Pensions in the Public Sector

Edited by
Olivia S. Mitchell and Edwin C. Hustead

Pension Research Council
The Wharton School of the University of Pennsylvania

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Chapter 15
The New Jersey Pension System

Tom Bryan

Retirement benefits are big business in the public sector: the Public Pension Coordinating Council found that the number of active participants in the plans was over 11 million and employer contributions to the plans were $31.2 billion for the 261 large public plans responding to its 1996 survey (Zorn 1988). The New Jersey public employee pension system is one of the largest of these funds, ranking ninth among the top 1,000 pension funds in terms of assets (*Pensions and Investments* 1999). For the 1997 actuarial valuation period, the New Jersey retirement systems had valuation assets of $53 billion and an actuarial accrued liability of $52 billion. They paid out $2.9 billion in benefits, and held excess valuation assets of $1 billion with a combined funded ratio of 102 percent. As of 1998, the combined New Jersey retirement systems had over 418,000 active members and 166,000 retirees and beneficiaries. Indeed, one out of every 14 residents of the state participates in a public pension system.

The current healthy state of the New Jersey retirement systems is the result of the state's long history of public retirement systems and also two public policies, which shaped that history. The first was an early recognition of the need to establish public retirement systems on a "scientific" (i.e., actuarial) basis. The second policy was consolidation of retirement benefits for public employees in state-administered retirement systems, an early development and one extended to centralized asset investment and administration of the systems during the 1950s. Because of national and state economic cycles, a dramatic increase in public employment in the 1970s and 1980s, and benefit enhancements provided in recent decades, funding of retirement benefits in New Jersey has presented frequent budgetary challenges as well as opportunities for creative funding of public employee retirement benefits.

Historical Developments in the New Jersey State Retirement Systems

New Jersey has been in the retirement benefits business for a long time. Pensions for various categories of police and fire personnel were authorized under state law beginning in the 1880s (New Jersey State Legislature 1976). A statewide contributory annuity plan for teachers financed by member contributions was established by the Teacher's Retirement Fund Law in 1896 (L. 1896, c. 32). In 1906, pensions payable from public funds were authorized for teachers with 40 years of service. But because no provision was made for funding the liability for these pensions, the Teachers' Retirement Fund experienced financial difficulties almost immediately and collapsed in 1919. In addition, there was a substantial unfunded liability relative to the teachers' service pension law by that time. To address both problems, the Teachers' Pension and Annuity Fund (TPAF) was established in 1919 and continues today as the statewide retirement system for teachers in New Jersey (L 1919, c. 80).

A significant aspect of the law which created TPAF was its recognition as public policies that public funds should be used to fund public employee pensions, and that public retirement systems should be "established on a scientific basis" (actuarial basis) to "protect the future well-being" of their members (L. 1919, c.80, Preamble, p. 157). These policies were also reflected in a 1921 law which established a system similar to TPAF for state employers, the State Employees' Retirement System (SERS). This system was made available to county and municipal employees at the option of local employers.

Uniform provisions for benefits and administration of police and fire pension funds of counties and municipalities were provided under state law in 1920 (L. 1920, c. 160). These provisions were intended to provide financially sound and efficiently administered pension plans for policemen and firemen, but the hope was not realized. In fact, in 1944, the local funds were closed to new members and new employees were required to enroll in a new state-administered plan, the Police and Firemen's Retirement System (PFRS; L. 1944, c. 255). In 1952, some two hundred closed local police and fire pension funds were consolidated into a state-administered fund, the Consolidated Police and Firemen's Pension Fund (CPFPF), to provide for centralized administration of the benefits and funding on an actuarial reserve basis. Provision was made for liquidation of the unfunded accrued liability of the local funds with a substantial State contribution to the liquidation (L. 1952, c. 266).

Investment of pension assets and administration of the retirement systems were initially the responsibility of the boards of trustees of the several state retirement systems. The investment and administration responsibilities were centralized in new state agencies, the Division of Investment and the

Division of Pensions, respectively, in the 1950s (1950, c. 270; L. 1955, c. 70). The two major state systems for public employees other than policemen and firemen, TPAF and SERS, were integrated with social security in 1955. SERS was terminated and the Public Employees' Retirement System (PERS) was established with essentially the same membership and benefits, but it was integrated with social security (L. 1954, c. 84). PERS is currently the retirement system for state employees and local government employees not eligible for other state or local retirement systems. TPAF was reorganized and integrated with Social Security (L. 1955, c. 70). Under the integration, pension benefits under the two systems were reduced by the initial amount of the social security benefits received by retirees.

In 1959, the Prison Officers Pension Fund, which was created in 1941 for officers at the state prisons, was effectively closed to new members. New employees were required to join PERS (L. 1959, c. 170). Prison officers were made eligible to participate in PFRS in 1973 (L. 1973, c. 156). In 1965, the State Police Retirement System (SPRS) was established as the successor of the State Police Retirement and Benevolent Fund, which was created in 1924. The purposes for the new system were to provide for actuarial reserve funding of the system and systematic amortization of its unfunded accrued liability (L. 1965, c. 89).

In 1969, an alternative retirement plan (to PERS and TPAF), the alternate benefit program (ABP), was provided for the faculty at the state colleges and universities and the county colleges (L. 1969, c. 242). It constituted a significant departure from the long-standing public policy for retirement benefits for public employees, that is, defined benefit retirement systems administered by the state, in that it was a defined contribution plan administered by a third party (initially the Teachers' Insurance and Annuity Association and the College Retirement Equity Fund, TIAA-CREF, but now includes six additional vendors). In 1973, the judicial retirement system (JRS) was established for justices and judges of the state and county courts. Numerous prior laws which provided for pension and survivorship benefits for judges were repealed (L. 1973, c. 140).

Today the process of consolidation of public retirement benefits in state retirement systems is virtually complete. Only one municipal system and a few special funds for lifeguards in a few beachfront cities are open to new members.

A Period of Enhancements

The integration of PERS and TPAF with social security was the beginning of a period of enhancement of retirement benefits for public employees that continued for the next three and a half decades. Some of the more significant enhancements are listed in Table 1.

TABLE 1. Retirement Benefit Enhancements in New Jersey's Public Pension System, 1958–92

- 1958 all systems—Ad hoc percentage increases in retirement allowances provided for persons who retired from state-administered retirement systems through 1951 starting in 1959 (L. 1958, 143).
- 1965 CPFPF—Service retirement benefit formula changed from 1.67 percent of final average compensation for each year of service to 2 percent a year of service up to 25 years and 1 percent thereafter (L. 1964, c. 242).
- 1965 PFRS—Service retirement benefit formula changed from 1.67 percent of final average compensation for each year of service to 2 percent a year of service up to 25 years and 1 percent thereafter; ordinary disability pension (nonservice connected) increased from 25 percent to 40 percent of final average compensation (L. 1964, c. 241).
- 1966 PERS—Relationship to social security changed from integration to coordination of benefits (offset of PERS retirement benefits for initial social security benefit eliminated, but employee contribution offset related to social security retained); minimum ordinary disability benefit increased to 40 percent from 28 1/3 percent (L. 1966 c. 67); vesting period reduced from 20 to 15 years; participation in PERS made mandatory for all public employees not required to enroll in another contributory plan under state law (L. 1966, c. 217).
- 1966 TPAF—Relationship to social security changed from integration to coordination of benefits (offset of TPAF retirement benefits for initial social security benefit eliminated, but employee contribution offset related to social security retained); minimum ordinary disability benefit increased to 40 percent from 28 1/3 percent; vesting period reduced from 20 to 15 years (L. 1966, c. 66 and c. 218).
- 1967 PFRS—Member contributions for group life insurance program eliminated and pensions provided for dependent widows/widowers and children (L. 1967, c. 250).
- 1969 all systems—Annual cost-of-living adjustments (COLA) provided for retirees from state-administered retirement systems effective January 1, 1970 (L. 1969, c. 169 and c. 230).
- 1969 PFRS—Special early retirement benefit provided, under which a member could retire at age 51 with 25 years of service on an unreduced benefit (L. 1969, c. 90).
- 1971 PERS, TPAF, PFRS, CPFPF, and POPF—Major benefit liberalizations provided which included the following: reduction in period for final average salary from five years to three years; change in the annual percentage reduction for early retirement with 25 years of service before age 60 from 6 percent to 3 percent; and, payment of noncontributory and contributory (if applicable) group life insurance benefit in addition to an annual pension in cases of accidental death (L. 1971, c. 121, c. 175, c. 179, c. 181 and c. 213).
- 1971 all systems—Annual cost-of-living adjustments extended to eligible survivors effective January 1, 1972 (L. 1971, c. 139).
- 1972 state employees—State payment for retiree health benefits coverage under the State Health Benefits Program for qualified retirees (25 years of service or disability retirement) and their eligible dependents, but not survivors, and reimbursement for Part B Medicare premiums (1972, c. 75).
- 1973 PERS and TPAF—Age for early retirement with unreduced benefit reduced from 60 to 55 (L. 1973, c. 129).

TABLE 1. Continued

- 1973 PFRS and CPFPF—"25 and out" benefit provided under which a member could retire on a benefit of 50 percent of average final compensation after 25 years of service regardless of age (L. 1973, c. 109 and c. 110).
- 1979 PFRS—Special retirement benefit increased from 50 percent to 60 percent of average final compensation with 25 years of service (L. 1979, c. 109).
- 1981 CPFPF—Special retirement benefit increased from 50 percent to 60 percent of average final compensation with 25 years of service (L. 1981, c. 241).
- 1982 PFRS—Basis for special retirement benefit changed from average final compensation (three years) to final compensation (final year) (L. 1982, c. 198).
- 1984 CPFPF—Basis for special retirement benefit changed from average final compensation (three years) to final compensation (final year) (L. 1984, c. 127).
- 1985 PFRS—Widow/widowers pension increased from 25 percent to 35 percent of average final compensation (L. 1985, c. 393.).
- 1987 TPAF—Postretirement medical benefits (PRM) for qualified retirees (25 years of service or disability retirement) paid by the retirement system; actuarial reserve funding on a phased-in basis provided for COLA and PRM benefits (L. 1987, c. 385).
- 1987 CPFPF—Surviving widow or dependent widowers pension changed to surviving spouse pension and percentage increased from 25 percent to 50 percent of member's final average salary (L. 1987, c. 128).
- 1989 PFRS—Special retirement benefit increased from 60 percent to 65 percent of average final compensation with 25 years of service; actuarial reserve funding for COLA benefits provided; State to pay annual contributions to the system in the amount of 1.8 percent of covered compensation to fund the increase in the special retirement benefit granted in 1979 (L. 1989, c. 204).
- 1990 PERS—Actuarial reserve funding provided for COLA benefits on a phased-in basis (L. 1990, c. 6.).
- 1991 PFRS—Widow/widowers pension increased from 35 percent to 50 percent of average final compensation with the state to pay increased costs to the retirement system for the benefit enhancement (L. 1991, c. 511).
- 1992 PERS and ABP—Payment by the State for PRM benefits provided for qualified retirees of school boards (school district support staff, e.g., secretaries, custodians, cafeteria workers) and county colleges who are not members of TPAF (L. 1992, c. 126).

Source: Author's compilations.

The rising tide of benefit enhancements did not go unnoticed. With the dramatic growth in the number of public employees from 1960 through the 1980s and the high inflation rates in the 1970s, the cost of public retirement benefits began to present significant challenges to state budgets beginning in the late 1970s. Only a few voices sounded the alarm in the wilderness of budgets and benefits.

Storm Warnings of Problems Ahead

The first significant call for attention to public employee pensions and their growth was a program analysis by a nonpartisan staff agency to the Legis-

lature. As part of its responsibility to "ascertain compliance with legislative intent by the conduct of performance audits and efficiency studies," the Office of Fiscal Affairs of the New Jersey Legislature was authorized by its governing body, the Law Revision and Legislative Services Commission, to undertake a program analysis of the contributory public employee pension programs in the mid-1970s. The result was a comprehensive, three-volume report that included expert pension policy and actuarial analysis by pension and actuarial consultants. The second volume, entitled *Program Analysis of the Public Employees' Retirement System*, highlighted the need for the study as follows:

> In terms of growth in coverage and assets, and critical importance in providing for the economic independence of an ever larger proportion of our population, public employee pensions have achieved a role and significance unparalleled in years past. (New Jersey State Legislature 1976: 1)

It documented this statement by highlighting the fact that membership in the four active retirement systems grew by 134 percent from 1961 to 1973, and assets increased by 313 percent over the same time period. The primary purpose of the study was to provide the legislature with the data and analytic tools necessary to undertake policy development in the area of public pension and retirement policy. Legislative involvement in such policy development was necessary due to the "magnitude of the resources contributed by the State, county and local governments in New Jersey to these pension plans and the ever increasing burden of Social Security wage taxes" (New Jersey State Legislature 1976: 7).

The primary recommendations of the study related to the funding of the retirement systems and included the conclusion that the actuarial assumptions used to determine the liabilities and funding requirements for the retirement systems, especially the salary increase and interest assumptions, be closer to the actual experience of the systems to provide a more accurate measure of the liabilities and current funding requirements. In addition, the report examined the relationship of the two major systems, the Public Employees' Retirement System and the Teachers' Pension and Annuity Fund, to social security and recommended that the sizable and increasing state and other employer contributions to social security be considered as part of the overall costs of public employee retirement benefits. It argued that measures to control the overall costs be considered if the trend of increasing cost for social security continued. The report recommended that changing the actuarial funding method from a projected benefit to an accrued benefit method be considered to target the funding of the systems more closely to their ongoing liabilities and to potentially lower employer contributions. Finally, it argued that pension adjustment benefits (cost-of-living adjustments in pension benefits or COLA) be funded on an actuarial reserve basis unless the

annual rate of increase in the cost-of-living, the growth in the number of covered employees, and the rate for the increase in the pension benefit (50 percent of the change in the consumer price index, CPI) remained at their current levels. The report may have been too scholarly and "objective" for the political environment to which it was addressed, and in any event it generated little or no action.

The next voice of concern, from State Treasurer Clifford A. Goldman, sounded a clarion call for immediate attention to the potential budgetary catastrophe from "explosive growth" in pension costs. In 1981 he posed the problem starkly:

> The independent actuary for PERS and TPAF has just completed a study of the costs and benefit levels for the two major systems. The study confirms our fear that the explosive growth in pension costs will continue and present the next administration with some unavoidable questions about the future of our public retirement systems. I believe that the preservation of these systems is going to require some fundamental change in the benefit structures and that the earlier the need for change is recognized, the less severe it will have to be. (New Jersey State Pension Study Commission 1984a)

Treasurer Goldman identified the critical factors driving up the costs as the actuarial factors of life expectancy and salary levels, and the cost impact of double-digit inflation on COLAs. An aggravating factor was continued pay-as-you-go funding of the cost of living adjustment. Treasurer Goldman recommended that the plan fund cost-of-living adjustments on an actuarial reserve basis; establish a new noncontributory system for new employees with a retirement benefit at age 65 of 1 percent of final compensation per year of service; set a maximum percentage for the cost-of-living adjustment of 4 percent; and, permit current employees to transfer to the new system, trading in future larger benefits for a return of paid-in contributions and ending their contribution requirement. It was too late in the Byrne administration for any action on the recommendations, but they clearly came to the attention of the new administration of Governor Kean in 1982.

The increasing cost of public employee pensions and benefits was a major focus of the Kean administration. In 1982, Governor Kean issued Executive Order No. 7, creating an 11-member pension review commission consisting of: the state treasurer or his designee; a member of the State Investment Council, two elected member's of the boards of trustees of the state retirement systems, and three public members, all appointed by the governor; and, two members of the Senate and General Assembly appointed by the leaders of the respective houses on a bipartisan basis. The preamble clauses to the order described the need for the study as follows:

> Whereas, Substantial portions of the annual budgets of the State and its political subdivisions consist of appropriations to fund various retirement systems established

by law for the benefit of public employees and their beneficiaries; and Whereas, The State bears an especially large burden with respect to the funding of public employee pension liabilities, being responsible for employee pension contributions on behalf of approximately 87,000 State workers, 137,000 schoolteachers, 300 judges and many other active and retired public employees; and Whereas, The State Treasurer has estimated that for the fiscal year 1983 State contributions to the Teachers' Pension and Annuity Fund and the Public Employees' Retirement System alone, exclusive of payments to fund cost-of-living adjustments to retirees and beneficiaries under those retirement systems, will increase from fiscal year 1982 by approximately 21 percent, with combined cost of $294 million; and Whereas, Forecasts for expenditures suggest regular increases of the same magnitude; and Whereas, It is incumbent upon the State and local governments to maintain the integrity of their pension funds. (Kean 1982: Preamble)

The Pension Study Commission provided its own statement of the problem facing the State relative to retirement and health care costs for public employees:

The problem facing the State of New Jersey is that both retirement and health care costs have escalated over the past 10–15 years more rapidly than any other State expenditure. There are many reasons for this escalation, but if such trends continue, both the State and its local governments will find it difficult, if not impossible, to meet their employee benefit obligations without cutting other services. . . . the cost of mandated retirement and health benefits to State employees has increased from approximately 12.9 percent of the general fund in 1976 to 18.2 percent in 1983. (New Jersey State Pension Study Commission 1984b: 4)

The commission recommended several changes in the benefits under PERS and TPAF. These included an increase in the age for unreduced benefits for early retirement (with twenty-five years of service) from 55 to 60 or 62; an increase in the normal retirement age (regardless of service) from 60 to 65 or 62; a reduction in the retirement benefit formula from 1.67 percent of final average salary (three years) for each year of service to 0.75 percent of final average salary for each year of service; the elimination of employee contributions to the systems; a limit on the percentage of cost-of-living adjustments (60 percent of the CPI change) to 3 percent or 5 percent; the establishment of an incentive savings plan with employee contributions to a maximum of 10 percent of pay with matching employer contributions equal to 50 percent of employee contributions to a maximum of 1.5 percent of pay; the new plan would be mandatory for new employees and employees under 40 years of age with less than ten years of service; other employees would have the option to transfer to the new plan; and, cost-of-living adjustments would be funded on an actuarial reserve basis with the unfunded liability for prior service funded over a forty-year period by level percentage of payroll contributions. The Commission noted in its executive summary that its solutions were consistent with the recommendations of Treasurer Goldman to Governor Byrne (New Jersey State Pension Study Commission 1984c).

A minority report was filed by three members of the commission, a senator, and assemblyman, and a trustee of the Teachers' Pension and Annuity Fund, requesting that the governor not endorse the recommendations of the majority of the commission. The minority report criticized the lack of meetings of the whole commission and the fact that the work of the commission seemed to be conducted by the staff director and the consultants without much guidance, direction or input from the commission members. It stated that

> The impression of several commission members was that the commission was being used to ratify and legitimize a series of predetermined conclusions of the current administration regarding the need to save State monies at the expense of employee and health benefits. (New Jersey State Pension Study Commission 1984d: 3)

It also contained a point-by-point rebuttal of a number of the recommendation in the majority report. The minority members got their wish, as the majority report was quickly abandoned.

Despite the failure of the Pension Study Commission Report to generate any momentum for change relative to the state retirement systems, Governor Kean continued to highlight pension and benefits as mandated major growth areas in the budget, a practice that was begun under the Byrne administration. In his budget message for FY 1989, he addressed the problem of pension and health benefits increases:

> Still, I believe there are a number of areas where legally-required, formula driven state spending is growing at an unsupportable rate. Even in an overheated economy, some areas are growing much faster than revenues. . . . Spending on pensions and employee health care has increased by 140 percent, three times the rate of inflation, since I took office. (Kean 1989: 5A)

His budget message for FY 1990 (the last year of his administration) dramatized the problem with more colorful language:

> The problem is simple: we suffer from mandate-mania. Each year, legally mandated, formula-driven, spending increases at rates far in excess of the rate of inflation. The three problem areas are education funding, pension and employer-sponsored health care and Medicaid. Each year these legally required programs devour an increasingly large share of the budget. . . . State spending on pension and health benefits increased this year by more than $137 million and has grown by 183 percent since 1983. (Kean 1988: 23A)

The message also graphically illustrated the point over fiscal years 1984 through 1990. Other forces were at work that would bring the potential retirement benefit funding crisis to a head.

The Crisis Comes to a Head

The economic recession of the early 1990s precipitated severe budget crises in the new administration of Governor Florio. For fiscal year 1990 income and sales tax revenue increased by only 1.5 percent and 1.9 percent, respectively, and the corporation tax revenue declined by 11.1 percent. The Florio administration was faced with two major budget challenges in its first year in office. The General Fund was awash in red ink and a new court mandate requiring substantial additional state school aid was expected shortly. The budget deficit was estimated to be over a billion dollars. The state budget picture did not improve much in the second year of the Florio administration. Faced with a still bleak budget picture in 1992, Governor Florio proposed a major budget initiative relative to retirement benefit funding. The stated purpose for the initiative was to enable the State to provide more property tax relief. Governor Florio described the initiative in his budget message for fiscal year 1992–93:

> I am proposing that we adopt a sound, conservative accounting practice, that will allow us to continue more property tax relief. In this budget, we are taking the prudent and long overdue step of revaluing State pensions by assessing them at market rather than book value. Making this accounting adjustment is required by law in the private sector. . . . For years, the best accounting and auditing firms, as well as the Kean administration and our Senate and Assembly leaders, have suggested that the State adopt this sensible practice. In making this move, New Jersey is joining the majority of other States, which use this more accurate and equitable system. The soundest accounting principles dictate we take this step. Let me say it in no uncertain terms: every penny that has been paid into our State pension system is secure and will remain that way. (Florio 1992: iii)

This budget initiative was commonly known as pension revaluation.

Pension Revaluation

As its name suggests, the primary innovation of pension revaluation was a change in the valuation method for pension assets. Until that time, public pension assets were valued at book value. During the 1980s, the Division of Investment increased the percentage of pension assets invested in equities, and by 1991, there was a $5 billion difference between the book value and market value of pension assets. Although the reasons for making the valuation change were obvious, adoption of the proposal was not straightforward. A struggle developed in the legislature over how the pension asset windfall would be used. The state teachers' association, NJEA, and the state employee unions wanted some of the money for improved funding for COLA and PRM benefits. There was also an effort to enhance the autonomy of the boards of trustees of the systems to give them greater control over

the governance of the retirement systems. The two primary governance proposals were to give the boards of trustees the right to choose the actuaries and legal advisors to the retirement systems. The state treasurer had the authority to choose the actuary and the attorney general was the legal advisor to all the state retirement systems. This effort was spearheaded by the NJEA and elected member representatives on the TPAF Board of Trustees.

A compromise was reached over use of the additional assets, under which 60 percent would be used to reduce employer contributions and 40 percent would be used to improve funding for COLA and PRM benefits. The liability for these benefits had been added to TPAF and PERS only a short time previously (1987 for TPAF and 1988 for PERS). Annual COLA benefits had been provided to retirees and beneficiaries beginning in 1969 on a pay-as-you-go basis. The state had been paying the full cost of health benefits coverage and Part B Medicare premiums for its qualified retirees (twenty-five years of service or disability retirement) and their eligible dependents since 1972. The NJEA and other teacher representatives had succeeded in having legislation enacted in 1987 to provide for payment for health benefits coverage by TPAF for qualified retirees under the system. The qualification requirements were the same as for state employees. The rationale offered for providing the benefit to teachers was that they were "state employees" for retirement benefit purposes because the State paid the employer contributions for their pension benefits under TPAF. Because the past service liability and annual normal costs for these benefits would have caused extraordinary increases in employer contributions if they were funded in a more traditional way, recognition of the liability was being phased slowly—over thirty years for TPAF from 1987 and over twenty-five years for PERS from 1988. Both the normal contribution and the unfunded accrued liability contributions were being phased in at the phase-in rate for recognition of the liability. Once the liability was fully recognized, it would still take a substantial additional period of time before the unfunded accrued liability would be fully funded.

Under the compromise, 40 percent of the additional assets were used to accelerate the phase-in percentages for recognition of the liability for COLA and PRM. The additional assets fully funded the accrued liability for basic benefits and for COLA for retirees and thus eliminated the unfunded accrued liability for these items. This permitted acceleration of the phase-in percentages and higher contributions for COLA and PRM.

The legislation which enacted pension revaluation also did several other things (L. 1992, c. 41). It changed a number of actuarial assumptions under PERS and TPAF: increased regular interest (rate of return on investments) from 7 percent to 8.75 percent; increased the average salary increase assumption from 4.75 per cent and 5 percent to 6.25 percent; increased the COLA inflation assumption from 2.25 percent and 2.5 percent to 3 percent;

and, increased the medical inflation assumption (first ten years) from 10 percent to 12 percent. It reduced the percentage rate of total covered compensation for state contributions to PFRS from 1.8 percent to 1.4 percent. It required that local employer contributions for fiscal year 1992 be refunded to the state. This latter provision was in lieu of a reduction in state aid to municipalities which would have been required without the savings. It provided for actuarial reserve funding for COLA and PRM benefits under SPRS and JRS and for use of the additional assets from revaluation for the funding in those systems. The legislation also sought to allay fears of members of the retirement systems that the changes might somehow affect their retirement benefits by stating that "[n]o present or future retirees of the [listing of the affected retirement systems] shall receive any reduction in benefits or incur any additional costs" as a result of the revaluation provisions.

The governance effort led to the passage and presentation to the governor of two bills, one with all the funding changes and some governance changes, and the other with the same funding changes and additional governance enhancements for the boards of trustees. The governor conditionally vetoed the first bill whereupon it was quickly amended to incorporate the governor's recommendations and passed, and signed on the last day of fiscal 1992. The governance changes in this bill included the following:

- Gubernatorial appointments on the several pension boards were made subject to advice and consent of the Senate.
- Public pension boards were given the authority to select and employ legal counsel for any matter for which the attorney general determined that a conflict of interest would affect the ability of the attorney general to represent the board.
- An eleventh member was added to the State Investment Council who would be appointed by the governor from a list of three persons nominated jointly by the senate president and the speaker of the General Assembly.
- The terms of current gubernatorial appointees to the pension boards were terminated at the end of the sixth calendar month following the effective date of the act.

The governor also conditionally vetoed this second bill, but it was amended later in the year to incorporate the governor's recommendation and was enacted (1992, c. 125). The final version of the bill made three additional governance changes:

- It changed the authority to appoint pension actuaries from the state treasurer to a Retirement Systems Actuary Selection Committee consisting of four state officers, including the state treasurer, or their designees,

and representatives of the three major pension boards, PERS, TPAF, and PERS.

- It preserved the authority to set the regular interest rate for the state treasurer, but restricted this assumed rate to no more than 3 percent higher than the average percentage of the salary increase assumption, and the pension boards were prohibited from setting the average percentage of the salary increase assumption below 6 percent.
- The Director of the Division of Pensions and Benefits was required to communicate annually to the pension boards the relevant factors used in calculating the state's contributions to the accrued liabilities of the retirement systems, and the pension boards were to have access to all the relevant actuarial information relating to any actuarial matter under consideration by the boards.

On the same day that this bill was signed, another bill, which provided for state payment for retiree health benefits coverage for qualified support staff of school districts and county college employees not in TPAF, was signed.

The budget impact of pension revaluation was immediate and dramatic. State contributions to the public retirement systems were reduced by $733 million in 1992 and $552 million for fiscal 1993; local employer contributions fell by $233 for fiscal year 1993. Table 2 provides a detailed list of the savings for the two fiscal years.

Despite the savings from pension revaluation and improving economic conditions, the state budget was again in trouble during Governor Florio's fourth year. Legislation was enacted to remove the sharp increases in the phase-in percentages for COLA and PRM benefits under TPAF and PERS (L. 1993, c. 6 and c. 182).

One of the first budget initiatives of Governor Whitman's administration involved a major pension funding revision, described in her first budget message:

> We are changing the way we fund pensions and health benefits for retirees in a way that will save you more than $600 million this year and more than 3½ billion dollars over the next four years without affecting benefits for a single retiree. We are not taking a penny out of the pension system. We will continue to pay for health benefits on an annual basis. (Whitman 1994: iii)

This budget initiative was commonly known as the Pension Reform proposal.

Pension Reform

Six changes under pension reform were in the plan proposed initially by the governor:

TABLE 2. Effects of Pension Revaluation in New Jersey

	Contributions before reval.	*Contributions after reval.*	*Difference*	*% change*	*Contribution rate before reval. (%)*	*Contribution rate after reval. (%)*	*Difference*
1992 Employer contributions and rates							
PERS-state	$217,810,428	$105,450,960	($112,359,468)	(52)	10.1	4.9	(5.2)
PERS-local	$254,602,473	$66,069,547	($188,532,926)	(74)	7.6	2.0	(5.6)
TPAF	$619,156,837	$272,442,807	($346,714,030)	(56)	15.8	6.9	(8.9)
PFRS-state	$48,408,556	$21,814,788	($26,593,768)	(55)	32.5	41.5	9.0
PFRS-local	$187,604,239	$157,352,074	($30,252,165)	(16)	17.9	15.3	(2.6)
SPRS	$26,192,429	$0	($26,192,429)	(100)	25.9	0.0	(25.9)
JRS	$9,158,741	$7,191,769	($1,966,972)	(21)	29.4	23.5	(5.9)
CPFPF	$6,283,451	$5,461,992	($821,459)	(13)	N/A	N/A	N/A
Total	$1,369,217,154	$635,783,937	($733,433,217)	(54)			
1993 Employer contributions and rates							
PERS-state	$261,424,459	$136,225,509	($125,198,950)	(48)	11.5	5.9	(5.6)
PERS-local	$296,615,200	$101,866,244	($194,748,956)	(66)	8.2	2.8	(5.4)
TPAF	$726,271,036	$350,125,886	($376,145,150)	(52)	17.1	8.2	(8.9)
PFRS-state	$57,325,482	$26,559,078	($30,766,404)	(54)	32.9	15.8	(17.1)
PFRS-local	$217,630,772	$178,898,681	($38,732,091)	(18)	18.9	15.7	(3.2)
SPRS	$18,034,210	$0	($18,034,210)	(100)	18.3	0.0	(18.3)
JRS	$10,689,377	$9,518,759	($1,170,618)	(11)	29.6	26.4	(3.2)
CPFPF	$6,634,211	$5,717,967	($916,244)	(14)	N/A	N/A	N/A
Total	$1,594,624,747	$808,912,124	($785,712,623)	(49)			

Source: New Jersey Division of Pensions and Benefits (1992).

- Eliminate actuarial reserve funding for PRM benefits under TPAF and for state employees under PERS, SPRS, and JRS. Fund the benefits on a pay-as-you-go basis.
- Change the funding method under the state retirement systems from entry age normal to projected unit credit.
- Increase the amortization period for funding the unfunded liabilities of the systems from thirty to forty years.
- Eliminate the 2 percent reduction on employee pension contributions on compensation below the social security compensation limit.
- Extend the phase-in of the impact of revised actuarial assumptions under TPAF from two years to five years.
- Decelerate the phase-in schedule for recognition and funding of COLA benefits to the schedule prior to pension revaluation.

Rationales were provided for each of the proposed changes. Because of the uncertainty over what the health care system in the country would be due to the activity the federal level at the time, it was not prudent to contribute hundreds of millions of taxpayer dollars to prefund PRM benefits. The change to the projected unit credit method for funding the retirement systems would more accurately reflect and fund the liability for retirement benefits on a current basis as the benefits accrue each year. (The study by the Office of Fiscal Affairs in 1976 suggested consideration of such a change in the funding method.) A forty-year amortization schedule for the unfunded accrued liability was a common practice and was authorized under a proposed new rule of the Government Accounting Standards Board. The elimination of the 2 percent offset was long overdue and equitable because it continued long after the basis for it, the offset in retirement benefits for initial social security benefits, had been eliminated (in 1966). The extension of the phase-in for the revised TPAF actuarial assumptions was justified because the primary revision related to improved mortality and the impact of the improved mortality would not be experienced for several years. The deceleration of the phase-in schedule for recognition and funding of COLA benefits was justified because the acceleration under pension revaluation was an unwarranted and costly alteration of the original schedule which was reasonable for funding the benefit.

The proposal generated a bitter battle in the legislature. Led by the NJEA and the state employee unions, the opposition lobbied hard to defeat the proposal. Despite the opposition of these normally powerful interest groups, the proposal passed with all the main elements of the initial proposal included and with a few additional elements some of which enhanced the savings under it.

As enacted by Chapter 62, Laws of 1994, pension reform made several

key changes. It eliminated actuarial reserve funding for PRM benefits under TPAF and PERS (state only), SPRS and JRS, and provided for pay-as-you-go funding with additional annual state contributions to the PRM funds under TPAF and PERS to provide a "cushion of reserves" designed to grow at the rate of 0.5 percent of the covered payrolls of the systems. In addition, it changed the actuarial funding method from entry age normal to the projected unit credit method, and reset the amortization period for the unfunded accrued liability from thirty to forty years with required funding progress for ten years until the schedule was reduced to thirty and a flexible schedule which could not exceed thirty years thereafter to accommodate gains and losses. Also, pension reform changed the employee contribution rates under PERS and TPAF from variable rates based on entry age to a flat 5 percent and eliminated the 2 percent offset in the rates on compensation subject to FICA, with a postponement of the change for one year for current members and a transitional one-year flat rate of 4 percent for current members who had effective contribution rates (full rate less the 2 percent offset) of less than 4 percent. It also extended the phase-in of the impact of revised actuarial assumptions under TPAF from two to five years (the TPAF Board of Trustees delayed revision of the assumptions for one year and phased-in the impact over two years). It reverted to the percentage level recognition and funding of COLA benefits under the schedule originally established under the laws which provided for funding the benefit under the retirement systems, and extended the schedule to forty years from the beginning date of the original schedule. In addition the law change reduced the CPI inflation assumption for COLA benefits to 4 percent (the COLA increase assumption is 60 percent of the CPI inflation assumption or 2.4 percent), and gave the pension boards the right to review and change the CPI inflation assumption if the CPI exceeded 4 percent for two consecutive years. In tandem, it reduced the average salary increase assumption to 2.8 percent less than the regular interest rate (8.75 percent) making it 5.95 percent for four years with the pension boards having the right to review and change the rate to a reasonable level if necessary thereafter. It also reduced from 1.4 percent to 1.1 percent the percentage rate of total covered compensation for State contributions to PFRS to fund the increase in the special retirement benefit granted in 1979.

Table 3 shows the estimated savings for five years for each of the elements of the final agreement on pension reform, and Table 4 illustrates the effect of pension reform on employer contributions and contribution rates for fiscal years 1994 through 1996 for each New Jersey retirement system.

The opposition did not give up the fight, but instead moved to another venue. The NJEA and the largest state employee union, CWA, instituted suit in federal court to overturn the pension reform legislation.

Despite the continuing savings from pension reform, the state budget

TABLE 3. Analysis of New Jersey Public Pension Reform: Savings ($ millions)

	FY'94	*FY'95*	*FY'96*	*FY'97*	*FY'98*	*Totals*
(A) Change in pre-funding of PRM						
State total	239.0	328.0	228.6	261.3	279.4	1,336.3
Local total	0.0	0.0	0.0	0.0	0.0	0.0
(B) Change to projected unit credit method and 40-year amortization						
State total	58.5	151.8	226.1	278.3	318.3	1,033.0
Local total	80.0	108.8	122.1	148.2	168.6	627.7
(C) Delay assumption change in TPAF from 2 to 5 years						
State total	0.0	60.0	56.0	40.0	23.0	179.0
(D) Revise member contribution to flat 5% rate						
State total	0.0	0.0	30.0	65.0	70.0	165.0
Local total	0.0	0.0	9.0	20.0	22.0	51.0
(E) Return to original COLA phase-in schedule						
State total	33.0	88.0	53.0	64.0	75.0	313.0
Local total	57.0	62.0	67.0	72.0	77.0	335.0
(F) Revise COLA assumption from 3% to 2.4% per year						
State total	23.3	58.5	85.7	108.1	124.8	400.4
Local total	24.8	27.0	48.5	52.9	54.8	208.0
(G) Reduce average salary scale to 2.8% below regular interest						
State total	11.5	21.6	34.3	40.7	39.3	147.3
Local total	18.4	27.2	17.4	4.9	5.6	73.5
(H) Waiver of life insurance over $50,000						
No savings estimated						
(I) SHBP one-year withdrawal moratorium						
No direct savings anticipated						
State savings	365.3	707.9	713.7	857.4	929.8	3,574.0
State aid offset*	180.2	73.7	86.5	97.6	107.4	545.4
Total state savings	545.5	781.5	800.2	955.0	1,037.2	4,119.4
Local savings	180.2	225.0	264.0	298.0	328.0	1,295.2
State aid offset*	180.2	73.7	86.5	97.6	107.4	545.4
Total local savings	0.0	151.3	177.5	200.4	220.6	749.8

Source: New Jersey Division of Pensions and Benefits.
*Estimates 100% of local savings will accrue to the state in FY'94 and 32.75% beginning with FY'95.

continued to face problems. Table 5 shows the actual amounts and annual increases in the three major taxes and total revenues for fiscal years 1993 through 1998 and the estimated amounts for fiscal years 1999 and 2000. Because of pension revaluation and pension reform, it seemed unlikely that there could be another pension funding initiative. However, history shows that one should never underestimate the talents of creative budgeters.

TABLE 4. New Jersey Pension Reform Anaysis: Contributions ($ millions)

	Contributions			*Employer contribution rate*		
System	*FY 1994*	*FY 1995*	*FY 1996*	*FY 1994*	*FY 1995*	*FY 1996*
PERS-state						
Before reform	$148.4	$198.5	$233.0	6.31%	7.96%	9.54%
After reform	$57.8	$64.8	$91.7	1.26%	0.97%	1.48%
Difference	($90.6)	($133.7)	($141.3)	-5.05%	-6.99%	-8.06%
TPAF						
Before reform	$380.5	$585.0	$725.0	8.32%	11.68%	13.99%
After reform	$119.1	$61.2	$189.4	2.61%	0.96%	1.00%
Difference	($261.4)	($523.8)	($535.6)	-5.71%	-10.72%	-12.99%
PERS-local						
Before reform	$138.6	$191.3	$225.0	3.58%	4.56%	5.28%
After reform	$33.6	$29.5	$38.4	0.84%	0.60%	0.76%
Difference	($105.0)	($161.8)	($186.6)	-2.74%	-3.96%	-4.52%
PFRS-state						
Before reform	$53.2	$111.5	$103.0	33.69%	52.80%	45.98%
After reform	$36.4	$69.8	$78.7	19.53%	33.08%	34.93%
Difference	($16.8)	($41.7)	($24.3)	-14.16%	-19.72%	-11.05%
SPRS						
Before reform	$10.8	$44.8	$47.5	10.70%	39.40%	40.56%
After reform	$13.7	$27.9	$29.8	13.70%	24.50%	25.80%
Difference	$2.9	($16.9)	($17.7)	3.00%	-14.90%	-14.76%
JRS						
Before reform	$9.6	$12.3	$13.1	24.90%	29.90%	31.95%
After reform	$9.1	$11.2	$15.5	23.40%	27.30%	38.40%
Difference	($0.5)	($1.1)	$2.4	-1.50%	-2.60%	6.45%
PFRS-local						
Before reform	$195.1	$195.6	$222.3	19.85%	15.10%	16.01%
After reform	$119.1	$127.8	$178.1	9.65%	9.86%	12.95%
Difference	($76.0)	($67.8)	($44.2)	-10.19%	-5.23%	-3.06%
	1994	*1995*	*1996*			
Total state savings	$366.4	$717.2	$716.5			
Total local savings	$181.0	$229.6	$230.8			

Source: Author's compilations from data supplied by the New Jersey Divison of Pensions and Benefits.

Governor Whitman's budget message for fiscal year 1998 unveiled another pension funding initiative:

I am also excited about our pension bond proposal. Here are the facts. Like three dozen other states, our pension fund has an unfunded liability. With this proposal, pensioners can rest easy knowing that their pensions are fully funded and that the money will be there when they retire. We are saving today's taxpayers millions of dollars by taking advantage of favorable market conditions and low interest rates to lock into tomorrow's pension payments at today's prices. And we are protecting future

TABLE 5. Annual Growth of Three Major Taxes and Total Revenues, FY 1993–2000

Year	*Sales tax revenue*	% *change*	*Income tax revenue*	% *change*	*Corporate tax revenue*	% *change*	*Total tax tax revenue*	% *change*
1993	3,651,122		4,325,305		960,754		14,833,258	
1994	3,725,645	2.04	4,493,660	3.89	1,091,142	13.57	14,967,778	0.91
1995	4,132,657	10.92	4,540,400	1.04	1,085,492	(0.52)	15,298,868	2.21
1996	4,318,373	4.49	4,733,786	4.26	1,171,509	7.92	15,873,379	3.76
1997	4,415,429	2.25	4,825,411	1.94	1,286,447	9.81	16,466,605	3.74
1998	4,766,195	7.94	5,590,579	15.86	1,231,629	(4.26)	17,444,555	5.94
1999*	5,015,000	5.22	6,065,000	8.49	1,478,000	20.00	17,961,746	2.96
2000*	5,258,000	4.85	6,477,000	6.79	1,555,600	5.25	18,859,136	5.00

Source: Whitman (1999).
*Estimated.

generations by refinancing this obligation over a shorter period of time. Clearly, this proposal is good for us today and good for our grandchildren tomorrow. (Whitman 1997: ii)

This last pension initiative of the 1990s has become known as the pension security proposal (PSP).

The Pension Security Reform

This proposal was rather more complicated than the two previous initiatives. According to actuarial valuations, the state had an unfunded accrued liability under the retirement systems of $3.2 billion. There was also a projected future unfunded liability from the phased-in recognition and funding of COLA benefits with a present value of $1 billion. Under PERS and TPAF, the basic benefits and retiree COLA were fully funded and had an asset surplus of $543 million. The assets and liabilities for the COLA benefits for active employees were tracked separately from basic benefits and retiree COLA because of the phased-in recognition and funding of the active COLA. This surplus was being amortized over the amortization period for the unfunded accrued liability and was providing an annual credit against the employer normal and unfunded accrued liability contributions. And finally, the last piece of the puzzle was a surplus in the market value of pension assets (the difference between the market value and the actuarial value of the assets) of $1.9 billion.

Governor Whitman's original proposal was to issue pension obligation bonds to fund the state's unfunded accrued liability to the state retirement systems. These bonds would not be general obligation bonds, but rather would be *appropriation bonds* which means that payment would depend on the availability of legislative appropriations and there could be no guaran-

TABLE 6. The New Jersey Pension Security Proposal ($ millions)

	Original proposal	*Plan adopted*
TPAF/PERS surplus assets (basic benefits)	$543	$543
Surplus market assets	1,919	1,919
Subtotal surplus assets	2,462	2,462
Pension obligation bonds	3,213	2,750
Subtotal pension obligation bonds and surplus assets	5,675	5,212
Unfunded accrued liability	3,213	3,213
Projected COLA unfunded liability	1,042	1,042
Subtotal accrued and projected unfunded liability	4,256	4,256
Pension obligation bonds and surplus assets	5,675	5,212
Interest discount on bond proceeds	357	305
Accrued and projected unfunded liability	4,256	4,256
1997 state pension contributions due	334	334
1997 state pension contributions paid	82	82
1998 state pension contributions due	415	415
1999 state pension contributions paid	67	67
1998 employee contribution reduction	0	47
Net surplus assets	670	3
FY'97 and FY'98 budget savings	$601	$601

Source: Author's compilations from data supplied by the New Jersey Division of Pensions and Benefits.

tee of such appropriations. The valuation assets of the retirement systems would be reset to full market value for the actuarial valuations on which the fiscal year 1998 pension contributions were based. The surplus assets from resetting the pension assets to market value and the surplus assets for basic benefits in PERS and TPAF would be used to fund the projected COLA unfunded liability and the state pension contributions for fiscal years 1997 and 1998 to the extent of availability of surplus assets in the several funds. Table 6 shows the pertinent numbers for the original proposal and the plan actually adopted.

The rationale for bonding the unfunded accrued liability was that due to favorable conditions in the financial market, it could be funded at a lower rate and over a substantially shorter time period than it could through the retirement systems. Most of the unfunded liability was attributable to COLA benefits under PERS and TPAF. Due to the phased-in recognition and funding of this liability under these systems, the liability would not be fully recognized until fiscal year 2029. The liability would not be fully funded until fiscal year 2056. The total contribution to the retirement systems to fund the liability over 59 years would have been $57 billion. The regular interest rate (assumed rate of return on investment of pension assets) under the systems was 8.75 percent. Under PSP, the liability could be funded over 32 years at

TABLE 7. New Jersey State Retirement Systems: Five-Year Projection of Assets, Liabilities, and Employer Contributions ($ Millions)

	PERS State	*TPAF*	*PFRS State*	*SPRS*	*JRS*	*CPFPF*	*POPF*
Fiscal year 2000							
Market assets	8,860	28,703	1,350	1,345	358	56	20
Valuation assets	7,830	24,936	1,233	1,459	333	62	20
Actuarial liability	6,986	23,941	1,208	1,372	312	59	16
Unfunded liability/ (Surpluss)	(844)	(995)	(25)	(86)	(21)	(3)	(4)
Excess assets	(559)	(131)	(25)	(86)	(21)	(3)	(4)
Employer contributions							
Normal contributions	97	339	91	32	13	0	0
Excess asset offset	97	144	30	32	13	0	0
UL contribution	0	0	2	0	0	0	0
PRM contribution	54	131	0	0	0	0	0
Total contribution	54	326	62	0	0	0	0
Net excess assets	(656)	0	0	(55)	(9)	(3)	(4)
Fiscal year 2001							
Market assets	9,391	30,654	1,619	1,800	369	49	19
Valuation assets	8,496	27,374	1,419	1,535	348	54	19
Actuarial liability	7,474	25,741	1,351	1,481	333	52	15
Unfunded liability/ (Surpluss)	(1,022)	(1,633)	(68)	(54)	(15)	(2)	(4)
Excess assets	(737)	(781)	(68)	(54)	(15)	(2)	(4)
Employer contributions							
Normal contributions	107	356	96	35	13	0	0
Excess asset offset	107	356	49	35	13	0	0
UL contribution	0	0	2	35	0	0	0
PRM contribution	58	144	0	0	0	0	0
Total contribution	58	144	48	0	0	0	0
Net excess assets	(844)	(425)	(19)	(19)	(2)	(2)	(4)
Fiscal year 2002							
Market assets	9,939	32,412	1,760	1,968	382	42	18
Valuation assets	9,160	29,558	1,587	1,630	364	47	18
Actuarial liability	8,010	27,553	1,510	1,608	356	46	14
Unfunded liability/ (Surpluss)	(1,150)	(2,005)	(77)	(22)	(8)	(1)	(4)
Excess assets	(867)	(1,173)	(77)	(22)	(8)	(1)	(4)
Employer contributions							
Normal contributions	118	375	101	37	14	0	0
Excess asset offset	118	375	53	22	8	0	0
UL contribution	0	0	1	0	0	0	0
PRM contribution	62	159	0	0	0	0	0
Total contribution	62	159	49	15	6	0	0
Net excess assets	(985)	(798)	(24)	0	0	(1)	(4)

TABLE 7. Continued

	PERS State	*TPAF*	*PFRS State*	*SPRS*	*JRS*	*CPFPF*	*POPF*
Fiscal year 2003							
Market assets	10,501	34,225	1,914	2,151	396	36	17
Valuation assets	9,823	31,742	1,763	1,743	380	41	17
Actuarial liability	8,595	29,447	1,683	1,744	381	40	13
Unfunded liability/ (Surpluss)	(1,228)	(2,295)	(80)	1	1	(1)	(4)
Excess assets	(945)	(1,485)	(80)	0	0	(1)	(4)
Employer contributions							
Normal contributions	129	394	106	40	14	0	0
Excess asset offset	129	394	56	0	0	0	0
UL contribution	0	0	1	0	0	0	0
PRM contribution	66	175	0	0	0	0	0
Total contribution	66	175	50	40	14	0	0
Net excess assets	(1,074)	(1,091)	(24)	0	0	(1)	(4)

Source: Author's compilations of data for PERS, SPRS, JRS, CPFPF, and POPF supplied by Buck Consultants, and for TPAF supplied by Milliman & Robertson.
Assumed asset investment return 8.75%; assumed market investment return FY2001 8.75%.

a lower interest rate at a cost of $10 billion. This would yield a saving of $47 billion in future pension contributions.

Opposition to this initiative was different from that expressed regarding the pension reform plan. Now employee representatives were divided. The state was proposing to pay off its unfunded liability to the state retirement systems with bond proceeds. It would put several billion dollars into the pensions funds and fully fund the state obligations under all the systems. The NJEA recognized very early in the process the benefits to the retirement systems from the proposal. It wanted some changes in the proposal, such as a limit on the state's ability to continue to use excess assets to offset pension contributions and a benefit for the members of the retirement systems. In exchange, state officials wanted the lawsuit over pension reform to be settled. Concessions to the NJEA led that group to become an early and strong supporter of the proposal. State employees unions were divided on the proposals. They had weak relations with the Whitman administration, leading them to be reluctant to support the proposal. Eventually, the proposal was supported by the national leadership of CWA, but some locals opposed it; the AFL-CIO decided not to oppose it.

A few additional items were added to the proposal while it was under consideration in the legislature. A limit was placed upon the ability of the state to use the full amount of excess assets to offset normal contributions. It could use the full amount through fiscal year 2003. It could use 84 percent and 68 percent over the next two fiscal years, respectively, and 50 percent in

TABLE 8. New Jersey State Retirement Systems: Five-Year Projection of Assets, Liabilities, and Employer Contributions (in Millions)

	PERS State	*TPAF*	*PFRS State*	*SPRS*	*JRS*	*CPFPF*	*POPF*
Fiscal year 2000							
Market assets	8,860	28,703	1,350	1,345	358	56	20
Valuation assets	7,830	24,936	1,233	1,459	333	62	20
Actuarial liability	6,986	23,941	1,208	1,372	312	59	16
Unfunded liability/ (Surpluss)	(844)	(995)	(25)	(86)	(21)	(3)	(4)
Excess assets	(559)	(131)	(25)	(86)	(21)	(3)	(4)
Employer contributions							
Normal contributions	97	339	91	32	13	0	0
Excess asset offset	97	144	30	32	13	0	0
UL contribution	0	0	2	0	0	0	0
PRM contribution	54	131	0	0	0	0	0
Total contribution	54	326	62	0	0	0	0
Net excess assets	(656)	0	0	(55)	(9)	(3)	(4)
Fiscal year 2001							
Market assets	8,626	28,180	1,619	1,656	339	45	17
Valuation assets	8,343	26,879	1,419	1,506	342	54	17
Actuarial liability	7,474	25,741	1,351	1,481	333	52	15
Unfunded liability/ (Surpluss)	(869)	(1,138)	(68)	(25)	(9)	(1)	(2)
Excess assets	(584)	(286)	(68)	(25)	(9)	(1)	(2)
Employer contributions							
Normal contributions	107	356	96	35	13	0	0
Excess asset offset	107	318	49	25	9	0	0
UL contribution	0	0	2	35	0	0	0
PRM contribution	58	144	0	0	0	0	0
Total contribution	58	182	48	10	4	0	0
Net excess assets	(691)	32	(19)	0	0	(1)	(2)
Fiscal year 2002							
Market assets	9,107	29,760	1,619	1,811	349	38	16
Valuation assets	8,860	28,627	1,558	1,576	352	45	16
Actuarial liability	8,010	27,553	1,510	1,608	356	46	14
Unfunded liability/ (Surpluss)	(850)	(1,074)	(48)	33	4	0	(2)
Excess assets	(567)	(241)	(48)	0	0	0	(2)
Employer contributions							
Normal contributions	118	375	101	37	14	0	0
Excess asset offset	118	268	53	0	0	0	0
UL contribution	0	0	1	1	0	0	0
PRM contribution	62	159	0	0	0	0	0
Total contribution	62	266	49	38	14	0	0
Net excess assets	(685)	0	0	0	0	0	(2)

TABLE 8. Continued

	PERS State	*TPAF*	*PFRS State*	*SPRS*	*JRS*	*CPFPF*	*POPF*
Fiscal year 2003							
Market assets	9,596	31,447	1,761	1,991	365	32	15
Valuation assets	9,381	30,462	1,708	1,675	367	38	15
Actuarial liability	8,595	29,447	1,683	1,744	381	40	13
Unfunded liability/ (Surpluss)	(786)	(1,015)	(25)	69	14	2	(3)
Excess assets	(503)	(205)	(25)	0	0	0	(3)
Employer contributions							
Normal contributions	129	394	106	40	14	0	0
Excess asset offset	129	228	30	0	0	0	0
UL contribution	0	0	1	2	1	2	0
PRM contribution	66	175	0	0	0	0	0
Total contribution	66	341	77	42	15	2	0
Net excess assets	(632)	0	0	0	0	0	(3)

Source: See Table 7.
Assumed asset investment return 8.75%; assumed market investment return FY2001 0.00%.

fiscal years thereafter. In order for there to be excess assets, the valuation assets have to be sufficient to cover the full accrued actuarial liability and the projected liability for COLA benefits under PERS and TPAF. Members of PERS and TPAF were guaranteed a 0.5 percent reduction in their contribution rates (from 5 percent to 4.5 percent) from excess assets 1998 and 1999, and continued contribution reductions of up to 0.5 percent if there were excess assets and the state used them to offset normal contributions. The state employee unions succeeded in obtaining a statutory guarantee against a change in benefits once a member attained five years of service. This was not a change in the vesting period which remained at 10 years and PRM benefits were not included in the guarantee. Ultimately, PSP was passed by a close vote in the Senate and a larger majority in the General Assembly; the Governor signed it immediately in June of 1997, whereupon NJEA and CWA dropped their law suit over pension reform.

Interest from investors was enormous. When the pension bonds were first offered to the market, demand was eight times the value of bonds supplied. Interest in the offering helped to reduce the interest rate, which came in at average rate of 7.64 percent. This pension funding initiative like its two predecessors had a dramatic positive impact on the state budget. Reduced contribution amounts totaled $600 million for FY 1997 and 1998; over $200 million in contribution savings were budgeted for fiscal year 1999, and over $400 million in FY 2000. There were also positive impacts on the public pension funds. One was due to the immediate addition of $2.75 billion to the funds and the second was due to the enhanced investment return on not

TABLE 9. Annual Investment Return on Pension Assets and CPI Change: 1985–1998.

Year ending	*Average annual return (%)*	*5-yr average annual return (%)*	*Consumer price index (%)*	*5-yr average annual increase price index (%)*
6/30/1985	31.2		3.70	
6/30/1986	30.90		1.70	
6/30/1987	14.90		3.70	
6/30/1988	70.00		3.90	
6/30/1989	14.50	17.50	5.30	3.65
6/30/1990	13.30	14.10	4.30	3.77
6/30/1991	9.30	10.40	4.70	4.38
6/30/1992	13.80	10.10	3.00	4.24
6/30/1993	12.50	12.70	3.00	4.06
6/30/1994	0.70	9.40	2.50	3.50
6/30/1995	19.70	10.70	3.00	3.24
6/30/1996	16.10	12.10	2.80	2.86
6/30/1997	22.10	13.70	2.30	2.72
6/30/1998	22.70	15.60	1.70	2.46
10-year average annual return	14.14%			
10-year average annual CPI change	3.25%			
14-year average annual return	15.43%			
14-year average annual CPI change	3.25%			

Source: Author's compilation of data supplied by the New Jersey Department of the Treasury, and Whitman (2000).

only on the pension bond proceeds, but also the entire fund. For FY 1998, the first full year after the addition of bond proceeds, the Division of Investment had an average rate of return on the pension assets of 22.7 percent. Since the pension funds earned $624 million on the bond proceeds but debt service was $91 million, net earnings totaled $533 million. They were $414 million more than the amount to cover the average interest rate (7.64 percent) on the bonds, and $384 million more than the amount to cover the interest assumption for the systems (8.75 percent). Partly as a result of this plan, and double-digit investment returns on pension assets, fund balances entering the *new* millennium are projected at $647 million.

Outlook for the Future

New Jersey pension funds are expected to do well in the next several years. Estimates of pension assets, liabilities, and employer contribution requirements appear in Tables 7 and 8, under two scenarios. One assumes that the

rate of return will be the regular interest assumption, 8.75 percent while the second scenario assumes one flat year of zero return on investment, and three years at the regular interest assumption. Under either scenario, the State is projected to not have to make a normal contribution to PERS in each of the four years. In TPAF, there would be a complete normal cost offset for three of the four years with an 8.75 percent return, and substantial offsets in each year even with one flat investment year.

The ability to undertake the funding initiatives of the 1990s is attributable to the recent favorable investment climate. The State Investment Council and Division of Investments has generated remarkable returns on pension asset investment, since it began to invest more of the pension assets in equities. Table 9 shows the average annual pension returns and CPI changes since 1984, and shows that the fund averaged returns of more than 14 percent in the last decade and over 15 percent in the last five years (inflation averaged 3.25 percent over the same periods). We conclude that the public funds will continue to be in good shape even if there were an economic slowdown in the near future. In fact, with current assets, the pension plans could pay out current annual benefits for over 20 years without another contribution or another dollar in investment earnings.

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