How Lawmakers Can Raise Teacher Pay Without Decimating Pension Funds

Marguerite Roza

5-7 minutes

Piggy bank Drowning In Water -

Getty

When the pandemic hit, school districts across the country were in the process of giving their teachers a raise. But hiking teacher salaries now will strain state pension funds at a time when the economic fallout from the coronavirus is decimating public pension systems. In March, Moody's Investment Service said U.S. public pension funds had already suffered nearly $1 trillion in investment losses.

Lawmakers can't make lost assets reappear. But they can take a step that will reduce future losses and protect pensions: make any near-term teacher raises non-pensionable. Such a step could save governments billions. Down the road, those savings could protect K-12 teachers and students from cuts needed to service the debt.

If such a policy had been in place when the last recession began to hit budgets, the California State Teachers Retirement System (CalSTRS) would have saved 11%—$1.35 billion—on its liabilities between 2008 and 2010 alone. Illinois' Teachers Retirement System (TRS) would have saved 18%—$438 million—over two years. That savings translates to lower pension bills for districts, which would have freed up more money at a time when it was desperately needed.

Many major districts award pay raises even during a recession, in part because the raises may have been negotiated prior to financial havoc. Seattle raised teacher salaries on average by 38% between 2005 and 2010. Those raises then drove up retirement costs for teachers nearing retirement at the very moment when most private sector workers' retirement savings were shrinking. That's because, when a teacher retires, the final salary they received from the district determines their pension payout for each year thereafter. As has been well documented, teacher pensions are highly sensitive to even modest changes in final salary. My Georgetown research team's 2014 analysis found that a $3,000 raise in final salary for a single teacher triggered some $30,000 in additional pension debt in states like New Jersey, California and Illinois.

Where states have to pay outsized pension bills, they have fewer funds available for districts, which can prompt layoffs, class size hikes and program cuts. Decisions like these created the strained professional environment that led to teacher strikes in 2018 and 2019.

For those districts moving forward with raises, deeming them as non-pensionable during the recession could help. Teachers would get their raises, but not the pension impacts of those marginal dollars during recessionary months.

There are educators who will not like this proposal, particularly those nearing retirement who see their raise as a way to further boost their annual pension. A veteran Illinois teacher currently earning $110,000 will retire with $90,000 per year in pension, but a pensionable pay raise will make the pension payment even higher. For younger teachers who work beyond the recession, the issue is essentially moot, because early career salaries aren’t a factor in the pension formula. Besides, most teachers don’t stick around long enough to earn a fully vested pension and could instead save some money on employee contributions.

The problem with most other proposed pension formula changes is that they end up overturned in the courts unless they only apply to new hires. But there is precedent in place to pave the way for making raises temporarily non-pensionable. Large districts like those in New York City, Newark, Los Angeles and Chicago have over the years deemed some pay non-pensionable, sometimes by framing the compensation as a bonus, retroactive pay or one-time payment.

Even Illinois, which has seemingly attempted every possible strategy to curb its pension debt, hasn’t directly tried this one. While its pension reform was rejected in 2015, the state Supreme Court was silent on the question of whether pensionable pay could be capped. A legal analysis of the decision noted that state courts have long held that public employees’ protected rights don’t include the expectation that their salary will increase.

After a difficult decade for teachers, it might seem mean-spirited for politicians to limit pensions. But Virginia is already looking at putting off its scheduled $600 million in teacher pay increases over the next two years, and more states are likely to consider similar measures. Ignoring pension debt ultimately means there will be fewer dollars for teachers and students. For instance, the cost of fully funding California's pension commitments over ten years would equate to a 36% (or nearly $30,000) raise for all teachers.

We need to look at the long term. Much of the focus for state lawmakers right now will be on where and how much spending to cut to balance the current budget and for the upcoming fiscal year. It’s possible we’ll see skipped or reduced pension payments, as we did during the last recession. This only worsens the funding problem and creates larger bills down the road.

We’ve seen this story before. In every recession over the last 20 years, pension systems never recovered their fiscal health. The result: states and districts had less money to invest in teachers and students. This time, lawmakers could change that ending, by harnessing the moment to make decisions now that reduce the financial pain later.