Subject: Response to Andrew Biggs Editorial

I hope you will consider publishing this response to the November 27 editorial by Andrew Biggs regarding placing teachers in a 401(k)-style pension plan.

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JCTA President

A host of inaccurate and misleading arguments were used in a recent editorial by Andrew Biggs to advocate for the Governor's plan to close the existing Defined Benefit (DB) teacher pension system and place future teachers in a 401(k)-style Defined Contribution (DC) retirement plan.

The editorial incorrectly asserts that DC retirement plans are less expensive than DB pensions. Evidence demonstrates, however, that DB pensions are far more efficient at delivering better retirement benefits at much lower cost to taxpayers than DC plans. There are several reasons for this.

A number of studies have found that, on average, the professional money managers that run DB plans significantly outperform novice individual investors making investment decisions with their DC accounts. And, because DB pensions include funds from thousands of plan members in one large pool, participating in a DB pension is like the investing equivalent of joining a wholesale club. The large volume of funds DB plans invest allows them to negotiate lower commissions and fees than individuals in DC plans, who have to pay full retail price. These two factors combine to generate about a 27% cost savings for DB pensions over individual DC plans.

Including thousands of plan participants in DB pensions also allows benefits to be paid out based on the average life expectancy of the entire group. If one person lives longer, another does not. Even if a DC plan holder was able to match the investment return of a professionally managed DB plan, the DC retiree would have to trickle out his or her retirement savings based on a life expectancy of 95 or 100, so as not to run out of money. This makes DB plans an additional 10% less expensive than DC plans, for the same retirement benefit.

And, because DB plans constantly have new members entering them, they are ageless and can keep most of their funds in high-yield investments. When a DC plan holder retires, he or she has to shift to more conservative, low-yield investments. This causes DB plans to be yet another 11% less expensive than DC plans.

So if DC plans are much more expensive for the same benefits, why have private sector companies shifted to them? There are a number of reasons, none of which apply to public sector employers likes states and school districts.

First, and most importantly, 1990's Financial Accounting Standards tied corporate earnings to short term pension swings, so a profitable business could look like it was losing money because a down market had reduced its pension assets. This, in turn, could interfere with raising investment capital for future corporate growth. There is no equivalent to this in public education. Second, rigid ERISA funding requirements make cash flow volatility more significant for corporations with DB plans than DC plans. And, third, the sort of long-term employee retention that we value in school teachers and which is promoted by DB pensions, has come to be valued far less in the private sector. DC plans can be seen as a better fit for corporations with periodic employee layoffs. Finally, many mid to small sized companies simply do not have enough employees for DB plans to make sense. So the private sector shift to DC plans is all about Wall Street, not because DC plans are less expensive.

So those who believe in efficient government should reject more expensive DC teacher retirement plans that waste taxpayer dollars costing far more for far lower benefits. This is illustrated by the objective financial analysis of the Governor's proposed DC plan by Cavanaugh-McDonald which found, not surprisingly, that switching teachers from a DB pension to a DC plan would cost taxpayers $4.4 Billion more in the first twenty years of the new plan, as compared to simply making the full payments for the more efficient DB pension currently in place.

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