Debt-Saddled Municipal Budgets Get a Lifeline

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Body

While underfunded public-employee pensions capture the headlines, health-insurance benefits for retired state and local workers are also a huge problem. But a recent ruling by the Supreme Court may help state and local governments scale back these benefits.

Unlike public pension plans, retiree health benefits aren't funded in advance; they are typically paid out of current tax revenues, so they compete with other budget priorities like schools and police. This competition will only grow more intense, as unfunded retiree health benefits are close to $1 trillion, according to a recent study in the Journal of Health Economics.

Several cities and states have tried to reduce the scope of retiree health-care services, or to increase the portion of the premiums paid by retired workers going forward. Public unions have frequently sued, claiming the benefits are vested for life -- roughly parallel to the legal arguments the unions have made against efforts to curb future pension costs.

In late January, however, the Supreme Court issued an unanimous decision that will increase the chances of local governments winning such lawsuits. While the case involved a private business and its union, the principles should generally apply to public-sector agreements.

M&G Polymers vs. Tackett involved a collective-bargaining agreement that provided certain retirees, along with their surviving spouses and dependents, with a full company contribution toward the cost of their health-care benefits "for the duration of [the] Agreement." The contract was subject to renegotiation after three years, but the critical legal question was whether the retirement health-care benefits continued even after the agreement expired -- in effect whether the intent was to vest these benefits for life.

The union argued that the contract did vest these benefits for life and the Sixth Circuit Court of Appeals agreed. The Supreme Court reversed, noting that to prevail, the plaintiffs, in this case the union, had to supply concrete evidence -- "affirmative evidentiary support" -- that lifetime vesting of retiree health benefits was what both parties to the agreement intended.

Normally, the explicit terms of a contract are taken to reflect the parties' intentions; only when a contract's language is ambiguous does a court look to the parties' intent. Here the Supreme Court followed a traditional rule of contract law: If a contract is ambiguous, proof requires evidence of what the parties intended, not what a court -- in this case the appellate court -- might infer from the ambiguous contract.

Two principles in Tackett should be especially relevant to reductions in retiree health-care benefits where the duration of these benefits is often unclear. The court, Justice Clarence Thomas wrote, supported the ″traditional principle that courts should not construe ambiguous writings to create lifetime promises.″ Similarly, he wrote that the court endorsed the traditional principle that ″contractual obligations will cease, in the ordinary course, upon termination of the bargaining agreement.″

This is where the Supreme Court's decision is particularly significant for the public sector. There must be explicit proof that a collective-bargaining agreement intended long-term commitments to bind a city or state long past the incumbency of the public officials who signed the agreement.

Today elected officials trade generous retiree benefits in the future for current wages. By doing so, they avoid having to take responsibility for current cutbacks in state and municipal services that would accompany wage increases.

The Supreme Court's ruling in Tackett means that lifetime benefits cannot be inferred but must be made explicit. As a result, if public officials now attempt to revise the benefits in a current or new collective agreement, unions will doubtless demand that any long-term promises be made explicit. But public officials who make these promises explicit send a strong signal that they are putting potentially enormous burdens on future taxpayers and elected officials. This makes it harder for current officials to make such promises. That is a step forward -- not just in interpreting contracts but also in enhancing political accountability.

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