NIRS Fact Check
Peaks, Cliffs and Valleys: The Peculiar Incentives of Teacher Pensions
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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. An article entitled "Peaks, Cliffs and Valleys: The Peculiar Incentives of Teacher Pensions" was published in the Winter 2008 issue of Education Next, a publication of the Hoover Institution. In our review of this article, we uncovered a number of shortcomings, the most significant of which we describe herein.

Given the importance of education to our society, economy, and democracy, the question of how best to recruit, retain, and retire our nation's teaching workforce is one of our most important public policy discussions. Research tells us that one of the most effective retention tools available to employers seeking an engaged and productive workforce is the defined benefit (DB) pension plan. Unfortunately, however, the function and operation of DB plans is sometimes mischaracterized – whether intentionally or because of a lack of understanding of how these plans work. A recent article entitled "Peaks, Cliffs, and Valleys," is an example.

Unnecessary Alarmism

- The authors motivate their analysis with a good deal of alarmism, intimating that a fiscal disaster is looming as "teacher retiree benefit costs spiral upwards." They also invoke so-called "large unfunded liabilities" in public pension plans as a justification for their proposal to radically overhaul the retirement system covering teachers.

- These exaggerated assertions are at odds with the findings of a recent study by the U.S. Government Accountability Office, which found that public pension plans are well funded and on track to manage future obligations without a major impact on state and local budgets.

- The definitive source for information on funding of public pension plans, NASRA's Public Fund Survey, indicates that the average plan was 85.8% funded last year, with an even brighter outlook in the future.

- The authors do a disservice to an informed public policy debate in this area by conflating pensions (which are funded in advance and have predictable costs) with retiree health benefits (which are usually not pre-funded and whose costs are escalating rapidly). While mixing these two issues helps create drama, it does little to enlighten the discussion.

Misunderstanding the Nature of DB Plans

- The strength of DB plans is their incorporation of insurance-like features – e.g. sharing of investment risks, longevity pooling – which allows them to provide a comprehensive range of benefits – retirement, disability, and survivor benefits – in an extremely cost effective manner. DB plans provide employees with a highly desirable benefit – an assured monthly retirement benefit that cannot be outlived.

- Employers also like DB plans. Vesting provisions and benefit accrual patterns can be tailored to meet employers' recruitment and retention goals. Many employers prefer to design DB plans to provide incentives for skilled employees to stick with the job for a long period of time. Final-pay based benefit formulas and enhanced early retirement benefits are two ways that employers can reward experienced workers for their loyalty. (That said, there is nothing inherent in a DB plan that *requires* such a benefit accrual pattern or generous early retirement benefits. Indeed, the authors describe the steady benefit accrual pattern of one type of DB plan, the cash balance plan.)

Light on Analysis, Heavy on Rhetoric

- The authors' analysis provides retirement researchers with no new information. It merely demonstrates something which is already widely known – that is, the increasing rate of wealth accrual that occurs over the course of a career in final-pay based DB plans. From here, the authors make a giant leap in asserting that such a pension plan design serves "no compelling public policy purpose." Retaining well-qualified teachers in our public schools *is* an important public policy goal.

- The authors claim that eliminating DB plans would reduce exits at the end of the career to the benefit of school systems and aid attraction of mid-career teachers. However they provide no actual evidence for this.

- Moreover, the authors completely ignore important empirical evidence on the actual impacts of DB plans on mid-career turnover. Research to be published in the *Economics of Education Review* finds that DB pensions exert a strong retention effect for teachers, significantly reducing turnover at younger ages and mid-career.

Be Careful What You Wish For

- By fixating entirely on the incentives DB pension plans provide at the *end* of teachers' careers, with no attention to their demonstrated effects over the *entire course of* a career, the authors ignore the possibility that their policy proposals are likely to have a serious, negative, unintended consequence. That is, a switch to a cash balance DB plan or a defined contribution (DC) plan is likely to exacerbate turnover of mid-career teachers. When you eliminate DB plans, their strong retention effects go away too. Taking account of only one impact (reducing exits of senior teachers) without addressing the other (greater turnover among younger and mid-career teachers) is a bit like balancing your checkbook, but only tracking deposits, and ignoring withdrawals. You might feel good for a while, but eventually, you're going to realize that you have a major problem on your hands.

- By failing to address the fact that DB plans are far more efficient than DC plans – they can provide the same benefit at half the cost – the proposal to switch from DB to DC plans for the nation's teaching workforce borders on fiscal recklessness. Surely, taxpayers deserve to have an effective retirement system that allows for the recruitment, retention, and retirement of high quality teaching workforce at a cost that is economically responsible.

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