

# Modernizing Teacher Pensions to Work for All Teachers (in an Ecosystem of Broad Educational Choice)

By Martin F. Lueken

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## Key Points

- Most public-sector teachers are enrolled in final-salary defined benefit retirement plans, which are back-loaded and provide strong incentives to “pull” and “push” teachers at arbitrary points in their careers.
- These plans reward the small group of teachers that work in a retirement system for a full career while imposing significant mobility costs on teachers who do not (including teachers who devote their entire careers to the teaching profession).
- As educational options proliferate outside the traditional public schooling system, states should implement plans for teachers that facilitate a dynamic labor market and recognize the diverse factors involved in teachers’ decisions related to changing jobs and retirement.

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2021 represents a breakthrough year for educational choice. So far, 18 states have enacted new school-choice programs or expanded existing programs.<sup>1</sup> Families increasingly have access to a host of settings and options for educating their children, such as public, private, virtual, and home schools; hybrid home schools; and learning pods. As educational options expand, teachers will remain a primary source of educators for K–12 students in these settings.<sup>2</sup> Therefore, it is important to have systems that facilitate the flow of teachers so they can easily transition from shrinking to expanding school settings. Not to mention, we need systems that serve all teachers well and put them on a path to a secure retirement.

Retirement benefits are integral to teacher compensation; yet, most pension plans are designed to reward teachers who remain in a system for a full career while levying substantial penalties on those who do not. Even teachers who devote their lives to the profession but do not remain in a single system for their entire careers are not served well by many of these plans. States must facilitate a dynamic educational workforce while placing teachers on a path to a secure retirement. Unfortunately, many teachers’ retirement plans today fall short of these objectives.

## Final-Salary Defined Benefit Plans

A vast majority of all public school teachers participates in final-salary defined benefit (DB) plans. Of the 92 percent of all public school teachers who have access to DB plans, 85 percent participate in them.<sup>3</sup> In contrast, just 22 percent of workers in private industry have access to DB plans, and the majority of these workers participate in 401(k)-style plans.

Under DB plans, a teacher's benefit is a function of salary, years of service, and an accrual factor. Retirement eligibility is based on age, years of service, or a combination of both. Teachers receive benefits for their entire lives, starting when they become retirement eligible. For example, teachers with 30 years of service, a \$70,000 final average salary, and a 2 percent accrual factor would receive \$42,000 in annual pension payments for their entire retired lives.

To collect benefits upon reaching retirement-age eligibility, teachers must vest by working a minimum number of years. Vesting typically occurs after five years, though many states have vesting requirements as high as 10 years. Teachers who leave before vesting may receive a refund of their contributions.

## Pension Borders

When teachers move to another state or a nonpublic educational setting (whether they continue teaching), they leave their retirement system.<sup>4</sup> If not vested, teachers will receive a refund of their contributions, sometimes with interest.<sup>5</sup> Vested teachers who leave before they reach age eligibility may choose to receive a refund benefit or defer their benefits (meaning they can collect a pension once they do reach age eligibility). Either way, the value of the benefits under this scenario is substantially less than what the teachers could have received if they worked under a single retirement system for their full careers.<sup>6</sup>

Seminal work by economists Robert M. Costrell and Michael Podgursky demonstrates the substantial costs these pension borders impose on mobile teachers. Compared to teachers who work the same number of years in a single system for a full career, the value of pension benefits for teachers who split time teaching in two systems over the

same teaching career is typically about half.<sup>7</sup> Thus, the system is set up such that two identical teachers who devote the same number of years to the teaching profession, in which one remains in one system and the other is mobile, will receive vastly different benefits.

## Issues with How Benefits Accrue

How pension benefits accrue under most DB plans leads to large disparities between full-career stayers and mobile teachers. This disparity occurs because DB plans are intentionally back-loaded. That is, pension benefits accrue slowly in the first half of a teacher's career and rapidly increase in the later years (typically through one's 50s).

The incentives embedded in these plans are designed to "pull" teachers to work in a system until their 50s or 60s and then "push" teachers out.<sup>8</sup> The timing of these incentives is completely arbitrary and independent of a teacher's skill, capacity to work, or life circumstances. Consequently, if the timing of teachers leaving a system, for any reason, doesn't align with the timing of these incentives, the teachers stand to lose a potentially substantial amount of pension wealth. Figures 1 and 2 depict the back-loaded nature of pension benefits and the pull and push incentives for a teacher in Connecticut.

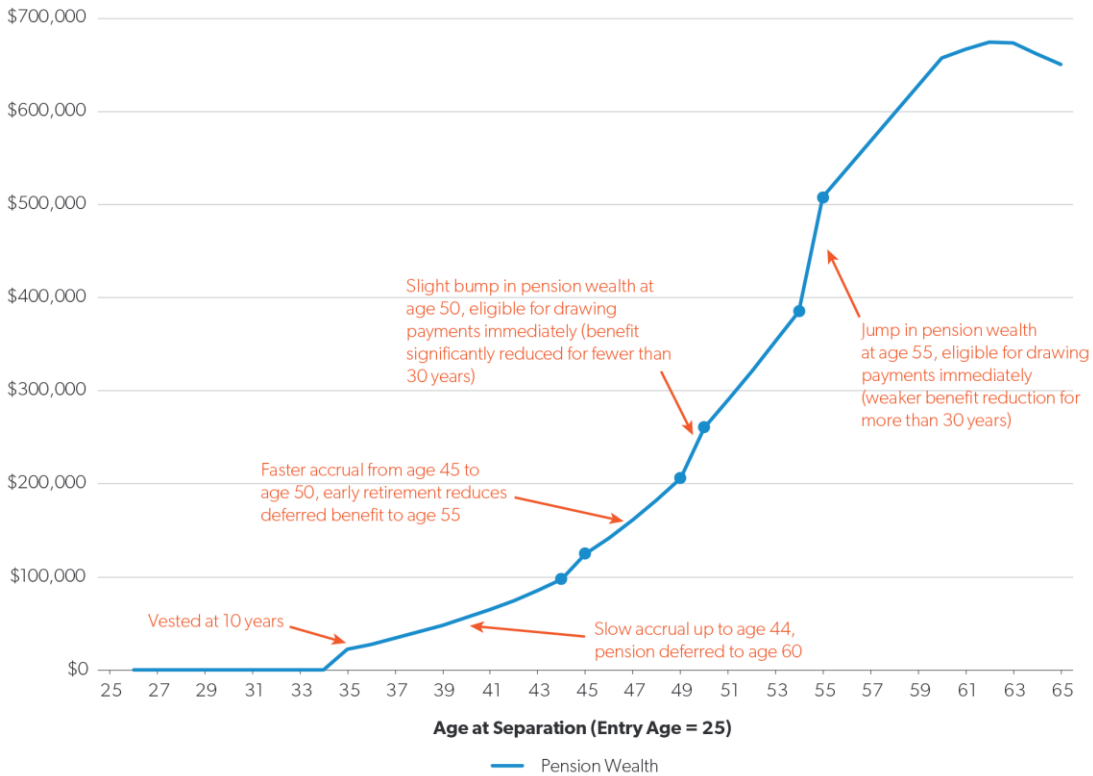
It often takes decades for teachers to qualify for retirement benefits worth at least as much as their contributions to the system's pension fund.<sup>9</sup> Only a small group of teachers actually remains in a system long enough to even reach retirement eligibility, once they have accrued the maximum pension wealth.<sup>10</sup>

## Reforms

States should ensure that their pension plans place all teachers on a path to a secure retirement, especially mobile teachers. To begin, state leaders can lower vesting requirements and ensure that contributions and refund policies are sufficient for teachers who do not spend their entire careers in one system.

States that provide only DB plans should consider providing teachers with at least an option for a fully portable retirement plan. Teachers today do

**Figure 1. Pension Wealth Growth for a Female Teacher in Hartford, Connecticut**



Note: Inflation is 2.5 percent, and real interest rate is 5.5 percent.

Source: Martin F. Lueken, *Growing Liability: How Connecticut Teacher Pensions Put Teachers, Taxpayers and Students at Risk*, Yankee Institute for Public Policy, September 2019, <https://yankeeinstitute.org/wp-content/uploads/2019/10/Teacher-pensions-2-compressed-1.pdf>.

not resemble the teaching workforce a century ago, when states started creating pensions for teachers. Although difficult, efforts should continue to modernize retirement benefits for a dynamic workforce.

Just reforming pension plans or offering teachers a choice of different plans is insufficient. States must ensure that they create and offer high-quality options. Ultimately, how well a retirement plan serves teachers comes down to how well the plan is structured, not the type of plan.

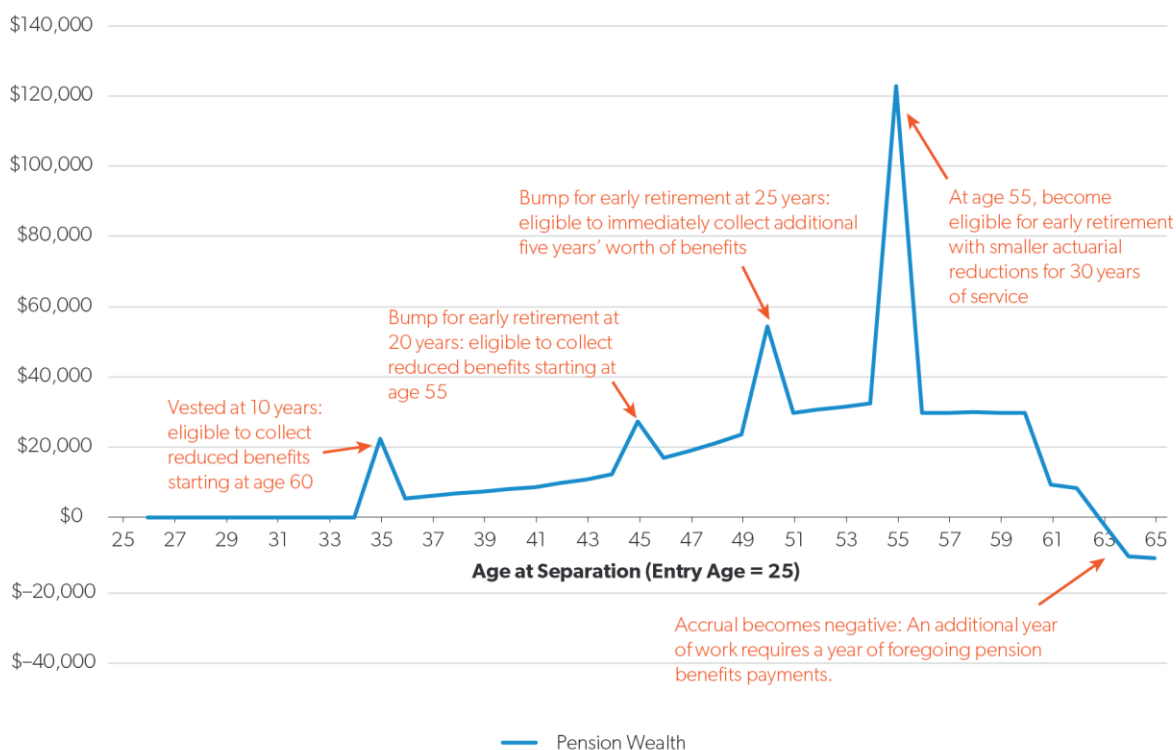
Another area of focus for states should be providing plans with smooth accrual, to not penalize teacher mobility. Policymakers should consider smoothing the arbitrary pull and push incentives embedded in DB plans so that pension wealth does not spike at these arbitrary points.

## Why Conservatives Should Champion Pension Reforms

Teachers are an integral part of most K–12 students’ education, and they should be able to easily fill vacancies in emerging educational settings when needed without facing fiscal penalties for their mobility. Especially in the wake of the COVID-19 pandemic, we have seen a proliferation of school choice, from learning pods to major increases in private, charter, and home-school enrollments.<sup>11</sup> For such proliferation to continue, teachers must be able to move easily among settings.

From an efficiency standpoint, many of today’s retirement plans for teachers do not make sense. Moreover, it is important to have systems that place all teachers on a secure retirement path from

**Figure 2. Year-over-Year Change in Gross Pension Wealth for a Female Connecticut Teacher**



Note: Net of interest and adjusted for inflation.  
 Source: Martin F. Lueken, *Growing Liability: How Connecticut Teacher Pensions Put Teachers, Taxpayers and Students at Risk*, Yankee Institute for Public Policy, September 2019, <https://yankeeinstitute.org/wp-content/uploads/2019/10/Teacher-pensions-2-compressed-1.pdf>.

a societal welfare standpoint. Workers whose retirement security is at risk may become dependent on government assistance in their retired lives, driving up long-term costs. Thus, conservatives should champion a system that can work well for all teachers in the profession, regardless of their mobility or the timing of their departures.

### Limitations and Considerations

While current pension plans serve some teachers well, they don't serve most teachers well. The desired path forward is to increase benefit portability for young and mobile teachers and place them on a path to a secure retirement. Some reform opponents claim that the current plans intentionally "favor longer-term employees as an incentive for teachers to remain in the profession, so school districts can retain experienced teachers and provide

a return to students and taxpayers on the investment the public has made in their career."<sup>12</sup> This overlooks that pension plans are fundamentally about keeping individuals in a single *system* rather than keeping them in the profession. Teachers who devote their entire careers to teaching but move among systems are not served well by these pension plans and face increased risk for their retirement security.

Retirement plans are structured in complex and varied ways. One type of plan is not automatically superior to another, and one can design both good and bad plans, regardless of type. For instance, some advocates for pension reform call for replacing DB with defined contribution (DC) plans. It's possible, however, to structure a solid DB plan to meet a set of objectives, and it's possible to create a DC plan that performs poorly.

The distribution of benefits represents just one important issue facing public employee pensions today, though this issue seems to garner less attention than other challenges do. Some pension plans also face severe funding challenges, which often overshadow issues related to benefit accrual. As tackling these funding challenges will require a different set of reforms, I will leave pension funding for a future installment of this “Sketching a New Conservative Education Agenda” series.

### **Concluding Thoughts**

As states continue to expand educational choice nationwide and weaken the link between education and residence, they should implement plans for teachers that facilitate a dynamic labor market

and reform policies that disadvantage teachers by imposing financial losses from mobility. Teachers have different preferences for when and where they want to teach, changing and diverse life circumstances, and varying capacities for instruction. The teaching profession should be treated as exactly that—a *profession*. The failure to recognize these diverse factors amounts to a system that benefits a few, rather than a system that treats all teachers as professionals planning for their careers and lives. Ultimately, a system that works well for teachers will work better for students, families, and communities.

## About the Author

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## Notes

1. Jason Bedrick, "How Many Students Are Now Eligible for New, Expanded School Choice Programs," EdChoice, August 19, 2021, <https://www.edchoice.org/engage/how-many-students-are-now-eligible-for-new-expanded-school-choice-programs/>.
2. This is not to say that parents are not the primary source of their children's education.
3. US Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in the United States, March 2021*, September 2021, <https://www.bls.gov/ncs/ebs/benefits/2021/employee-benefits-in-the-united-states-march-2021.pdf>.
4. Some states require charter schools to offer the same retirement plans that district schools offer, while other states give charter schools an option to either enroll in the state's public pension plan or provide teachers a different retirement plan.
5. Most final-salary defined benefit plans do not refund employer contributions, while defined contribution plans usually do.
6. Teachers who enter a system midway through their careers face the same disadvantages as those who leave midway through their careers do.
7. Robert M. Costrell and Michael Podgursky, "Distribution of Benefits in Teacher Retirement Systems and Their Implications for Mobility," *Education Finance and Policy* 5, no. 4 (Fall 2010): 519–57, [https://doi.org/10.1162/EDFP\\_a\\_00015](https://doi.org/10.1162/EDFP_a_00015).
8. Robert M. Costrell and Michael Podgursky, "Peaks, Cliffs, and Valleys: The Peculiar Incentives in Teacher Retirement Systems and Their Consequences for School Staffing," *Education Finance and Policy* 4, no. 2 (Spring 2009): 175–211, <https://doi.org/10.1162/edfp.2009.4.2.175>.
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10. Josh B. McGee, *Defined-Contribution Pensions Are Cost-Effective*, Manhattan Institute, August 2015, [http://www.manhattan-institute.org/pdf/cr\\_100.pdf](http://www.manhattan-institute.org/pdf/cr_100.pdf); and Chad Aldeman and Andrew J. Rotherham, *Friends Without Benefits: How States Systematically Shortchange Teachers' Retirement and Threaten Their Retirement Security*, Bellwether Education Partners, 2014, [https://www.teacherpensions.org/sites/default/files/Bellwether\\_PensionPaper\\_070814\\_Web.pdf](https://www.teacherpensions.org/sites/default/files/Bellwether_PensionPaper_070814_Web.pdf).
11. EdChoice and Morning Consult, *The Public, Parents, and K–12 Education: A National Polling Report*, August 2021, <https://edchoice.morningconsultintelligence.com/assets/137977.pdf>; and Mike McShane, "The Push and Pull of Homeschooling," *Forbes*, August 5, 2021, [www.forbes.com/sites/mikemcshane/2021/08/05/the-push-and-pull-of-homeschooling](http://www.forbes.com/sites/mikemcshane/2021/08/05/the-push-and-pull-of-homeschooling).
12. Kaitlin Mulhere, "Many Teacher Pension Plans Get Failing Grade: New Report," *Money*, August 31, 2021, <https://money.com/bellwether-teacher-retirement-plan-ranking/>.

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