NIRS Fact Check
2008 State Teacher Policy Yearbook
January 29, 2009

In the interest of promoting the highest standards of research in the area of retirement security, as part of its mission, the National Institute on Retirement Security routinely reviews emerging work in the field. A report entitled "2008 State Teacher Policy Yearbook" was published in January 2009 by the National Council on Teacher Quality. In our review of this report, we uncovered a number of shortcomings, the most significant of which we describe herein …

One of the pressing policy priorities of our time is recruiting and retaining qualified educators to teach our nation's children. Traditional pensions have been proven highly effective at this task – that is, transforming new teachers into veteran teachers.

The National Council on Teacher Quality's *State Teacher Policy Yearbook* identifies a laudable goal – to identify ways to retain effective teachers. However, their recommendations in the area of retirement plans are out-of-step with established research findings and the consensus of expert opinion. This is particularly true of the NCTQ's embrace of defined contribution (DC) plans and condemnation of defined benefit (DB) plans.

NCTQ's Recommendations at Odds with Those of Retirement Policy Experts

The NCTQ's strident advocacy in favor of DC plans is remarkably out of step with a broad, bi-partisan recognition that such plans are falling woefully short when it comes to providing for American's retirement security.

The current economic crisis has made painfully clear how exposed and vulnerable workers are when they must rely solely on DC plans to provide their retirement income. But even before the recent financial meltdown, the pitfalls of 401(k) and other DC plans were well recognized. Indeed, the 110th Congress held at least ten separate hearings that addressed the shortcomings and pitfalls of 401(k) plans. There is little doubt that the 111th Congress will continue to investigate and take action in this area.

Experts on retirement policy agree that a major cause of our national retirement crisis is that over the course of the past two decades, 401(k) plans have increasingly been called on to do a job for which they were never designed. In other words, 401(k) plans were originally designed as *supplemental* retirement plans, not to be stand-alone options, nor as substitutes for DB plans.

These experts include Alicia Munnell who served in the Treasury Department under President Clinton and also on his Council of Economic Advisors, who said "What's happening is the old-fashioned pensions have disappeared, and so this [401(k)] plan that was sort of a supplementary plan is now everybody's basic plan, and it's so poorly designed, because it was never designed to be the mainstay of people's retirement."

Another retirement expert, Jeffrey Brown, who served on President Bush's Council of Economic Advisors and on the President's Commission to Strengthen Social Security has also vocalized the shortcomings of 401(k) plans. "The shift toward individual responsibility has swung too far. Participants are unprepared to manage the dizzying amount of choices and decisions they must make in order to prepare for retirement" in 401(k) plans.

When the non-partisan Government Accountability Office studied the effectiveness of DC plans as primary retirement vehicles, they concluded that although the plans might be able to provide a "meaningful contribution to retirement security for some workers," they were unlikely to prove sufficient for many, especially those with lower incomes.

And earlier this week, an editorial in *The New York Times* stated, "So far, the cumulative wipe-out of household retirement savings totals about $2 trillion, and no one believes that the downturn is anywhere near over. As a result, participants in 401(k)'s are in greater danger than ever of coming up short in retirement."

NCTQ's advocacy of defined contribution plans as the primary retirement vehicle for our nation's teachers stands at odds with the broad consensus of expert opinion in the area of retirement policy.

Report Ignores Research Findings on the Positive Effects of DB Plans on Retention

There is an established empirical literature on DB plans' effect on employee retention. Economists have repeatedly demonstrated that DB pension plans exert strong retention effects. Considering these findings and NCTQ's concern with retaining effective teachers, the report's recommendations to encourage DC plans are that much more puzzling.

In fact, the findings of the most recent study on DB plans, retention, and employee commitment should be highly relevant to a discussion of how to retain effective teachers. Published in the Journal of Pension Economics and Finance, the study found …

> "DB plans significantly increase employees' commitment to their organizations, owing largely to the higher perceived value of these

> programs. Even after controlling for plan appreciation, employees with a DB plan tend to report higher levels of commitment than those with only a DC plan. And strikingly, this result is strongest among younger workers."

NCTQ's report makes much of the assertion that young teachers do not appreciate DB pensions. This is a common, yet incorrect assumption. Young workers value DB plans as much, if not more than, their older peers. Neglecting these research findings has led NCTQ down an unfortunate path of making policy recommendations which are unlikely to achieve the organization's stated goals.

Teachers Consistently Express a Preference in Favor of DB Plans

Teachers, in particular, highly value DB plans – a fact borne out by the actual experience of systems where teachers are given the option of choosing which type of plan they prefer. Teachers consistently and overwhelmingly choose the DB plan over the DC. For instance, in Ohio, nine in ten teachers opt in favor of the DB plan. In South Carolina, 86% of K-12 teachers choose the DB plan.

Another real-world test comes from West Virginia, where employees who had been hired into a DC plan were recently given the option of switching out, and joining the DB plan. Eight in ten teachers opted to move to the DB plan. Three-quarters of teachers under the age of 40 chose to make the switch, again defying the assumption that DB plans are not valued by young teachers.

Considering that only a very small minority of teachers (including young teachers) appear to prefer DC plans, NCTQ's recommendation that states should spend scarce taxpayer dollars to establish such duplicative systems appears misplaced.

DB Plans Have Proven to be a More Efficient Use of Taxpayer Dollars

Because of their group nature, DB plans are much more efficient at delivering retirement benefits than individual account based DC plans. In fact, a recent NIRS study shows that a DB plan can provide a target level of retirement income at almost half the cost of a DC plan.

Against the fiscal constraints facing states and localities, policymakers need to be more attentive than ever to putting scarce financial resources to their best use. Based on the research to date, it is questionable whether establishing a parallel DC retirement option that is less efficient, that may not do the job of providing adequate financial security, and that teachers do not appear to be demanding is indeed the best use of valuable tax dollars.

Resources

Can you Afford to Retire? PBS Frontline, May 16, 2006.

Private Pensions: Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees GAO-07-21, Washington DC: Government Accountability Office, November 2006.

Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers GAO-08-8, Washington DC: Government Accountability Office, November 2007.

Editorial "From Here to Retirement," *The New York Times*, January 26, 2009.

S. A. Nyce "Behavioral effects of employer-sponsored retirement plans," *Journal of Pension Economics and Finance*, 6 (3) : 251–285, November 2007.

Olleman, M.C. "Defined contribution experience in the public sector," *Benefits & Compensation Digest,* 44(2), pp. 20-24, February 2007.

"When 401(k) Investing Goes Bad," *Wall Street Journal*. August 4 2008, Page R1

B. Almeida and W. Fornia *A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans,* Washington DC: National Institute on Retirement Security, August 2008. .

<u>Hearings in the 110th Congress on Retirement Issues</u>

- House Committee on Education and Labor, *Field Hearing: The Impact of the Financial Crisis on Workers' Retirement Security*, October 22, 2008.

- House Committee on Education and Labor, *The Impact of the Financial Crisis on Workers' Retirement Security*, October 7, 2008.

- U.S. Senate Committee on Health, Labor, Education and Pensions, *401(k) Fee Disclosure: Helping Workers Save for Retirement*, September 17, 2008.

- US Senate Special Committee on Aging, *Saving Smartly for Retirement: Are Americans Being Encouraged To Break Open The Piggy Bank?* July 16, 2008.

- Joint Economic Committee, *Your Money, Your Future: Public Pension Plans and the Need to Strengthen Retirement Security and Economic Growth,* July 10, 2008

- House Ways and Means Committee, Subcommittee on Select Revenue Measures, *Individual Retirement Accounts (IRAs) and their role in our retirement system*, June 26, 2008.

- House Committee on Education and Labor - Health, Employment, Labor and Pensions Subcommittee, *Securing Retirement Coverage for Future Generations*, November 8, 2007.

- US Senate Special Committee on Aging, *Hidden 401(k) Fees: How Disclosure Can Increase Retirement Security*, October 24, 2007.

- House Committee on Education and Labor, *HR 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007*, October 4, 2007.

- House Committee on Education and Labor, *Are Hidden 401(k) Fees Undermining Retirement Security?* March 6, 2007.