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Rhode Island Averts Pension Disaster Without Raising Taxes.

Chicago is facing its biggest tax increase in memory, to raise money for pension payments. Illinois is stymied by a $110 billion pension shortfall. In New Jersey, public workers are in court over a failed pension deal. From Pennsylvania to California, pensions costs are crowding out aid for public education.

But even as pensions keep squeezing budgets and setting off court battles around the country, Rhode Island, America's smallest state, appears to have found its way out of the quagmire. Its governor, Gina M. Raimondo, has finished a four-year pension overhaul without raising taxes or issuing risky pension-obligation bonds. Union leaders who fought her at first ultimately negotiated the terms, deciding that a court fight over her plan might do more harm than good.

"Raimondo had the highest hill to climb," said Daniel DiSalvo, a senior fellow at the Manhattan Institute who has been comparing different states' efforts to rein in pension costs. Her initiative was among the most ambitious, he said, and she started "from what was, in many respects, the weakest institutional position."

Her experience, Mr. DiSalvo and others say, could be a case study for other states and municipalities struggling with pensions and other long-term obligations that cost much more than expected. And the timing could hardly be more critical, given predictions that the fiscal health of state and local governments is likely to remain under stress for years as the population ages.

"We may be entering a new fiscal ice age," a long period when demographic forces will make financing cities and states even harder than it is now, Mr. DiSalvo said.

That is not to say everyone is happy with the result. To the contrary, bitterness remains in Rhode Island, where public retirees' annual increases have been suspended, and public workers have had to trade in part of their defined-benefit pension plan for a 401(k)-style benefit, where they must bear investment risk.

"No other entity would get away with what the State of Rhode Island is doing to their retirees," said Louise Bright, a retired state financial manager, who had wanted a trial to resolve key legal issues. "A contract is a contract, even when that contract involves senior citizens."

Ms. Raimondo, who started her battle as state treasurer, faced obstacles not unlike those confronting Mayor Rahm Emanuel of Chicago: entrenched political machinery, powerful unions, a decades-old practice of promising rich pensions without setting aside enough money to pay them, truculent taxpayers, record numbers of retirees and an all-enveloping fog of discredited numbers. Both are Democrats in blue states. Both had to deal with "mature" pension systems that were paying out more in benefits than they were receiving in contributions, a situation that can quickly become unmanageable.

But Ms. Raimondo was able to revamp her state's pension system, keeping some of the traditional

structure while lowering the cost, and surviving lawsuits by workers and retirees who called her moves unconstitutional.

Mr. Emanuel's attempts to rein in pension costs, in contrast, have been thrown out by a judge, leading to his appeal this week for a big tax increase.

"Our greatest financial challenge today is the exploding cost of our unpaid pensions," he told the Chicago City Council on Tuesday. "It is a big dark cloud that hangs over the rest of our city's finances." Without raising taxes, he warned, Chicago will have to finance its pension promises by laying off thousands of police officers and firefighters, ending rat-control programs and letting street repairs lapse, among other cost-cutting measures.

"Our city would become unlivable," he said.

That is the bullet Ms. Raimondo has dodged. A former venture capitalist and Rhodes Scholar with an economics degree from Harvard, she could see early on that her state's cheery pension disclosures were papering over a crisis.

Ms. Raimondo was also willing to rest her case for a pension makeover on a contrarian interpretation of the law and hold firm when the unions sued.

"We thought we had a good case," she said, "but most important, I knew I couldn't be afraid of a potential lawsuit."

Ms. Raimondo also had a quirk of the law on her side. In most states, lawmakers or the courts have taken steps to make public pension systems creatures of contract law, as opposed to mere creatures of statute. This may sound obscure, but the difference is critical. Statutes are relatively easy to change — lawmakers just amend the law. But states that want to tear up pension contracts face an uphill fight, because of a clause in the United States Constitution that bars them from enacting any law that retroactively impairs contract rights.

The clause dates to post-Revolutionary America, when the framers wanted to stop the states from giving themselves debt relief. Since then, similar clauses have been added to state constitutions as well. And over the last century, many states have extended the contract clause to cover their pension systems.

But in Rhode Island, Ms. Raimondo said, lawmakers never got around to making the state pension system contractual. "In every state it's different, but in Rhode Island, the whole pension system is set out in statute."

Unions disputed that, but Ms. Raimondo forged ahead based on her conviction. That gave her a big tactical advantage: All she had to do was persuade the state legislature to amend the pension law, something it had already done many times.

Compare that with Mr. Emanuel's predicament.

Unlike Rhode Island, Illinois did make public pensions contractual. Its constitution bars cities like Chicago from imposing pension cuts on their workers.

So while Ms. Raimondo was able to move toward her statutory goal in Rhode Island, Mr. Emanuel has been left haggling with 33 unions in Chicago, trying to find common ground for a makeover that would shrink pensions but fund them properly.

Eventually, he did get buy-in from all but three unions and from state lawmakers in Springfield. The city even programmed pension changes into its computers. But then the deal fell apart, when a small number of holdouts won an injunction. Chicago was ordered to wait for the State Supreme Court to decide the constitutionality of a separate pension overhaul by the state. The court found it unconstitutional and not long after that, a Cook County judge said the ruling was binding on Chicago, too.

And that is why Mr. Emanuel is calling for a big tax increase.

For Ms. Raimondo, persuading the state legislature to do radical pension surgery was a matter of explaining the depths of the problems. She began a series of town hall meetings, where she said that the state had promised its workers far more than it could deliver. The mismatch was so big that if the pension system collapsed, it could take the state down with it, she warned.

And then, in the middle of her road show, the small city of Central Falls went bankrupt. It had never joined the state pension system, preferring to run its own plan, and now its pension fund for police officers and firefighters had run completely out of money. The pensions of retirees, some elderly and infirm, were cut sharply.

“You’d see them interviewed on the nightly news,” Ms. Raimondo recalled. “These were guys who did everything right. They followed all the rules, and then their city went bankrupt and their pensions were cut in half.”

That was a persuasive moment for lawmakers. In November 2011, Gov. Lincoln Chafee called the legislature into special session. Amendments to the pension law passed overwhelmingly, allowing cuts to be made.

Unions and retiree groups sued, and the judge hearing the dispute, Sarah Taft-Carter, said early on that unlike Ms. Raimondo, she saw an “implicit contract” protecting public pensions in Rhode Island. But that was not the end of it. Contract jurisprudence still gives a state some wiggle room to unilaterally impair contracts, under narrow circumstances and with close judicial supervision.

Judge Taft-Carter ordered the state and the unions to try to resolve their disputes in mediation, warning that if they failed, there would be a jury trial.

Confidential talks began, but in the meantime, the state was permitted to carry out the changes.

A settlement finally emerged this year, which, among other things, gave one-time payments to current retirees, to soften the blow of losing their cost-of-living adjustments. Judge Taft-Carter held a “fairness hearing,” giving those affected a chance to sound off. Many expressed anger. But one union leader, Robert Walsh of the National Education Association of Rhode Island, said that after much soul-searching he had decided to support the settlement as the best deal for his 7,500 members.

A settlement, he said, “can be fair and heartbreaking at the same time.”

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