STATE FISCAL CONSTITUTIONS AND
THE LAW AND POLITICS OF PUBLIC
PENSIONS

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Pension plans for state and local employees are, as a whole, significantly underfunded. This underfunding creates intense fiscal pressure on governments and often either crowds out other desired governmental spending or results in employees and retirees losing earned benefits. Political theorists explain that underfunded public pension plans are all but inevitable given the political realities that affect funding decisions. Politicians who desire to be reelected should rationally prefer to spend money on current constituents, rather than commit scarce funds to a pension plan to pay benefits due to workers decades in the future. These dynamics are exacerbated by existing state fiscal constitutions that require balanced budgets and often restrict the ability to raise taxes. Paying a pension plan less than the amount due provides an easy way to free up money in the state budget by creating a form of debt that is ignored for purposes of balanced budget requirements. This Article presents an original analysis of the effect that state fiscal constitutions—even those that contain explicit requirements to fund public pension plans—have on public pension funding dynamics. It finds that even where explicit constitutional funding requirements are in place, plans often continue to be underfunded both because of political and financial pressures and because of the distinct lack of an enforcement mechanism. The Article concludes by suggesting that these weaknesses in pension funding requirements can be addressed through the creation of clear and objective funding standards and, most importantly, through the creation of enforcement mechanisms that can, where appropriate, override legislative decisions to underfund public pension plans.

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I. INTRODUCTION

In Central Falls, Rhode Island, the city’s bankruptcy resulted in retired city employees, including police and firefighters, having their
earned pension benefits reduced by fifty percent.\textsuperscript{1} Retirees in Detroit, Michigan were threatened with similar cuts under the city’s initial bankruptcy plan.\textsuperscript{2} These pension benefits are at risk in bankruptcy because the governments involved did not fully fund their plans, and the plan’s unfunded liabilities are therefore a debt of the city that may be adjusted in bankruptcy.\textsuperscript{3} Reducing pension benefits because politicians failed to adequately fund a plan puts public employees at particular risk, given that over one quarter of such employees do not participate in the federal Social Security program, and therefore have no other form of guaranteed retirement income.\textsuperscript{4}

The negative effects of underfunding are not, however, limited to cities in bankruptcy. The majority of public plans are underfunded;\textsuperscript{5} and such underfunding can place enormous fiscal pressures on cities and states by crowding out other governmental spending.\textsuperscript{6} If a state systemically underfunds its pension plan and thereby creates significant unfunded pension liabilities, it will have less money available in the future to hire teachers, police officers, and firefighters, or to invest in any other type of public spending when the pension bill eventually comes due.\textsuperscript{7} In addition, significant pension liabilities may impact a state or city’s ability to borrow funds at a reasonable cost through the bond market.\textsuperscript{8} Because of the widespread effect that pension liabilities have on a state or city’s fiscal health, responsible plan funding is an issue in which all taxpayers have an enormous stake.

\begin{enumerate}
\item Jess Bidgood, Plan to End Bankruptcy in Rhode Island City Gains Approval, \textsc{N.Y. Times}, Sept. 7, 2012, at A21.
\item See, e.g., Matthew Dolan, \textsc{Detroit Files Debt-Cutting Plan}, \textsc{Wall St. J.}, Feb. 21, 2014, online. wsj.com/article/SB10001424052702540375504579369921807239508; Steven Yaccino & Michael Cooper, \textsc{Cries of Betrayal as Detroit Plans to Cut Pensions}, \textsc{N.Y. Times}, July 22, 2013, at A1; see also Rick Lyman & Mary Williams Walsh, \textsc{One City’s Return to Solvency Leaves Big Problem Unsolved}, \textsc{N.Y. Times}, Dec. 6, 2013, at A1 (noting that Stockton’s bankruptcy plan will leave pensions unaffected).
\item See, e.g., \textsc{Pew Ctr. on the States, The Widening Gap Update} (2012), available at http://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2012/PewPensionsUpdated.pdf (finding that thirty-four states had plans that were below eighty percent funding level generally considered healthy for public plans); \textsc{Boston Coll. Ctr. for Ret. Research Public Plans Database, Funding and Required Contribution (ARC)} (available at http://pubplans.bc.edu/pls/apex/f?p=1998:1614:0:0:295450318:10:RP,16 (finding that, on average, public plans were 75.6 percent funded). But see \textsc{Am. Acad. of Actuaries, The 80\% Pension Funding Standard Myth} (2012), available at http://www.actuary.org/files/80_Percent_Funding_IB_071912.pdf (disputing the notion that a plan’s funded ratio accurately reflects a plan’s financial health).
\item \textsc{Pew Ctr. on the States}, supra note 5, at 4.
\item Id.
\end{enumerate}
Given that public plans are funded through political budget processes, it is unsurprising that many of these plans do not receive the necessary annual contributions to ensure the plans’ financial health and stability. For a politician, it may be unwise to spend scarce budgetary dollars on a pension plan contribution, which will help provide benefits decades in the future, compared to spending those budgetary dollars on something that provides immediate returns to the constituents that the politician relies upon for reelection.

State constitutions, which in nearly every state include balanced budget requirements, and in many cases limit the ability to raise taxes, heighten this pressure.9 As a New Hampshire politician explained, “it becomes budget desperation when you’re looking to balance the budget. You need a few million dollars, well, we’ll just adjust some projections, and short-fund the retirement system and take six million dollars, and spend it some place else.”10 These constitutional provisions are particularly problematic during times of economic downturn, as pension funding needs tend to be countercyclical, resulting in increased contributions when the economy is suffering because of declines in the market value of assets held by the plans. As a result, pension contribution requirements are often historically large during years in which state revenues are reduced.11 Where a state’s constitution requires a balanced budget, and politicians are either unable or unwilling to raise revenue through a tax increase, underfunding pensions is an easy solution to budget pressure. When required pension contributions are not made, the state is essentially borrowing from the plans—it has paid them less than they are due. Pension debt, however, is not recognized for purposes of balanced budget amendments,12 and is therefore an easy way to engage in debt-financed spending while staying within the confines of the law.

In some states, politicians and the public have recognized the political pressures that may result in plan underfunding, and have amended their constitutions to require such plans to be funded on an annual, actuarially sound basis.13 To the extent that they are effective, these provi-
sions help ensure that a plan has sufficient assets to pay promised benefits, and also help enforce intergenerational fairness by preventing pension costs of the current generation being shifted to future generations.

Intergenerational fairness in the pension context generally refers to the belief that pension costs should be paid by the taxpayers who benefited from the service of the employees. In other words, pension costs should be paid as they are accrued, and not shifted to future taxpayers who did not benefit from the teachers, firefighters, and police officers of decades past. Ensuring intergenerational fairness therefore means that pension costs are funded adequately on an ongoing basis. As the Michigan Supreme Court explained, “failing to fund pension benefits at the time they are earned amounts to borrowing against future budgets, or ‘back door’ spending.”

Unfortunately, as this Article will explain, even states that have attempted to ensure intergenerational fairness and fiscal stability through constitutional funding mandates have had difficulty creating clear, enforceable funding requirements. A primary weakness in these constitutional funding requirements is that there is no generally accepted standard for funding a pension on an “actuarially sound” basis, and the constitutional language does not define the funding requirement any further. Essentially, anything that falls within the range of acceptable actuarial standards of practice would be permissible, and these standards allow for a significant amount of manipulation. For example, by simply assuming your pension plan assets will earn ten percent over time instead of six percent, your annual pension contributions will be greatly reduced. Thus far, courts have been uniformly unwilling to police these methods and assumptions.

Even if we could solve the problem of manipulable funding standards and assumptions, there would remain a problem with respect to enforcement. Where politicians voluntarily fund pension plans in accordance with acceptable funding standards, no problem exists. But as this Introduction has briefly discussed, politicians have no incentive to do so. The enforcement issue, therefore, is the issue of forcing pension allocations against legislative will. Even in cases where state constitutions utilize mandatory language with respect to pension funding (e.g., “the legislature shall fund pension plans . . .”) courts have found such provisions to be unenforceable. There are two primary hurdles with respect to en-


forceability. The first is standing. Courts have held that pension participants lack standing to challenge the legislature’s failure to comply with funding requirements because such participants cannot show that they have been harmed by underfunding.\textsuperscript{17} Pursuant to such reasoning, a participant could not successfully challenge underfunding until the plan actually runs out of money to pay the challenging participant’s benefits. The second hurdle is the lack of a remedy. For various reasons, courts have held that they lack the power to remedy breaches of constitutional funding requirements.\textsuperscript{18} Sometimes this is because state law prohibits any allocations from the treasury other than through the legislature.\textsuperscript{19} In other cases, there simply are not monies available to be directed.\textsuperscript{20} As a result, even where there is clear, mandatory language in a state constitution requiring pensions to be adequately funded on an annual basis, such provisions are often meaningless against contrary legislative will, leaving both pension participants and future taxpayers vulnerable to the effects of cumulative underfunding.

This Article begins in Part II by providing background on public pension plans and the basics of funding such plans, including a discussion of the political factors that impact funding decisions. Part III then explores the possibility of using law to impose funding discipline. It begins by examining the effectiveness of existing state constitutional pension funding requirements in the eight states the currently have such provisions in their constitutions. After examining the effectiveness of these mandates, Part III then analyzes whether amending state constitutions to require pension funding is normatively desirable, or whether funding decisions are best left to the political process. Part IV concludes by proposing improvements to states’ fiscal constitutions in order to produce pension funding requirements that are enforceable, flexible, and respectful of institutional competence and democratic accountability. Specifically, this Article explores various mechanisms available to make funding requirements enforceable, including the necessity of having a clear understanding of what “actuarially sound” funding entails. Once funding standards are adequately defined, the next requirement is to create an enforcement mechanism if the state or city declines to comply with the funding requirement. Such mechanisms range from self-enforcing constitutional funding requirements, which would fully fund pensions without need for legislative action, to creating liens on future tax revenues or specifying (and thereby creating) legal remedies that can be pursued in

\textsuperscript{17} See id. at 23 (finding that New Hampshire public pension participants do not have standing to sue when the plan is underfunded).

\textsuperscript{18} See Musselman, 448 Mich. at 521 (finding that the Michigan Supreme Court does not have the authority to issue a writ of mandamus to order state officials to meet the constitutional requirement to fund state pensions annually).

\textsuperscript{19} Id. at 522.

\textsuperscript{20} See id. at 521.
court. If states and cities are going to continue to offer defined benefit pension plans, creating such funding requirements is necessary to ensure that promised benefits can be paid when due, without shifting economic burdens to future taxpayers.

II. BACKGROUND ON PUBLIC PENSION PLANS & THEIR FUNDING

A. The State of Public Pensions

Over twenty-seven million individuals are covered by state and local government pension plans (for simplicity, this Article will use the term “public pension plans” or “public plans” to refer to these state and local plans). These plans hold an enormous amount of assets, with most recent estimates putting that figure at $2.8 trillion. Unfortunately, their liabilities are a trillion dollars larger, at $3.8 trillion. Despite this large deficit, the $1 trillion funding gap does not mean that public plans are in imminent danger of being unable to pay benefits. Most plans have sufficient assets to continue paying benefits for years or even decades to come.

The trillion dollar funding gap does, however, have a staggering impact on state and local finances. A plan that has an unfunded liability must eventually make up that funding shortfall if it is to pay promised benefits. And the larger a plan’s unfunded liability, the larger its annually required contributions will be. The increased funding needs caused by plan underfunding is putting significant fiscal pressure on both states and cities, and has been recognized as one of the most critical issues in state and local finance today.

B. Pension Funding 101

Most cities and states offer retirement benefits to their employees in the form of traditional pension plans—technically referred to as “defined

21. See U.S. GOV’T ACCOUNTABILITY OFFICE, supra note 4, at 1.
23. Id.
24. See ALICIA H. MUNNELL ET AL., HOW WOULD GASB PROPOSALS AFFECT STATE AND LOCAL PENSION REPORTING? 9–14 (2011), available at http://crb.bc.edu/wp-content/uploads/2011/11/slp_23.pdf (providing plan funded ratios and methodology for calculating “run-out” dates under a proposed GASB specification. Under that specification, for example, the run out date for the Illinois Teachers’ plan is 2024. Id. at 11. The plan with the earliest run out date is Kentucky Employees’ Retirement System, with a run out date of 2017. Id. at 12.).
25. Id.
27. See id. at 33.
benefit plans.” A defined benefit pension plan is one that guarantees the benefit amount to be paid to the participant at retirement, usually based on a formula that takes into account final salary and years of service. Unlike 401(k) plans, these defined benefit plans guarantee a retirement benefit. The sponsoring government has the responsibility to invest plan contributions in a manner that will ensure that assets are sufficient to pay out promised benefits. If investments fail to meet return expectations, the government bears the risk and generally must make up any shortfall in assets that results.

While most public sector employees are covered by defined benefit plans, such plans are increasingly uncommon in the private sector, where 401(k) plans have become the norm. A debate about the most desirable form of retirement benefits is beyond the scope of this Article. It is important to note, however, that many public sector employees do not participate in the federal Social Security system. As a result, public pension plans are often the only guaranteed source of retirement income for covered employees. In other words, for many public employees, the availability of their employer-provided pension benefits are as important to their retirement security as Social Security benefits are to private-sector employees.

The differences between 401(k)-style retirement plans and defined benefit plans are also important to understand in the context of funding. A 401(k) plan cannot be underfunded. Rather, the participant is entitled only to the amount in his or her individual account under the plan. Contributions are made according to plan terms, and those contributions are then invested, generally at the participant’s direction, and the participant is entitled to the end result of investing such contributions. An employer’s responsibility with respect to plan funding ends when contributions are made each year.

The same is not true for defined benefit plans. A defined benefit plan must have sufficient assets to pay a lifetime stream of income to a participant once he or she attains the plan’s retirement age. It is the

31. U.S. Gov’t Accountability Office, supra note 4, at 5.
33. See id.
plan sponsor’s responsibility to make sure that there are sufficient assets to pay those benefits when they become due at retirement and throughout a beneficiary’s life. One possible method of funding such a plan would be on a pay-as-you-go basis, meaning that the plan sponsor simply comes up with the money to pay benefits as they are due. For an individual who began working for the state when they were twenty-five, and then retired forty years later at age sixty-five, the state would simply wait until the employee attained age sixty-five and would pay out the individual’s benefits from current assets.

The problem with pay-as-you-go funding is that it shifts the compensation costs for the worker to retirement years. Assuming the plan’s benefit formula is based in part on years of service, the employee in the previous example earned her pension over the course of forty years of service, accruing a bit more of her benefit each year. If the state does not pay for that employee’s retirement benefits over the course of her working career, it has essentially shifted a compensation expense to future taxpayers (those who are paying taxes when the employee in our example is age sixty-five and older), even though her services did not benefit such taxpayers. As a result, public pension plans do not (intentionally) fund benefits on a pay-as-you-go basis. Instead, they are funded so that the benefits earned by an employee are funded throughout that employee’s career so that compensation costs are not shifted to a younger generation.

Determining how to fund a pension plan throughout an employee’s working years is not necessarily easy. The general starting point is that each year the employer and employees should contribute enough money to the plan to cover the cost of benefits earned during the year. Calculating the amount that is sufficient to fund benefits earned during the year is not straightforward. Because the benefit is not payable until some years in the future, and its amount depends on many factors such as the age at which the participant retires, how long the participant lives, what their final salary is, and the rate of investment return from the time of contribution until payout, the contribution amount is necessarily an estimate.

35. See, e.g., ALICIA H. MUNNELL ET AL., THE MIRACLE OF FUNDING BY STATE AND LOCAL PENSION PLANS, CTR. FOR RET. RESEARCH AT BOSTON COLLEGE 1, 1 (2008). Historically, many pension plans were funded on a pay-as-you-go basis, and plans that had been funded on such a basis have shifted to prefunding at different points in time.
36. See id.
38. Id. at 843. In fact, some financial economists argue that the method used by public plans to calculate the present value of a plan’s future liabilities is fundamentally flawed and that, as a result, pension liabilities are very significantly understated. See, e.g., Jeffrey R. Brown & David W. Wilcox, Discounting State and Local Pension Liabilities, 99 AM. ECON. REV. 538, 538-42 (2009); Robert Novy-Marx & Joshua D. Rauh, Public Pension Promises: How Big Are They and What Are They Worth?, 66 J. FIN. 1207, 1207-08 (2010). The discount rate used by public plans is higher than that used by private
The fact that the amount contributed to cover the benefits earned in a given year is an estimate means that the amount contributed can be more or less than necessary. For example, if a plan calculates contribution amounts assuming an eight percent rate of return on investments, but the plan earns only five percent, the plan will have a funding shortfall—referred to as an unfunded liability. As a result, in addition to funding benefits earned in a given year, plans must also make up any funding shortfalls from previous years by paying down any unfunded liability. Unfunded liabilities are usually paid down (also referred to as “amortized”) over a period of not more than thirty years, thereby preventing large financial shocks to the plan sponsor.

States and cities have generally determined their annual funding amounts using Government Accounting Standards Board (“GASB”) standards for determining annual pension cost. The GASB standards were not developed as funding standards or requirements, but rather were developed as guidelines for correct annual accounting of pension costs for state and local governments. They have, however, become de facto funding guidelines. GASB Statement 27 provides that a state or locality’s annual pension cost is equal to the plan’s Annual Required Contribution (“ARC”) for the year, calculated in accordance with certain valuation and actuarial parameters. Plans then report the ARC in their annual financial statements, and also report the percentage of the ARC that was contributed by the plan sponsor, thereby theoretically providing a simple method for stakeholders to determine whether the employer has made a contribution that will cover that year’s pension


41. See MUNNELL ET AL., supra note 35, at 3.

42. See id.


costs. For this reason, many states and cities voluntarily tie their contribution amounts to the ARC.\textsuperscript{45}

The ARC is not, however, the objective measure that it might appear. Governments have the ability under GASB 27 to select from a range of actuarial assumptions for use in calculating the ARC.\textsuperscript{46} For example, plans can select one of six actuarial cost methods, each of which might produce a different ARC for the year.\textsuperscript{47} Plans are free to set economic assumptions, such as the rate of return, “based on an estimated long-term investment yield for the plan, with consideration given to the nature and mix of current and expected plan investments.”\textsuperscript{48} Because of the discretion plans have in selecting the assumptions used to calculate the ARC, it is not a terribly helpful measure to compare funding discipline across plans. In part because of the dissatisfaction with the ARC measurement, GASB has eliminated the ARC reporting requirement for public plans going forward.\textsuperscript{49}

Despite the fact that the ARC is an imperfect measure, vulnerable to manipulation through aggressive determination of actuarial assumptions, it is still somewhat helpful in evaluating funding discipline. A state’s failure to contribute the ARC shows that the state is not even contributing what might be an artificially low contribution amount. Recent experience illustrates that many states fail even this basic test of financial discipline.\textsuperscript{50}

Before discussing why public plans tend to have such poor funding discipline, it is worth briefly noting that private employer pensions have very different funding rules. The federal government regulates pension plan funding for private employer plans, and enforces requirements that plans be funded so that costs are spread over employees’ working lives.\textsuperscript{51} State and local plans are exempt from these federal requirements,\textsuperscript{52} how-

\textsuperscript{46} See Statement No. 27, supra note 44, ¶ 10.
\textsuperscript{47} See id. ¶ 10.d.
\textsuperscript{48} See id. ¶ 10.c.
\textsuperscript{50} See PEW CTR. ON THE STATES, supra note 5, at 5 (showing that thirty-one states failed to pay one-hundred percent of their required contribution for the 2010 fiscal year).
\textsuperscript{52} 29 U.S.C. § 1003(b)(1).
ever, and therefore it is entirely up to a state or city to determine how it will fund its pension plans.

C. Why Do Public Plans Lack Funding Discipline?

The explanation of why states fail to adequately fund pension benefits on an annual basis is multifaceted. First, pension contributions must generally be allocated through the state’s annual budgeting process—a political exercise subject to political pressures. Most states have balanced budget requirements, creating the potential for serious constraints on budget allocations. Politicians must often make difficult choices in this context between raising taxes and reducing expenditures in order to balance the budget. Politicians are also known to sometimes use various accounting “gimmicks” to balance the budget. Where politicians seek to lower pension contributions in order to ease budgetary pressure, they can either allocate less than the full required contribution, given that doing so does not create debt that is recognized for purposes of balanced budget requirements, or in an effort to disguise such underfunding they can manipulate actuarial assumptions in order to lower the required contribution amount, in either case freeing up funds to allocate elsewhere.

Next, funding pension benefits in the current year is actually setting aside money that will become due in the future. As a result, current year funding of pensions does not pay any immediate political dividends—aside perhaps from the gratitude of those employees who are paying attention to plan funding and are grateful for the improvement in the security of their benefits. If budget dollars are scarce, and a politician must make the choice between meeting current needs and funding benefits to be paid years in the future, a politician is very likely to favor the current needs. Not only is there good evidence that individuals often irrationally favor current needs over future needs, but given the political context there is also the fact that favoring current needs likely has greater political benefit. A politician who supports funding for the current needs of

55. See Gamage, supra note 53, at 763.
56. Poterba, supra note 54, at 8.
58. See James M. Buchanan & Richard E. Wagner, Democracy in Deficit: The Political Legacy of Lord Keynes 93–94 (1977) ("Elected politicians enjoy spending public monies on projects that yield some demonstrable benefits to their constituents."). See also Brian Gale & Jonathan Klick, Recession and the Social Safety Net: The Alternative Minimum Tax as a Counter-
her constituents is likely to gain more political support than a politician who underfunds current needs in order to responsibly fund pension benefits payable years in the future.60 Politicians, after all, typically have relatively short time horizons, with the next election being the crucial time frame that they operate within.61 Consistent with this theory, a recent study found that as political competition within a jurisdiction increases (that is, as politicians face greater electoral uncertainty and pressures), funded ratios for public plans decrease,62 benefits become more generous,62 and plans are more likely to select a higher interest rate for discounting their actuarial liabilities (thereby lowering their required contributions).63

The short-term and self-interested focus of politicians is not unique to pension funding. What may be unique, however, is the fact that there is no obvious counterbalance to politicians’ inclination to underfund.64 One might imagine that workers and their representatives would lobby to ensure sound, annual funding. But it is not always in workers’ best interests to do so. First, as previously mentioned, most plans are not on the brink of insolvency.65 In many cases, therefore, current workers do not need to worry about their pensions being paid. And even where current workers’ benefits are at risk, those workers may believe that the legal protection provided to plan benefits will be sufficient to force the state or city to fund the plan sufficiently in the future. In addition, by keeping annual pension contributions low, workers should be able to secure higher overall compensation, because pension costs appear artificially lower than their true cost. In other words, workers and politicians can both benefit by obscuring the true annual cost of pension benefits. Workers are able to get politicians to promise higher levels of pension benefits, while politicians get both the benefit of pension promises and the ability


59. David Gamage has explained a similar dynamic with respect to state legislators’ unwillingness to use surpluses during periods of strong economic performance to fund rainy day funds to cushion periods of weak economic performance. See Gamage, supra note 53, at 766 (noting that investing in a rainy day fund is the equivalent of a gift to one’s political successors, and that a politician can advance both her personal electoral prospects and partisan agenda by instead either using the surplus to cut taxes or to increase current spending).

60. BUCHANAN & WAGNER, supra note 58, at 159.


62. Id. at 26.

63. Id. at 31.


to pay for other current constituent needs.\textsuperscript{66} Evidence suggests that this political behavior is bipartisan.\textsuperscript{67} As Anzia and Moe point out, the ability to increase benefits without having to face the costs of doing so “is an alluring political calculus that knows no party lines.”\textsuperscript{68}

Compounding these problems is the fact that pension contribution needs tend to be countercyclical. When the economy is doing well and state revenues are high, pension funds usually enjoy strong investment returns and thus have relatively low contribution needs.\textsuperscript{69} When the economy is doing poorly, state revenues are down, and social needs greatest, pension funds often experience market losses and, therefore, require relatively larger contributions.\textsuperscript{70} In other words, pension funds often need the most money at the exact time that states are under the greatest fiscal stress.

Perhaps because of these known political pressures, many states have sought to impose funding discipline through various legal requirements to contribute the ARC. Many states have done so through statutory requirements, although previous research has illustrated that these have been largely ineffective.\textsuperscript{71} Eight states, however, have done more than simply passed a statutory funding requirement (which can easily be amended if political pressure to do so is strong enough). They have instead amended their fiscal constitutions to require state pension plans to be funded annually on an actuarially sound basis.\textsuperscript{72}

Whatever the method used, finding a way to impose effective funding discipline is important if states and cities want to maintain defined benefit pension plans. Without funding discipline, lawmakers will face the undesirable choice between reducing benefits that have been earned by employees\textsuperscript{58} or shortchanging taxpayers by allowing pension funding to crowd out desired public services. Neither is a good outcome, and both result in significant negative consequences for a state or city and its citizens.\textsuperscript{74}

\textsuperscript{66} See Buchanan \& Wagner, supra note 58, at 99 (explaining that by borrowing to pay for publicly-financed goods, rather than paying for such goods through current taxation, governments “will tend to purchase more publicly provided goods and services than standard efficiency criteria would dictate”) (internal quotations omitted). See also Beermann, supra note 28, at 27–29.

\textsuperscript{67} See Anzia \& Moe, supra note 64.

\textsuperscript{68} Id. at 6.

\textsuperscript{69} See U.S. Gov’t Accountability Office, supra note 4, at 17–18.

\textsuperscript{70} See id.


\textsuperscript{72} See Part III.A, infra.

\textsuperscript{73} See Poterba, supra note 54.

\textsuperscript{74} See, e.g., Anna Golpern, Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt, 121 Yale L.J. 888, 905–07 (2012).
III. Using Law to Imposing Funding Discipline

Flaws in the political budgeting process are not unique to pension funding allocations. Politicians who seek to be reelected will often favor debt-financed spending on current needs, because it allows them to get the benefit of spending while leaving future politicians to pay the bill.\footnote{Buchanan & Wagner, supra note 58, at 159.} And for various reasons, politicians may often want to allocate more or less money to specific budgetary needs than would be optimal. States have often reacted to these perceived political shortcomings by adopting what are known as “fiscal constitutions.”\footnote{See Israel Rodriguez-Tejedo & John Joseph Wallis, Lessons for California from the History of Fiscal Constitutions, 2 Calif. J. of Pol. & Pol’Y 1, 3-6 (2010), available at http://econweb.umd.edu/~wallis/MyPapers/Tejedo&Wallis_Final.pdf.} That term refers to provisions enshrined in state constitutions that dictate the bounds of legislative fiscal activity.\footnote{See id. at 3.}

Nearly every state’s fiscal constitution contains some type of restriction on the ability of the state to finance its operations through debt, often referred to as balanced budget requirements.\footnote{See Gamage, supra note 53, at 755 (noting that forty-nine states have balanced budget requirements); Rodriguez-Tejedo & Wallis, supra note 9, at 19; Shefrin, supra note 9, at 206 (every state except Vermont has some type of balanced budget requirement).} Many states also have constitutional restrictions on the ability of the state to raise tax rates, and some also contain limitations on specific expenditures.\footnote{See Gamage, supra note 53, at 757.} In order to smooth revenue among periods of economic boom and bust, a majority of states also have some type of requirement to set aside budget surpluses for use in economically lean times, although the requirements and specifics of these rainy day funds vary significantly.\footnote{See, e.g., Brian Knight & Arik Levinson, Rainy Day Funds and State Government Savings, 52 Nat’l Tax J. 459, 463-65 (1999).} Other than the handful of states that have pension funding requirements, few states have explicit spending requirements in the state constitution. The most prominent example of a constitutional spending requirement is California’s Proposition 98, which requires the state to allocate a specific amount to K-14 education.\footnote{For an overview of Proposition 98, see Rob Manwaring, Proposition 98 Primer, CALIF. LEG. ANALYST’S OFF. (Feb. 2005), available at http://www.lao.ca.gov/2005/prop_98_primer/prop_98_primer_02/08/05.htm. See also Nirupama Jayaraman, California Budget Project, School Finance in California and The Proposition 98 Guarantee (2000), http://www.cbp.org/pdfs/20060604_prop98.pdf. One of the primary criticisms of Proposition 98 is that it has “paralyzed” the California state budget. Some studies have disputed this effect. See, e.g., John G. Matusaka, A Case Study on Direct Democracy and Fiscal Gridlock: Have Voter Initiatives Paralyzed the California Budget?, 5 State Pol.’Y & Pol’y Q. 248 (2005).}

While the historical context of balanced budget amendments and tax limitations differ significantly from each other,\footnote{See Gamage, supra note 53, at 761-63.} there are certain shared features of fiscal constitutions that are important to understand.
The purpose of fiscal constitutional provisions is, at its core, to prevent certain types of state and local fiscal decisionmaking. In a sense, fiscal constitutions are a type of precommitment device for legislators, often imposed not by legislators themselves, but by the electorate.

State fiscal constitutions have been roundly criticized in the academic literature on various grounds. Such criticism has been based largely on the economic impact of balanced budget requirements and tax limitations, which prevent state governments from responding to economic boom and bust cycles as Keynesian economic theory would suggest. A state that cannot incur debt during economic downturns, and is at the same time constrained in its ability to raise taxes, may find itself not only unable to meet its citizens’ needs, but also inadvertently making the effects of the economic downturn worse by constraining spending. The existence of rainy day funds may help mitigate these effects, although studies show that the use and effectiveness of such funds is mixed.

Historically, states reacted to fiscal contraction through a mix of tax increases and spending cuts. With the advent of the antitax movement, however, states have increasingly responded to fiscal contraction through spending cuts, with much less reliance on tax increases. This increased reliance on spending cuts in the face of fiscal contraction puts increasing pressure on budget allocations. This pressure has been particularly noteworthy in its effect on “countercyclical programs”—that is, programs whose needs increase in the face of economic downturns. Examples of such programs include state Medicaid programs, as well as programs such as unemployment and food aid, where needs increase when state residents lose jobs or income. Super has found that fiscal constitutions

87. See id. at 777–78; Schragger, supra note 83, at 869. While many states have provisions in place for so-called rainy day funds, which are designed to allow a state to set aside funds during strong economic performance for use during downturns, such funds have not generally performed as intended. See Brian Gale & Kirk J. Stark, *Beyond Bailouts: Federal Tools for Preventing State Budget Crises*, 87 IND. L. REV. 599, 611–17 (2012).
89. Gamage, supra note 53, at 757.
that constrain both state debt and tax increases “systematically disfavor countercyclical programs and tend to shift money out of those programs over the course of the business cycle.”

While not the focus of Súper’s work, his criticism of state fiscal constitutions can easily be extended to their impact on pension funding. Pension funding needs are also countercyclical, in that market downturns negatively affect assets held by pension plans, which increases their unfunded liabilities, in turn increasing their funding needs. In addition, failing to adequately fund a pension plan is a convenient way to move debt “off-budget,” further adding to the attractiveness of shortchanging pension contributions when revenues shrink and debt financing is otherwise constrained. As a result, state fiscal constitutions, absent effective pension funding requirements, may strongly contribute to pension underfunding.

The existing studies of state fiscal constitutions, however, have been general studies, and have not examined the use of such provisions as they relate to pension funding requirements. This Part attempts to fill that gap, by examining whether state fiscal constitutions that contain specific pension funding requirements can be used to effectively impose annual pension funding discipline. As will be discussed in more detail below, the study finds very little reason to believe that current state constitutional funding requirements are effective where a legislature chooses not to comply.

Previous work by Shnitser found that state fiscal constitutions that contain pension funding requirements have a small positive correlation with a plan’s funded status, but a correlation that is not consistently statistically significant under each specification used in the study. The study presented in this Part qualitatively examines the eight states with constitutional funding requirements across a number of dimensions, to determine whether and to what extent such requirements are effective in ensuring funding discipline. The Part concludes with a discussion of whether, as a normative matter, legal funding requirements, which in-

92. Súper, supra note 85, at 2615.
93. See Schragger, supra note 83, at 869.
94. Bd. of Trs. of The New Hampshire Judicial Ret. Plan v. See’y of State, 7 A.3d 1166, 1172 (N.H. 2010) (citing NEW HAMPSHIRE JOURNAL OF THE CONSTITUTIONAL CONVENTION 263 (1984) (statement of Delegate King)) (“It becomes budget desperation when you’re looking to balance the budget. You need a few million dollars, well, we’ll just adjust some projections, and short-fund the retirement system and take six million dollars, and spend it some place else?”).
95. See generally Azariadis & Galasso, supra note 84; Gamage, supra note 53; Schragger, supra note 83; Súper, supra note 85.
96. Most states have legislative funding requirements, rather than constitutional requirements. Previous work has found that such legislative funding requirement are often unsuccessful in achieving funding discipline, and it is for that reason that these statutory requirements were not included in the current study. See Fitzpatrick & Monahan, supra note 71, at 7.
fringe upon legislative authority and potentially require the judiciary to overrule legislative budget allocations, are a preferable method of achieving funding discipline.

A. State Constitutional Funding Requirements

Many states have some type of legal requirement in place to fund pension benefits on an annual basis. In most cases, this requirement is contained in a statute.98 Previous work has found that these statutory requirements vary tremendously in their effectiveness, and are in many cases easily ignored by legislators when making budget allocations.99 The current study instead looks at state constitutional funding requirements, which are the strongest form of funding requirement currently in use. In order to identify states to be included in the study, each state constitution was searched for any mention of “pension” or “retirement.” Each such reference was reviewed for any language regarding plan funding. Because of the desire to focus solely on the strongest funding requirements, only constitutional provisions that included mandatory language regarding annual plan funding were included in the study.100 Eight states met the criteria to be included. The text of the constitutional requirements in the states identified is provided in Appendix A. South Carolina’s Constitution provides an example of the type of language used in these provisions: “[t]he General Assembly shall annually appropriate funds and prescribe member contributions for any state-operated retirement system which will insure the availability of funds to meet all normal and accrued liability of the system on a sound actuarial basis as determined by the governing body of the system.”101 Provisions of this type look ideal for imposing funding discipline; they clearly require the legislature to make annual, actuarially sound contributions.

The study presented below includes descriptive statistics, but is a purely qualitative study designed to gain a better understanding of whether constitutional funding requirements are effective in overcoming the political and budgetary pressures that typically lead to chronic pension underfunding. As the Sections below will illustrate, the results indicate that despite the seemingly clear language and intent, these provi-

99. See id. at 7.
100. It should be noted that some state constitutions contain requirements that any benefit increases be funded on an actuarial sound basis. Fla. Const. art. X § 14; Miss. Const. art. 14, § 272-A. Because such requirements are limited to discrete plan changes, and not to ongoing funding requirements, such states were not included in this study. In addition, other states have requirements that simply state the legislature must come up with actuarially sound funding principals, or delegate the authority to select actuarial standards to the retirement board. See Ga. Const. art. III, § X; N.M. Const. art. 20, § 22; Tex. Const. art. 16, § 67. Because these requirements are not actually by their terms requiring a specific amount of money to be contributed to the plan on an annual basis, they were similarly excluded from the study.
sions have generally not been effective in imposing funding discipline or ensuring a plan’s financial health.

1. A Note on Endogeneity

One concern with a study of this type is that the results may not reflect the thing being studied (in this case, the effectiveness of state constitutional funding mandates), but instead simply reflect existing, endogenous features of the states themselves.\(^{102}\) For example, if the study finds that states that adopt constitutional mandates enjoy very strong funding discipline, it may have nothing to do with the effectiveness of the legal provision, but rather reflect the fact that only states with a strong commitment to pension funding would amend their constitutions in the first place.

While impossible to account entirely for endogeneity in a limited, qualitative study of this type, each state’s history of pension funding prior to the constitutional amendment was reviewed in order to determine, where possible, whether the constitutional requirement was merely confirming an already existing practice of full funding, or whether the requirement was added in an attempt to impose funding discipline on a previously undisciplined state.

Many of the states that currently have constitutional funding requirements enacted such provisions in response to a lack of funding discipline. In Michigan, for example, the 1963 constitution included a specific requirement to fund pension benefits on an annual basis in response to persistent underfunding of benefits.\(^{103}\) New Hampshire, like Michigan, adopted constitutional protection precisely because the state had previously been undisciplined in funding its pension plans.\(^{104}\) The constitutional amendment was made shortly after a high-profile diversion of state retirement system assets by the legislature to fund general state revenues during a budget crisis.\(^{105}\)

Louisiana’s constitutional provision arose out of a perceived need also. In the late 1980s Louisiana faced a cash flow crisis and was unable to borrow funds through the credit market.\(^{106}\) In response to this financial crisis, and to ensure that the pension system remained viable, the legislature proposed amending the state’s constitution regarding retirement

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104. See Bd. of Trs. of New Hampshire Judicial Ret. Plan v. Sec’y of State, 7 A.3d 1166, 1169 (N.H. 2010) (noting preconstitutional amendment practice of contributing less than required amount to pension plans).
105. Id.
benefits.\textsuperscript{107} Maine similarly amended its constitution in response to a very poorly funded pension system.\textsuperscript{108} Virginia had a history of pension raiding prior to the adoption of its constitutional funding requirement in 1995.\textsuperscript{109}

Research was unable to determine whether Montana’s constitutional amendment came about as a result of previous funding problems.\textsuperscript{110} There was a similar lack of information available regarding pension funding history in South Carolina prior to its constitutional amendment in 1979.\textsuperscript{111} However, for many years South Carolina not only had a funding requirement, but also a prohibition on equity investments, making the fund relatively low-risk.\textsuperscript{112} News reports regarding the plan’s currently unfunded status do not mention a history of failing to make annual contributions.\textsuperscript{113}

Arizona was the only state of the eight included in the study that was identified as having healthy pension funding prior to its constitutional amendment. Arizona’s funding requirement, approved by voters in 1998, was approved and passed at a time when all of Arizona’s plans were more than one-hundred percent funded.\textsuperscript{114}

Of the eight states in the study, five appear to have sought to use their constitutional funding requirements precisely to impose funding discipline on previously undisciplined actors. It may be the case, however, that states that adopted constitutional funding requirements were committed, going forward, to improving funding discipline and that the constitutional provisions simply reflected an agreement to improve going forward. We must be careful, then, to account for the fact that in some states the constitutional provision may not be the driving force behind funding discipline.

\begin{itemize}
  \item \textsuperscript{107} See id.
  \item \textsuperscript{108} See Susan M. Cover, State Budget Gets Grip on Pension Costs, ME, SUNDAY TELEGRAM, July 17, 2011, at A1 (describing the poor state of plan funding in the 1980s and early 1990s, prior to the adoption of the funding amendment).
  \item \textsuperscript{110} The publicly available history of Montana’s constitutional amendment contains no information regarding the perceived need for the funding amendment, nor does news coverage of the amendment discuss such need. See Larry M. Elison & Fritz Snyder, THE MONTANA STATE CONSTITUTION A REFERENCE GUIDE 167 (2001) (illustrating the lack of information on the constitutional amendment).
  \item \textsuperscript{111} 1979 S.C. Acts 3.
  \item \textsuperscript{113} See id. See also Letter to the Editor, Retirement System Has Been Greatly Improved, STATE (Columbia, S.C.), Nov. 3, 1990, at 10A (claiming, in the year prior to the constitutional funding amendment, that studies showed that South Carolina’s retirement system was among the best performing in the United States).
  \item \textsuperscript{114} Craig Harris, Big Pension Costs Also a Burden for Other States, ARIZ. REPUBLIC, Nov. 20, 2010, http://www.azcentral.com/news/articles/arizona-pensions-funds-national.html.
\end{itemize}
2. Current Funded Status

After identifying the states to be included in the study, the largest pension plan for public employees in each state, measured by asset size, was identified for inclusion in the study. The eight plans identified were then evaluated across several different measures, described in more detail below. The first evaluation of the plans was based on their funded status as of the end of fiscal year 2012, and is presented in Table 1.

115. The Boston College Center for Retirement Research’s database of public plans was utilized for purposes of identifying the largest plan in each state. See Public Plans Database, CTR. FOR RET. RESEARCH, http://err.bc.edu/data/public-plans-database/ (last visited Nov. 20, 2014).
<table>
<thead>
<tr>
<th>Plan</th>
<th>FY2012 Funded Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maine Public Employees Retirement System</td>
<td>79.1%116</td>
</tr>
<tr>
<td>(“Maine PERS”)</td>
<td></td>
</tr>
<tr>
<td>Arizona State Retirement System</td>
<td>75.8%117</td>
</tr>
<tr>
<td>(“Arizona SRS”)</td>
<td></td>
</tr>
<tr>
<td><strong>National Average</strong></td>
<td><strong>73.5%118</strong></td>
</tr>
<tr>
<td>Virginia Retirement System</td>
<td>69.9%119</td>
</tr>
<tr>
<td>(“Virginia RS”)</td>
<td></td>
</tr>
<tr>
<td>South Carolina Retirement System</td>
<td>67.4%120</td>
</tr>
<tr>
<td>(“South Carolina RS”)</td>
<td></td>
</tr>
<tr>
<td>Montana Public Employees Retirement System</td>
<td>67%121</td>
</tr>
<tr>
<td>(“Montana PERS”)</td>
<td></td>
</tr>
<tr>
<td>Michigan Public School Employees Retirement System</td>
<td>64.7%122</td>
</tr>
<tr>
<td>(“Michigan Teachers”)</td>
<td></td>
</tr>
<tr>
<td>New Hampshire Retirement System</td>
<td>56.1%123</td>
</tr>
<tr>
<td>(“New Hampshire RS”)</td>
<td></td>
</tr>
<tr>
<td>Teachers Retirement System of Louisiana</td>
<td>55.9%124</td>
</tr>
<tr>
<td>(“Louisiana Teachers”)</td>
<td></td>
</tr>
</tbody>
</table>


Table 1 illustrates that, of the eight states with constitutional funding requirements for their public pension plans, only two had funded ratios as of the end of fiscal year 2012 that surpassed the national average for public plans. And all eight plans were below the eighty percent funded level generally considered “healthy” for public plans.125 This finding does not necessarily mean that constitutional funding requirements do not contribute to a plan’s fiscal health. Many of the constitutional provisions were added relatively recently, and in states with histories of undisciplined funding.126 As a result, some of these plans may be digging themselves out of deep funding deficits, such that a snapshot of 2012 funding does not tell the full picture. In addition, it is important to note that a plan’s funded status depends on various actuarial assumptions. The measurement of a plan’s liabilities is subject to the assumptions used to calculate those liabilities, while the plan’s measure of assets depends on the type of asset smoothing the plan utilizes. Funded percentages cannot, therefore, be easily compared across plans.

3. Do States with Constitutional Funding Requirements Make Their Annual Required Contribution?

While a plan’s funded status may not tell us much with respect to whether constitutional funding requirements contribute to fiscal discipline, examining whether a plan has consistently received its ARC over a period of time gives us a better measure of the success of constitutional requirements. Before examining the data, it is important to recall that the ARC is, at best, an imperfect measure for funding discipline, given that it can be manipulated through the actuarial assumptions used to calculate the contribution amount.127 Even a plan that receives one-hundred percent of the ARC consistently over time may not actually be fully funded if the actuarial assumptions underlying the ARC calculations are inaccurate. Nevertheless, examining whether the plans in our study received the ARC over a period of time will help us gauge whether the constitutional provision has at least held them accountable to this imperfect measure of

126. See supra Part III.A.1.
funding discipline. Table 2 presents the study’s findings regarding receipt of annual required contributions.

<table>
<thead>
<tr>
<th>Plan</th>
<th>100%+ of ARC consistently received 2001-2012?</th>
<th>Average Percentage of ARC received 2001-2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maine PERS</td>
<td>Yes</td>
<td>109.4%&lt;sup&gt;128&lt;/sup&gt;</td>
</tr>
<tr>
<td>Arizona SRS</td>
<td>Yes</td>
<td>100%&lt;sup&gt;129&lt;/sup&gt;</td>
</tr>
<tr>
<td>South Carolina RS</td>
<td>Yes</td>
<td>100%&lt;sup&gt;130&lt;/sup&gt;</td>
</tr>
<tr>
<td>New Hampshire RS</td>
<td>No</td>
<td>95.8%&lt;sup&gt;131&lt;/sup&gt;</td>
</tr>
<tr>
<td>Louisiana Teachers</td>
<td>No&lt;sup&gt;32&lt;/sup&gt;</td>
<td>95.5%&lt;sup&gt;133&lt;/sup&gt;</td>
</tr>
</tbody>
</table>


132. Easily accessible records of the ARC made to the Louisiana Teachers’ Plan were only available for the years 2004 to the present. However, within that period, the Plan received less than the full ARC in 2004, 2010, and 2011. Louisiana Teachers’ 2012 CAFR, <i>supra</i> note 124, at 66; Teachers’ Ret. Sys. of La., Comprehensive Annual Financial Report 2004 60 (2004). In many of the other years, however, the plan received a contribution that exceeded one-hundred percent of the ARC. See id.

133. See id.
<table>
<thead>
<tr>
<th>Montana PERS</th>
<th>No</th>
<th>91.4%\textsuperscript{134}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Michigan Teachers</td>
<td>No</td>
<td>89.1%\textsuperscript{135}</td>
</tr>
<tr>
<td><strong>National Average</strong></td>
<td>N/A</td>
<td>88.4%\textsuperscript{136}</td>
</tr>
<tr>
<td>Virginia RS</td>
<td>No</td>
<td>80.6%\textsuperscript{137}</td>
</tr>
</tbody>
</table>

Here we see some positive evidence regarding fiscal discipline. The percentage of the ARC received by the plans was examined over the past twelve years, a period chosen to reflect a broad range of economic conditions. Three of the eight plans received at least one-hundred percent of the ARC during that time, while two other states very nearly met that standard. Only one state received less than the national average percent of ARC contributed. Interestingly, while the plans in the study illustrated above-average percentages of ARC received, over half of all plans with a constitutional funding mandate did not, in fact, receive one-hundred percent of their annual required contributions during each year of the study period. It is important to note, however, that the years studied include several years in which pension plans experienced significant declines in asset values due to market conditions, and therefore contributions during some of these years were significantly higher than historical levels\textsuperscript{138}. In addition, general economic conditions in 2007 and thereafter resulted in states’ revenues declining\textsuperscript{139} making those large pension contributions even more difficult to allocate. Nevertheless, the data clearly indicates that constitutional funding requirements do not result in a plan consistently receiving its annually required contribution.

4. *Are Actuarial Assumptions Better or Worse than Average?*

Previous studies have found that governments sometimes react to the combination of fiscal stress and high pension contributions by ma-
Manipulating actuarial assumptions in order to artificially lower the ARC. Where that happens, the fact that a plan has received one-hundred percent of the ARC may not in fact reflect sound funding policy. Actuarial calculations rely on many assumptions; several key assumptions used by each plan in fiscal year 2012 are presented in the tables and text below.

A plan’s investment return assumption is critical in determining funding requirements. The higher the rate of return that is assumed, the lower the amount necessary to put into the plan. As Table 3 indicates, there is little evidence that the plans in this study artificially lowered their ARCs by raising their investment return assumptions, as only three of the plans had rates that exceeded the national average and even then by a half-percentage point at most. This is not to say that the investment return assumptions used by these plans are necessarily appropriate, only that plans subject to constitutional funding mandates do not appear to be significantly more aggressive than their peers in selecting a return assumption.

TABLE 3: ASSUMED RATE OF INVESTMENT RETURN FOR FISCAL YEAR 2012

<table>
<thead>
<tr>
<th>Plan</th>
<th>Assumed Rate of Return FY2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Louisiana Teachers</td>
<td>8.25%</td>
</tr>
<tr>
<td>Arizona SRS</td>
<td>8%</td>
</tr>
<tr>
<td>Michigan Teachers</td>
<td>8%</td>
</tr>
<tr>
<td>National Average</td>
<td>7.75%</td>
</tr>
<tr>
<td>New Hampshire RS</td>
<td>7.75%</td>
</tr>
<tr>
<td>Montana PERS</td>
<td>7.75%</td>
</tr>
<tr>
<td>South Carolina RS</td>
<td>7.5%</td>
</tr>
<tr>
<td>Maine PERS</td>
<td>7.25%</td>
</tr>
</tbody>
</table>

140. See supra note 127.
141. Louisiana Teachers’ 2012 CAFR, supra note 124, at 36. The investment assumption has been lowered to 8% beginning in fiscal year 2013.
143. Michigan Teachers’ 2012 CAFR, supra note 122, at 81.
145. New Hampshire 2012 CAFR, supra note 123, at 72. The investment return assumption was reduced from 9% in 2004 and 8.5% in 2005.
146. Montana PERS 2012 CAFR, supra note 121, at 131. The investment return assumption was reduced from 8% in 2009.
147. South Carolina 2012 CAFR, supra note 120, at 57 (reduced from 8% effective 2012 fiscal year).
<table>
<thead>
<tr>
<th>Virginia RS</th>
<th>7%^{149}</th>
</tr>
</thead>
</table>

In calculating annual payments, plans must not only fund the benefits earned in that year (referred to as the “normal cost”), they must also fund a share of the unfunded liability that has arisen because of insufficient past contributions or inaccurate actuarial assumptions.\(^{150}\) For example, if a plan assumed a ten percent rate of return on investments, but only achieved a three percent rate of return, an unfunded liability would result even if the plan had made one-hundred percent of its ARC in all previous years. When a plan develops an unfunded liability, that liability is amortized (paid down in installments) over a period of years using one of a variety of amortization methods. For purposes of calculating the ARC, a thirty-year amortization period is used.\(^{152}\) Plans, however, can choose a different amortization period for purposes of funding the plan.\(^{152}\) Table 4 provides the methods used by plans for paying down their unfunded liabilities.

---

149. Virginia RS 2012 CAFR, *supra* note 119, at 117. The investment return assumption was lowered from 7.5% in 2009.


TABLE 4: Amortization of Unfunded Liability as of FY 2012

<table>
<thead>
<tr>
<th>Plan</th>
<th>Amortization period and basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizona SRS</td>
<td>30 years/level dollar basis/open</td>
</tr>
<tr>
<td>Louisiana Teachers</td>
<td>30 years/level dollar basis/closed</td>
</tr>
<tr>
<td>Maine PERS</td>
<td>Level percent of payroll/closed/16 years remaining</td>
</tr>
<tr>
<td>Michigan Teachers</td>
<td>40 years/level percent of payroll/closed</td>
</tr>
<tr>
<td>Montana PERS</td>
<td>Statutory contribution rate/does not amortize</td>
</tr>
<tr>
<td>New Hampshire RS</td>
<td>26 years/level percent of payroll/closed</td>
</tr>
<tr>
<td>South Carolina RS</td>
<td>30 years/statutory contribution rate</td>
</tr>
<tr>
<td>Virginia RS</td>
<td>30 years/level percent of payroll/open</td>
</tr>
</tbody>
</table>

In terms of analyzing a plan’s method of paying down unfunded liabilities, the easiest place to start is the time period over which the liabilities are amortized. The shorter the amortization period, the more aggressive the plan is being in paying off its debts. But the amortization period does not tell us the whole story. The next factor to examine is whether the amortization period is open or closed. If a plan uses a thirty-year closed amortization period, that means it will pay off the unfunded liability that exists today within thirty years. If, however, the plan uses a thirty-year “open” amortization period, that means that it would pay off one-thirtieth of the unfunded liability this year and then, in the following year, essentially refinance the unfunded liability over a new thirty-year period.

The final piece of the puzzle is how the unfunded liability is spread over the amortization period. If the liability is spread over the repayment period using the “level dollar” method, the result is like that of a standard mortgage repayment, where some interest and some principal is paid every year. Under the “level percent of payroll” method, unfunded liability payments are very small at the beginning of the repayment period.

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154. Louisiana Teachers’ 2012 CAFR, supra note 124, at 91.


156. Michigan Teachers’ 2012 CAFR, supra note 122, at 81. Michigan currently has twenty-four years remaining on its closed forty-year amortization period.

157. Montana PERS 2012 CAFR, supra note 121, at 127. Montana’s pension contribution rates are set by statute and, as of fiscal year 2012, the statutory payment rate was, according to the plan’s actuaries, “insufficient to amortize” the plan’s unfunded liability.


159. South Carolina RS 2012 CAFR, supra note 120, at 92.


161. Background Information, supra note 153, at 2.
with higher dollar amounts occurring later.\textsuperscript{162} Using the level percent of payroll method can result in negative amortization, where the early contribution amounts are less than interest due on the liabilities.\textsuperscript{163} In such cases, it may be twenty years before the amount of unfunded liabilities is actually reduced.\textsuperscript{164} And if an open amortization period is used, the system may never get to the point where unfunded liability is paid down. “This situation is akin to buying a house, paying less than the interest amount, refinancing the higher balance next year, again paying less than the interest amount, refinancing the higher balance.”\textsuperscript{165} The bottom line is that the level percent open method can result in perpetual negative amortization, while the level dollar open method can result in the unfunded liability never being completely paid off.\textsuperscript{166}

Not surprisingly, the Government Finance Officers Association recommends against the use of open amortization.\textsuperscript{167} Nevertheless, the use of open methods is not unheard of.\textsuperscript{168} Despite the fact that open amortization periods are roundly criticized, one report noted that they might be used where the plan is sufficiently underfunded that full funding is not possible budgetarily or politically, or simply where politicians for various reasons do not desire full funding or do not believe underfunding is a problem.\textsuperscript{169}

The results of this study show a significant divergence among the plans with respect to the methods they use to pay down unfunded liabilities. At the troubling end of the spectrum, Montana’s unfunded liabilities are essentially not expected to be paid down under the current statutorily-determined contribution rate.\textsuperscript{170} Similarly, Arizona and Virginia both use open amortization periods that may result in negative or incomplete

\begin{footnotes}
\footnotetext[162]{Letter from Glenn Bowen and Suzanne Taranto, Principal and Consulting Actuaries, Milliman, to Chris Brown, Chief Operating Officer, City of Detroit (July 6, 2012), available at https://burypensions.files.wordpress.com/2013/08/milliman_detroit_report.pdf (regarding Milliman’s analysis of the City of Detroit’s actuarial liabilities).}
\footnotetext[163]{Id.}
\footnotetext[164]{Id.}
\footnotetext[165]{Id.}
\footnotetext[167]{GOV’T FIN. OFFICERS ASSN., BEST PRACTICE; SUSTAINABLE PRACTICES OF DEFINED BENEFIT PENSION PLANS 4 (2009), available at http://gfoa.org/sites/default/files/CORBA_SUSTAINABLE_FUNDING_PRACTICES_OF_DEFINED_BENEFIT.pdf.}
\footnotetext[168]{See McCaulay, supra note 166, at 20.}
\footnotetext[169]{For a more detailed discussion of why open amortization methods are used, see generally MN. LEGIS. COMM. ON PENSIONS & RET., BACKGROUND INFORMATION ON THE AMORTIZATION OF DEFINED BENEFIT RETIREMENT PLAN UNFUNDED ACTUARIAL ACCRUED LIABILITIES (2011), available at http://www.commisions.leg.state.mn.us/lepr/documents/backgrounddoc/amortization_of_uaal.pdf.}
\end{footnotes}
amortization. The remaining five plans appear to be on track to pay down their liabilities within a fixed period of time, with some plans being more aggressive than others. Maine, for example, has a closed amortization period and only sixteen years remaining until its unfunded liability is paid off in full.

Overall, this brief look at the plans subject to constitutional funding mandates suggests that such mandates are insufficient to create funding discipline. Each of the eight plans were below the level generally considered healthy, although funded ratio is an imperfect measure of financial health and funding discipline and therefore is not a terribly helpful measure for our purposes. Looking at three key funding factors—percentage of ARC received, assumed rate of investment return, and amortization of unfunded liability—we are left to conclude that constitutional funding requirements, at least as currently written, do not by themselves solve the political and budgetary problems that plague public pension funding. Table 5 attempts to pull the pieces together in a highly simplified manner to provide an overall look at the plans. While funded status is included for ease of reference, it was not taken into account in determining the plan’s overall rating.

TABLE 5: SUMMARY OF ACTUARIAL ASSUMPTIONS & FUNDING AS OF FY2012

<table>
<thead>
<tr>
<th>Plan</th>
<th>Funded status</th>
<th>ARC</th>
<th>Return assumption</th>
<th>Amortization method</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maine</td>
<td>79.1%</td>
<td>+</td>
<td>+</td>
<td>✓</td>
<td>Above average</td>
</tr>
<tr>
<td>South Carolina</td>
<td>67.4%</td>
<td>+</td>
<td>+</td>
<td>✓</td>
<td>Above average</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>56.1%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Average</td>
</tr>
<tr>
<td>Louisiana</td>
<td>55.9%</td>
<td>✓</td>
<td>-</td>
<td>✓</td>
<td>Average</td>
</tr>
<tr>
<td>Michigan</td>
<td>64.7%</td>
<td>✓</td>
<td>-</td>
<td>✓</td>
<td>Average</td>
</tr>
<tr>
<td>Arizona</td>
<td>75.8%</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>Below average</td>
</tr>
<tr>
<td>Montana</td>
<td>67%</td>
<td>✓</td>
<td>✓</td>
<td>-</td>
<td>Below average</td>
</tr>
<tr>
<td>Virginia</td>
<td>69.9%</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>Below average</td>
</tr>
</tbody>
</table>

+ indicates above-average performance
✓ indicates average performance
- indicates below average performance

171. See Background Information, supra note 153, at 1–2.
172. See Table 4, supra, noting the five plans with closed amortization periods ranging from sixteen to forty years.
Table 5 necessarily involves subjective judgment regarding the relative importance of factors and the rating provided to each plan. For each of the actuarial factors reviewed above, I assigned each plan either a plus, indicating above-average performance in that category, a check mark for average performance, and a negative sign for below average. I then reviewed each plan across all factors to determine how they compared to national averages. While there can be differences of opinion regarding importance and weight, my conclusion was that five of the plans were either average or above average, while three were below average—not a ringing endorsement of the effectiveness of constitutional funding requirements. It seems clear, therefore, that having a constitutional funding requirement in place does not guarantee sound funding methodology or funding discipline. The Section below provides a key explanation for why seemingly clear and concrete funding requirements have been ineffective in many cases. Enforcement of constitutional funding requirements where the legislature chooses not to voluntarily comply with them has never been successful in the eight states studied.

B. Do Fiscal Constitutions Provide Effective Recourse Where Plans Are Underfunded?

Given that many states with constitutional funding mandates in place appear to have failed to comply with such requirements in one or more years, this Section will review whether, and to what extent, stakeholders have any effective recourse where funding is noncompliant. First, however, it is worth noting that the relative underfunding of these plans has had real consequences aside from any funding lawsuits. While none of these plans have run out of money to pay benefits, every single plan in this study made at the very least prospective reductions in benefits since 2001.\footnote{See id.} Many of the plans made changes that impact current employees and retirees as well.\footnote{See id.} An overview of the changes made by each of the plans is provided in Appendix B.

It is difficult, of course, to pinpoint why such changes were made. In some cases, it may be the case that benefit design was adjusted based on a thorough study of compensation design that had nothing to do with unfunded plan liabilities. However, in other cases, legislators at the very least relied on the existence of such unfunded liabilities to justify the changes.\footnote{See id.} There is some evidence, therefore, to support the argument

\footnote{For details of these changes, see Appendix B.\textit{infra.}}
that unfunded plan liabilities often lead to detrimental changes to pension benefits. With this in mind, the Sections below will explore what action participants and stakeholders can and do take to avoid the creation of such unfunded liabilities where they have a state constitutional funding requirement upon which to rely.

1. Attempts to Enforce Funding Requirements

Recall that the constitutional mandates included in this study have strongly worded funding requirements, which generally state that the government shall fund the pension plan annually on a sound actuarial basis. Theoretically, then, a stakeholder should be able to sue to enforce this funding requirement.\(^\text{177}\) Such lawsuits would most obviously occur where a plan received less than the full ARC, but could also take place where contributions are being calculated on questionable actuarial assumptions. Most of the plans in our study should have faced the possibility of such lawsuits, as they either received less than the full ARC each year, or they used actuarial assumptions that could be challenged as inconsistent with best practices.

In order to identify any enforcement efforts, all relevant case databases were searched to determine whether any participant or other stakeholder had attempted to enforce the state’s fiscal constitution with respect to pension funding. Because of concerns that readily available databases would not reveal lower court enforcement actions, or actions that were settled out of court, news sources were also searched to verify whether lower-level enforcement efforts had taken place. These searches were not limited to a specific time period, but rather were designed to find any legal action ever brought or threatened to enforce funding mandates. Similarly, the searches were not limited to any particular plan, but covered any legal action brought regarding any public plan in the state. This research identified only three cases where legal challenges were brought to enforce constitutional funding requirements, and each is discussed below.

2. Challenges to Actuarial Assumptions: Kosa & Professional Firefighters of New Hampshire

Two of the three lawsuits brought to enforce funding requirements were challenges to the actuarial assumptions used by the plan to calculate the underlying contribution requirements. The first case, *Kosa v.*

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\(^\text{177}^\) *But see* Gamage, supra note 53, at 761 (suggesting fiscal constitutions are not generally enforceable).
Treasurer of the State of Michigan,\textsuperscript{178} concerned the Michigan Public School Employees Retirement System (the “Michigan Teachers’ Plan”). Michigan’s constitution requires both that pension benefits be funded in the year in which they are earned, and also that current contributions may not be used to fund accrued unfunded liability that existed at the time of the constitution’s effective date (referred to as “preconstitution” liabilities).\textsuperscript{179} In the mid-1970s, the Michigan Teachers’ Plan no longer had funds available to pay benefits that were earned but unfunded at the time the constitutional funding provision became effective.\textsuperscript{180} The constitutional provision, however, prohibited the plan from using funds received postconstitution from paying those preconstitution unfunded benefits.\textsuperscript{181} Nevertheless, the plan did just that, borrowing from the postconstitutional funds to pay preconstitutional benefits, and plan beneficiaries brought suit to enforce the constitutional funding provisions.\textsuperscript{182} The Michigan Court of Appeals issued a writ of mandamus, requiring the plan to cease paying preconstitutional benefits with postconstitutional funds.\textsuperscript{183} While the case was on appeal to the Michigan Supreme Court, the Michigan legislature passed a bill changing the funding method that the Michigan Teachers’ Plan used, from the “attained age” method to the “entry age normal” system.\textsuperscript{184} The effect of this change in funding method was to create “reserves” that had not existed under the attained age method, thereby freeing up money held by the plan to pay preconstitutional benefits.\textsuperscript{185} The additional funds were available because the entry age normal funding method has smaller initial reserve requirements than the attained age system.\textsuperscript{186}

Plan beneficiaries argued to the Michigan Supreme Court that changing the funding method in this manner—to retroactively bless the payment of preconstitutional benefits from postconstitutional funds—violated the constitutional funding requirements.\textsuperscript{187} The court disagreed, finding that both funding methods were generally accepted and actuarially sound methods of funding benefits.\textsuperscript{188} The court explained that while initial reserves were lower under the entry age method, they would, over the course of several years, be equal in amount to those under the at-

\textsuperscript{179} Mich. Const. art. IX, § 24.
\textsuperscript{180} Kosa, 292 N.W.2d at 457-58.
\textsuperscript{181} Id. at 457.
\textsuperscript{182} See id. at 457–58.
\textsuperscript{183} Id. at 458. The Court of Appeals did not, however, issue a writ of mandamus requiring the legislature to appropriate sufficient funds to pay the retirees for whom adequate funds had not been set aside.
\textsuperscript{184} Id. at 462.
\textsuperscript{185} Id. at 461-62.
\textsuperscript{186} Id. at 462.
\textsuperscript{187} See id. at 459.
\textsuperscript{188} Id. at 460.
tained age system.\textsuperscript{189} The court seemed to imply, therefore, that participants would eventually enjoy the same level of benefit funding under the entry age method as they would under the attained age system.

In this case, therefore, we see an example of a state \textit{clearly} changing funding methods in order to lower its current contribution requirements. The state was permitted by a court to do so based, it seems, on the fact that the funding method chosen was within the realm of accepted funding practices. The fact that the decision may have been poorly motivated and indicative of financial irresponsibility was not persuasive to the court. This case illustrates one of the fundamental problems with constitutional funding requirements. Where there exists a range of permissible funding methods and practices, it is extremely difficult to get a court to find a method or practice within that range to be impermissible, even where there is clear game playing going on. Part IV will discuss possible methods to address this shortcoming of constitutional funding requirements in more detail.

The second case, \textit{Professional Fire Fighters of New Hampshire v. New Hampshire},\textsuperscript{190} illustrates yet another type of enforcement problem. New Hampshire’s constitutional language is stronger than most. It states that “the employer contributions certified as payable to the New Hampshire retirement system . . . to fund the system’s liabilities, as shall be determined by sound actuarial valuation and practice, independent of the executive office, shall be appropriated each fiscal year to the same extent as is certified.”\textsuperscript{191} In 2011, after independent actuaries informed the New Hampshire Retirement System Board that the state plan would be underfunded under the actuaries’ recommended downward revision of the plan’s investment return assumption, the board voted to increase employer contribution rates.\textsuperscript{192} The New Hampshire legislature responded quickly by passing House Bill 2 that, among other things, barred the Board from revising the plan’s investment assumption, thus eliminating the Board’s justification for increasing employer contributions.\textsuperscript{193} In addition, House Bill 2 cut state-funded contributions to the plan by twenty-five percent, increased employee contribution rates, and eliminated four seats from the Board that had previously been designated seats for public employees, replacing them with four seats reserved for public employers.\textsuperscript{194} Following this legislative action, the Board, which still had an employee majority, sued, claiming that the legislature’s action violated New Hampshire’s constitutional funding requirement.\textsuperscript{195} Shortly thereafter,

\begin{flushleft}
189. \textit{Id}. at 462.


193. \textit{See id}. at 3-4.

194. \textit{Id}.

\end{flushleft}
the terms of four employee-representative board members expired, and those members were replaced with employer representatives pursuant to House Bill 2. The newly constituted, majority-employer retirement board then dropped its lawsuit.196

After the newly constituted board dropped its lawsuit, the state was sued by plan participants who alleged that reducing the employer contribution was unconstitutional.197 The court dismissed the participants’ claim on the basis that they lacked standing to bring the suit.198 Generally speaking, an individual has standing to pursue a legal action in federal court where the plaintiff has suffered an injury-in-fact, the injury was caused by the party against whom legal action is being taken, and the harm is redressable by the court.199 Standing in state courts depends on the language of the state’s constitution and its interpretation by courts, although in most instances state standing is similar to federal standing requirements. In New Hampshire, when evaluating whether a party has standing, the first inquiry is whether the party suffered a “legal injury against which the law was designed to protect.”200 “A party will not be heard to question the validity of a law, or of any part of it, unless he shows that some right of his is impaired or prejudiced thereby.”201 In Professional Fire Fighters of New Hampshire, the court found that the participants lacked standing because the alleged underfunding had not harmed participants.202 The court stated that the participants “tacitly admitted” that a reduction in employer contributions would not affect the rights of the plaintiffs to receive pension benefits.203 As a result, even though the state clearly interfered with an actuarial determination regarding the proper rate of return assumption for the purposes of lowering current contributions, participants could not enforce the constitutional funding requirement because they could not show that they had been harmed.

3. The Remedy Problem: Musselman

The final case attempting to enforce a constitutional funding requirement is Musselman v. Governor, a case brought by current and re-

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198. Id. at 23-24.


203. Id. at 19.
tired members of the Michigan Teachers’ Plan to compel funding for retiree health benefits provided under the plan. In that case, the Michigan Supreme Court found that the legislature had violated Michigan’s constitutional requirement to fund retirement benefits on an annual basis, but that the remedy requested—a writ of mandamus requiring funding—was unavailable. While the court acknowledged that the constitutional provision had been enacted to specifically require annual funding, it also pointed out that at least one delegate seemed aware that the requirement could not be enforced by a court. The court concluded that it did not have the requisite authority to issue a writ of mandamus ordering the appropriate official to transfer the requisite funds. Because the money at issue had not been set aside, the only source of the funds would have been the state treasury. As the court explained, only the legislature had the authority to appropriate funds from the treasury, based on a constitutional provision that specifically states, “No money shall be paid out of the state treasury except in pursuance of appropriations made by law.” Because the pension funding requirement did not alter the rule that only the legislature can appropriate funds, no relief was available. The court did suggest, however, that if the provision had been a self-executing appropriation, the enforcement problem would be solved. That possibility will be explored further in Part IV, below.

In the end, however, there were no cases among the eight states with constitutional funding mandates in which courts have forced the state to contribute a greater amount to the pension plan than the amount allocated by the legislature.

4. Why Aren’t Enforcement Actions More Common?

Given the lackluster reviews of the plans’ funding discipline provided in this Article, it is somewhat surprising that there have been so few efforts to enforce the constitutional funding mandates. One possibility is that the three unsuccessful attempts to enforce the mandates, and the legal issues raised therein, have caused other potential litigants to believe

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204. 533 N.W.2d 237 (Mich. 1995).
205. Id. at 246.
206. The court quoted a delegate to the constitutional convention as saying “[F]rom now on any governmental body cannot avoid paying for a retirement fund that they promise an employee. They’ve got to make those payments annually, on time.” Id. at 241 (quoting 1 OFFICIAL RECORD, CONSTITUTIONAL CONVENTION OF 1961 772 (statement of Del. Stafseth)).
207. See id. at 246 (quoting 1 OFFICIAL RECORD, CONSTITUTIONAL CONVENTION OF 1961 773 (statements of Del. Brake)) (“[B]ut there is no way to compel the legislature to appropriate money . . . . We have to put some faith in somebody, and this is being put in the legislature.”).
208. Id.
209. Id. (citing Mich. Const. art. 9, § 17).
210. Id.
211. See id.
that enforcement attempts are futile. But there are many other factors that are perhaps even greater influences over the lack of enforcement.

First, in order to have enforcement, stakeholders must actually monitor plan funding on an annual basis. While the ARC is a relatively visible and easy to monitor indicator, most of the plans studied received nearly the full ARC, even during times of fiscal stress. The problem for many plans was not that they received less than one-hundred percent of the ARC, but rather the assumptions used to calculate the ARC. Those factors are much more difficult to monitor, both because they are less visible, and because they are less easily understood.\footnote{Changes to GASB standards will eliminate ARC reporting, and will instead require governments to list “net pension liabilities” on their financial statements. It is not clear, however, that this change will at all affect the ease of participant and stakeholder monitoring.}

Even if stakeholders educate themselves about actuarial assumptions and monitor their use, there is still the problem that, from a plaintiff’s perspective, the potential benefit of funding lawsuits is likely to be perceived as relatively modest. Assume a participant is currently fifty-five, is ten years away from retirement, and participates in a state plan that is projected to run out of money when the participant is ninety years old. If this participant learns that her plan’s actuarial assumption are suboptimal (for example, because its assumed rate of return is unreasonably high), she could sue to force a more reasonable rate of return assumption be adopted to calculate a plan’s required contributions. Even if successful, the participant has not necessarily gained a significant advantage. True, if a lower rate of return assumption is used, the plan is more likely to have sufficient assets to pay the participant the benefits due to her. But the plan might have had enough money anyway, because the challenged rate of return might, in fact, turn out to be accurate. Or the state might have made up the shortfall in the future. Or the participant may not live past the age of ninety, in which case the higher level of funding does her no good. Given the uncertainties involved in pension funding, and the corresponding uncertainty in the payoff of lawsuits, it is not surprising that few seek to enforce these mandates.

But there are also other explanations for the lack of enforcement. It may be that participants do not want to force full annual funding because they would in fact prefer that the government spend scarce funds on current needs (such as current salaries or current governmental programs such as education). A participant may worry that if the state is forced to fund pensions, that participant’s job or salary level may be at risk. Similarly, they may worry that action to increase the employer’s contribution to the plan may lead to the employee’s share of the contribution being increased as well.\footnote{For example, although Arizona received one-hundred percent of the ARC in the study years, this was only after the Arizona legislature in 2006 and 2007 changed the initial funding requirements set by the plan’s actuary. Despite this seemingly clear violation of the Arizona constitution, there was}
will live up to its pension promises even if insufficient funds have been set aside. Particularly in states that provide strong legal protection to the pension benefits themselves, participants may believe that benefits are guaranteed regardless of the plan’s funded status. If a belief in strong legal protection of benefits is in fact driving a lack of enforcement actions, we should expect to see attempts to enforce funding requirements increase given the apparent vulnerability of pensions in the recent high profile bankruptcies in Detroit, Stockton, and San Bernadino.

C. Should Law be Used to Impose Discipline? Answering the Institutional Question

Before discussing how state fiscal constitutions might be improved and made more effective with respect to pension funding, it is worth challenging an implicit assumption of this Article, which is that pension funding should, in fact, be legally required, rather than simply an explicit goal for politicians to pursue. Everyone, I think, would agree with the goal that pensions should be adequately funded on an annual basis. On my view, and that of many others, pension benefits are deferred compensation. Once the employee has performed the services that entitle her to pension benefits, she has a contractual right to those benefits. Funding such benefits is necessary to ensure intergenerational equity, by requiring that the generation that benefits from the services provided will pay for the corresponding pension benefits just as they pay for current salary.

Supporting the position that pension benefits should be fully funded on an annual basis does not, however, necessarily require support for a legal requirement to fund such benefits. After all, the process of allocating scarce budgetary dollars to competing needs is perhaps the quintessential political act. The first-best solution, then, would be for politicians to fund pension benefits responsibly and voluntarily. Theoretically, if politicians fail to adequately fund pension benefits and that underfunding does not reflect the will of the polity, those politicians will be held democratically accountable and will lose their jobs. If, instead, we allow no attempted enforcement by beneficiaries. One possible explanation for the lack of enforcement may be that in Arizona, participants are required to fund fifty percent of the required annual contribution, regardless of its amount. Prior to 2006 and 2007, contribution rates had been rising as a result of market losses in the early 2000s. As a result, if participants were to challenge the legislature’s actions, their contribution rates would rise further still.

214. For an overview of the state legal protections provided to public pension benefits, see generally Amy B. Monahan, Public Pension Plan Reform: The Legal Framework, 5 EDUC. FIN. & POL’Y 617 (2010).


216. See id. at 1046.

courts to force budget allocations, we remove democratic accountability. 218 We essentially proclaim that representative democracy is not to be trusted in this circumstance. 219 And, by asking courts to enforce funding requirements, we may be giving a budgetary decision to an institution less well-suited to the task than the legislature. 220

I am quite sympathetic to this institutionalist critique in other contexts, even in other public pension contexts; 221 but nevertheless believe that pension funding may be a singular case. The political economic forces surrounding public pension funding make it nearly irrational for a politician to seek full, annual funding for pension benefits. 222 In addition, the consequences of underfunding are not felt until decades in the future, thus making it nearly impossible for the electorate to hold politicians accountable for their funding decisions. No market pressure exists to push against either of these forces. For reasons previously discussed, workers will generally not push hard for full annual funding because such actions may lower their overall compensation or risk their employment. 223 Other market actors, such as credit markets, will generally only penalize states for underfunded pension plans once the funding level has reached crisis levels. 224 Despite the fact that recent GASB rule changes now require governments to list “net pension liability” on their financial statements, it seems unlikely that this change will result in any new market pressures. Market monitors were already evaluating pension status, and simply listing liabilities on financial statements seems unlikely by itself to raise governmental borrowing costs. Tiebout markets 225 might also exert pressure on pension funding, although, again, that pressure is likely to be felt only when the underfunding rises to a critical level. 226

One might argue, however, that it would be preferable to grant pension benefits the strongest form of legal protection and simply leave the

218. See id. at 114.
220. See Conti-Brown & Gilson, supra note 217, at 17 (arguing that the legislature is better suited to controlling budgetary decisions than the courts).
221. I find Conti-Brown & Gilson’s institutionalist critique of the role of courts in adjudicating public pension benefit disputes quite persuasive. See id.
222. See Galle & Stark, supra note 87, at 608 (suggesting that the political inclination to favor current needs over future needs may be more prevalent at the state level than at the federal level, given the threat of exit of state residents and businesses).
223. See supra Part III.B.4.
224. For example, Illinois only suffered significant credit downgrades once its pension plans had reached what was perceived as crisis level. See Illinois, supra note 8, at 1.
225. The term “Tieboutian markets” in this context refers to the interjurisdictional pressure that states are under to structure their government in a way that attracts and retains citizens. According to Tiebout’s political theory, states and other governmental units must compete for citizens. In the pension context, if a state underfunds its pension plans, thereby creating significant unfunded liabilities, it may lose taxpayers to other jurisdictions because those taxpayers do not want to face the possibility of having to pay off those liabilities in the future.
226. See Schragger, supra note 83, at 870-73. Before a pension plan reaches critical underfunding, it may in fact be the case that Tieboutian markets operate to put pressure on state legislators to favor current needs over annual pension funding. See Galle & Stark, supra note 87, at 607.
funding decisions to the legislature. Doing so would appear to protect the outcome we care most about (paying promised benefits), while not interfering with political budgetary decisions. The problem with this approach, as with the market-based approaches described above, is that it does nothing to ensure responsible funding. In the best case scenario, it would allow politicians to push pension costs to future generations. In the worst case scenario, politicians fail to fund pension benefits and then states and cities end up reducing pension benefits pursuant to the state’s power to impair contracts where “reasonable and necessary to serve an important public purpose.”

Clearly, we want to be cautious about giving the judiciary power that amounts to budgetary authority. But we can perhaps ease our discomfort about the role of the judiciary by crafting a funding standard that leaves little room for discretion, whether legislative or judicial in nature.

The stakes of consistently underfunding public pension plans are very high. Plan participants may lose their most significant form of retirement income, future taxpayers may face inequitable burdens, and it is not hyperbole to state that the entire state or city’s future may be at risk. The very nature of the pension promise supports using law to force plan funding. If citizens of a state or municipality believe that promised pension benefits are entitled to strong legal protection, and that those promised benefits should be paid in nearly every circumstance, using law to constrain political budget allocations can be justified as a necessary action to secure such benefits. These factors lead to the conclusion that if public employee compensation is structured to include a defined benefit retirement plan, some form of legal funding requirement is a necessary companion. As Schragger explains, “It is quite difficult on democratic grounds to justify allowing a judge to impose particular fiscal ends unless the political pathologies of the local and state budgeting process are so wide and deep that coercion outside elective politics is required.”

IV. IMPROVING THE LAW AND POLITICS OF PUBLIC PENSIONS

Thus far, this Article has argued that there is a role for law to play in ensuring adequate public pension funding. However, it has also illustrated that state constitutional funding mandates, as currently enacted, are imperfect legal mechanisms to accomplish that goal. This Part will

227. For a detailed examination of the ability of states to reduce pension benefits even where they are considered contractual in nature, see Monahan, supra note 214, at 4.

228. Schragger, supra note 83, at 883.
explore how fiscal constitutions might be better used to provide the funding discipline public plans are currently lacking.

In particular, this Part explores what would be required in order to create a legal mechanism to impose funding discipline. As explained below, for any funding requirement to be enforceable, it must first be clear. The type of game-playing that is permitted under current actuarial standards of practice needs to be tightened if funding requirements are to have any meaning. Second, there must be a mechanism to enforce the funding requirement against legislative will. This, of course, is highly controversial. But if we are to successfully impose funding discipline, history tells us it cannot simply be left to the discretion of the legislature. Nevertheless, a legal funding mechanism must also allow for some flexibility to respond to extraordinary fiscal conditions. Before examining the complex task of crafting such a mechanism, this Part first looks at whether common law and private pension funding requirements are a helpful model for statutory requirements.

A. Lessons from Common Law Jurisdictions

While this Article focuses on fiscal constitutions to support pension funding, there are some jurisdictions in which courts have developed common law pension funding requirements. The reasoning, rationale, and methods used by such courts may be helpful in determining how best to go about fixing the problems with existing constitutional mandates that Part II identified.

What further examination shows, however, is that while several states have what appear to be strong common law rules requiring actuarially sound funding of pension systems, the cases in which these rules often developed dealt with situations where the legislature had allocated a certain amount of money to the pension fund and either the legislature or the governor subsequently diverted that money to other uses. As a result, while many rule statements from these cases look promising, very few cases involved challenging actuarial assumptions, for example, or attempting to force full funding of the ARC against legislative will.

First, with respect to the clarity of common law funding requirements, a review of all state cases for the term “actuarial soundness” and related terms illustrate a clear hesitation on the part of courts to even attempt to define “actuarial soundness.” Most decisions simply use it as a

229. See e.g., Westly v. Cal. Pub. Empl’s Ret. Sys. Bd. of Admin., 130 Cal. Rptr. 2d 149, 155 n.8 (2003) (“The People of the State of California hereby find and declare as follows: . . . (c) ‘Politicians have undermined the dignity and security of all citizens who depend on pension benefits for their retirement by repeatedly raiding their pension funds. (d) . . . To protect the financial security of retired Californians, politicians must be prevented from meddling in or looting pension funds.”).
concept without any definition. In cases where the term is defined, it is typically defined as some variation of the plan having sufficient funds to meet its obligations when they mature. In other cases, courts have simply noted that it is within the legislature’s discretion to interpret the term.

With respect to enforcement, the only case identified where standing was granted and actuarial methods were successfully challenged was a New York case, *McDermott v. Regan*. In that case, the legislature was seeking to change the actuarial method used by a plan over the objections of the plan’s sole trustee (the state comptroller). The legislature sought to make the change because the method it sought to adopt would result in lower plan contributions, thereby freeing up funds for other purposes during difficult budgetary times. The court rejected the change, finding that plan participants had a contractual right to have the trustee determine the actuarial methods used to fund the plan. While the court was not, therefore, ruling on the propriety of the various actuarial methods, the case does suggest the possibility that shifting power to an independent actuary to determine funding requirements may be one method of avoiding game playing with actuarial assumptions.

The only case identified in which the court actually issued a writ of mandamus requiring the treasurer to pay a pension plan funds that were not allocated by the legislature involved the California State Teachers’ Retirement System (“CalSTRS”). In the 2003-04 fiscal year, the California legislature took action to reduce the state’s contribution to a supplemental benefit account within CalSTRS. The supplemental benefit account was essentially designed to provide CalSTRS participants

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231. *Lexin v. Superior Court*, 222 P.3d 214, 222-23 (Cal. 2010) (stating that a plan meets the applicable funding requirements when, “through actuarially sound contribution rates and prudent investment, principal is conserved, income is generated, and the fund is able to meet its ongoing disbursement obligations”) (citation omitted); *Fla. Ass’n of Cnty’s. v. Dept’ of Admin., Div. of Ret.*, 595 So. 2d 42, 43-44 (Fla. 1992) (stating that funding a plan on a “sound actuarial basis” means that “a retirement program must be funded in such a way that the retirement fund is able to meet its continuing obligations as and when they mature”) (citation omitted); *Stone v. State*, 664 S.E.2d 32, 38-39 (N.C. Ct. App. 2008) (“An ‘actuarially sound retirement system’ is defined as a ‘retirement plan that contains sufficient funds to pay future obligations, as by receiving contributions from employees and the employer to be invested in accounts to pay future benefits’ Black’s Law Dictionary 39 (8th ed. 2004).”)

232. See, e.g., *Retired State Emps. Ass’n v. State*, 119 So. 3d 568, 573 (La. 2013) (“[T]he mechanism by which actuarial soundness is achieved is left to the discretion of the legislature.”) (citations omitted).


234. *Id.* at 535.

235. *Id.*

236. *Id.* at 536.


238. *Id.* at 1020.
with cost-of-living adjustments in retirement. A statutory provision was in place requiring that the legislature allocate 2.5 percent of creditable compensation to the supplemental benefit account each year, and further that employees had a contractual right to such a contribution. In the fiscal year at issue, however, the legislature allocated $500 million less than the required 2.5 percent contribution, and the board of CalSTRS sued. It was established during the proceedings that the supplemental benefit account was not in danger of insolvency, and was considered actuarially sound. Further, the bill that reduced the contribution by $500 million required that the missed contribution be amortized and made up over a set number of years to ensure continued solvency of the fund. Nevertheless, the court found that taking away $500 million of the required contribution was an unconstitutional impairment of contract and issued a writ of mandamus to force the contribution. The court emphasized that its decision did not rest on the actuarial soundness of the plan. Rather, it found that the existing statute created an unambiguous contractual right to the 2.5 percent contribution each year, regardless of whether the plan was actuarially sound or not. As a result, the robust health of the plan, and its ability to pay benefits for decades, did not factor into the court’s decision. This case, then, is unhelpful in that it does not give us guidance on determining what is appropriate within a range of funding methodologies. But it does show the power of an unambiguous legal funding obligation. It also illustrates that a clear obligation to fund can be forced even where there are more pressing budgetary priorities, a problem that will be addressed in Subsection C.3 below.

B. The Federal Standard

The federal government has, for decades, regulated annual funding requirements for private pension plans. For many years, these funding standards arguably suffered from some of the same problems inherent in state funding requirements, most notably flexible requirements that allowed employers to manipulate funding assumptions to generate artifi-

239. Id. at 1021.
240. Id. at 1022.
241. Id. at 1020.
242. Id. at 1024.
243. Id.
244. Id. at 1020.
245. Id. at 1030-31.
246. Id.
247. In the CalSTRS case, the funding obligation was clear because it was simply a fixed percentage of payroll. While such a funding standard is highly effective with respect to clarity, such fixed contribution amounts are not typically effective in ensuring adequate funding. See Shnitzer, supra note 97, at 15 (discussing the implications of a fixed contribution rate). Ideally, a legal funding requirement would be both clear and adjustable based on a plan’s funding needs over time.
cially lower funding requirements. In 2006, however, Congress significantly tightened annual pension funding requirements in an attempt to end or at least significantly lessen such manipulation. It is worth, therefore, briefly reviewing the current federal standards to determine if they would be an attractive model for states to adopt.

Sponsors of private pension plans have, since the 1970s, been required to make the annual minimum required contribution each year or face a significant excise tax. The Pension Protection Act, however, significantly changed several aspects of the minimum required contribution calculation. First, it shortened the period of time to pay down any unfunded plan liabilities from thirty years to seven years. It also requires plans to discount plan liabilities using a segmented yield curve of high-quality corporate bonds, and specifies the mortality table to be used for determining present value or making any funding calculations. While no other actuarial factors are specified, the law requires that the funding calculations be made “on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), and which, in combination, offer the actuary’s best estimate of anticipated experience under the plan.” Further, significant changes in actuarial assumptions that decrease the liabilities of an underfunded plan must be approved by the Secretary of Labor. Such approval is required where changes result in a decrease in the plan’s funding target of (1) more than $50 million or (2) more than $5 million and the decrease is five percent or more of the funding target. Finally, special rules apply to plans considered “at risk.” Where a plan is at risk, federal law accelerates contributions and requires plans to use specific actuarial assumptions to calculate funding requirements.

Regardless of what one believes regarding the desirability of the specifics of these federal funding requirements, they make clear that it is possible to define annual funding requirements with much more specific-

250. There is also the possibility that the federal government could directly impose such funding requirements as a condition of public plans receiving tax-favored status. I save a discussion of the desirability of such federal regulation for future work.
253. Previously, plans were required to use the 30-year Treasury rate. The corporate bond yield curve therefore lowers required contributions compared to previous law, all other things being equal.
254. Id. § 1083(h)(3).
257. Id. § 1083(h)(5)(B).
258. A plan is considered “at risk” if, for the preceding year: (1) the plan’s funding target attainment percentage, determined without regard to the at-risk assumptions, was less than eighty percent, and (2) the plan’s funding target attainment percentage, determined using the at-risk assumptions, was less than seventy percent. Id. § 1083(i)(4)(A).
259. Id. § 1083(h)(1).
ity than states currently use. They are also a helpful illustration of the funding approach taken by an entity (the PBGC) that has a distinct interest in ensuring that pension assets are sufficient to pay benefits when due.

C. Toward an Effective Fiscal Constitution for Pension Funding

As explained in Part II, existing fiscal constitutions work against pension funding in many cases, both by constraining spending and by providing a strong incentive to use gimmicks, such as shortchanging pension contributions, to create debt that is not counted for purposes of balanced budget requirements. Political economic forces also work against sound pension funding by punishing politicians who pursue responsible pension funding against more pressing and visible current needs. Fiscal constitutions that require pension funding can counteract these pressures, but they must be structured in a manner that is effective and enforceable, and also flexible in the face of evolving state fiscal realities.

While this part specifically discusses constitutional standards, it should be noted at the outset that it is also possible to enact the same standards through statute. The primary disadvantage of a statutory approach to funding requirements is that such a requirement can be relatively easily eliminated by the legislature if put under pressure.

I. Creating an Effective Constitutional Funding Requirement

One of the primary defects of current constitutional funding requirements is that the funding requirement is tied to the concept of “actuarially sound” funding. Many actuaries upon hearing this language will immediately respond with “what does ‘actuarially sound’ mean?” In fact, there is not a commonly accepted definition of the term. Even if “actuarially sound” is interpreted to mean funding that is consistent with professional standards of actuarial practice, there are a wide range of accepted actuarial assumptions the adoption of which can lead to wildly different annual funding requirements. Without being more specific about what is required of legislators, there will be no possibility of enforcement. Politicians will be free to adopt those actuarial assumptions that satisfy their political needs.

260. For example, both Illinois and New Jersey enacted statutory funding requirements as part of their recent pension reforms. 40 ILL. COMP. STAT. 5/2-125 (2014) (authorizing state retirement boards to bring a mandamus action in the Illinois Supreme Court to compel the required payment); N.J. Chap. 78 P.L. 2011 § 2b, available at http://www.njleg.state.nj.us/2010/Bills/PL11/78__HTM (amending § 5 of P.L. 1997 c. 113 to provide that pension plan participants have a contractual right to annual funding enforceable in state trial court).

261. Based on the author’s experience in presenting drafts of this article to audiences that included pension actuaries.

Unfortunately, this is a problem that is not well-suited for lawyers to solve. Instead, it would be ideal if either the governing body of actuaries, or GASB, were to adopt funding methodologies with more specificity. Another possibility would be to require that an independent actuary determine the proper funding methodology for the plan, without any influence of either politicians or plan trustees. While this latter solution might sound ideal, ensuring independence in that situation would likely be difficult at best. Regardless of who performs the task, however, we must come to a shared understanding of responsible funding if we are to effective impose funding discipline. The specifics that are agreed upon must, therefore, be included in the constitutional funding provision and not left to the discretion of the legislature. It might also make sense to require the government to retain an independent actuary solely for the purpose of calculating the required contribution amount, and to impose personal liability for any errors or omissions, in order to ensure accuracy and accountability.

Once we agree upon the proper method of specifying funding requirements, the next step toward an effective fiscal constitution is to make the funding requirement enforceable. As we have seen in the states with current funding mandates, the courts generally do not consider such provisions enforceable or remediable.

One potential avenue for creating an enforceable funding requirement would be to make the constitutional provision self-executing. A constitutional provision is considered self-executing where “no legislation is necessary to give effect to it.” The basic test to determine whether a provision is self-executing is to examine whether it “lays down a sufficient rule by means of which the right or purpose which it gives or is intended to accomplish may be determined, enjoyed, or protected with the aid of legislative enactment.” The only possible way for a pension funding provision to satisfy this test would be to enact a funding requirement that is so specific no legislative action would be necessary. For example, the current language of “actuarially sound” is necessarily vague and requires legislative interpretation. If, instead, the provision provided very specific instructions regarding how to calculate the required funding amount the provision might be considered self-executing. Even better, the provision could include language stating that it was a self-executing provision, a label generally respected by courts. For example, the provision might provide, “Except as otherwise provided in this Section, all

263. Existing literature on states’ use of rainy day funds generally confirms that, when it comes to state budget policy that attempts to require politicians to smooth resources over time, more detailed (and restrictive) rules are better than looser standards. See generally Fatus & Mihov, supra note 88; Knight & Levinson, supra note 87; Stansel & Mitchell, supra note 88.
265. Id. § 104 (citations omitted).
266. See id. (citations omitted).
retirement plans for state and municipal employees shall receive their annual required contribution. From all state and municipal revenues, as applicable, there shall be first set aside any applicable annual required contribution and such monies shall be contributed to such plans prior to any other budgetary allocations. This provision shall be self-executing, and shall not require legislative or other appropriation.\textsuperscript{267}

A self-executing funding requirement may, however, be stronger than a state desires for a number of reasons. It may also be impossible to specify funding requirements with sufficient detail to allow the provision to be self-executing. Other possible methods for ensuring enforceability are therefore worth considering. One of these possibilities would be to give plan participants property rights to secure their pensions. This property right might take the form of a statutory lien or trust on future tax revenues or other governmental assets.\textsuperscript{267} Assume for simplicity a state’s constitution is amended to provide that participants in all state and local pension plans shall have a lien on the assets and future tax revenues of the state or municipality, as applicable, to the extent that the trust established to fund the plan is insufficient to pay currently due vested, accrued benefits. By itself, this lien would not force the government to make its full annually-required contribution. Indeed, if there was no requirement apart from the lien, the government could theoretically not prefund pension benefits at all. However, the lien should have great significance to the citizens of the state, because if the legislature failed to adequately fund pension benefits on an ongoing basis, future generations would very clearly bear the cost. The lien would create a priority over all other competing interests in the state or municipality’s assets, and would be respected in bankruptcy proceedings as well, provided that the lien was not first enacted in anticipation of bankruptcy.\textsuperscript{268} Essentially the lien could ensure that pensioners are always paid first if the state or municipality is unable to pay its bills.\textsuperscript{269}

While this approach appears to be sufficient to ensure that retirees are, in fact, paid the full pension that they have earned, it does not necessarily require that such pensions are funded in a fair manner. After all, if citizens do not in fact pay any attention to the lien provision, or understand what it can mean to them in the future, there might not be any political pressure on legislators to fund pension benefits adequately on an ongoing basis. Legislators might still be able to successfully push funding onto future generations. Credit markets, however, might provide the

\textsuperscript{267} This idea was first put forth in the context of ensuring priority in municipal bankruptcy. Hynes & Walt, supra note 3, at 40. It is just as effective, however, in creating an incentive to fully fund pensions to begin with.


\textsuperscript{269} Hynes & Walt, supra note 3, at 48.
necessary pressure.\textsuperscript{270} If the statutory lien successfully creates a priority for pension benefits above all other debtors with respect to repayment, states and cities may find it difficult to borrow money from credit markets if their pensions are not adequately funded. Whether this pressure would be sufficient to force a “fair” funding pattern is unclear. It may be that credit market pressure would only come into play when a pension fund is at risk of insolvency during the repayment period for a given bond. For example, if a state issues bonds with a twenty-year repayment period, and the state’s pension plans have enough money to pay benefits for thirty years, no pressure to fund the pension annually would be created by the bond market.

While self-executing provisions may be impossible to craft (or simply undesirable), and creating liens an insufficient guarantee of fair funding, another possibility is to instead provide in the constitution an explicit remedy in cases where the legislature does not adequately fund the plan.\textsuperscript{271} Historically, courts have struggled with finding standing in cases challenging funding mandates, and also with fashioning a remedy. Indeed, these two issues are related, because in order to have standing a participant must often show that a remedy is available to redress the alleged harm suffered. The first issue, therefore, is how a court should determine the harm suffered. For example, if a plan used a nine percent rate of return assumption, and a court determined that the plan should have used seven percent, there is a clear argument that a participant’s benefit security has been reduced. But what if the plan has sufficient assets on hand to pay benefits throughout the participant’s life expectancy? This problem could be relatively easily solved by providing in the constitutional provision that a failure to fund in accordance with the provided standards shall be considered to have harmed the participant, perhaps even with an explicit statement that such participants shall have standing to pursue legal enforcement.\textsuperscript{272}

The second issue, however, is ensuring that courts have the requisite authority to address the underfunding. Courts often do not have the au-

\textsuperscript{270} Credit rating agencies, such as Moody’s, already monitor public pension debt. See, e.g., \textit{MOODY’S INVESTOR SERVICE, ADJUSTED PENSION LIABILITIES FOR U.S. STATES} (2013), \textit{available at http://www.nesl.org/documents/summit/summit2013/online-resources/Moody-Adjusted-Pension-Liability-Medians.pdf.}

\textsuperscript{271} Both Illinois and New Jersey have taken this approach in their recently enacted pension reform legislation, although they did so through statutory provisions rather than constitutional amendment. 40 ILL. COMP. STAT. 5/2-125 (2014) (authorizing state retirement boards to bring a mandamus action in the Illinois Supreme Court to compel the required payment); N.J. Chap. 78 P.L. 2011 § 26, \textit{available at http://www.njleg.state.nj.us/2010/Bills/PL11/78_HTM (amending § 5 of P.L. 1997 c. 113 to provide that pension plan participants have a contractual right to annual funding enforceable in state trial court as an impairment of a contract, but not specifying precisely how such impairment will be remedied).}

\textsuperscript{272} For example, “In the event that the legislature shall fail to contribute the annual required contribution, participants in any plan subject to the funding requirement contained in this section shall be considered to have suffered harm as a result of such failure to fund, and shall have standing to seek a writ of mandamus to require the full required contribution to be paid to the plan.”
authority to order money paid from the state treasury. Even if they had such authority, there would need to be money available to contribute the underfunded amount. What, then, do we want a court to do in the face of underfunding? One possibility would be for the court to declare the entire budget unconstitutional, and require the legislature to draft a new budget allocating sufficient amounts to the pension plan. For example, “In the event that the legislature fails to allocate the annual required contribution pursuant to this Section, the legislative budget shall be void as unconstitutional and no monies shall be distributed from the Treasury until a budget complying with the requirements of this section is enacted.” This approach solves the remedy problem nicely, and also respects the democratic role of the legislature in making budget allocations. The primary problem with this solution is that it would necessitate very quick action on the part of plaintiffs and courts. It would only work if lawsuits challenging budget allocations were filed immediately and resolved prior to fiscal distributions. Another possibility would be to specify in the constitution that the court has authority to issue a writ of mandamus requiring the state treasurer to pay over the funds, if available, or to create an automatic lien on next year’s revenues if sufficient funds are not presently available. For example, “In the event the legislature fails to allocate the annual required contribution in a given year, there shall be created an automatic lien against the following year’s revenues in an amount equal to any contribution shortfall and such amount shall be automatically contributed to such plans without need for legislative appropriation in the following budgetary year.”

A recent decision in New Jersey highlights the importance of having some type of fail-safe mechanism in place for situations in which legal funding requirements are not met. When New Jersey enacted pension reform in 2011, it included in the statute language granting participants the right to bring suit if the state failed to fulfill its funding obligations under the new law. New Jersey also, however, has a constitutional balanced budget requirement, and pension contributions are made on the last day of the fiscal year. For fiscal year 2014, the New Jersey legislature allocated the pension contribution required by law. However, as of the end of the fiscal year, the state did not have sufficient funds to make

273. Louisiana’s constitutional provision contains language that appears to have a similar goal: “If, for any fiscal year, the legislature fails to provide these guaranteed payments, upon warrant of the governing authority of the retirement system, following the close of said fiscal year, the state treasurer shall pay the amount guaranteed directly from the state general fund.” L.A. Const. art. X, § 29. Neither the retirement system nor the courts has yet had to test whether this language is legally effective.


276. Id. at 9.
the allocated contribution. As a result, Governor Christie issued an executive order lowering the amount of the pension contribution for fiscal year 2014 in order to satisfy the balanced budget requirements. Participants sued to challenge the reduction, but were unsuccessful due to the necessity of complying with the balanced budget requirement (along with the court’s agreement with Governor Christie that there were not other late-year expenditures that could be cut with less impact). An important take-away from this case is that it is important for the law not only to specify a cause of action, but also to specify a remedy in case the contribution is not fulfilled and there are not funds available to immediately address the shortfall. For example, the funding requirement might specify that, in the event a required annual contribution is not made, the shortfall will be made up from the first dollars of the next fiscal year, over a five year period, or some other specific time period, rather than simply leaving the court to determine the best method of remedy. In the case of New Jersey, the statute simply specified that a failure to fund would be considered an impairment of participants’ contractual rights, but said nothing further about available remedies.

If politicians choose to ignore their provisions, it is an uncomfortable role for the judiciary to play in allocating budgetary dollars against the political will. But if we cannot tolerate this type of judicial role, it suggests the need for more drastic solutions. Such solutions include abandoning defined benefit plans in favor of plans that do not allow funding to be pushed to future generations, or cutting pension benefits prospectively where economic conditions and legislative decisions do not support pension funding. If defined benefit plans are to retain their current form, however, it may be that we need to embrace judicial enforcement of funding decisions.

2. Addressing the Need for Fiscal Flexibility

While this Article has argued that enforceable pension funding requirements are a desirable feature of fiscal constitutions, there is a valid objection to such pension funding requirements based on the inflexibility that they introduce into the budgeting process. If there is no viable means for the state to avoid its pension obligation in a current year, the result may be that more pressing societal needs are underserved. For ex-

277. Id. at 10.
278. Id. at 9.
279. Id. at 72-74, 76-83.
281. See Fitzpatrick & Monahan, supra note 71, at 38-48 (discussing the possibility of using prospective benefit reductions to help solve the funding problem).
ample, economic conditions in a given year may result in significantly reduced revenues, combined with increased social welfare needs. The pension contribution in that year may also be higher than normal if equity returns have fallen because of an economic downturn. If the state has no choice but to make its full pension contribution in that year, it may be that the state has insufficient funds to provide a basic social safety net for its unemployed citizens that year, even though the current electorate desires a different outcome. This outcome is serious, and deserves to be taken into account in discussing strong funding requirements.

Both private business and state and local governments sometimes have years with less revenue than expected, resulting in a temporary underfunding of their pension plans that is made up in subsequent years. Congress has in fact acted on multiple occasions to reduce otherwise required pension contributions to private employer plans to allow employers flexibility in the face of economic downturns, and federal law allows companies that sponsor defined benefit pension plans to apply for a waiver of annual funding requirements in special circumstances. The ideal approach for fiscal constitutions may therefore be to put in place strong incentives for full funding, but allow some degree of flexibility from year to year.

Flexibility could be introduced into fiscal constitutions through various mechanisms. One possibility is to allow the legislature to override the fiscal constitution where a supermajority approves such action. If overriding pension funding requires a two-thirds majority, many states would need the support of both parties in order to pass such a measure, lessening the likelihood that overrides would occur for spurious reasons. A somewhat similar idea would be to allow the fiscal constitution to provide a reduced required contribution (for example, seventy percent of the full required contribution) where one or more triggers are present (such as reduced revenues or increased contribution amounts as a percentage of payroll), to be made up on a specific schedule (for example, a closed five-year period). Such a mechanism would allow states to smooth pension contribution requirements in order to respond to fiscal downturns, without allowing them to push off the obligation indefinitely. These responses to fiscal fluctuations will always be second-best solutions, but they are likely preferable to either abandoning funding re-

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283. See Super, supra note 85, at 2616 (noting that state constitutional requirements for education and local government aid may be higher than what the political process would otherwise have produced and that privileging these payments can crowd out other expenditures).

284. I.R.C. § 430(e) (2012). For an overview of the many times Congress has passed temporary relief from pension funding requirements, see generally Endless Funding Relief, PENSIONS & INVESTMENTS (Feb. 4, 2013), http://www.pionline.com/article/20130204/PRINT/302049999/endless-funding-relief/.

quirements altogether, or forcing full pension contributions even in the worst of economic times. In addition, they provide an important back-up mechanism in situations in which adequate funds simply are not available in the current fiscal year.286

3. Complimentary Strategies

In addition to strong fiscal constitutional provisions, it is worth noting that there are other legal reforms that would complement and support this pension funding strategy. For example, prohibitions on retroactive increases in pension benefits would help prevent legislators from significantly increasing pension benefits during years of economic growth. Various antiabuse measures, such as prohibiting the payment of “13th checks,”287 would also be useful to ensure sound funding. The Maine Constitution addresses some of these issues by providing, in addition to the requirement to fund pension benefits on an annual, actuarially-sound basis, that “[u]nfunded liabilities may not be created except those resulting from experience losses. Unfunded liability resulting from experience losses must be retired over a period not exceeding 10 years.”288 The effect of this provision is to both prohibit any legislative action that results in the creation of unfunded liability (such as increasing benefits without corresponding funding), but also providing a short pay-off period for unfunded liabilities that result from incorrect actuarial assumptions, thereby placing pressure on those determining the actuarial assumptions to provide accurate projections. In short, states and cities would do well to consider holistically how they can prevent unfunded liabilities from sneaking into a system, even where that system is backed by a strong fiscal constitution.

V. CONCLUSION

Public pension plans have a funding problem. Due in part to existing state fiscal constitutions that require balanced budgets, as well as the particular political economic forces at play, states are often unable or

286. For example, when New Jersey violated its statutory funding requirement and was sued by various employee groups, there was no mechanism in place in the existing statute to address situations like the one that arose, where the funds had been allocated by the legislature but were unavailable due to a revenue shortfall. See N.J. Chap. 78 P.L. 2011, available at http://www.njleg.state.nj.us/2010/Bills/PL11/78_HTM.

287. Normally, a participant is entitled to a monthly pension check, for a total of twelve checks per year. However, some pension plans have an administrative practice of sending out an additional monthly payment, referred to as “13th checks,” when the plan’s investment returns exceed assumptions for the year. See, e.g., Megan McArdle, Detroit’s Pension Madness, BLOOMBERG (Sept. 26, 2013, 4:54 PM), http://www.bloomberg.com/articles/2013-09-26/detroit-s-pension-madness (detailing Detroit’s practice of providing 13th checks to retirees).

288. ME. CONST. art. IX, § 18-A. The term “experience losses” refers to losses that result from the plan failing to meet investment return assumptions and certain other actuarial assumptions.
unwilling to pay the amount necessary to fund promised pension benefits, particularly in years of economic downturn. This underfunding has led to predictable results: states have either retroactively reduced promised benefits, or have shifted pension costs to future generations. A critical question in addressing these undesirable outcomes is whether law or politics should be left to solve the issue. This Article has proposed that states’ fiscal constitutions should be amended to require full, annual pension funding, yet with some degree of flexibility to allow states to respond to revenue decreases. If states are unwilling to live with such funding constraints, workers should take strong notice, as it suggests that the state’s benefit promises are not to be trusted.
APPENDIX A

RELEVANT STATE CONSTITUTIONAL LANGUAGE

Arizona Constitution, article XXIX, § 1

Section 1. A. Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.

Louisiana Constitution, article X, § 29

(E) Actuarial Soundness. (1) The actuarial soundness of state and statewide retirement systems shall be attained and maintained and the legislature shall establish, by law, for each state or statewide retirement system, the particular method of actuarial valuation to be employed for purposes of this Section.

(2) For public retirement systems whose benefits are guaranteed by this constitution as is specified in Paragraphs (A) and (B) of this Section:

(a) …

(b) The legislature shall, in each fiscal year, by law, provide an amount necessary to fund the employer portion of the normal cost, which shall be determined in accordance with the method of valuation established under (1) above.

(c) The legislature shall, in each fiscal year, by law, provide for the amortization of the unfunded accrued liability existing as of June 30, 1988, which shall be determined in accordance with the method of valuation selected in (1) above, by the year 2029, commencing with Fiscal Year 1989-1990.

(d) Amounts provided for under (b) and (c) above are hereby guaranteed payable, each fiscal year, to each retirement system covered herein. If, for any fiscal year, the legislature fails to provide these guaranteed payments, upon warrant of the governing authority of the retirement system, following the close of said fiscal year, the state treasurer shall pay the amount guaranteed directly from the state general fund.

(3) For statewide public retirement systems not covered by Paragraphs (A) and (B) of this Section, the legislature shall determine all required contributions to be made by members, contributions to be made by employers, and dedicated taxes required for the sound actuarial maintenance of the systems, including the elimination of the unfunded accrued liability as of the end of the 1988-1989 Fiscal Year, under the method of
valuation selected under (1) above, by the year 2029, commencing with Fiscal Year 1989-1990.

(4) For all state and statewide public retirement systems, neither the state nor the governing authority of such system shall take any action that shall cause the actuarial present value of expected future expenditures of the retirement system to exceed or further exceed the sum of the current actuarial value of assets and the actuarial present value of expected future receipts of the retirement system, except with respect to the following:

(a) Normal business operating expenses of the retirement system.
(b) Capital outlay expenditures of the retirement system.
(c) Management of investments of the retirement system.
(d) Cost-of-living increases to retirees, as provided by law, provided the retirement system is approaching actuarial soundness as provided by law, and the granting of such increase does not cause an increase in the actuarially required contribution rate.

**Maine Constitution, article IX, § 18-A**

Beginning with the fiscal year starting July 1, 1997, the normal cost of all retirement and ancillary benefits provided to participants under the Maine State Retirement System must be funded annually on an actuarially sound basis. Unfunded liabilities may not be created except those resulting from experience losses. Unfunded liability resulting from experience losses must be retired over a period not exceeding 10 years.

**Michigan Constitution, article IX, § 24**

Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

**Montana Constitution, article VIII, § 15**

(1) Public retirement systems shall be funded on an actuarially sound basis. Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses.

(2) The governing boards of public retirement systems shall administer the system, including actuarial determinations, as fiduciaries of system participants and their beneficiaries.
New Hampshire Constitution, part 1, article 36-a

The employer contributions certified as payable to the New Hampshire retirement system or any successor system to fund the system’s liabilities, as shall be determined by sound actuarial valuation and practice, independent of the executive office, shall be appropriated each fiscal year.

South Carolina Constitution, article X, § 16

The General Assembly shall annually appropriate funds and prescribe member contributions for any state-operated retirement system which will insure the availability of funds to meet all normal and accrued liability of the system on a sound actuarial basis as determined by the governing body of the system.

Virginia Constitution, article X, § 11

Retirement system benefits shall be funded using methods which are consistent with generally accepted actuarial principles. The retirement system shall be subject to restrictions, terms, and conditions as may be prescribed by the General Assembly.
### APPENDIX B

**Benefit Changes 2001-2012**

<table>
<thead>
<tr>
<th>Plan</th>
<th>Changes Made</th>
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<tr>
<td>Arizona SRS</td>
<td>Increased retirement multiplier in 2001;(^{290}) Eliminated deferred retirement option program; (^{290}) Decreased pension benefits for new hires on or after July 1, 2011; (^{292}) and made various changes to distribution options effective July 1, 2013 (^{293})</td>
</tr>
<tr>
<td>Maine PERS</td>
<td>Cost of living adjustments (COLAs) frozen and capped for certain members; (^{294}) Raised normal retirement age (^{295})</td>
</tr>
<tr>
<td>Michigan Public School Employees Retirement System</td>
<td>New employees moved to hybrid defined benefit/defined contribution plan effective July 1, 2010; (^{296}) Current employees in existing defined benefit plan must make an election to receive lower benefits for future years of service or make larger employee contributions to the plan and keep current accrual rates (^{297})</td>
</tr>
<tr>
<td>Montana PERS</td>
<td>Increased retirement multiplier in 2001; (^{298}) Raised employee contribution rates for new members effective July 1, 2011 and made other benefit design changes; (^{299}) Changed/capped definition of compensation used to calculate benefits (^{300})</td>
</tr>
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\(^{289}\) This table includes changes to plans’ basic benefit formulas, but does not include anti-abuse provisions such as anti-spiking laws.

\(^{290}\) SB 1295.


\(^{294}\) 2011 Me. Laws 380.

\(^{295}\) Id.


\(^{298}\) Mont. SB 306 (2001).

\(^{299}\) 2011 Mont. Laws 369.

\(^{300}\) 2013 Mont. Laws 386.
<table>
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<th>Retirement System</th>
<th>Changes</th>
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<tr>
<td>New Hampshire Retirement System</td>
<td>Made various benefit-reducing changes to plan for new hires and unvested employees, such as raising the normal retirement age and reducing benefit multipliers&lt;sup&gt;301&lt;/sup&gt;</td>
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<tr>
<td>South Carolina Retirement System</td>
<td>Increased employee (and employer) contribution rates for current employees and new hires&lt;sup&gt;302&lt;/sup&gt;; capped COLAs for current and future retirees&lt;sup&gt;303&lt;/sup&gt;</td>
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<tr>
<td>Teachers Retirement System of Louisiana</td>
<td>COLA changes;&lt;sup&gt;304&lt;/sup&gt; various benefit changes for new hires;&lt;sup&gt;305&lt;/sup&gt; Attempted to move current employees to cash balance plan for future accruals.&lt;sup&gt;306&lt;/sup&gt;</td>
</tr>
<tr>
<td>Virginia Retirement System</td>
<td>Reduced COLAs and made various benefit changes for new hires effective July 1, 2010&lt;sup&gt;307&lt;/sup&gt;; required all state employees to pay employee share of contribution (prohibiting employers from paying such amounts for employees)&lt;sup&gt;308&lt;/sup&gt;; established a hybrid plan for new employees effective January 1, 2014&lt;sup&gt;309&lt;/sup&gt;</td>
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<sup>301</sup> 2011 N.H. Laws 224.  
<sup>302</sup> 2012 S.C. Acts 278.  
<sup>303</sup> Id.  
<sup>305</sup> 2010 La. Acts 992.  