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A serious problem for retired teachers is the decreasing buying power of their retirement benefit. Older teachers who have been retired for 10 years or more face serious economic problems because of low salaries in the past, weak benefit formulas, lost service credit by teachers who moved from one State to another during their teaching careers, and, for teachers under social security, the availability of social security coverage only since 1950. Some States have adopted methods to cope with the impact of rising living costs on the retirement income of teachers. These include: (1) Special adjustments by State legislatures, (2) cost of living adjustments, (3) automatic percentage increases, (4) retirement benefit adjustments when salaries of active employees rise, (5) excess interest or earnings supplements, and (6) variable annuities. Although there has been progress in the past 10 years, a correcting mechanism is needed to provide for continuous adjustments in postretirement income to minimize the effects of inflation on the purchasing power of retired persons living on fixed incomes. (Author/MF)

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THE LONG-TERM ADEQUACY OF PUBLIC SCHOOL PENSION PLANS

Without any doubt, one of the most serious problems for a retired teacher is the loss of the buying power of his retirement benefit. This problem is hardly new, but it is becoming more and more acute. To place the problem in its full setting, we should consider several related matters.

A teacher who retires today at age 65 can expect to live 16 years more if he is a man and 20 years if a woman. How well will this teacher's retirement allowance serve for 16 or 20 years however adequate it appears to be now in 1969? What will inflation and economic change do to the retirement dollar if the benefit remains at the same amount over the retired teacher's life? To answer these questions, we should examine the characteristics of our economy as measured by trends in rising prices and our constantly improving standard of living. But before I get into this, let me make another point.

What is adequacy?

We cannot talk about the long-term adequacy of the retirement benefit without first asking whether the benefit payable when the teacher retires is sufficient to permit him to live in economic security and dignity. Ideas on how much the retirement benefit should be are changing. In years past, the National Council on Teacher Retirement and others pioneering in improving retirement systems have considered a retirement benefit of 50 to 60 percent of lifetime or final average salary to be a reasonable goal. Currently, more forward-looking thinking as embodied in NEA resolution 68-7, is that the retirement benefit should be closer to 75 percent of average of the three highest years of salary for a career teacher with 30 years of service. To reach this goal,

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will take much planning and hard work. Only a few teacher retirement systems are close to or have attained it.

For many retired teachers, but especially for the older teachers who have been retired for 10 years or more, the retirement allowance they started with was low. Thus, the foundation on which to build post-retirement adjustments is shaky. Several factors have contributed to the inadequate benefit of the older retired teachers. One was the extremely low salaries. Until 1961, the salaries of teachers lagged behind the salaries of other professions and occupations. It was only in the 1960's, a time of unprecedented economic growth and prosperity in this country, that teachers' salaries began catching up. Currently, with negotiated contracts, increases in teachers' salaries are averaging about 6 percent. Part of this gain, however, serves only to counteract the effects of inflation on purchasing power.

Among the other factors that have contributed to the low retirement allowances in the past, were low salary ceilings on contributions to the retirement fund and on computation of the retirement benefit, weak benefit formulas, loss of service credit by teachers who moved from one state to another during their teaching careers, and, for teachers under social security, the availability of social security coverage only since 1950.

During the past few years, some of these shortcomings have been removed, and numerous improvements and corrections have been made in teacher retirement plans. These changes should provide more adequate benefits for future retired teachers. Typically, retirement benefits for teachers are based on formulas which are expressed as a fraction or percentage of final average salary (usually the average of highest five years or the last five years of service). The use of final average salary adjusts for changes in the economy up to the time the teacher retires. If the teacher has been making a good salary and the benefit formula is reasonable in the terms of the goals of adequacy already mentioned, the retire-

ment allowance for the first few years of retirement will relate fairly well to economic conditions. For the longer run, however, a correcting mechanism will be needed to provide for continuous adjustments in post-retirement income to minimize the effects of inflation that erodes the purchasing power of retired persons living on fixed income. Only through building in a protective device can there be long-term adequacy of public school retirement plans.

Economic trends

The trends in the economy over the years are reflected by a number of indicators. One of these indicators is the well-known Consumer Price Index (CPI) published monthly by the U. S. Bureau of Labor Statistics. This index measures average changes over time in prices of goods and services bought by urban wage-earners and clerical workers. For the past 50 years, CPI has shown a gradual rise at an average rate of about 2 percent per year. At this rate, the purchasing power of the fixed dollar income has been reduced by about one-third from 1950 to mid-1968. This means that a teacher who retired on a fixed retirement allowance in 1950 would need \$1.40 for every \$1.00 of his original retirement dollar to maintain his equivalent buying power at mid-1968 price levels.

The advance in the cost of living in recent months has been far more rapid. The Bureau of Labor Statistics reported a rise of 0.4 percent for the month of November 1968 and a further rise of 0.2 percent for December 1968, to the level of 123.7 percent of the 1957-58 average. Translated into dollars, a cross-section of goods and services that cost \$10 in 1957-58 base period now costs \$12.37. Overall, the CPI climbed 4.2 percent during the year 1968, the biggest increase in 17 years. Measured from December 1967 to December 1968, the increase amounted to 4.7 percent. These price advances gravely affect persons trying to live on a fixed income. I should point out here that these individuals are affected in another way as well. Their economic position is weakened as the salaries of workers increase and living standards generally rise, for they have little or no

opportunity to share in the general advancements of our growing economy.

Devices for post-retirement adjustments

A number of methods to cope with the impact of rising living costs on the retirement income of teachers have been provided for by legislative actions. Most prevalent are special adjustments which state legislatures enact from time to time to meet existing crises. However, these have not been long-range solutions, only one-time increases in benefits and only for teachers already retired. Adjustments of this nature take many forms. One form utilizes graduated percentage increases related to changes in living costs. For example, California in 1967 provided monthly percentage increases on the first \$300 of the monthly retirement allowance to retired teachers. These increases ranged from 2 percent for teachers who retired in the year ending July 1, 1965, up to 23 percent for teachers who retired on or before July 1, 1956. The provision, however, did not take care of future rises in living costs or provide for teachers who retired after 1965.

Other special-type methods are across-the-board percentage increases, flat dollar amount increases, benefit adjustments in line with modifications in the benefit formula applicable to active employees, and raising the minimum retirement allowance.

Several approaches to long-term protection of the retirement benefit against lost buying power have been devised and are in effect in some states. These are cost-of-living adjustments, automatic percentage increases, retirement benefit adjustments when salaries of active employees rise, excess interest or earnings supplements, and variable annuities.

Cost-of-living adjustments: A method which has a good deal of appeal and which is likely to find growing acceptance is the one first enacted by the Congress in 1962 for the Federal Civil Service retirement plan. Already it has served as a model for Massachusetts, Utah, and New York. This federal program uses a Consumer Price Index formula to provide for the automatic adjustment in retirement benefits

the
as^A cost of living changes. The plan applies to both present and future retirees. It provides that retirement benefits are to be increased by a percentage comparable to the percentage rise in the Consumer Price Index. The adjustments are made after the CPI has risen at least 3 percent over the base month and persists for three consecutive months. There is no downward adjustment if prices drop.

The legislation adopted by Massachusetts in 1966 and amended the following year granted cost-of-living increases based on the CPI to public employees, including teachers, who retired before January 1, 1965, and whose annual retirement allowances do not exceed \$6,000. Beginning with 1970, all retirement allowances not in excess of \$6,000 will be automatically increased or decreased when the CPI rises or falls at least 3 percent compared with the base period. However, no decrease that will reduce the original amount of the retirement allowance established or that will reduce the retirement allowance fixed as of December 31, 1969, may be made.

Utah also added a cost-of-living feature based on the movement of the CPI when it reorganized its retirement system for teachers and other public employees in 1967. A cost-of-living increase is granted each year in which living costs rise 1 percent or more. A 5 percent increase is granted after the member has been retired five years. A 1 percent increase is added each year thereafter if the CPI has advanced.

The automatic cost-of-living adjustment plans enacted into law by the New York legislature in 1968 for both the state teachers retirement system and the New York City teachers retirement system are also geared to variations in the CPI. Here, increases are provided in the pension allowance when at least a 3 percent price rise is reported. For New York City teachers, the percentage applies to the first \$7,000 of the pension allowance.

I should also mention a qualified provision enacted in Alaska in 1965. The Alaska law allows a post-retirement adjustment in the benefits of retired

teachers of up to 1-1/2 percent for each year of retirement when the administrator determines that the cost of living as measured by CPI has increased and the financial condition of the teachers' retirement fund permits.

Automatic percentage increase plans: Another approach in providing automatic post-retirement percentage increases in benefits, and one which is gaining adherents, is the plan originally devised by the Chicago teachers retirement system in 1959. Under the Chicago plan, teachers during their working years, besides making normal contributions for retirement, contribute an additional non-refundable one-half of 1 percent of salary to a separate fund. The city matches the contribution. From this fund, the benefits of those retiring are raised automatically by 1-1/2 percent of the basis allowance annually, regardless of trends in living costs. Thus, a teacher with an original allowance of \$5,000 a year receives in addition \$75 each year by the end of the tenth year, the amount of the annual allowance reaches \$5,750.

This type of plan adjusts well for a gradual rise in prices. It is less adequate when the prices of goods and services rise sharply as they did in 1968.

Besides Chicago, three states--Hawaii in 1961, Nevada in 1963, and Kentucky in 1966--enacted automatic post-retirement adjustment plans. As in Chicago, the employer and the employee in Hawaii and Nevada each contribute one-half of 1 percent of salary; on retirement, the increase in the base retirement allowance is 1-1/2 percent each year. In the Kentucky teachers system, however, the annual automatic increase in benefits is 1 percent, with the cost of the plan being financed at present by excess interest earnings on the investment of the system's funds.

Adoption of the joint-contributory prefunded plan for automatic benefit increases by other states may be expected in the future.

Benefit adjustments as salaries are raised: A device for adjusting retirement income, accepted as yet by only one state-wide retirement system which has

teacher-members is the plan, passed in Maine in 1965. This plan provides that each time the salaries of active state employees are adjusted generally, the same percentage increase or decrease shall be applied to all retired state employees, teachers, or their beneficiaries. To finance this plan, active members contribute, on a non-refundable basis, 1/2 percent of salary to a separate adjustment fund.

The Connecticut state employees retirement system has a similar plan, scheduled to become effective in July 1969. This plan calls for biennial adjustments in benefits equal to the percentage increase in average salaries of all full-time permanent state employees. The retired person becomes eligible for the adjustment three years after the date he retires. This feature, however, has not been enacted for the Connecticut teachers retirement plan.

There are two advantages to plans that automatically raise retirement benefits as active salaries go up. They protect retirement benefits from inflation and they raise the living standards of retired employees. The drawback to wide acceptance is the cost of financing. Actuaries consider this type of plan to be more costly than any other method devised.

Excess investment earnings supplements: At least one state system, the Arizona system, supplements retirement benefits by providing retired teachers with a proportionate increase in their annuities based on excess earnings from investments. The payments are accomplished by what is called a 13th check.

The variable annuity: One of the more promising ways to solve the problem of the decreasing purchasing power of the retirement annuity is the variable annuity concept introduced in 1952 by the Teachers Insurance and Annuity Association when it established the College Retirement Equities Fund (CREF). Following this lead, Wisconsin in 1957 was the first state to inaugurate variable annuity programs for its two state-wide retirement systems, the teachers system and the public employees system, while a variable annuity plan was incorporated into the Milwaukee teachers retirement system in 1959. More recently, Oregon adopted a variable annuity program

for its teachers and other public employees in 1967, as did the New York City teachers retirement system. In the same year, Minnesota enacted a supplementary mandatory retirement plan for faculty members in state colleges, including junior colleges. This plan allows individual members to choose to have their contributions and the matching state's share invested in a growth share account. Whether a similar program will be passed for public-school teachers below the college level remains to be seen. One other state, New Jersey, established a supplemental variable annuity program for those members of its retirement systems who wish to make voluntary deposits for this purpose. The program does not apply to the normal retirement contributions.

Participation of teachers in variable annuities is always optional. The systems vary as to what portion of the contributions may be allocated for the variable annuity. The TIAA-CREF plan, for example, now allows a participant to place up to 75 percent of his and the employer's contributions in the variable annuity fund.

The Wisconsin plan illustrates how the principles of the variable annuity work. It permits the teacher to have one-half of his required deposits in the retirement system invested in equities securities--primarily common stock--and to share in the proceeds of these investments. As already mentioned, one purpose of the variable annuity is to provide a stable income in terms of purchasing power and thereby protect the retired teacher against the hazards of inflation and rising living costs. Generally, income from equities investments increase during periods of inflation and decline during periods of deflation. Another purpose of the variable annuity is to permit the teacher to participate in the expanding economy by sharing in the profits of business and industry through stock dividends and capital gains. To guard against the possibility of declines in the return from investments in common stock because of poor performance or general stock market downturns, the remaining 50 percent of the teacher's contributions are invested in

fixed income securities such as bonds and mortgages. When the teacher retires, he receives an annuity which consists of two parts: one is of the conventional type, a guaranteed fixed dollar amount; the other is the variable annuity, the amount of which varies each year according to the market value of the equity investments, the realized income from dividends, interest, and capital gains or losses.

Experience with variable annuities for those plans that have been in operation for some time have been quite favorable, although there have been some years when the variable annuity payments declined over the previous years.

Summary

This, then, sums up what is being done to provide long-term adequacy of teacher retirement benefits. There has been some progress in the past ten years but more states need to act in a corrective way. As serious attention and study are focused on the problem of the adequacy of the retirement benefit, other effective ways may be devised to provide allowances that will keep pace with economic and social changes. Improvements in teacher retirement plans continue to receive high priority in the legislative programs of the state education associations and the state retired teachers associations, and their current proposals are being directed to the 47 state legislatures that are meeting in regular sessions in 1969. It is hoped that the cooperative efforts of the two associations in each of the states will produce equitable results for the active teacher and his retired counterpart.

For the older retired teacher, the only effective solution may be a guaranteed annual retirement income that allows him to live decently. Society owes him that for a lifetime devoted to teaching the nation's youth. The active members of the teaching profession should be committed to help him achieve this.