analysis

To review, public pension contracts are formed whenever a public employee is hired by the State of Illinois.⁶² These common law contracts require public employers to provide retirement annuity benefits to public employees. Retirement annuity benefits, and other fringe benefits, such as medical coverage,⁶³ “receive the status of ‘vested’ rights at one of four different points in the employment relationship: (1) when the employee begins employment or joins the pension system; (2) after each day of service provided by the employee; (3) when the employee satisfies the eligibility requirements to receive a pension; or (4) when the employee retires and begins receiving [benefits].”⁶⁴

Within this context, retirement annuity benefits often are delivered through defined-benefit pension plans⁶⁵ that “[promise] . . . employees a specified monthly benefit [upon] . . . retirement.”⁶⁶ As explained by *In re Pension Reform Litigation*, retirement annuity benefits are constitutionally protected from being unilaterally diminished or impaired.⁶⁷ In other words, unilateral modification is not a viable public pension reform option in Illinois.

61. “Dead capital” is the idea that property has little-or-no-value when it cannot be made liquid. Examples of dead capital, within the public sector contracts context, include government-owned property that is not put to its best use (at least, for public employers such as the State of Illinois) and the right to avoid the opportunity costs that are associated with deferred compensation (at least, for public employees with public pensions). *Cf.* Hernando de Soto, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* 6 (2000) (“[Examples of dead capital, at least within the context of development economics, include] houses built on land whose ownership rights are not adequately recorded, unincorporated businesses with undefined liability, [and] . . . industries located where financiers and investors cannot see them [which limits access to capital].”).

62. *See In re Pension Reform Litig.*, 2015 IL 118585 ¶ 4, 32 N.E.3d 1, 4 (Ill. 2015).

63. *See* LEXIS TAX ADVISOR FEDERAL TOPICAL § 1B:4B.01 (Lexis 2015) (“The term ‘fringe benefit’ refers exclusively to ‘free’ low-cost benefits conferred by employers on their employees.”).

64. Madiar, *supra* note 13, at 181.

65. *See* Civic Federation, *supra* note 9, at 5 (“In Illinois nearly all public pension plans are defined-benefit pension plans.”).

66. Kelly Pitcher, *Pension Plans In Distress: A Case Study of Cincinnati*, 82 U. CIN. L. REV. 1271, 1274 (2014).

67. *See Pension Reform Litig.*, 2015 IL 118585, ¶ 40, 32 N.E.3d at 15.

So, how can Illinois respond to the U.S. public pension crisis without diminishing or impairing retirement annuity benefits? One option is to encourage more bilateral modifications of public pension contracts. These bilateral modifications may be achieved in several ways, including through the use of Pension Waiver Credits. Pension Waiver Credits encourage the execution of more bilateral modifications by providing fresh consideration to each of the parties, i.e., public employers and public employees. This additional consideration takes the form of a new tax credit allocation for public employees, i.e., this tax expenditure provides early access to retirement benefits, which would otherwise be accessible upon retirement, and thereby provides fresh consideration for public employees, and the legal right to discontinue offering defined-benefit pension plans, i.e., the waiver of this legal duty, which would otherwise need to be discharged at some point, serves as fresh consideration for public employers.

In other words, Pension Waiver Credits resolve the fresh consideration dilemma for public pension contracts in Illinois.⁶⁸ This dilemma is overcome by using the tax expenditure to generate additional consideration for each of the parties to a public pension contract. Pension Waiver Credits do so, specifically, by operating as a common law accord and satisfaction.⁶⁹

By definition, an accord and satisfaction is “the legal consequence of a creditor’s acceptance of a substitute performance for a previously existing [contract] . . . claim or a prior original duty.”⁷⁰ A valid accord and satisfaction has three elements. These elements are that “there must be an existing claim or duty, the parties must offer and accept a substitute performance in full settlement of that existing claim or duty, and there must be adequate consideration.”⁷¹ In cases where each element is met, there is no longer any legal claim or a duty.⁷² These claims or duties may be extinguished, even if they are constitutionally protected, by executing a waiver or a settlement.⁷³

68. The requirement of fresh, or new, consideration was imposed in response to the common law pre-existing duty rule. See Perillo, *supra* note 22, § 5.14.

69. See Sally Brown Richardson, *Civil Law Compromise, Common Law Accord and Satisfaction: Can the Two Doctrines Coexist in Louisiana?* 69 LA. L. REV. 175, 182 (2008) (“In the American common law, the term ‘accord and satisfaction’ is used to express the ‘the legal consequence of a creditor’s acceptance of a substitute performance for a previously existing claim or prior original duty.’”).

70. 13 Sarah Howard Jenkins, CORBIN ON CONTRACTS: Discharge § 70.1 at 301 (13th ed. 2003).

71. Richardson, *supra* note 69, at 187.

72. *Id.*

73. By use of the term “settlement,” the article makes reference to the decision by a public employee to give up the right to litigate a valid claim for retirement benefits in exchange for a monetary payment by a public employer. See Albert Feuer, *When Are Releases of Claims for ERISA Plan Benefits Effective?*, 38 J. MARSHALL L. REV. 773, 783 (2005).

B. Normative Analysis

1. Program Overview

In light of the preceding analysis, public employees who waive their rights to participate in a defined-benefit plan should receive Pension Waiver Credits from public employers such as the State of Illinois.⁷⁴ This tax credit allocation must be, at least, equal in value to the retirement annuity benefit that would be forfeited by executing an accord and satisfaction. The value of each Pension Waiver Credits allocation should be computed, in present value terms, as soon as the waiver is effective.⁷⁵ As a result, the tax expenditure could limit unfunded pension liabilities.

2. Program Design

Once a Pension Waiver Credits allocation is computed and distributed by a public employer, in keeping with the requirements of a yet-to-be-enacted authorizing statute that draws on elements of the Illinois Tax Credit For Affordable Housing Donations,⁷⁶ a tax credit certificate may be issued to a participating public employee.⁷⁷ Tax credit certificates generally contain the terms and conditions of each allocation.⁷⁸ Specific terms and

74. “Alienability,” or the ability to transfer the value that is associated with an asset in exchange for some valuable consideration, is an option because public pensions are not subject to the Employee Retirement Security Act of 1974. *Cf.* Eric D. Chason, *Settlements and Waivers Affecting Pension Benefits Under ERISA*, 14 *BENEFITS L.J.* 61, 61–2 (2001):

Agreements that purport to waive settlements or settle claims under ERISA raise unique issues [especially for tax-qualified retirement plans]. A primary issue . . . is the antialienation rule of ERISA. In essence, the antialienation rule says that retirement plans can neither be sold nor made available to creditors of the employee (subject to some exceptions).

75. The term “present value” is a synonym for the economic concept of “present discounted value.” By definition, present value is “the [current]. . . value of a payment due to be received in the future. If the payment is due t periods into the future and the proportional interest rate is r per period, the present discounted value of a sum A to be received t periods in the future is given by: $V=A/(1+r)^t = A(1+r)^{-t}$.” Black, *supra* note 7, at 363.

76. The author assumes that the Illinois Department of Central Management Services could serve as the administrator of any future Pension Waiver Credits program. This state agency is uniquely-situated to carry out this work, due to its broad experience with handling public employee benefits and state property sales. *See* ILLINOIS DEPARTMENT OF CENTRAL MANAGEMENT SERVICES, <http://www.illinois.gov/cms/Pages/default.aspx>. Another state agency that could play a major role in implementing, and overseeing, Pension Waiver Credits is the Illinois Department of Revenue, which has undertaken similar oversight work with the Illinois Tax Credit for Affordable Housing Donations. *Cf.* ILL. ADMIN. CODE tit. 86, § 100.2190 (2015) (“Tax Credit for Affordable Housing Donations”).

77. One precaution could consist of limiting the number of Pension Waiver Credits that may be issued, or redeemed, in a given year. *Cf.* ILL. ADMIN. CODE tit. 47, § 355 (2015) (“Illinois Affordable Housing Tax Credit Program.”).

78. *Id.*

conditions of this tax expenditure may include restrictions on the overall allocation size.⁷⁹

Within this context, Pension Waiver Credits could be redeemed in several ways.⁸⁰ Tax credit certificates, for example, may be used to offset a public employee's state tax liability. Among the taxes that could be offset are the income tax⁸¹ and the real estate transfer tax.⁸² The mix of tax types also could be changed by public employers such as the State of Illinois, in order to maximize total state tax revenues.

A second option is to trade-in Pension Waiver Credits for state-owned property. This property could include vehicles, single-family homes and commercial office space. These trades are likely to come at little cost, so long as the state builds on its existing programs.⁸³

Pension Waiver Credits, lastly, may be freely transferred to any eligible third-party.⁸⁴ The term "eligible" could be defined in terms of

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79. It is well-established that placing an upper limit on the total number of tax credits that may be distributed, which is referred to as a "cap" or a "ceiling" on the tax credit allocation, provides budgetary certainty. See, e.g., Mihir Desai et al., *Investable Tax Credits: The Case of the Low Income Housing Tax Credit*, (HKS Faculty Research Working Paper 2008), available at <http://www.hbs.edu/faculty/Pages/item.aspx?num=33531> ("There may be political advantages to capped credits, since there is then no budgetary uncertainty."). Other potential terms and conditions may include restrictions on using tax credits, such as statutory time limits for redemption. These terms and conditions may be adjusted, or even eliminated, in order to protect the value of Pension Waiver Credits. Cf. Ted Johnson, *Louisiana Movie, TV Industry Fears Slowdown After Limits Placed on Tax Credits*, VARIETY (June 24, 2015), <http://variety.com/2015/artisans/news/bobby-jindal-president-movie-tv-tax-credit-1201527464/> ("There . . . has been concern that the value of . . . credits will drop with limits on redemption.").
80. Cf. Kelli Harsch et al., *Initiatives and Tools for the Preservation of Affordable Housing in Illinois*, 18 J. AFFORDABLE HOUSING 403, 405 (2009) ("An important feature of the donation credits is the ability of the donor to either (i) use the credits to reduce its Illinois Income tax liability or (ii) transfer the credits to other taxpayers. To facilitate such a transfer, the donation credit is issued in the form of a certificate to the donor. Through its endorsement of the certificate, the donor can transfer and assign all of its rights, title, and interest in the certificate and credits to a credit purchaser.").
81. See ILL. ADMIN. CODE tit. 86, § 100 (2015) ("Income Tax.").
82. See ILL. ADMIN. CODE tit. 86, § 120 (2015) ("Real Estate Transfer Tax.").
83. Illinois has various websites that are dedicated to the sale of state-owned personal property. See, e.g., *IBID*, THE STATE OF ILLINOIS, <https://ibid.illinois.gov/index.php?>. This state also has positioned itself to sell-off certain state-owned real properties, especially commercial real estate with higher-than-average operational costs. See, e.g., Greg Hinz, *Get Ready to Say Goodbye to the Thompson Center*, CRAIN'S CHI. BUSINESS, Oct. 13, 2015, <http://www.chicagobusiness.com/article/20151013/BLOGS02/151019965/get-ready-to-say-goodbye-to-the-thompson-center> ("Gov. Bruce Rauner has decided to move to sell and vacate the James R. Thompson Center . . . Rauner said the arguments in favor of a sale are 'compelling' . . .").
84. See, e.g., Josh Goodman, *Tax Breaks for Sale: Transferable Tax Credits Explained*, PEW CHARITABLE TRUST, (Dec. 14, 2012), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2012/12/14/tax-breaks-for-sale-transferable-tax-credits-explained> ("[U.S. states] . . . have become adept at providing tax breaks larger than business' tax burdens . . . One way they do that is through 'transferable' tax credits. If the value of the company's credits is higher than its tax liability, it can sell the excess credits to another taxpayer who owes the state taxes.").

third-party compliance with state laws.⁸⁵ This eligibility requirement may limit certain transaction costs,⁸⁶ which are associated with program administration, although non-financial barriers to trade could arise, including bounded rationality,⁸⁷ information problems,⁸⁸ negotiation costs and opportunism on the part of unrelated third parties.⁸⁹

3. Potential Benefits

Having explored positive and normative views of this yet-to-be implemented tax expenditure, it is clear that Pension Waiver Credits could yield a range of benefits. For example, U.S. states may benefit by improving their liquidity and credit ratings.⁹⁰ These fiscal improvements could help jurisdictions, such as Illinois, to restructure their long-term debt obligations.

Public employees also may benefit from this tax expenditure. These benefits stem from the fact that public employees would be guaranteed to receive the present value of their retirement annuity benefits. Pension Waiver Credits, furthermore, encourage public employees to identify other investment opportunities.⁹¹

In addition, third parties could benefit from Pension Waiver Credits. These benefits may include the ability to avoid externalities,⁹² which too

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85. Examples of potential eligibility criteria including being up-to-date with state taxes and licenses. Cf. ILL. HOUSING DEVELOPMENT AUTHORITY, <http://www.ihda.org/developer/IAHTC.htm>.
86. See Posner, *supra* note 18, § 15.1 (“Transaction costs [are] . . . the costs involved in organizing economic activity through voluntary exchange.”) Among the transaction costs that would be avoided through the use of Pension Waiver Credits are: 1) the expenses that are associated with holding, and investing, public pension funds over time; 2) the excessive payments that would be otherwise made to a variety of legal persons, under defined-benefit pension plans, 3) payments that go toward the underlying principle that is owed and 4) fixed, or variable, interest payments.
87. By definition, “bounded rationality” is “the argument that there is a finite limit to the amount of information the human brain can hold, and the amount of calculations that it can understand In practice individuals and organizations consider only a relatively small number of alternatives, and frequently stop searching once they find a tolerable course of action, rather than seeking the best possible.” Black, *supra* note 7, at 36.
88. An example of an “information problem” is when “each participant in a market knows some things the others do not, and does not know some things that other people do.” Black, *supra* note 7, at 236.
89. See Black, *supra* note 7, at 473–74.
90. Cf. *S & P Revises Illinois Credit Rating Outlook to Negative*, REUTERS (July 23, 2014), <http://www.reuters.com/article/2014/07/23/usa-illinois-sp-idUSL2N0PY29A20140723> (“Standard & Poor’s Rating Services . . . warned that Illinois’ already low credit rating could sink further if the state is unable to implement reforms to curb its big unfunded pension liability and balance its budget.”).
91. See *Investment Risk and Financial Advice*, VANGUARD <https://www.vanguard.co.uk/documents/adv/literature/investor-risk-profiling.pdf>.
92. Black, *supra* note 7, at 167 (An externality is “a cost or benefit arising from any activity which does not accrue to the person or organization carrying on the activity.”).

often are imposed on third parties such as state taxpayers. Examples of these externalities could include the costs of undertaking litigation.

4. Potential Criticisms

Special interest groups, nevertheless, still may oppose Pension Waiver Credits.⁹³ For example, interested third parties could seize on the fact that public employees may not be fully protected.⁹⁴ Members of this group could include U.S. public sector unions and advocacy groups.⁹⁵

A second category of special interest may withhold support simply because the status quo is preferred.⁹⁶ In fact, many of these interested third

93. British special interests groups raised a number of concerns when the United Kingdom undertook public pension reform in 2014, especially about the potential tax implications of gaining earlier access to vested pension benefits. *C.f.* Ben Quinn, *One in Eight People Plan to Cash in Their Entire Pension Pot Next Year*, GUARDIAN (Oct. 27, 2014), <http://www.theguardian.com/money/2014/oct/28/one-in-eight-people-cash-in-pension-pot-george-osborne-reform>:

Tom McPhail, head of pension research at Hargreaves Lansdown, told the Times [of London]: ‘Whilst we support the basic principles behind the government’s reforms, the speed and complexity of these changes mean that a lot of investors are going to be paying unnecessarily large amounts of tax to the government. The chancellor has effectively engineered a tax windfall for the government from unsuspecting pension investors.’

Additional concerns also may be raised about the dangers of alienating public pensions, which could echo the recent criticisms that have been lodged at structured settlements in the U.S. *C.f.* Terrence McCoy, *The Flawed System that Allows Companies to Make Millions off the Injured*, WASH. POST (Dec. 27, 2015) https://www.washingtonpost.com/local/social-issues/the-flawed-system-that-allows-companies-to-make-millions-off-the-injured/2015/12/27/cce16434-9212-11e5-a2d6-f57908580b1f_story.html:

Unlike traditional settlements, which are paid out in one sum, structured settlements dispense the payout in portions over a lifetime to protect vulnerable people from immediately spending it all. Since 1975, insurance firms have committed an estimated \$350 billion to these agreements, spawning a secondary market in which companies compete to buy payments for a smaller amount of upfront cash. Such deals, industry advocates say, get desperate people the money that they need for emergencies and big expenses, such as home purchases. But they also expose sellers to the risk that they will exchange lifetimes’ worth of income for pittance.

94. See Quinn, *supra* note 93; McCoy, *supra* note 93.

95. See, e.g., Michael T. Carrigan, *Why 401(k)s Shouldn’t Replace Pensions*, HUFFINGTON POST (Dec. 28, 2014), http://www.huffingtonpost.com/michael-t-carrigan/why-401ks-shouldnt-replac_b_6367062.html:

New data from the National Institution for Retirement Security . . . shows just how much Illinois taxpayers stand to lose if we switch to privatized accounts. To provide workers with the same modest retirement benefits, traditional pensions are 48 percent less expensive than 401(k)-style plans. That’s a 48 percent savings to Illinois taxpayers.

96. See, e.g., Thomas P. Napoli, *Retirement Security for Americans and the Role of Defined-Benefit Pension Plans*, 72 PUB. ADMIN. REV. 483 (2012).

parties could bristle at making any change to the public pension system.⁹⁷ Examples may include pension fund managers and placement agents.⁹⁸

A final set of special interests may question the wisdom of issuing Pension Waiver Credits. Some members of this group could argue that there are too many tax expenditures already.⁹⁹ These interested third parties are likely to be drawn from the large population of U.S. elected officials.¹⁰⁰

5. Response to Critics

This opposition, nonetheless, could be overcome in a variety of ways. First, U.S. states may point out that Pension Waiver Credits are different from other tax expenditures. Specifically, these governments could show how Pension Waiver Credits help U.S. states to make better use of public sector resources. One representative example is described, i.e., Illinois, in this article.

U.S. states also may highlight the problems with the public pension status quo.¹⁰¹ These problems include excessive payouts, optimistic

97. See generally Steven Davidoff Solomon, *After Scandals, Evaluating Pension Funds' Middleman*, N.Y. TIMES, May 12, 2015, http://www.nytimes.com/2015/05/13/business/dealbook/after-pay-to-play-scandals-evaluating-pension-funds-middleman.html?_r=0 (“Placement agents have been maligned, banned and even imprisoned. And yet, pension funds continue to use them.”).

98. *Id.*

In 1991, placement agents were nonexistent. But in mid-2014 . . . they were involved in 41 percent of the fundraising for North American private equity firms For example, the California Public Employees' Retirement System, the large state pension agency better known as Calpers, invested in 784 funds using placement agents from 1991 to 2011 That's about 27 percent of the funds Calpers invested in during that time.

99. See, e.g., Leonard E. Burman & Marvin Phaup, *Tax Expenditures, the Size and Efficiency of Government, and Implications for Budget Reform* (NBER Working Paper Series 2012) <http://www.nber.org/papers/w16728>:

One possible explanation for the difficulty in controlling the budget is that a major component of spending—tax expenditures—receives privileged status . . . This paper explores the implications of that classification and illustrates how it can lead to higher taxes, larger government, and an inefficient mix of spending (too many tax expenditures).

100. See, e.g., Patrick McGreevy, *Citing Past Budget Anxiety, Gov. Brown Vetoes Several New Tax Credits*, L.A. TIMES, Oct., 2015, <http://www.latimes.com/local/political/la-me-pc-citing-budget-gov-brown-vetoes-several-new-tax-credits-20151010-story.html>:

[California] . . . Gov. Brown . . . vetoed nine bills that would have provided new tax credits to benefit California lawmakers' priorities Brown reminded lawmakers that when he took office in 2011 the state faced a \$26.6-billion budget deficit and estimated shortfalls of \$20 billion and it has taken tough measures to turn around the state's finances.

101. See, e.g., Peter Conti-Brown, *Direct Democracy and State Fiscal Crises: The Problem of Too Much Law*, 7 DUKE J. CONST. L. & PUB. POL. 43, 43–4 (2012):

[What] . . . if the problem facing the [U.S.] . . . states is not a problem of too much debt, but one of too much law? Put differently, state debt crises might be symptomatic

projections and modest contributions.¹⁰² Each problem arises, as illustrated in a recent study, from questionable decisions made by public pension managers.¹⁰³

Lastly, U.S. states could take additional steps to protect public employees. For example, U.S. states may provide alternatives to fully monetizing retirement annuity benefits. One option is to permit rollovers, especially into state-administered defined-contribution pension plans.¹⁰⁴ This alternative could be made immediately available, or only after an initial draw-down.¹⁰⁵

6. Implementation Plan

Fortunately, the concerns about Pension Waiver Credits may be overcome by creating a detailed implementation plan. This plan could be drafted, and implemented, in several ways. State officials may do the drafting, although public employees should have some input.¹⁰⁶

In creating this implementation plan, U.S. states may engage in collective bargaining. This approach could lead some governments to collaborate with U.S. public sector unions and individual public employees. As a result, there may be little need to pursue unilateral modifications.

of a deeper crisis whereby the state fiscal policy-making process is gummed up by statutory and constitutional restrictions on the use of public [sector] . . . resources, such that combating budget shortfalls—whether caused by economic recession, political gridlock or some combination of the two—becomes increasingly unlikely.

102. See Moore, *supra* note 10, at 260 (“Many factors contributed to the current level of underfunding. These include: missed state contributions, loss in the value of plan assets, inaccurate valuing and reporting methods, cost of living adjustments that exceeded the rate of inflation, and short-sighted benefit increases.”).

103. See Solomon, *supra* note 97 (“A new study . . . finds. . . private equity funds using placement agents underperformed the market by as much as 3.5 percent annually. In other words, most pension funds appear not to get value from placement agents.”).

104. See Civic Federation, *supra* note 9, at 6:

A defined contribution plan combines a fixed employer contribution (the contribution is ‘defined’) with employee contributions in an individual retirement savings account. The funds in the account are generally invested according to choices made by the employee. The retirement benefit is then based on the value in the account when the worker retires. Employees are not guaranteed a specific benefit Common examples of defined contribution plans are 401(k), 403(b) and 457 plans.

105. See *Topic 413 – Rollovers from Retirement Plans*, INTERNAL REVENUE SERVICE, (Jan. 04, 2016), <http://www.irs.gov/taxtopics/tc413.html> (“A rollover occurs when you withdraw cash or other assets from one eligible retirement plan and contribute all or part of it, within 60 days, to another eligible retirement plan. This rollover transaction is not taxable, but it is reportable on your federal tax income.”).

106. See Jodi DiCenzo, *Employees’ Retirement Choices, Perceptions and Understanding: A Review of Selected Survey and Empirical Behavioral Decision-Making Research* 5, SOCIETY OF ACTUARIES (2014), <https://www.soa.org/research/research-projects/pension/research-can-annuity.aspx> (click *Employees’ Retirement Choices, Perceptions and Understanding: A Review of Selected Survey and Empirical Behavioral Decision-Making Research* under related links) (“Decision-making context has a dramatic impact on [retirement plan] . . . participation and contribution decisions.”).

Alternately, U.S. states could negotiate directly with individual public employees. This option is likely to have relatively high transaction costs, at least in comparison with other options. Direct negotiation, nevertheless, may be justified if it increases the participation rate.¹⁰⁷

Finally, U.S. states may ask their legislatures to codify any negotiated agreements. This approach has a number of potential benefits, as it could be used on its own or in combination with other reforms.¹⁰⁸ These benefits may arise from increased transparency or, possibly, less dissent.

IV. CONCLUSION

This article identifies a novel approach to public pension reform, which takes into account existing political and legal constraints. It does its work in at least four ways. First, the article encourages better use of public sector resources by calling for the elimination of public pension inefficiencies. Next, it explains how to limit public pension inefficiencies, at least on a prospective basis, by moving away from defined-benefit pension plans. Third, the article describes one way to move beyond defined-benefit pension plans through the creation of a new tax expenditure program, specifically, a Pension Waiver Credits Program. Finally, it explains how to implement this new tax expenditure program so as to address the U.S. public pension crisis.

Ultimately, U.S. states should consider Pension Waiver Credits, at least as a partial solution to the public pension crisis, because this new tax expenditure concept is a viable alternative to tax increases and spending cuts.¹⁰⁹ It also draws attention to dead capital,¹¹⁰ such as unclaimed property,¹¹¹ which is rarely exploited by most governments.¹¹² Lastly,

107. *See id.* at 136 (“Prohibiting inertia by requiring a participation decision (either positive or negative) has increased [some public employee] enrollment rates . . . by nearly 30 percent.”).

108. Many public pension reformers are focused on tax increases or spending cuts, which both require legislative action and could be used in concert with Pension Waiver Credits. *See, e.g.,* Chris Fusco, Dan Mihalopoulos and Patrick Rehkamp, *Generous Pension Benefits Only One Part of State, City Financial Crisis*, CHI. SUN-TIMES, Sept. 17, 2015, <http://chicago.suntimes.com/the-watchdogs/7/71/612451/watchdogs-generous-benefits-one-part-state-city-pension-mess> (“The only solutions appear to be to somehow cut expenses—which are made up largely of personnel costs—or generate increased revenues. And the quickest, surest way to raise a lot of revenue could be a property tax increase.”). None of these reform options, however, are likely to prevent future public pension crises. Future crises may be avoided, only, by more informed state decision-making.

109. *See* Lav & Grundman, *supra* note 2, at 2.

110. *See* de Soto, *supra* note 61 at 6.

111. *See, e.g.,* Jordan M. Goodman, *Unclaimed Property*, Illinois Institute for Continuing Legal Education 13.4-5 (2010) (“All 50 [U.S.] . . . states have enacted unclaimed property statutes The Illinois Uniform Disposition of Unclaimed Property Act (Illinois Act), 765 ILCS 1025/0.05, et seq., is modeled on the 1966 Revised Uniform Disposition of Unclaimed Property Act.”).

Pension Waiver Credits could help U.S. states to make better use of their public sector resources.

These governments, however, should avoid situations that reduce the effectiveness of Pension Waiver Credits. For example, U.S. states may limit conflicts of interest. One way to do so is to set clear administrative rules, especially with respect to the relationship between program participants and administrators. The Illinois Tollway used this approach successfully.¹¹³

U.S. states, moreover, should eliminate any unjustified use of public sector resources.¹¹⁴ By doing so, these governments could increase the demand for Pension Waiver Credits over time. Other tax expenditure programs, such as federal tax credit programs, provide useful examples.¹¹⁵

Lastly, sub-national governments should assure the long-term viability of Pension Waiver Credits. One way to do so is by shielding this tax expenditure from collateral attacks. An example of how to carry out an attack is by using a repeal option such as the Illinois Regulatory Sunset Law.¹¹⁶

Regardless of how U.S. states design their programs, it is clear why they may need Pension Waiver Credits. First, this tax expenditure encourages the parties to a public pension contract to voluntarily modify their agreement. Pension Waiver Credits also help each party to access their “dead capital,” so as to realize efficiency gains. Finally, in bringing about these efficiency gains, the tax expenditure partially addresses the U.S. public pension crisis.

112. Cf. Lisa Prevost, *A Start-up Helps Towns Market Their Property*, N.Y. TIMES, Aug. 5, 2014, http://www.nytimes.com/2014/08/06/business/a-start-up-uses-the-web-to-help-towns-market-their-property.html?_r=0 (“Two public policy graduates at the Kennedy School at Harvard University are trying to build a business of helping municipalities with a task at which they are notoriously deficient: managing and marketing their real estate portfolios.”).

113. Cf., *Auctions and Real Estate, Vehicles, Equipment and Surplus Inventory*, ILL. TOLLWAY, <http://www.illinoistollway.com/doing-business/auctions-real-estate> (“Illinois Tollway directors, employees, consultants, their spouses, children or any person having any direct involvement with the disposition of Illinois Tollway surplus property may not bid on or purchase Illinois Tollway Property.”).

114. See, e.g., Randall K. Johnson, *Who Wins Residential Property Tax Appeals*, 6 COLUM. J. TAX. L. 209 (2015) (finding that the filing, and granting, of unnecessary residential property tax appeals may constitute an unjustified use of public sector resources).

115. See, e.g., Karen Dynan, Ted Gayer and Natasha Plotkin, *An Evaluation of Federal and State Homebuyer Tax Incentives* 10 n.12, BROOKINGS (2013), http://www.brookings.edu/~media/research/files/papers/2013/06/28-homebuyer-tax-incentives-dynan-gayer/28_homebuyer_tax_incentives_dynan_gayer2.pdf (“Fraud . . . likely reduced the impact of the [certain federal] . . . credits on housing activity. However, the amount of fraud appears to have been small relative to the total size of the program.”).

116. See 5 ILL. COMP. STAT. ANN. 90/1-14 (2015) (“Regulatory Sunset Act”).