

Securities fraud case against New Jersey exposes pensions crisis

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The legal action against the state of New Jersey for securities fraud, announced August 18 by the Securities and Exchange Commission, provides a glimpse of the enormous crisis facing state and local pension funds covering millions of public employees.

According to the federal regulators, between 2001 and 2007, state officials falsely claimed that they set aside funds for new pension benefits for teachers and other state employees. The misrepresentations began under a Republican governor, Donald DiFrancesco, and continued under his Democratic successors, James McGreevey and Jon Corzine. The state covered up the underfunding through accounting gimmicks that listed pension payments that were actually transfers of funds already in the retirement system.

The SEC action was announced in the form of a settlement agreement. The state accepted a cease-and-desist order without admitting or denying the SEC charges. No state officials or bond underwriters were named, and no penalties were imposed. The action was not even a slap on the wrist. “Yes, they charged the State of New Jersey with fraud, but there’s no price paid here,” a former SEC official told the *New York Times*. “There’s no fine, and no accountability on the part of any individuals.”

One reason for the lack of “accountability” is the fact that New Jersey is only one example of what is a deepening and almost universal crisis throughout the US. The SEC action is a form of damage control, designed to reassure investors and allow New Jersey and other states to continue to raise billions of dollars in the bond market, while in fact the crisis continues to worsen.

Although the SEC action is the first ever against a state and the second against any government in connection with public pension funds (San Diego was the first, in 2006), others may follow. What New Jersey officials were attempting to do was to cover up the fact that pension funds affecting 244,000 current and retired state workers were underfunded by tens of billions of dollars.

The New Jersey shortfall, as of June 2009, was nearly \$50 billion. It had only \$66 billion when its pension funds should

have had assets of \$112 billion to meet current and future obligations. As a direct result of accounting maneuvers earlier in this decade, the amount it now has to contribute to its pension funds has risen to \$3 billion a year, but for the second consecutive year, as a result of the budget deficits that mushroomed after the financial crisis that began in 2008, it is contributing nothing.

New Jersey is far from unique. Lynn Turner, a former SEC chief accountant, told Bloomberg News, “There’s likely to be a dozen that have the same type of problems as New Jersey, and it’s not just states but cities too.”

The SEC is reportedly looking at Miami and other cities in this regard. An investigative unit was set up recently to look into various municipal securities and pension funds. The stock market collapse has drastically deepened an already existing shortfall in state pension funds. The stage is being set for devastating attacks on public employee pensions.

According to the National Bureau of Economic Research, public employee pensions are underfunded to the tune of roughly \$3 trillion, even if the retirement age is raised to 74 and all cost-of-living increases to existing pensions are eliminated.

This figure was presented at a State and Local Pensions conference held by the NBER last week in Jackson Hole, Wyoming. In a paper presented to this conference, Joshua Rauh, a professor at Northwestern University in Illinois, explained that “assuming states don’t start defaulting on their bonds and other debts, it seems that taxpayers will be footing most of the multitrillion dollar bill for the pension promises that states have already made to workers.”

Nor is a default by a US state totally out of the question. *Barron’s* magazine discussed this possibility in a feature article some months ago. “Sovereign default is a hot topic these days,” *Barron’s* declared last March. “With Greece tottering and other European countries in fiscal distress, some have even voiced the possibility that a US state—also considered a sovereign entity—could suffer a general-obligation debt default.”

The magazine quoted a law professor at George Mason

University comparing the situation to General Motors. “In many ways, some of our states are like General Motors before its bankruptcy, suffering from falling revenue, borrowing money to cover operating expenses and operating under crushing legacy health and pension liabilities. It’s entirely possible, given the gigantic size of the pension liabilities, that some states might do what was once the unthinkable at GM and default.”

The implications of this threat for literally millions of public employees, both current and retired, are clear. The precedent set at GM can and will be extended to these sections of the working class, ripping up living standards and the retirement funds that workers have been promised for decades, and all of the plans they made accordingly.

The securities fraud charges against New Jersey, seen in this context, clearly are not the result of some lapse in oversight or mistake, nor are they part of the typical corruption for which New Jersey and other state governments are well known. They are the product of conscious policies that have been followed for decades.

Some commentators have referred euphemistically to the “political culture,” meaning that successive state and local governments have in essence purchased political support and relative social stability by promising that American capitalism, symbolized for most of the past quarter of a century by the soaring stock market, would provide a secure retirement for state workers.

The underfunding of New Jersey pensions did not begin in 2001. When “moderate” Republican Christine Todd Whitman became governor in 1994, she reduced payments to the pension funds so that she could enact tax cuts popular with the wealthy and sections of her upper-middle class constituency. Similar measures were adopted in many states and cities.

As a result, pension benefits for public employees were made hostage to Ponzi-type real estate and stock market bubbles that have now come crashing down.

Leading economic spokesmen and media pundits are beginning to spell out what Democratic as well as Republican politicians are understandably reluctant to explain: whether in the form of defaults on pensions, enormous budget cuts or massive tax increases, the ruling elite is going to be demanding that workers pay for the crisis. Wall Street and its political representatives will not be paying any price for the lies they have peddled for decades. Those who were victimized by these lies will have to foot the bill.

This is explained in the abovementioned *Barron’s* article by Jonathan R. Laing. “Like a California wildfire, populist rage burns over bloated executive compensation and unrepentant avarice on Wall Street,” wrote Laing last

March. “Deserving as these targets may or may not be, most Americans have ignored at their own peril a far bigger pocket of privilege—the lush pensions that the 23 million active and retired state and local public employees, from cops and garbage collectors to city managers and teachers, have wrangled from taxpayers.”

Laing’s point is not very subtle, despite his pretense of objectivity through the suggestion that Wall Street “may” be a deserving target. The aim is to pit sections of the middle class as well as poorer sections of workers against the shrinking number of working people who still have a half-decent pension.

This declaration of war against teachers and other public employees was taken up in even more demagogic style recently by *New York Times* columnist Ron Lieber, who began his August 6 piece as follows: “There’s a class war coming to the world of government pensions.”

This class war, according to Lieber, is not one between the working class, the vast majority of the population, and the billionaires and multimillionaires, the top one-tenth of one percent of the population that controls staggering wealth and has condemned increasing numbers of workers to poverty.

According to Lieber: “The haves are retirees who were once state or municipal workers. Their seemingly guaranteed and ever-escalating monthly pension benefits are breaking budgets nationwide.

“The have-nots are taxpayers who don’t have generous pensions. Their 401(k)s or individual retirement accounts have taken a real beating in recent years and are not guaranteed...”

This is a transparent attempt to pit workers who have lost pension protection, as firms have widely replaced them with 401(k)s that have been depleted by the financial crisis, against the dwindling sections of working people who still receive pension benefits. What is being prepared is a ruthless assault on public employee pensions as part of the decimation of all forms of social spending.



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