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The Foundation for Educational Choice
RESEARCH BRIEF

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Underfunded Teacher Pension Plans: It's Worse Than You Think

The Foundation for Educational Choice and the Manhattan Institute recently commissioned a new study to examine the emerging crisis of underfunding public teacher pension plans in the states. The implications for public policy will likely be severe in the coming years. Public funding for K-12 education, and the potential for new reforms hang in the balance.

In their report entitled, "Underfunded Teacher Pension Plans: It's Worse Than You Think," authors Josh Barro and Stuart Buck reveal the major disparity between what states report and the true value of unfunded liabilities for teacher pensions. States put the price tag at teacher pension liabilities at $332 billion. The study shows the red ink is actually $933 billion, nearly three time greater, when applying more cautious and realistic accounting methods.

Teacher pension liabilities for all 50 states now total almost $1 trillion, almost triple the cost of what state officials have on their balance sheets, an unfunded public burden that could bankrupt state budgets including education programs in future years.

Snapshot of key findings:

- All fifty-nine pension funds studied face shortfalls.
- According to the fifty-nine funds' own financial statements, total unfunded liabilities to teachers—i.e., the gap between existing plan assets and the present value of benefits accrued by plan participants—are $332 billion.
- According to the authors' more conservative calculations, these plans' unfunded liabilities total about $933 billion.
- Only $116 billion (or less than one quarter) of this $600 billion discrepancy is attributable to the stock market drop precipitated by the 2007 financial crisis.
- The Dow Jones Industrial Average would have to nearly double overnight to make up for the present underfunding of these plans.
- California has the largest unfunded teacher pension liability: almost $100 billion.
- The worst-funded plan in our sample is West Virginia's, which we estimate to be only 31 percent funded.
- Five plans are 75 percent funded or better: teacher-dedicated plans in the District of Columbia, New York State and Washington State and state employee retirement systems in North Carolina and Tennessee that include teachers.

Going forward, there are structural changes that state governments can make that would avoid funding shortfalls and rein in out-of-control public pensions:

- States should consider shifting to defined-contribution retirement plans, especially on behalf of new and young employees; this is the norm in the private sector and was adopted successfully by Michigan in the 1990s. States are not obligated under such plans to provide any particular level of benefit.
- In cases where defined-contribution plans face major political resistance, states should consider hybrid options like cash-balance plans and TIAA-CREF, the latter having provided a version of defined-contribution retirement saving for employees of public colleges and universities for decades.

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Who's Best, Who's Worst

Of the fifty-nine funds in our sample, fifty-six show a funding deficit in their financial statements. After we made adjustments, all fifty-nine showed funding shortfalls. But some funds are in much better shape than others.

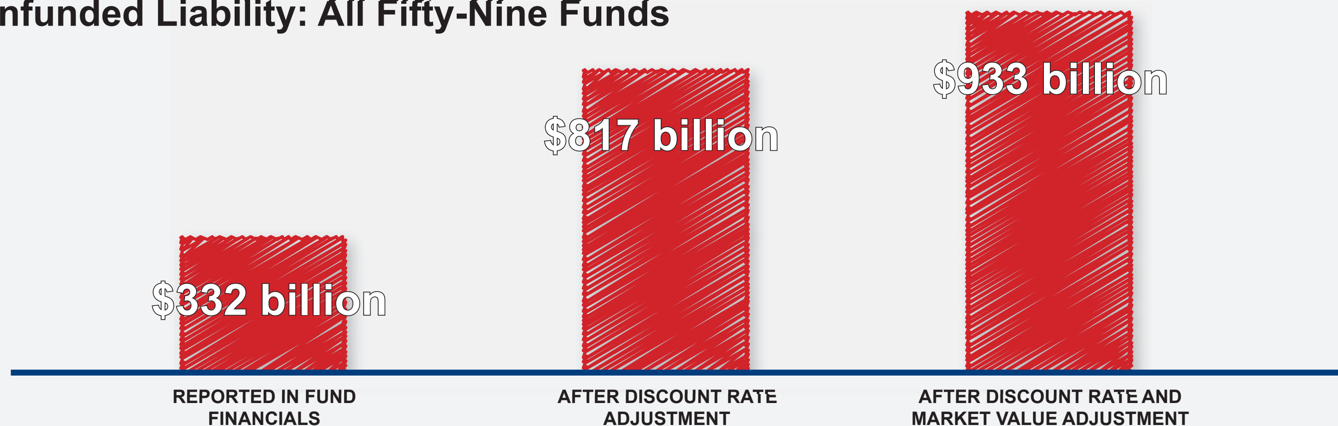
On the bright side, five plans are 75 percent funded or better: teacher-specific plans in the District of Columbia, New York State, and Washington State, and state employee retirement systems in North Carolina and Tennessee.

The worst-funded plan in our sample is the West Virginia Teachers' Retirement System, which we estimate to be only 31 percent funded. The four states whose plans have the next-worst funding gaps are Illinois, Oklahoma, Indiana, and Kansas; all are less than 40 percent funded.

The Illinois Teachers' Retirement System has the third-largest funding gap in our sample (over $70 billion, by our estimate), and the plan does not even cover Chicago, whose better-funded system faces a shortfall of its own of more than $9 billion.

If the Illinois and Chicago plans were combined, they would have the greatest teacher pension funding gap of any state except California, outstripping Texas ($72 billion), Ohio ($63 billion), and New York ($61 billion for the state and city systems combined).

Unfunded Liability: All Fifty-Nine Funds



Pension Costs' Threat to Education Quality

Education finance is a zero-sum game: the more that is spent on closing pension funding gaps, the less there is to spend on reducing class size or improving instruction. To see this effect in action, take a look at the Chicago Public Schools. In 2010, the CPS will make $609 million in pension contributions on behalf of teachers and support personnel. (Employees will contribute an additional $53 million or so, or 2 percent of their salaries.) Total employee salary costs are just over $2.6 billion, meaning that CPS will be making a pension contribution equal to an astounding 23 percent of employee salaries. (The district's total budget is $6.8 billion.)

As a result of the recent market downturn, the district expects that pension contributions will have to rise by a further $220 million in FY 2011. By our calculation, the unfunded liability of the Chicago

Public School Teachers Pension and Retirement Fund tops $9 billion. In that light, it is unsurprising that pension contributions will consume more than 10 percent of the CPS budget starting in 2011.

Indeed, the district's FY 2010 budget contains a stark warning: "Without cost containment on the pension or wage fronts, we cannot continue to protect school budgets in FY2010: the classroom will be affected." (Emphasis in original.)

With a plan that is 54 percent funded, which is the weighted average of the fifty-nine funds in our sample, Chicago is not in particularly bad shape; thirty-three systems rank lower.