



The State Teachers Retirement System (STRS) Misleads Taxpayers and Teachers

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In response to the Buckeye Institute's report, *Taxpayers on the Hook: Taxpayer Contribution Rates for Ohio Government Pensions Outpace National Averages*,¹ STRS conveniently leaves some undeniable facts at the door. By using their own data, reading their own admissions, and even following their own assertions, it is evident that Ohio taxpayers are far from off of the hook.

First, STRS is plum broke. It possesses only 59 cents for every dollar in liabilities, leaving a **\$38.7 billion** hole. On its current trajectory and without significant reforms, it will certainly require a bailout by Ohio taxpayers to close the difference between what it possesses and what it owes. According to STRS' latest Comprehensive Annual Financial Report, "*the amortization period for the unfunded accrued liability remained at infinity for the prior year.*" Clearly, "infinity," as in forever, exceeds the required 30-year window for paying off all of STRS' unfunded liabilities. No matter how one parses that finding, STRS has promised lavish benefits it cannot pay.

Second, in its own statements, STRS has pursued an even higher taxpayer contribution rate than the current 14 percent. As reported by the Columbus Dispatch,² STRS had asked for taxpayer contributions to increase from 14 to 16.5 percent. STRS Executive Director Michael Nehf added, "*If no changes are made we will eventually be unable to pay benefits.*" Contrary to what the pensions would have many believe, even if the taxpayer contribution rate had been increased to 16.5 percent, STRS would still fall outside of its 30-year funding window and remain well short of a 100 percent funding ratio.

Third, we took STRS' advice and ran a calculation comparing STRS' contribution rate to those of the other states and incorporated the Social Security contribution to the applicable states. While Ohio's ranking drops to 20th out of 34, this comparison is based on a 14 percent contribution rate that, according to Mr. Nehf, is **completely unsustainable**. There is little point in bragging about a "low" contribution rate when the system is drowning in red ink. A

¹ See <http://www.buckeyeinstitute.org/uploads/files/Taxpayers%20on%20the%20Hook.pdf>

² Steve Wartenberg, "Pension Plans Outline Reforms," Columbus Dispatch at <http://bit.ly/nHblVB>

better comparison is to use STRS' own recommendation of a 16.5 percent taxpayer contribution rate. Using the 16.5 percent rate, (a rate that still does not come close to delivering a 100 percent funded ratio) Ohio jumps to 10th highest out of 34.

Fourth, for current public or private sector workers, Social Security payments are a payroll tax. That payroll tax will result in a rate of return, if one can call it that, of near zero or negative for many "contributors." Unlike the pension contribution that has an enormous and unsustainable rate of return given the current payout formula, what many workers pay in to Social Security is a bad deal. That is why we did not include those percentages in our report.

The Heritage Foundation has created an interactive Social Security Rate of Return Calculator that shows how bad a deal Social Security is for many workers (<http://site.heritage.org/research/features/socialsecurity/>). The average teacher beginning her career today will see a minimal return, or even more likely, a negative return, on her Social Security "investment." A system that produces negative returns is not an investment, it is a raw deal. Therefore, it makes little sense to consider Social Security contributions, which produce a known poor or negative return, as valid retirement investments.

As Andrew Biggs and Jason Richwine concluded in their report, "Public v. Private Sector Compensation in Ohio: Public workers make 43 percent more in total compensation than their private-sector colleagues,":

In sum, Ohio public employees receive a significant implicit subsidy toward their pensions, while private-sector employees participating in Social Security receive a penalty. Ohio public employees receive a guaranteed rate of return of eight percent on their and their employers' contributions toward DB pensions, far above what they could earn while investing in low risk assets, while private-sector workers participating in Social Security receive a return below the government bond interest rate. While some believe that public-sector employees are disadvantaged by not taking part in Social Security, they actually receive a significant subsidy by not doing so.

As liberal writer Michael Kinsley observed in a 1996 article, "Social Security: From Ponzi Scheme to Shell Game,":

[I]f today's benefit promises can somehow be kept, Social Security represents a much worse return on "investment" (taxes paid in) for future retirees than past and present retirees have enjoyed. This is partly because some minor benefit reductions are scheduled already (raising the retirement age slightly and gradually). It is mainly because younger people will have paid much higher Social Security taxes throughout their working lives. The average return on Gen-Xers' Social Security investments will almost certainly be worse than they could have done by investing in the stock market.

In fact, including Social Security contributions into any comparison of state retirement plans does not address the fiscal realities of the times and leads to distorted, unrealistic results by

making it seem as if Ohio public employees are losing out by not getting Social Security. The reality is that state employees in Ohio are actually making out by not paying into Social Security. After all, when an employer does not have to pay a payroll tax, employees tend to see higher wages. Moreover, those workers not paying into Social Security get to keep their 6.2 percent portion in their pocket where they can invest them in vehicles that will produce a reasonable rate of return.

Finally, STRS has created a retirement system that is dramatically out of step with what average Ohioans currently possess. Most private sector Ohioans can expect a 6.2 percent employer contribution to Social Security and a 4.0 percent 401(k) employer contribution, totaling 10.2 percent. This level is considerably lower than both STRS' current 14 percent and its desired 16.5 percent contribution rate. By bringing STRS' rate in line with that of the average private sector Ohioan, hundreds of millions of taxpayer dollars could be saved annually.

The bottom line is that neither teachers nor taxpayers are well served by STRS' current retirement system. This reality was vividly illustrated by an email we received from a recently retired teacher who bought into STRS' claims. As the teacher complained about our work, the teacher appeared oblivious to the fact that the retirement he now securely has will change dramatically for all of those teachers who haven't reached the magic retirement number yet—meaning, active teachers will get a smaller retirement than he is getting despite making the same payments as the complaining teacher made. Where is the “fairness” in that outcome?

By ignoring its dire fiscal situation, STRS cannot guarantee teachers the type of retirement they are being promised. While the pensions can attempt to change the topic of conversation from their inability to meet their commitments despite a high taxpayer contribution rate to our efforts to actually solve a fiscal crisis, they simply cannot promise taxpayers that they will not have to bailout the pensions via higher contribution rates down the road. But for the November 2010 election, STRS likely would have gotten its way on the 16.5 percent taxpayer contribution bailout hike.

Instead of digging the fiscal hole even deeper by supporting the status quo or nibbling on the margins of reform, STRS and Ohio's other government pensions should take the responsible step of embracing significant pension reforms that would leave both Ohio and its teachers on a stronger and more realistic fiscal footing. The bottom line is that Ohio's pensions are writing checks that they won't be able to cash and, despite their protestations to the contrary, will result in a massive taxpayer bailout unless significant reforms are implemented soon.