

CONSTITUTIONAL PUBLIC PENSION GUARANTEES: Unfair, Unaffordable, and Bad Policy

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EXECUTIVE SUMMARY

Seven states have specific clauses in their constitutions that protect public employee pensions: Alaska, Arizona, Hawaii, Illinois, Louisiana, Michigan, and New York. These seven states hold 20 percent of state governments' total pension debt, and many billions more in local pension debt. These states should amend their constitutions to remove language guaranteeing pension benefits for public workers.

Constitutional amendments generally require a supermajority vote by the legislature and voter approval. All seven states have amended their constitutions in recent decades, in some cases dozens of times. The amendment process is worth pursuing, because protecting pensions in state constitutions is bad public policy. It limits the flexibility of bankruptcy negotiators, elevates the interests of workers over taxpayers, and prevents insolvent cities from discharging obligations that they cannot afford.

THE PROBLEM

Detroit's recent bankruptcy filing has raised awareness not only of the burden associated with funding public pensions, but of how hard it can be for even an insolvent government to scale back unaffordable benefit promises. Efforts to cut pensions in Chapter

9 municipal bankruptcy, such as are now underway in Detroit, face steep challenges when a state's constitution provides special protections for government worker pensions. Michigan's constitution has such a provision, as do six other states.

Will pension benefits guaranteed by state constitutions continue in force even when they conflict with federal bankruptcy law? That's the issue in Detroit, and the stakes are high, not only because fundamental principles of federalism are involved, but because of the billions of dollars in public pension debt held by the aforementioned seven states and their local governments. Still more important than the legal question, however, is the policy question of whether constitutional pension protections serve the public interest.

THE LAWS AND THE DEBT

The states listed in Table 1 owe about \$151 billion, or 20 percent of the \$757 billion that the Pew Center

on the States calculates all states owe for pensions.¹ And that figure doesn't even account for the cost of local pensions, which are also protected by the same constitutional provisions. Out of another Pew survey of 61 cities' pension liabilities, covering the largest city in every state and all others with a population of over 500,000, cities from these seven states hold 62 percent of the estimated \$99 billion that all cities owe.²

As Table 1 notes, the Alaska, Illinois, New York, and possibly Arizona constitutions protect even future accruals, thus conferring constitutional protection on compensation for work that has not yet been performed.³ A government employee can have his wages reduced, be required to pay more for his health benefits, or even be laid off, but the structure of his retirement benefits cannot be altered from the moment he enters public service.⁴

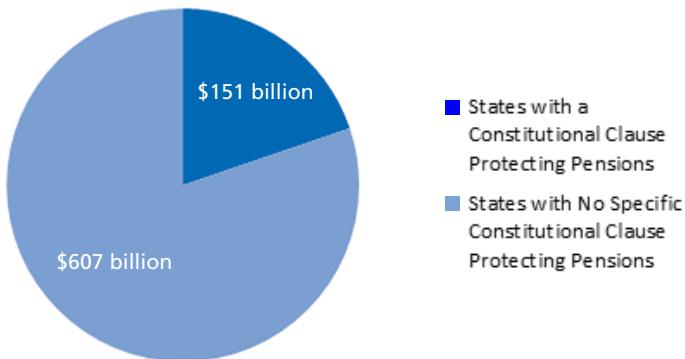
Notably, constitutional pension protections do not render reform impossible. According to the National

Table I: Constitutional Pension Protections in Seven States

State	What Does It Protect?	Year Added	Text
Alaska	Past and Future Benefits	1956	"Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired." (Article XII, Section 7)
Arizona	Past and Maybe Future Benefits	1998	"Membership in a public retirement system is a contractual relationship... and public retirement system benefits shall not be diminished or impaired." (Article XXIX, Section 1, Clause C)
Hawaii	Past Benefits	1978	"Membership in any employees' retirement system of the State or any political subdivision thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired." (Article XVI, Section 2)
Illinois	Past and Future Benefits	1970	"Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." (Article XIII, Section 5)
Louisiana	Past Benefits	1974	"Membership in any retirement system of the state or of a political subdivision thereof shall be a contractual relationship between employee and employer, and the state shall guarantee benefits payable to a member of a state retirement system or retiree or to his lawful beneficiary upon his death" (Article X, Section 29, Clauses A and B)
Michigan	Past Benefits	1963	"The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." (Article IX, Section 24)
New York	Past and Future Benefits	1938	"Membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired." (Article V, Section 7)

Source: Center for Retirement Research at Boston College

Chart I: Unfunded State Pension Liabilities in States with and without Constitutional Pension Guarantees



Source: Pew Center on the States

Conference of State Legislatures, all seven states have passed some type of pension reform since 2008. Alaska and Michigan rank among the few American states to have transitioned workers from traditional defined-benefit plans to the defined-contribution plans now common throughout the private sector.

But it is the municipal bankruptcy process which most clearly illustrates the problem with constitutional pension protections. The Detroit bankruptcy promises to be not only the largest in American history, but also the most complicated, due in no small part to the pension issue.⁵

Shortly after Detroit filed for bankruptcy in mid-July, a lower court judge tried to stop the case, arguing that, because the city had pledged to use bankruptcy to cut pensions, filing for Chapter 9 protections violated the Michigan constitution.⁶ A city can't file for bankruptcy without being authorized to do so by its state.⁷ Some have questioned if Michigan can allow Detroit to file for bankruptcy to cut pensions, while at the same time stipulating, in its constitution, that public pension benefits "shall not be diminished or impaired."⁸ Detroit retirees may also argue that pension cuts would violate their property rights in a way the state constitution specifically intended to prohibit. Michigan's attorney general, a Republican generally supportive of Governor Rick Snyder, who appointed Detroit emergency man-

ager Kevyn Orr and backs his bankruptcy plan, has pledged to defend the constitution's pension guarantee during bankruptcy proceedings.

The initial lower court's order was struck down and the Detroit bankruptcy continues to move forward as of this writing.⁹ However, it's already clear that Article IX Section 24 of the Michigan constitution creates a problem Detroit doesn't need and will complicate an already-uncertain struggle toward solvency.

THE MECHANICS OF CONSTITUTIONAL REVISION

To remove constitutional protections for pensions would require a constitutional amendment. The feasibility of such an amendment varies from state to state.

None of these seven states allow constitutional amendments to pass without the approval of the people. Most also require legislative approval.

THE ARGUMENT: UNFAIR TO TAXPAYERS AND CREDITORS, AND UNAFFORDABLE

The seven states that protect public pensions in their constitution should consider removing these protections, as they elevate what is fair to workers over what is affordable to taxpayers. Ordinarily, everyone should

Table 2: Constitutional Amendment Processes in Seven States

State	Constitutional Convention	Constitutional Amendment
Alaska	May be authorized by electorate or Legislature.	Proposed amendments must be approved by 2/3 majorities of both houses of the Legislature, and then approved by a majority of voters.
Arizona	Must be authorized by electorate.	If introduced in the Legislature, must be approved by majorities in both houses of the legislature and by a majority of the electorate; if introduced by initiative petition, must be approved by majority of electorate.
Hawaii	Must be authorized by electorate.	Must be approved by 2/3 majority in both houses in one session, or majorities over two sessions, and then by majority of electorate in next general election.
Illinois	Must be authorized by electorate.	If introduced by General Assembly, must be approved by 3/5 of members of both houses, and by either a 3/5 vote on the question or majority of those voting in the general election; if introduced by petition (in which case, amendment can only apply to "structural and procedural subjects"), must be approved by either a 3/5 vote on the question or majority of those voting in the general election.
Louisiana	Must be authorized by 2/3 majority in both houses of the legislature.	Must be approved by a 2/3 majority in both houses of the legislature, and a majority of the electorate.
Michigan	Must be authorized by electorate.	If introduced in Legislature, must be approved by 2/3 majority in both houses and by a majority of the electorate; if introduced by petition, must be approved by majority of electorate.
New York	Must be authorized by electorate	Must be approved by majorities of both houses and by majority of electorate.

be entitled to whatever compensation they were promised. But ordinary standards of fairness don't apply to a bankrupt city, whose challenges are, by definition, extraordinary. Pensions should not be protected by state constitutions because this may prevent insolvent cities from unburdening themselves of commitments they cannot afford to pay.

Bankruptcy, a long and costly process, should be guided as much as possible by the principle of shared sacrifice among creditors. Constitutional pension protections enhance the uncertainty of an already-complicated process and deny negotiators the flexibility they need to reach an appropriate settlement with all parties.

ENDNOTES

¹ “The Widening Gap Update,” Pew Charitable Trusts, June 2012.

² Alicia Munnell and Laura Quinby, “Legal constraints in changes in state and local pensions,” Center for Retirement Research at Boston College, August, 2012.

³ “A Widening Gap in Cities,” Pew Charitable Trusts, January 2013.

⁴ Strong legal protections on future accruals also exist in states that don’t have specific clauses in their constitutions protecting pensions. See Amy B. Monahan “Statutes as Contracts? The “California Rule” and Its Impact on Public Pension Reform,” *Iowa Law Review*, Vol. 97, pp. 1029-1083.

⁵ Clear evidence of the unique complexity of the Detroit case may be seen in Judge Steven Rhodes’ plan to appoint an independent fee examiner, an “unprecedented” step for municipal bankruptcies. Chris Newcomb, “Let’s Watch Those Attorneys’ Fees: Another First in Detroit,” blog.MuniBk.com, August 12, 2013.

⁶ Paul Egan, “Michigan AG challenges judge’s ruling that Detroit bankruptcy is unconstitutional,” *Detroit Free Press*, July 19, 2013.

⁷ As a technical matter, Alaska and Hawaii have not authorized local governments to file for bankruptcy, Arizona has, and Illinois, Louisiana, Michigan and New York grant limited or conditional authorization. Source: “The State Role in Local Government Financial Distress,” The Pew Charitable Trusts, July 2013.

⁸ Alison Frankel, “Detroit’s eligibility problem: Can state officials OK its bankruptcy?,” Reuters.com, July 22, 2013.

⁹ Chad Halcom, “Michigan Court of Appeals halts Judge Aquilina’s attempts to rescind Detroit bankruptcy petition,” *Crain’s Detroit Business*, July 23, 2013.