"STRS Ohio Responds to Fordham Institute Report": A Reply from the Authors

Robert M. Costrell (University of Arkansas)
Michael J. Podgursky (University of Missouri)

On June 7, the Fordham Institute released our report "Golden Peaks and Perilous Cliffs," a study of the incentives embedded in the Ohio teacher pension system. On the same day, the State Teachers Retirement System (STRS) of Ohio issued a response to our report, alleging that it contained "glaring mistakes and misstatements." Although such an allegation is typically considered serious enough to require a reply, we concluded at the time that STRS' press release did not require a reply, since:

(1) STRS did not address the central analysis of our report, and

(2) STRS' allegation of "mistakes and misstatements" was not supported by any specifics.

Since June 7, however, we have been asked by press and others for a reply to STRS' release, as it continues to be prominently featured on the STRS homepage (http://www.strsoh.org/pdfs/fordham.pdf), and a shorter version of it was the lead article in the STRS July newsletter, distributed widely in the state. Consequently, we provide this elaboration of our two general points above, as well as an ancillary issue raised by STRS regarding our consultation with STRS.

STRS did not address the central analysis of our report

The core analysis of our report is the idiosyncratic pattern of annual pension wealth accrual in Ohio's defined benefit system – the "Golden Peaks and Perilous Cliffs" referred to in the title of the report. The centerpiece is Figures 5 and 6 (p. 21), which show the peaks and cliffs in annual wealth accrual – a form of deferred income – from the pension formula.

The STRS release never refers to this analysis or any of the report's related analyses.

We think it is significant that a Columbus teacher entering the Ohio system at age 25, would, at age 50, suddenly earn $123,000 in pension wealth accrual, after much smaller annual accruals for the previous 24 years.[1] That is, at age 50, it is as if her 401(k) retirement account contributions totaled $123,000 in that one year. If she stays another 5 years, she accrues the equivalent of another $448,000 in contributions to her retirement account. Then, over the last half of her 50s, she gets very little increase in her pension wealth. If she sticks it out to age 60 (35 years), she gets one more year with a large accrual ($113,000). But if she stays any longer, the pension system punishes her, reducing her pension wealth each and every year.

The thrust of our report is that this is an irrational and arbitrary pension wealth accrual pattern, which generates perverse incentives, and that it would be preferable to have a more uniform pattern, so as not to distort teacher decisions to stay or leave.

We think this issue is of considerable importance to the citizens of Ohio. But STRS does not mention it at all in their reply.

[1] Annual accrual figures, here and below, are all inflation-adjusted, net of interest.

STRS' allegation of "mistakes and misstatements" is not supported by any specifics.
With regard to STRS' allegation of "glaring mistakes and misstatements," we found no specifics in their release to support this. STRS does provide a series of bullets with implied criticisms, to which we reply as follows:

(i) STRS' first bullet states their opinion that Ohio's system is "far from obsolete." STRS is certainly entitled to their opinion, but that does not constitute a finding of "glaring mistakes and misstatements." Nor does STRS' opinion address the irrationalities of the defined benefit (DB) program discussed above.

Instead, STRS points to Ohio's Defined Contribution (DC) option as a noteworthy innovation. We agree – and stated so in the report, referring to the legislature's "foresight" in creating this option, as well as a few other innovative options. However, we also point out the ways in which the Ohio pension system is still tilted toward the traditional DB plan, and why this might be expected to keep enrollments in the alternative plans lower than they would otherwise be.

(ii) STRS' second bullet provides some interesting data on how some teachers are working longer, due to the addition of the 3rd spike a few years ago. However, these data refer to years of service, not age, and also do not provide the baseline figures from which the percentage increases are calculated. The figure we cite in our report, of 58-year-old average retirement, is from STRS. STRS reiterated this figure in their comment on our report, for Ohio Public Radio, aired upon the report's release.

Once again, there is no "glaring mistake" or "misstatement" identified here.

(iii-v) Bullets 3-5 claim that STRS is not seeking contribution increases for the pension fund, but rather for their retiree health plan. This would seem to be intended to refute our report's discussion on p. 10, which states that it is the combination of pension and retiree health funding concerns that led to the proposal for an increase in contributions.

We stand by our report. STRS here seems to suggest that retiree health care and pension funding are separate entities. But Ohio is one of the few states where retiree health care is quite intertwined with pension funding: retiree health care is funded from a carve-out of the employer's 14% contribution, and this has varied widely over the years, depending on how flush the pension fund is, as our report explains.

Indeed, the only misstatement here seems to be that of STRS. STRS' rather emphatic June 7 statement that **"STRS Ohio is NOT seeking any contribution increase for the funding of its pension plan"** is explicitly contradicted by two features of the proposal. First, 0.6 percentage points of the proposed 5 point increase in contributions is designated for pensions (http://www.orsc.org/uploadpdf/2006_ORSC_Annual%20Report_126th%20GA.pdf p. 12). Moreover, as STRS states in its March 2007 report to the Ohio Retirement Study Council (ORSC), once the contribution hike is in place, "the current 1% of employer contributions going toward health care can start flowing back into the pension fund" (http://www.strsoh.org/pdfs/ORSC_03_07.pdf , p. 5).

Taken together, the proposed 5-point contribution increase will result in a 1.6 point increase for pension funding – about one-third of the total hike. **Clearly the hike is designed to shore up both pension and retiree health care funding (as our report states), contrary to STRS' claim that it "is not seeking any contribution increase for the funding of its pension plan."**.

(vi) STRS' bullet 6 states in bold-face that Ohio teachers are not part of Social Security. We're not sure what the "glaring mistake" or "misstatement" is here, since we state that fact clearly on p. 13 of our report.

(vii) STRS' bullet 7 states their opinion that the DB plan is transparent. Once again, STRS is of course entitled to their opinion, and we have no reason to doubt that STRS has educated its members well about the benefits offered by the system. But that misses the point.

A publicly funded pension system should be transparent to the public, to journalists, and to legislators (beyond those few involved in crafting pension legislation). As we stated in our report, "This formula is little understood by the general public…" (p. 15). That is why we devoted pp. 15-17 to explaining the formula's salient features, and the rest of the report to drawing out its implications for incentives. Readers are free to conclude from this material – or from reading the legislation itself – that the formula is transparent, but we doubt that will be the general reaction. The purpose of our report was to draw out the implications of the DB formula, precisely because they were not widely understood.

(viii) The last bullet is puzzling. It seems intended to rebut a figure of 19% of retirees returning to work. But that figure is found nowhere in our report, or, indeed any percent of retirees returning to work. What we did report, on p. 24, is the actual number of reemployed retirees, which is 19,749, a figure drawn from STRS' annual financial report (http://www.strsoh.org/pdfs/CAFR2006/2006_CAFR.pdf , p. 20).

As in every other instance, there is no "mistake" or "misstatement" identified here.

STRS Was Consulted, But Failed to Provide Requested Information

We would also like to address STRS' statement in their July newsletter that "STRS Ohio was not consulted during the study by the two individuals hired to write the report." This is simply false. Here is the history of our contacts with STRS:

After a series of e-mails last fall, a conference call was set up with an STRS board member and an ODE official to discuss the research we were undertaking, and to arrange for answers to our questions. That conversation took place on November 21. The outcome of that call was that STRS would provide some preliminary materials and we would write up technical questions for the STRS board member to pass on to staff and actuary. On December 4, we received from STRS a few public documents of the type that we had already been examining. On December 5, we submitted our list of six technical questions for STRS (plus one for ODE), as well as our request to follow up with STRS actuary. On December 6, the STRS board member e-mailed us his intent that "STRS draft a written response" to the STRS questions we had submitted to him, after which we would be provided access to the STRS actuary for further questions.

That was the last we heard from STRS on this matter: we never received any answers to our questions.

As it turned out, our report focused on the incentives embedded in the DB benefit formula, and this analysis could be conducted with publicly available information. That analysis stands – as does the rest of the report – despite STRS' failure to provide us with answers to our questions.

That said, it would still be useful for STRS to make the information requested available, especially our request for STRS estimates of "the unfunded liabilities associated with the retiree health insurance program." We submitted this question because the actuary report on retiree health care for STRS that we reviewed does not contain this figure (http://www.orsc.org/uploadpdf/ActuariallyFundHealthCare.pdf). [2]

This issue arose again during our briefings for public officials and STRS staff upon the release of our report on June 7. STRS staff stated the public availability of this information, but could not provide the figure when asked by us on that occasion. We have since followed up with another written request for these figures, on July 30, this time directly to Mr. Asbury, rather than through an STRS board member. As of 08-13-07, we have still received no response.

This is the third time we have requested this information from STRS: first in writing on December 5, then orally on June 7, and now in writing again on July 30. To reiterate, this information on retiree health funding was not central to our report, but we do believe that this is important information about the fiscal status of the pension and retiree benefit system that ought to be in the public domain. STRS' unfunded pension liability ($19.4 billion in 2006, with a funding period that exceeds the statutory 30 year requirement) is only part of the picture: a more complete fiscal picture would include the unfunded retiree health liability figure as well.

Conclusion

To conclude, we did not find anything in STRS' response to our report to back up their allegations of "glaring mistakes and misstatements." Indeed, **the only misstatements we have been able to identify are in STRS' response itself, both with regard to the nature of STRS' proposed contribution increase, and also with regard to our consultation with STRS.**

More importantly, STRS' response does not address the fundamental issues that we raised about the benefit structure of Ohio's teacher pension system, a subject that we believe Ohio citizens will want to understand and debate. We are confident that our report makes a significant contribution to that debate.

[2] It contains the liability for mandated Medicare Part B reimbursements, but not for the discretionary health care benefits that are the subject of the proposed contribution increase.