New Jersey Panel Proposes Major Pension Overhaul

March 9, 2015

MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

Proposed benefit cuts could hamper the state's ability to attract quality public employees.

The day after a New Jersey judge ruled that Governor Christie must make up $1.57 billion in pension underfunding, the governor's commission to study New Jersey's pension system **proposed a complete overhaul of the State's pensions**. The overhaul would include: 1) freezing current plans and replacing them with "cash balance" plans; 2) spreading the funding for the current plan over several decades; 3) cutting back the State's retiree health insurance provisions and using the proceeds to fund pensions; 4) shifting the burden of financing local education pensions to the localities; 5) enacting a constitutional amendment to insure that the state makes its payments; and 6) transferring the existing and new plans to entities controlled by the employees. The committee's report raises many interesting issues, some of which I find annoying.

First, it's important to remember how New Jersey got to this point. A 2011 deal produced big cuts in benefits for public sector workers in exchange for a State commitment to fund the pensions. Public sector workers saw their contributions increased and the cost-of-living adjustment to their benefits eliminated (though this latter provision is still tied up in the courts). As a result, the cost of New Jersey pensions for teachers and general employees are well below the national average. New hires have even lower benefits. The public employees have lived up to their half of the deal; the State has not. If a mess exists, the State has created it.

That said, let me describe some of the report's more annoying aspects. One is the premise that pension and health insurance benefits in the public sector should be set at private sector levels. It has become very clear that private sector workers, dependent primarily on 401(k) plans, will have inadequate retirement saving. On the health side, private sector companies are on their way towards eliminating retiree health insurance altogether. Private sector benefits hardly seem like a model to be emulated.

Another concern is that the report makes it sound like public sector workers will not lose benefits under the current defined benefit plan as a result of the freeze – "no one would lose a benefit credit for service before the freeze." This is true. But for mid-career workers those credits will be applied to their salary at age 40 or 50 rather than their much higher salary at retirement. These workers will end up with much less than they would have received if the plan had not been frozen. And even if the cash balance plan being substituted were equally generous – which it is definitely not – mid-career workers would come out behind.

The report also focuses solely on the benefits paid to public sector workers and ignores the impact of the proposed cuts on *total compensation* of public workers. Unless New Jersey's public employees are currently grossly overpaid, they will be significantly underpaid compared to their counterparts in the private sector if the Commission's plan were adopted. An increasing body of evidence shows that you get what you pay for. Lower compensation will result in less talented public sector workers.

Finally, I don't really understand the part of the proposal that involves transferring the assets, liabilities, and risks associated with both the old and new plans to employee entities. The motivation is to avoid having pensions adversely affecting the State's credit rating, but what's in it for the employees? Let me conclude by saying that I may be more exorcised over the New Jersey situation and the Commission's report than the state's public employees. Apparently, the leaders of the New Jersey Education Association, the public sector union with the greatest impact on state finances, worked with the Commission and may support the recommendations to freeze the current pensions and adopt a new system. It certainly will be interesting to see how this all plays out.