More Questions on New Jersey Superior Court Pension Decision

June 30, 2015

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Does the decision have deeper implications for security of promised pensions and for other debts?

I am still thinking about the recent New Jersey Superior Court ruling regarding the State's required pension contributions. The Court ruled that the New Jersey law enacted in 2011 committing the State to fund its pension systems runs afoul of the State's constitutional provisions by the creation of debt and liabilities for the State without voter approval. This decision raises some interesting questions.

First, did those crafting the New Jersey pension legislation know the state's commitment to pay was potentially unconstitutional when they offered it to employees? While it is impossible to know precisely, this specific constitutional provision has been a key element in two relatively recent court decisions. Lonegan vs. the State of New Jersey (2002) and Lonegan vs. the State of New Jersey II (2003) both involved the question of bond issuances without voter approval. In both cases, the courts found that the issuance did not run afoul of the provision, in part, because the debt repayment was subject to annual appropriation by the legislature.

This “subject-to-appropriation” debt is generally issued by an independent authority, which often has no revenue of its own, with the understanding that the debt will be repaid through appropriations made by the state to the authority. These bond issuances create a moral obligation on the State, but not a legal one. Today, the majority of New Jersey’s existing debt is subject-to-appropriation debt issued by independent authorities precisely to avoid running afoul of the constitutional provision. Given the somewhat recent court cases and New Jersey’s long-standing practice of issuing subject-to-appropriation debt, it is hard to imagine that those crafting the 2011 pension legislation were totally unaware of the constitutional provision and the challenges it presented. And if the state knowingly entered into an unconstitutional agreement, why do public sector workers have to live up to their side of the agreement?

Second, beyond any concerns regarding the sincerity of negotiations of the pension legislation, the ruling also brings into question assumptions regarding the security of public sector benefits. Under New Jersey state law, core pension benefits cannot be impaired. From my perspective, that would make the promise of future pension benefits a legally enforceable liability. But, as we all now understand, the New Jersey constitution does not allow the state to create legal obligations to make future payments (without voter approval). My suspicion is that, like the debt issued by independent authorities, the promise to pay benefits is a legal liability of the *pension retirement system* and not the State. But, in New Jersey (and potentially at least 20 other states that have similar debt provisions in their constitution) the state cannot be legally obligated to make future payments to the pension system that are needed to pay promised benefits. So, where does that leave plan members? If benefits are a liability of a pension plan, but the plan cannot lay a legal claim to its only source of revenue to fund its share of benefits, how secure are pension benefits really?

Finally, historically, the moral obligation of the State to repay debt has been enough to allow for continued borrowing by New Jersey's independent authorities. The thinking in the bond market must be that the state would incur such a significant penalty for non-payment that the debt issued is essentially equivalent to a legal obligation. Before this most recent court decision, I would have said the same for the obligation of the state to fund the pension system. Yes, it is still a moral obligation to contribute to the pension system so that benefits can be paid. However, it seems that Governor Christie is willing to see how significant the penalty is for dismissing that obligation. Does using a legal loophole to renege on promised pension contributions mean that New Jersey might use the same loophole to renege on its obligation to pay interest and/or principal for its bonds?