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OF NEW JERSEY

UGLY TRUTHS AND HARD FACTS ABOUT NEW JERSEY'S PENSION CRISIS, PART I:

A CASE STUDY OF WHAT HAPPENS WHEN A SPECIAL INTEREST LIKE THE NJEA BECOMES TOO POWERFUL

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Executive Summary

New Jersey's past is coming back to haunt the present at a very bad time.

In this time of COVID-squeezed budgets, Governor Phil Murphy has proposed making a $4.9 billion contribution to shore up New Jersey's worst-in-the-nation public pension system. That's 12 percent of Murphy's entire FY2021 $40.1 billion budget. State Treasurer Elizabeth Muoio recently revealed the ugly truth about the $4.9 billion payment: $4.2 billion, or 85 percent, will go to paying down the state's $100 billion of unfunded public pension liabilities. In other words, Murphy wants to spend over 10 percent of his entire FY2021 budget to pay for past underfunding. As Treasurer Muoio said, that's $4.2 billion that current citizens must pay for past neglect, and $4.2 billion that cannot be devoted to helping schools, hard-pressed families, laid-off workers, struggling small businesses, or any other important priorities during these difficult times.

The second ugly truth is that even this $4.9 billion is only 80 percent of the actual required contribution, which means that the unfunded liabilities will continue to grow despite the large payment. The full required payment would amount to $6.1 billion, or 15 percent of the state budget. Governor Murphy has committed to making the full payment, so for the foreseeable future, this massive burden will continue to crowd out other priorities.

The third ugly truth is that sixty percent of the state's pension payment will go to one of the single worst public pension funds in America, the Teachers' Pension and Annuity Fund (TPAF) -- a case of throwing the proverbial good money after bad. TPAF is the state's largest public pension fund and the poster-child for New Jersey's broken public pension system. Even before COVID hit, it was only 27 percent funded and ranked among the bottom five percent of public pension funds nationwide. Taking into account the effects from COVID, the Center for Retirement Research projects that TPAF will run out of assets by 2027. Thereafter, TPAF's $4.5 billion-plus of annual benefits payments will have to come directly from the state budget. Absent some sort of federal bailout, it is highly unlikely that New Jersey can make these payments without drastic service cuts or much higher taxes or perhaps even a debt restructuring. TPAF is a looming disaster

for the state.

How did TPAF get in such dire condition?

Treasurer Muoio was right. The numbers tell the story: 88 percent of the $3.7 billion state contribution to TPAF will go to paying down TPAF's $62 billion of unfunded liabilities. Incredibly, only 12 percent of the contribution will go towards the pensions that current employees are earning. In other words, the state must pay $3.3 billion because past legislatures made promises to the New Jersey Education Association (NJEA) and its members but did not fund them. So most of New Jersey's current bill for past neglect is due to TPAF.

Of course, the NJEA blames TPAF's crisis entirely on the state, but the facts show otherwise. The facts show that the NJEA played a lead role in structuring TPAF, undermining its funding, depleting its assets, enhancing its benefits and blocking reforms. The Sunlight Policy Center of New Jersey (SPCNJ) presents eight facts about how TPAF got into this position and the NJEA's undeniable leading role:

1. TPAF Is Projected to Be Insolvent by 2027

2. The NJEA Ensured TPAF Was an Obligation of the State

3. NJEA-Engineered Salary and Pension Structures Systematically Underfunded TPAF

4. The NJEA Led the Way in Undermining TPAF's Funding

5. The NJEA Strongly Supported the Disastrous 1997 Pension Obligation Bond Deal

6. The NJEA Led a Brazen Pension Raid in 2001

7. The NJEA Did Not Hold Lawmakers Accountable for Underfunding Until 2015

8. The NJEA Blocked All Reform Efforts until It Was Too Late

Of particular relevance to current New Jersey citizens, the facts show the NJEA was perfectly willing to abide pension underfunding so long as it believed it had the state and its citizens on the hook. The NJEA was unconcerned about the amount of unfunded liabilities or their ultimate cost to future generations: it only cared that the state and its citizens would be legally bound to pay out the pensions when they came due. Only when the NJEA lost the legal right to benefits and funding did the NJEA act to secure TPAF's funding in 2015, but by that point TPAF was already in deep crisis.

This is the TPAF that confronts the state today. Yet most citizens are unaware that billions of dollars of their taxes will go to paying off past pension debts rather than funding present needs. Most are unaware that TPAF is a looming disaster. But when budgets are squeezed and there is not enough money for COVID relief, or education aid, or social services, or infrastructure, or any other priority, New Jersey citizens will need to know why.

With this report, SPCNJ brings the facts to light. New Jersey citizens need to understand what happened in the past. They need to know that the sorry, avoidable plight of TPAF is what happens when a special interest accumulates too much political power. They need to know that the taxpayer-funded NJEA was able to dominate both political parties and construct the pension system it wanted, and then chose to stand by and let TPAF's financial soundness deteriorate, heedless of the cost to future generations.

Now the NJEA wants to escape the blame and stick the state and its citizens with the ruinous bill.

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I. Introduction

New Jersey's past is coming back to haunt the present at a very bad time.

Due to COVID-related shortfalls, Governor Murphy is proposing to borrow $4 billion and raise taxes by $1 billion in order plug large budget gaps. Yet the governor is also proposing to spend an equal amount - $4.9 billion of his $40.1 billion budget - to fund the state's public-sector pensions. That is 12 percent of the total budget going to shore up New Jersey's worst-in-the-nation public pension system.

State Treasurer Elizabeth Muoio recently revealed the ugly truth about the $4.9 billion payment: 85 percent is going to pay down the state's $100 billion of unfunded public pension liabilities. In other words, the state is paying $4.2 billion to make up for past underfunding. Treasurer Muoio made clear what this is costing the state:

> *[H]ad the state been meeting our assumptions and making the full required payment for all those years, instead of repeatedly skipping or shorting the pension system, our annual contribution this year would not be an 80 percent ADC payment of $4.9 billion, but instead a 100 percent ADC payment of roughly $750 million.*
>
> *Think of what we could have accomplished with the billions and billions of dollars that have gone instead towards making up for years of skipped pension payments.*[1]

This is the ugly truth behind New Jersey's current budget woes. Just when our state needs the money to cope with the impact of the COVID pandemic, the state has to commit over 10 percent of its entire budget to paying down unfunded pension liabilities. As Muoio said, that's $4.2 billion that cannot go to fund the many other important priorities that confront New Jersey during this emergency. Nor would Governor Murphy have to borrow $4 billion in bonds, which will only serve to pass on the costs to future generations.

The second ugly truth is that the $4.9 billion payment only covers 80 percent of the $6.1 billion full required payment, which means that despite the substantial payment, New Jersey's $100 billion of unfunded pension liabilities will increase. Governor Murphy has committed to making the full required payment, so the state will have to spend approximately 15 percent of its entire budget every year for the foreseeable future. Just as it did this year, these payments will inevitably squeeze the state budget.

The third ugly truth is that sixty percent of the $4.9 billion will go to fund one of the single worst public pension funds in America, the Teachers' Pension and Annuity Fund (TPAF).[2] TPAF is the state's largest public pension fund and is the poster-child for New Jersey's broken public pension system. Even before the impact of COVID, TPAF was only 27 percent funded. Even before COVID, TPAF was in the bottom five percent of public pension funds nationwide. With the effects of COVID added to its already woeful condition, the Center for Retirement Research at Boston College has projected that TPAF will become insolvent by 2027. Fully funding an unreformed TPAF is throwing the proverbial good money after bad. Borrowing money to do it is only paying off debt with more debt and passing on the costs to future generations.

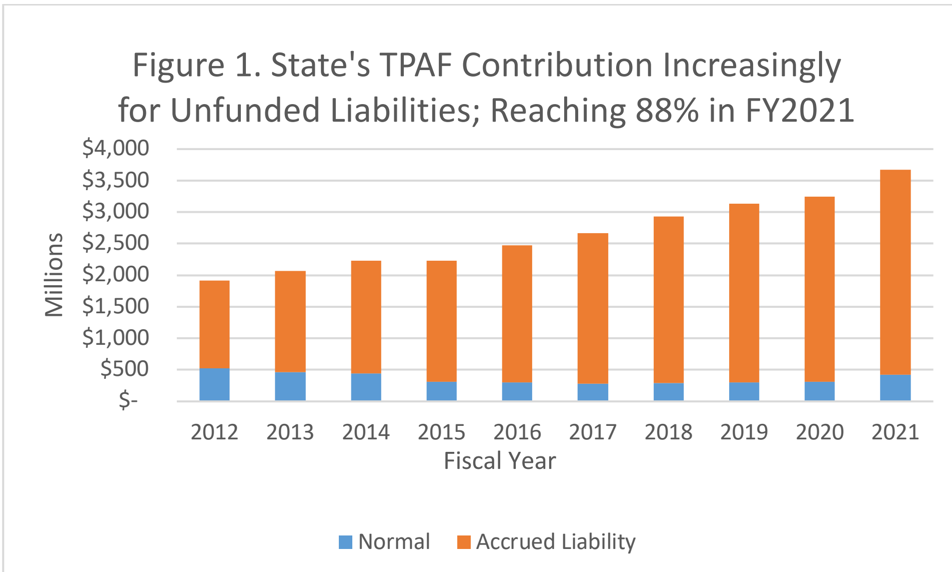
Even with this year's payment, TPAF remains a looming disaster for the state. Should TPAF become insolvent in 2027, the $4.5 billion-plus of TPAF's payments to retirees will have to be funded directly from budget appropriations every year, a near-impossibility for New Jersey's perpetually strained budget. This would be a fiscal disaster for the state, portending drastic service cuts and tax increases. In anticipation of this disaster, the bond rating agencies will downgrade New Jersey, which already has the second-lowest bond rating of any state. This will drive up the cost of issuing bonds, further straining the budget.

Most New Jersey citizens do not know about the billions going to public pensions or that over 10 percent of the current budget is making up for past neglect. Most are unware that TPAF is a looming disaster for the state. But they will know because absent some sort of federal bailout, New Jersey will be plagued by its pension problems for the foreseeable future. All New Jersey will feel the painful consequences.

With this report, the Sunlight Policy Center of new Jersey (SPCNJ) wants to shine a light on the facts behind TPAF's crisis. We want New Jersey citizens to know how and why this happened. Only then can the root-causes of the crisis be understood and steps be taken to ensure it never happens again.

II. How Did TPAF Get into This Position?

Just as Treasurer Muoio indicated, 88 percent of the state's TPAF payment goes to unfunded liabilities. The numbers tell the story. As shown in Figure 1 below, the state's annual contribution to TPAF has increasingly gone to paying for TPAF's massive unfunded liabilities rather than the actual pension benefits that current employees are earning. For FY 2021, $3.3 billion of TPAF's $3.7 billion annually required contribution (ARC) - or 88 percent – is going towards paying down TPAF's $62 billion in unfunded liabilities. In other words, 88 percent of the full, required payment is making up for past underfunding. Incredibly, the "normal cost" for TPAF – the annual amount of money necessary to fund the pensions of current active employees – is only $427 million, or 12 percent of the ARC. If in the past lawmakers had fully funded their pension promises, the state would only have to pay $427 million this year to properly fund TPAF, rather than $3.7 billion.



Source: State of New Jersey, Division of Pensions & Benefits

The bottom line is that we, the current generation of New Jersey citizens, are paying for past neglect. This report will show that TPAF's dire condition resulted from lawmakers making irresponsible pension promises to the New Jersey's most powerful special interest, the New Jersey Education Association (NJEA), but not funding those promises. For decades.

Of course, the NJEA wants to place all of the blame for underfunding TPAF on the state: "The state's failure to fund its share of pension costs is the only reason for [the] pension crisis faced by the state."[4] Certainly some of the blame does belong there, but the NJEA wants New Jersey to have collective amnesia about the facts of what really happened in the past. The NJEA wants New Jersey citizens to believe that it is blameless when it comes to TPAF's looming insolvency and its negative effects on the state. The NJEA wants to hide the truth about its own leading role.

SPCNJ wants New Jersey citizens to have the facts.

III. The Facts: The NJEA Played a Leading Role in the Ruination of TPAF[5]

"*Our excellent pension system . . . [is] the result of hard-fought legislation and politics.*"

-- NJEA president Michael Johnson, 1998[6]

The story of TPAF's demise is a political tale. As President Johnson said, public pensions are political creations. All their features are determined by political decisions. Johnson and the NJEA recognized this long ago: "Most of the 'benefits' our members enjoy are directly linked to and provided because of politics."[7] The NJEA knew that if it wanted to affect pensions, it had to exert political power. In the NJEA's own words: "Pension action is political action."[8]

As the most powerful special interest in the state for decades, the NJEA exerted its political power on both Republican and Democratic lawmakers. As always, politicians cared about getting elected, and the NJEA played a substantial role in deciding who got elected. The facts show that the one constant in the political battles over TPAF was the unmatched political influence of the NJEA.[9]

The NJEA initially used it clout to create the fundamental structure of TPAF: it was the obligation of the state rather than local districts; and it was systematically underfunded due to the mismatch between employee contributions and how employee pension benefits were calculated.

In the 1990s, the NJEA worked long and hard to win the non-forfeitable right to pension benefits, meaning that the benefits promised to its members could not be diminished in the future. The NJEA saw this as a license to acquiesce to underfunding because the promised benefits would have to be paid off when due, regardless of TPAF's funded status. The NJEA's role here was summarized well by University of Georgia Professor Jeffrey Dorfman:

> The basic process by which states get in such severe financial trouble is well established. Unions get protection from any future diminishing of pension obligations enshrined into state law or, ideally, the state constitution. Then public sector unions give state politicians big campaign contributions in exchange for large, irresponsible future pension benefits. The state legislature then underfunds those pensions, keeping the taxpayers from realizing the full cost of the promised pensions and eliminating any near term pain from the pension promises. Unions don't object to the underfunding because they know the law protects their pensions no matter how bad the situation gets.[10]

This describes precisely what occurred in New Jersey.

The NJEA gained the non-forfeitable right as part of the infamous 1997 deal with Governor Christine Whitman to issue pension obligation bonds (POBs). Thereafter, with the non-forfeitable right in hand, the NJEA no longer objected to underfunding, just as Professor Dorfman described, and TPAF's condition deteriorated accordingly.

Of course, the 1997 POB deal did not happen in isolation. The stage was set in 1991, when the NJEA achieved one of the more remarkable feats of political power in modern New Jersey history. Unhappy with Governor James Florio and the Democrats' shifting pensions to local districts and reducing education aid, the NJEA endorsed 46 Republicans and only three Democrats and was credited with flipping the legislature from Democratic majority to Republican super-majority. Governor Florio later said this taught future governors a lesson: "Don't mess with the teachers …"[11]

Neither the Republicans or Democrats forgot the lesson.

The facts show that for the next fifteen years, the NJEA was actively involved in the political decisions that ruined TPAF: the NJEA willingly participated in schemes that undermined TPAF's funding, depleted its assets and increased its liabilities. And it blocked all attempts at reform before it was too late.

President Johnson told the truth. Now that TPAF is a proven disaster, the NJEA wants to blame this all on the state and the politicians. But President Johnson told the truth: TPAF and its sorry, avoidable plight were indeed the result of hard-fought legislation and political influence by the NJEA. Indeed, the TPAF crisis is a case study in what happens to a state when a special interest becomes too politically powerful.

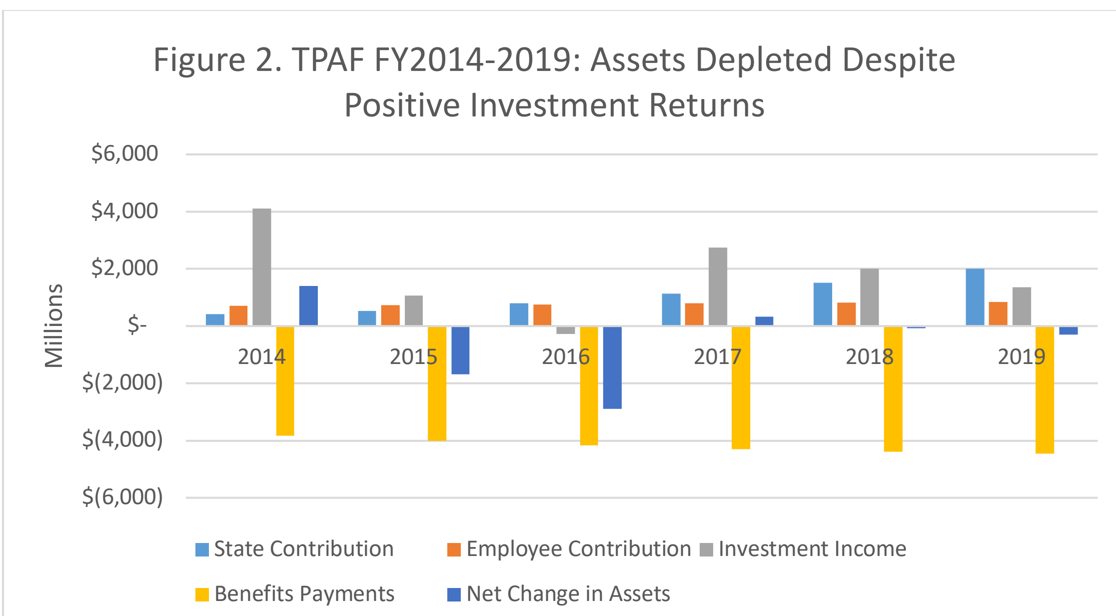
Fact #1: TPAF Is Projected to Be Insolvent by 2027

TPAF is one of the single worst public pensions in the nation. It was 27 percent funded before COVID hit.[12] The Rockefeller Institute of Government defines a government pension system that is below 40 percent funded as "in crisis." Even before COVID hit, TPAF was deeply in crisis.[13]

TPAF's massive unfunded liabilities also mean that $3.3 billion (or 88 percent) of the state's $3.7 billion FY2021 required contribution would go to paying down the unfunded liability, while a mere $427 million (12 percent) would fund the benefits that working teachers are accruing.[14] Had TPAF been responsibly funded in the past, that is $3.3 billion that the state could spend on its many other priorities.

Taking COVID into Account: TPAF Is Projected to Run Out of Assets in FY2027. The Center for Retirement Research at Boston College (CRR) estimated the impact of COVID on TPAF and found that it was particularly at risk for insolvency. CRR determined that TPAF, with its severely negative cash flow of -8.1 percent, will likely have only enough assets to cover two years of benefits payments after FY2025.[15] That is, TPAF will run out of assets in FY2027 and thereafter the $4.5 billion-plus of TPAF benefit payments would have to be funded by appropriations from the state budget every year – a near-impossibility for New Jersey's perpetually strained budget. Should this scenario play out, as TPAF's funded ratio approaches zero, the bond rating agencies will react and downgrade New Jersey's bonds, driving up the costs for New Jersey to issue bonds. So it is likely that a funding crisis would precede FY 2027.

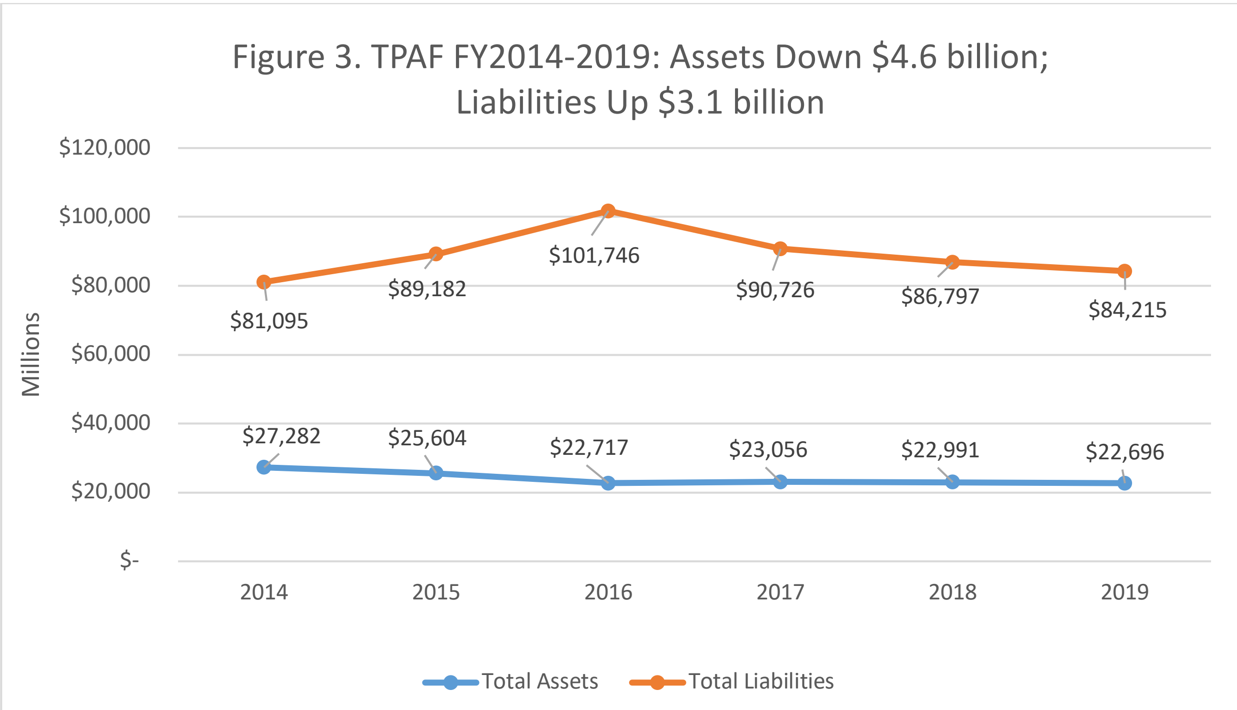
Figure 2 shows TPAF's precarious condition. With its severely negative cash flows, TPAF is totally dependent on strong investment returns, and when they are not sufficient, TPAF's assets are depleted. From FY2014-2018, total contributions from employees and the state amounted to less than half of the benefits paid out. Investment returns were positive every year except FY2016, but not positive enough because the fund's assets were depleted in four out of the six years. Of note, in FY2016, when investment returns were down a modest -1.15 percent, the fund's assets were depleted by $2.9 billion. For FY2019, investment returns totaled 6.18 percent but that was insufficient to cover the negative cash flow and TPAF's assets dropped by $294 million. It is highly likely that TPAF's assets will again be depleted this year.



Source: State of New Jersey, Division of Pensions & Benefits

TPAF Is Cash Flow Negative and Depleting Assets. TPAF's actuary reports that TPAF's negative cash flows as a percentage of assets have been so poor that when compared to other public pension plans, TPAF "has been at or below the 5th percentile" for each of the last ten years. That is, every year TPAF bleeds out more money via negative cash flow than more than 95 percent of public pension plans nationwide.[16]

Figure 3 shows the six-year, cumulative effect of the negative cash flows on fund assets alongside the inexorable growth of the liabilities. From FY 2014-2019, when the markets and returns were generally strong, TPAF's assets decreased by -$4.6 billion. Meanwhile, TPAF's liabilities increased $3.1 billion, resulting in a 2019 funded ratio of 27 percent.[17]



Source: State of New Jersey, Division of Pensions & Benefits

Fact #2: The NJEA Ensured TPAF Was an Obligation of the State[18]

Pensions Were Made Obligations of the State So that Both Salaries and Pensions Could Be Maximized. The NJEA fought long and hard to ensure that pensions were the obligation of the state, not local school districts (unlike New York, whose pensions are 98 percent funded). This disconnect meant that local teachers unions could collectively bargain for salaries with school districts freed from the need to consider the impact of the resulting salaries on pension costs. The actual and intended result: Teachers could maximize both salaries and pensions. The 2015 New Jersey Pension and Health Benefit Study Commission (the "Study Commission") concluded that this disconnected structure is "a major source of the State's budget crisis."[19]

Various governors recognized the risks in this disconnect. Governor Brendan Byrne, Governor Florio, and Governor Whitman all considered or attempted to place the responsibility for pensions back on school districts. All were thwarted by the NJEA and its allies.

This issue played a major role in 1991 when the NJEA was credited with flipping the legislature from a Democratic majority to a Republican super-majority. In 1990, Florio and the Democratic legislature had shifted pensions to school districts. As a result of NJEA-backed electoral defeats for the Democrats, Florio was forced to postpone and ultimately repeal the shift.

Choices Have Consequences: Locally funded pensions are better funded. Choosing to put teachers' pensions with the state had other consequences as well. Local districts must balance their budgets without the fiscal shenanigans available at the state level, so they have been more diligent about funding their pension obligations, such as those to police and firefighters. These pensions are therefore in better condition than teacher pensions.[20] The NJEA is well aware of this fact: "Local PERS is funded at a higher level than TPAF because Local PERS is funded by individual employers, rather than the state."[21] But the NJEA made sure that the state was responsible for teachers' pensions, and now TPAF is 27 percent funded.

Fact #3: NJEA-Engineered Salary and Pension Structures Systematically Underfunded TPAF[22]

Under NJEA-directed salary guides, teachers get automatic raises from year to year. Combined with NJEA-backed laws that privilege teacher seniority, this inevitably results in higher compensation costs as teachers move along in their careers. Pensions are then based on the highest salary levels at the end of a teacher's career, so a teacher's contributions over the course of a career will not be sufficient because they are based on all the years of employment—including the earlier years when the teacher was earning less—whereas the pensions are based on only the highest salary years at the end of a career. The NJEA sums up its philosophy well: "The quicker a member reaches maximum, the more years he or she will be paid at maximum, increasing career earnings as well as pension earnings."[23]

This has profound implications for the cost of pensions. Georgetown University's Edunomics lab determined that each dollar awarded in final average salary results in a $9.66 increase in the New Jersey's pension obligations.[24] As the researchers stated: "Give a raise in the final years of teaching, and the teacher gets a raise for life."[25]

Fact #4: The NJEA Led the Way in Undermining TPAF's Funding[26]

The time-period from the early 1990s to 2006 undermined the soundness of TPAF. Rather than use its unmatched political clout to secure its members' pensions, the NJEA was mostly a willing participant in numerous schemes to erode pension assets, reduce required pension contributions and enhance benefits. These are the main culprits for TPAF's enormous unfunded pension liabilities.

As the Study Commission pointed out, defined benefit pension plans are inherently volatile: the liabilities climb every year, while assets go up and down with the markets and contribution rates. In flush years, pension surpluses may be temporary, so these surplus assets must be retained against the bad years. This was not done in New Jersey.

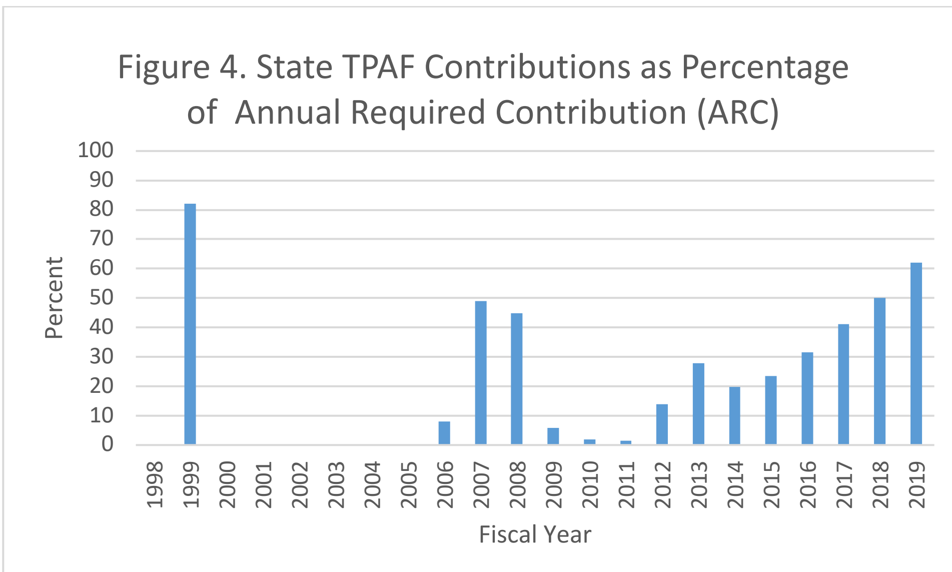
In fact, the opposite was done. Starting in 1992 under Governor Florio, the NJEA gained a long-sought expansion of retiree health benefits. To pay for the expansion, the NJEA acquiesced to the legislature's destructive practice of using surplus assets to substitute for regular pension contributions and to expand benefits. This depleted assets and starved the pension funds of needed contributions. When newly-elected Governor Whitman continued the same practice, the NJEA sued the Whitman administration for underfunding pensions. But not for long.

The NJEA strongly supported the 1997 POB deal with Governor Whitman and the legislature (see below), in which the NJEA traded sound pension funding for getting its members the non-forfeitable right to pensions (as described by Professor Dorfman). As part of the deal, the NJEA supported a law that officially sanctioned the use of surplus assets to substitute for regular contributions – exactly what it had sued over in the first place. And the NJEA also dropped its pension-funding lawsuit.

The 2006 legislative Special Session found that "this change in funding policy resulted in either full or partial reductions in the state's and local government employers' otherwise required normal contributions to the retirement plan for fiscal year 1997 through fiscal year 2003."[27] Alarmed by this practice, the 2005 Benefits Review Task Force declared it "unsound funding" and called for its discontinuance.[28] The Special Session recommended the enactment of legislation to eliminate the practice.[29] With the POB deal and the non-forfeitable right in hand, the NJEA effectively abandoned sound pension funding.

Thereafter, a 2001 law (discussed below) signed by NJEA-friendly Republican Acting-Governor Donald DiFrancesco granted another pension funding holiday. NJEA-endorsed Democrat Governor McGreevey was elected in 2001 and under him the state made ZERO contributions into TPAF. As permitted by law, he continued to use pension assets to reduce or eliminate the state's required pension contributions from FY2003 to FY2005.[30]

The resulting elimination of pension contributions is striking. As shown in Figure 4, in 1998 and from 2000 to 2005, the state did not make any contributions to TPAF. In other words, immediately following the POB deal, for seven out of the eight years from 1998 to 2005, ZERO new money was injected into TPAF. Incredibly, all during this time, New Jersey NEVER made the full annual required contribution (ARC). Not once. In total, from 1997 to 2006, the Special Session estimated that $8 billion of contributions were avoided – money that could have been compounding by earning investment returns.[31]



Source: New Jersey Division of Pensions and Benefits

<u>Fact #5: The NJEA Strongly Supported the Disastrous 1997 Pension Obligation Bond Deal</u>[32]

The POB deal with Governor Whitman allowed the state to borrow $2.8 billion of POBs to pay off unfunded liabilities while simultaneously reducing contributions, which meant that the state was effectively shifting the cost of funding pensions for current workers to future taxpayers.

The POBs also lost the state money: Due to the high rate of interest on the non-tax-exempt bonds, New Jersey has paid out more in interest than it earned from investing the proceeds. New Jersey will ultimately spend more than $10 billion in servicing this expensive debt, which will not be paid off until 2029. Realizing the damage POBs caused to the pension system, the legislature later enacted a moratorium on POBs.

The NJEA supported this scheme and intensely lobbied lawmakers to pass the POB bill because in exchange the NJEA gained the non-forfeitable right to promised pensions, and the proceeds from the bond sale would reduce pressure to shift teachers' pensions from the state to school districts. Overall, the NJEA called the disastrous POB deal a "success" and "victory."[33]

This deal shaped the pension system that exists today because the non-forfeitable right meant that any future efforts to reform pensions could target only new employees, leaving a substantial majority of pensions untouched. For example, the Christie-Sweeney pension reforms in 2010 and 2011 could apply only to newly hired educators, leaving 89 percent of teachers unaffected. Recognizing the burden it placed on future generations, the non-forfeitable right was repealed (for new hires) by the 2010 Christie-Sweeney pension reforms. Currently, 66 percent of teachers retain the non-forfeitable right to their promised pension benefits.[34]

Fact #6: The NJEA Led a Brazen Pension Raid in 2001[35]

To crown the ruinous decade of the 1990s, the NJEA led what can only be called a pension raid. The NJEA had been lobbying strenuously for years for pension enhancements, and the dot-com boom of the late 1990s gave the NJEA the nominal surplus assets to pay for them. With the NJEA-friendly Republican Donald DiFrancesco (who became Senate President after the NJEA flipped the legislature in 1991) as acting-governor and looming legislative elections in 2001, lawmakers fell over themselves to please the NJEA. The new law granted both existing and prospective retirees a nine percent pension increase, dramatically increasing the pension system's liabilities. And the law created a new pension-funding holiday.

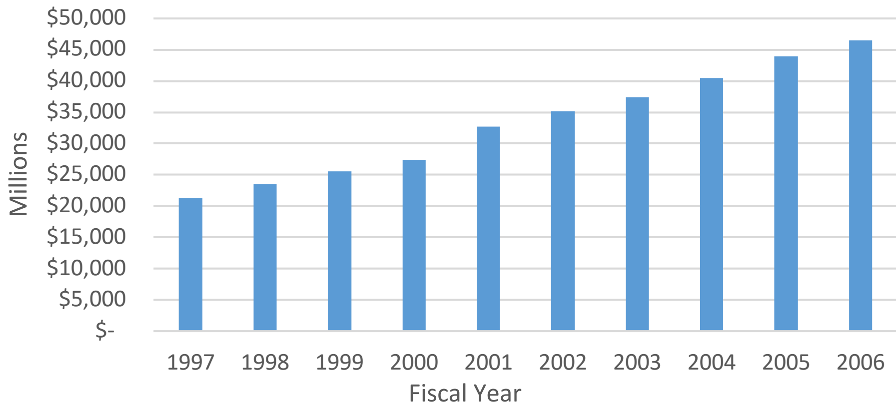
In a stunningly deceitful move aimed at creating "surplus" assets to fund the enhancement, the legislature reached back to June 30, 1999, to value pension assets when they were $5.3 billion higher than under the then-current valuation method—even though by 2001 the dot-com bust had in reality erased most of that value. Legislators and the NJEA were fully aware that this bill was depleting pension assets, yet the NJEA engaged in a major effort to support the bill. When it passed, the NJEA crowed that it was "one of the most significant legislative accomplishments in NJEA history."[36]

This raid on pension assets was so egregious that the legislature later enacted a moratorium on pension enhancements. The Study Commission underscored how this raid hurt the condition of the pension plans: "The burden of this instant retroactive increase in the state's pension obligations, combined with an extended pension-funding holiday, has been a key contributing factor to the current crisis."[37] The 2005 Benefits

Review Task Force called the raid a "poster child for why the current system is a failure … The process by which it was undertaken and the manner in which it was justified and implemented was indefensible."[38] Yet the NJEA was 100 percent behind it.

The decade from 1997 to 2006 severely damaged TPAF. While funding holidays meant that no new money was coming into the system, and pension raids meant that assets were being systematically removed from the system, TPAF's liabilities more than doubled, from $21 billion to $46 billion, as shown in Figure 5.

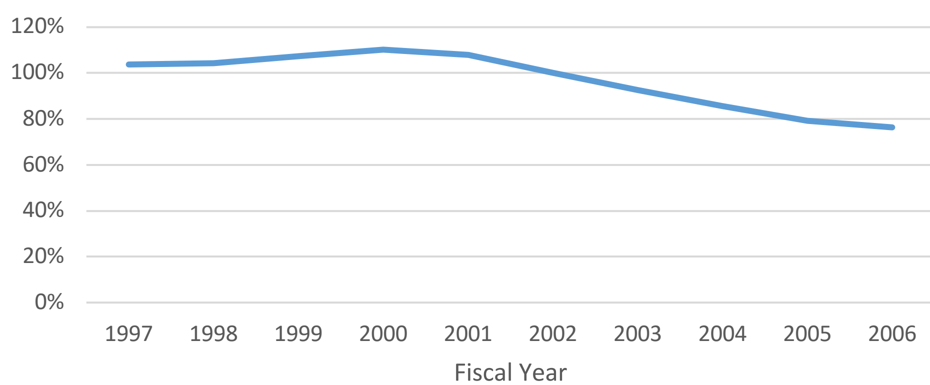
Figure 5. 1997 to 2006: TPAF Liabilities Increase 119 Percent, from $21 Billion to $46 Billion



Source: New Jersey Division of Pensions and Benefits

As a result, in Figure 6, TPAF's funded ratio dropped from 104 percent to 76 percent.

Figure 6. 1997 to 2006: TPAF Funded Ratio Drops from 104 Percent to 76 Percent



Source: New Jersey Division of Pensions and Benefits

It was in response to the deterioration of the state's public pensions that Acting-Governor Richard Codey created the Benefits Review Task Force in 2005 to try to control their spiraling costs.

<u>Fact #7: The NJEA Did Not Hold Lawmakers Accountable for Underfunding Until 2015</u>[39]

The historical facts show that the NJEA was very active in New Jersey politics during this crucial time-period – but never to hold lawmakers accountable for underfunding TPAF. On the contrary, the NJEA worked actively with lawmakers in deals that undermined pension funding: the NJEA lobbied very hard and successfully for the 1992 retiree healthcare expansion, 1997 POB deal and the 2001 pension raid, all of which used surplus assets to substitute for regular pension contributions.

The NJEA clearly knew how to flex its muscles when it did not like what the legislature was doing. As mentioned earlier, the NJEA was credited with flipping the legislature in 1991 in order to reverse shifting pensions to local districts and reductions in education aid.

And yet the NJEA did not oppose Governor Whitman's reelection in 1997 but took a neutral stance. The state's underfunding of pensions was supposedly a big issue for the NJEA – indeed, the NJEA had sued Whitman over it - yet the NJEA chose not to make it a campaign issue and did not work to defeat Whitman or make an example out of her.

In fact, the NJEA did not make an example out of anyone for pension underfunding. NJEA-endorsed Acting-Governor DiFrancesco[40] and NJEA-endorsed Governor McGreevey continued to use assets in place of regular contributions. The facts show that all during this time of zero funding – from 2000 to 2005 – the NJEA had the elected government it wanted: an NJEA-endorsed governor won in 2001, and an average of 90 percent of its endorsed candidates won in the 2001, 2003 and 2005 legislative elections.[41]

On the other hand, it often threatened to hold legislators accountable for trimming benefits – in particular during the 2005 Benefits Review Task Force, the 2006 Special Session and the 2008 Sweeney/Buono reform attempt (all discussed below). In 2011, no legislator who supported the Christie-Sweeney pension reforms was endorsed by the NJEA.

The NJEA Finally Acted After the Supreme Courts Ruled Against the

Funding Law. Finally, in the 2015 legislative elections and thereafter, the NJEA showed what it could do if it wanted to hold politicians accountable for pension underfunding. It is noteworthy that the NJEA only held lawmakers accountable for pension underfunding in 2015 after the New Jersey Supreme Court ruled that teachers did not have a contractual right to pension funding. As part of the 2011 Christie-Sweeney pension reforms, the legislature granted teachers the non-forfeitable right to pension funding (in addition to the 1997 grant to the non-forfeitable right to pension benefits), but the Supreme Court ruled that this was unconstitutional.

Accordingly, the NJEA finally got serious about securing TPAF's funding**.** The NJEA mounted an all-out effort in the 2015 Assembly elections. It re-elected every Assembly member who supported the FY2016 budget with full pension funding, and did not endorse any candidate and defeated four incumbent Republicans who voted against it. NJEA President Wendell Steinhauer made the message crystal clear: "if you refuse to uphold the law and fund our pensions, we will elect candidates who will."[42]

And just as Professor Dorfman described, the NJEA pushed to lock down TPAF's funding, along with the non-forfeitable right to pension benefits, by enshrining them in the state constitution. To get the constitutional amendment on the ballot, the bill had to be passed by two consecutive legislatures, so the NJEA successfully lobbied the 2015 legislature to pass the amendment as the first step to getting it on the November 2016 election ballot. The NJEA then renewed its push with the new 2016 legislature. After another intense NJEA lobbying campaign, the Assembly passed the bill, but Senate President Sweeney held up the vote in the Senate. The NJEA then threatened to withhold campaign donations to Democrats and held protest rallies against Sweeney. But Sweeney did not yield to the pressure and blocked the vote. The NJEA then sought to hold Sweeney accountable in the 2017 election by spending $5.4 million in an unsuccessful attempt to unseat him.

The NJEA's newfound commitment to securing pension funding has continued, with current, NJEA-endorsed Governor Murphy making pension funding a top priority. Despite COVID-related budget gaps, Murphy has gone so far as to propose to borrow $4 billion in order meet the state's pension funding promise - by issuing what are, in effect, POBs – as called for by the NJEA.

By its actions, the NJEA has clearly shown that it knew how to hold politicians accountable for underfunding pensions but chose not do so until 2015.

The NJEA was unconcerned about the ramifications for the state. It must be stressed how unconcerned the NJEA was with the broader ramifications of underfunding for the state and its citizens. The facts show that the NJEA was perfectly willing to abide pension underfunding so long as it believed it had the state and its citizens on the hook. The NJEA was apparently unconcerned about the amount of underfunding, or the aggregate amount of unfunded liabilities, or the ultimate cost to future generations: it only cared that the state and its citizens would be legally bound to pay out the pensions when they were due, no matter what the cost for the rest of the state. In other words, the NJEA was quite willing to inflict massive pain on later generations – our kids and grandkids – so long as its members were taken care of.

Fact #8: The NJEA Blocked All Reform Efforts until It Was Too Late[43]

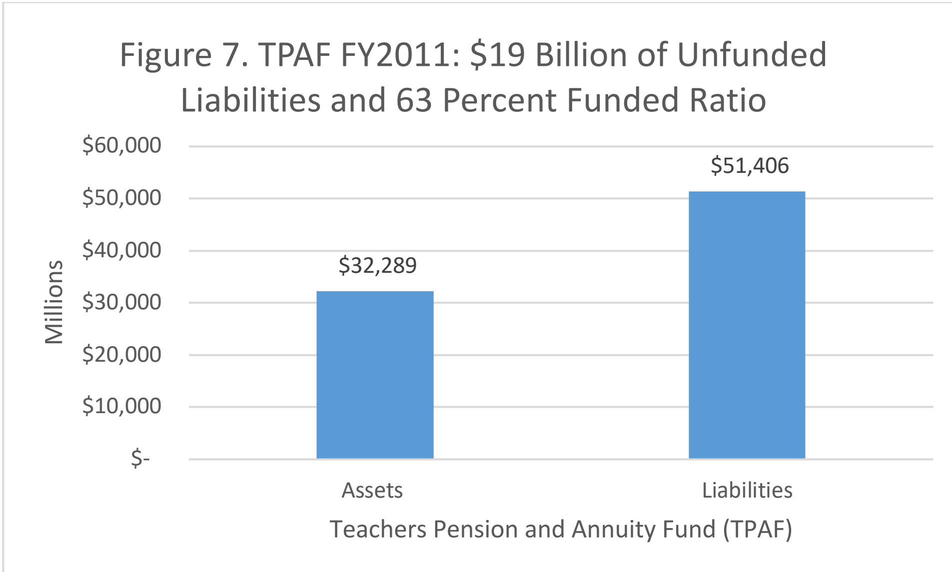
The NJEA not only used its political clout to lobby for political deals it liked but also wielded that power to block reform efforts. Emboldened by the non-forfeitable right to pensions, by not allowing reform of the system when its problems were less severe, the NJEA helped ensure that those problems would become more severe in the future.

In 2005, Acting-Governor Codey's task force recommended several reforms to make pensions more affordable for the state. The NJEA mobilized the entire organization and engaged in a lobbying, organizing and advertising campaign to defeat the resulting legislation.

In 2006, newly-elected Democratic Governor Corzine ordered the legislature into a Special Session to reign in the costs driving up property taxes by reducing public employee benefits. Once again, the NJEA used its full resources in a massive lobbying effort to block any major reforms that emerged from the Special Session. Corzine backed off and got the Democratic legislature to follow suit. The laws coming out of the Special Session ultimately produced only minor changes to the pension system.

In 2008, the NJEA engaged in another major lobbying campaign to block subsequent bills based on the Special Session's recommendations proposed by two powerful Democratic senators, Senate Majority Leader Steve Sweeney and Budget Chair Barbara Buono. The NJEA killed three Sweeney/Buono bills and watered down others.

By the time the Christie-Sweeney reforms were finally enacted in 2010 and 2011, TPAF was already in bad shape and deteriorating. As early as 2007, state officials were saying TPAF was "in dire shape, with a serious deficit."[44] As shown in Figure 7, by FY2011, TPAF had $19 billion of unfunded liabilities and a 63 percent funded ratio, although in reality it was in much worse shape.[45] Of course, the NJEA fought the Christie-Sweeney reforms tooth and nail. No legislator who voted for the reforms was endorsed in the 2011 legislative elections.



Source: New Jersey Division of Pensions and Benefits

IV. Conclusion

President Johnson was right: pensions are political creations made by politicians who are perpetually susceptible to political influence. All during the time that TPAF was systematically undermined, the NJEA was the most powerful special interest in the state. But rather than secure its members pensions, the NJEA used its political power in a way that has brought TPAF to the brink of insolvency.

Just as described by Professor Dorfman, the NJEA made a devil's bargain: it abandoned sound pension funding in exchange for the non-forfeitable right to promised pensions. This left TPAF highly vulnerable to the inevitable recessions and market downturns. The Great Recession and its aftermath damaged the unsound TPAF severely, and it entered the COVID recession already deeply in crisis. Absent a federal bailout, TPAF's insolvency and a state funding crisis loom in the not-too-distant future. All New Jersey will feel the pain.

Present-day New Jerseyans must understand that the NJEA was perfectly willing to inflict this pain on its fellow citizens. It did not have to be this way. The NJEA could have used its dominant political power to ensure that its members' pensions were secure, but it did not. Instead, the facts show that the NJEA participated in undermining these pensions and blocked needed reforms. All the while, the NJEA was perfectly content to let TPAF's hidden costs mount, heedless of the consequences for the state and its future generations.

In the end, the TPAF crisis provides a case study of what happens to a state when a special interest becomes too politically powerful. This is the root-cause of the TPAF crisis. When the reckoning comes, when people are looking to place blame and devise solutions, New Jersey citizens must know the facts presented in this report. And the state's most powerful special interest, the NJEA, must be held accountable for its leading role in New Jersey's pension crisis.

ENDNOTES

[1] State of New Jersey, Department of the Treasury, Press Release, "Treasurer Muoio Testifies Before Senate Budget Committee on Governor Murphy's Revised Budget Proposal," InsiderNJ, September 8, 2020, https://www.insidernj.com/press-release/treasurer-muoio-testifies-senate-budget-committee-governor-murphys-revised-budget-proposal/.
[2] All data for TPAF is drawn from Teachers' Pension and Annuity Fund of New Jersey, Actuarial Valuation Report as of July 1, 2019, Cheiron, April 2020, https://www.state.nj.us/treasury/pensions/documents/financial/actuarial2019/2019tpaf.pdf.
[4] New Jersey Education Association, "NJEA Statement on Lottery Proposal," May 12, 2017, https://www.njea.org/njea-statement-lottery-proposal/.
[5] For a full discussion of the NJEA's leading role in the pension crisis, and for all citations and sources, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[6] Michael Johnson, "President's Message," *NJEA Review* 72, no. 6 (February 1998): 6.
[7] Michael Johnson, "President's Message," *NJEA Review* 72, no. 6 (February 1998): 6.
[8] Kathryn Coulibaly, "Political Action: If (almost) nobody likes it, why do we do it?" *NJEA Review*, 59, no. 7, (March 2016): 22.
[9] See SPCNJ's "Money Equals Power: How the NJEA Dominates New Jersey Politics" for a full discussion of the NJEA's decades-long, unmatched political power.
[10] Dorfman was describing Illinois, another state with a public pension crisis. Jeffrey Dorfman, "Illinois Credit Downgrade Proves Public Pensions Should Be Outlawed," *Forbes*, June 5, 2017.
[11] Brigid Harrison, "We Should Have Listened to Florio," *Record*, July 17, 2016.
[12] State of New Jersey Division of Pensions and Benefits, *Financial Statements and Supplementary Schedules,* KPMG, June 30, 2019, 29, https://www.state.nj.us/treasury/pensions/documents/financial/annrpt2019/2019divisioncombined.pdf. Using the Bureau of Economic Analysis' discount rate, TPAF's funded ratio would likely be under 20 percent. See footnote _.
[13] As cited by Steven Malanga and Josh McGee, *Garden State Crowd-Out*, Manhattan Institute, January 2018, 8, https://www.manhattan-institute.org/html/garden-state-crowd-out-how-new-jerseys-pension-crisis-threatens-state-budget-10875.html.
[14] Teachers' Pension and Annuity Fund of New Jersey, Actuarial Valuation Report as of July 1, 2019, Cheiron, April 2020, 4, https://www.state.nj.us/treasury/pensions/documents/financial/actuarial2019/2019tpaf.pdf.
[15] Jean-Pierre Aubry, Alicia H. Munnell, and Kevin Wandrei, *2020 Update: Market Decline Worsens the Outlook for Public Plans,* Center for Retirement Research at Boston College, May 2020, https://publicplansdata.org/2020/05/12/2020-update-market-decline-worsens-the-outlook-for-public-plans/.
[16] Teachers' Pension and Annuity Fund of New Jersey, Actuarial Valuation Report as of July 1, 2019, Cheiron, April 2020, 17, https://www.state.nj.us/treasury/pensions/documents/financial/actuarial2019/2019tpaf.pdf.
[17] Investment returns: FY2014 16.79 percent, FY2015 4.08 percent, FY2016 -1.15 percent, FY2017 13.01 percent, FY2018 9.11 percent, FY2019 6.17 percent. State of New Jersey, Division of Pensions & Benefits, *Financial Statements and Supplementary Schedules (With Independent Auditor's Report Thereon*), KPMG, June 30, 2019, 67.
[18] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[19] New Jersey Pension and Health Benefit Study Commission, *Roadmap to Resolution*, State of New Jersey Department of the Treasury, February 24, 2015, 22.
[20] For example, the Police and Firemen's Retirement System, which is funded entirely at the local level, is 60 percent funded. State of New Jersey, Division of Pensions & Benefits, *Financial Statements and Supplementary Schedules (With Independent Auditor's Report Thereon*), KPMG, June 30, 2019, 61.
[21] New Jersey Education Association, "What is the status of the pension COLA?" *NJEA Review* 91, no. 5 (December 2017): 17.
[22] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."

[23] Ibid., 48-49. The NJEA's parent organization, the National Education Association, uses these tactics as well. See Dave Winans, "Field-Tested Salary Campaign Tactics," August 2007, www.nea.org/home/16253.htm.
[24] Marguerite Roza and Jessica Janovski, "How Late-Career Raises Drive Teacher-Pension Debt," Edunomics Lab, Georgetown University, December 2015, 5.
[25] Michael Podgursky and Marguerite Roza, "Teachers' Pensions and the Overgrazed Commons," *Governing*, March 26, 2015.
[26] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[27] Special Session Joint Legislative Committee, *Public Employee Benefits Reform Final Report*, 109.
[28] Special Session Joint Legislative Committee, *Public Employee Benefits Reform Final Report*, 110.
[29] Ibid.
[30] McGreevey left office in November 2004 and was responsible for the FY2005 budget. Mary Williams Walsh, "New Jersey Diverts Billions, Endangering Pension Fund," *New York Times,* April 4, 2007.
[31] Special Session Joint Legislative Committee, *Public Employee Benefits Reform Final Report*, 110.
[32] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[33] New Jersey Education Association, "1998 NJEA Legislative Program," *NJEA Review* 71, no. 6 (February 1998): 28.
[34] Teachers' Pension and Annuity Fund of New Jersey, Actuarial Valuation Report as of July 1, 2019, Cheiron, April 2020, 47, https://www.state.nj.us/treasury/pensions/documents/financial/actuarial2019/2019tpaf.pdf.
[35] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[36] New Jersey Education Association, "A Deal is a Deal – No Matter When It Was Made," *NJEA Reporter* 49, no. 3, (November 2005): 3.
[37] New Jersey Pension and Health Benefit Study Commission, *Supplemental Report on Health Benefits*, 27.
[38] State of New Jersey Benefits Review Task Force, *The Report of the Benefits Review Task Force to Acting-Governor Richard J. Cody,* December 1, 2005, 20.
[39] For a detailed account of the NJEA's pension-related political efforts, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[40] The NJEA endorsed DiFrancesco in the 2001 Republican primary – the first time it had endorsed a candidate in a gubernatorial primary. DiFrancesco lost to Brett Schundler.
[41] Governor Jim McGreevey won in 2001. In 2001, 94 percent of NJEA-endorsed Senate candidates won and 85 percent of Assembly candidates; in 2003 93 percent of all legislative candidates won; in 2005, 90 percent of all legislative candidates won. New Jersey Education Association, "Legislation + Political Action = Great Public Schools," *NJEA Review* 75, no. 6 (February 2002): 28; New Jersey Education Association, "Legislation + Political Action = Great Public Schools," *NJEA Review* 77, no. 6 (February 2004): 12; New Jersey Education Association, "Legislation + Political Action = Great Public Schools," *NJEA Review* 79, no. 6 (February 2006).
[42] Wendell Steinhauer, President's Message, "Election victories show legislators can't take NJEA for granted," *NJEA Review*, 59, no. 4 (December 2015): 7.
[43] For a full discussion of the NJEA's efforts to block pension reforms, along with sources and citations, see SPCNJ's "Job Number One: NJEA's Leading Role in New Jersey's Pension Crisis."
[44] Mary Williams Walsh, "New Jersey Diverts Billions, Endangering Pension Fund," *New York Times,* April 4, 2007.
[45] The 63 percent funded ratio was inflated because it was based on New Jersey's own accounting measures, which understated the amount of liabilities. In 2013, the Government Accounting Standards Board issued GASB 67, which required that states use more realistic rates to discount liabilities. Under GASB 67, TPAF's funded ratio dropped from 58 percent in FY2013 to 34 percent in FY2014 and currently stands at 38.4 percent.

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