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Expensive, Inequitable, and Out of Reach: The Problems With California's Teacher Pension System— and What Can Be Done

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by Max Marchitello

Executive Summary

State public education funding is at an all-time high in California. And yet, this moment of economic prosperity hides critical flaws in the state's underlying K-12 funding structures. Notably, California carries approximately $106 billion in unfunded teacher pension liabilities.[1] Because of these considerable debts, an ever-increasing share of education funding is diverted from classrooms to CalSTRS, the state teacher pension fund. This redistribution of resources threatens the quality of education California provides to students.

The high cost of the pension system is due to chronic underfunding, not lavish benefits for teachers. In fact, CalSTRS provides most of California's teachers with a low-quality benefit. Only 72 percent will vest and qualify for a pension at all. In the end, only 33 percent of teachers serve in California's schools until they reach normal retirement age. And since the state does not participate in Social Security for educators, those teachers who leave the profession or move to a new state are in worse shape financially than they would otherwise be.

Skyrocketing pension costs have led to markedly higher annual contribution rates to the fund. Teachers now pay more than 10 percent of their salary each year to a pension fund that is unlikely to benefit them in the long run. Indeed, had the contribution rate remained at 6 percent since 2013, the average teacher would have retained an additional $19,588 in salary.

Beyond siphoning away teachers' salaries, the high cost of the pension system drains K-12 education resources and crowds out other important spending. In 2020, without accounting for teachers' own spending, California spent approximately $10.5 billion, or 13 percent of its total K-12 budget, on teacher pensions.[2] At the local level, as of 2020, total benefit spending (inclusive of spending on CalSTRS, pensions for nonteaching staff, and other benefits, such as health care) accounted for 26 percent of district budgets, up from 21 percent a decade earlier.[3] As a result, districts are forced to make cuts elsewhere, such as deferring needed maintenance, increasing class size, or reducing enrichment opportunities.[4]

Making matters worse, state pension spending is regressive, sending greater amounts of state aid to higher wealth school districts that are able to pay higher teacher salaries. In this regard, the California teacher pension system is structured as a subsidy to wealthy communities.[5]

In short, CalSTRS is expensive, it is largely ineffective, and it compounds inequities in school funding. Yet there are steps California can take to address these issues. For instance, the state could adopt and implement a formal policy to ensure CalSTRS receives the full actuarially required contribution annually. The state could make supplemental payments to pay down some of the debt. To provide a better benefit to teachers, California could develop alternative retirement options for those educators who do not plan to spend 30 or more years in the classroom. The state could join Social Security. And finally, to address the inequities in state pension aid, California could increase the state

share of the employer contribution for high-poverty districts to ensure greater state funding goes to communities with greater need.

The state teacher pension system poses considerable challenges for California that both threaten the state's long-term financial sustainability and undermine its efforts to increase equity and provide a high-quality education. But with thoughtful reforms, California can regain control over the runaway unfunded liability, provide a benefit that more closely aligns with the needs of California's teachers of today, and ensure the system does not compound disparities between low- and high-wealth communities. Although it will be difficult, meaningful reform is possible and necessary to secure California's future.

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About the Author

Max Marchitello is an independent consultant who focuses on education equity. He specializes in school finance, teacher pensions, and accountability. His work has been featured in the *New York Times*, the *Atlantic*, the *Washington Post*, *USA Today*, and *Education Week*. He previously worked for Bellwether Education Partners, the Center for American Progress, and the Leadership Conference on Civil and Human Rights.

Cover photo by Allison Shelley for EDUimages

Introduction

State funding for education has reached an all-time high in California, even before accounting for federal coronavirus relief funds.[6] California's strong economic growth, which has quickly rebounded from a brief pandemic-induced recession, is fueling the surge in funding. These new and ongoing education resources are critical to addressing students' academic, social, and emotional needs as well as to removing the long-standing barriers that prevent students of color, low-income students, English learners, students with disabilities, and other marginalized young people from achieving a high-quality and equitable education.

Today's rosy fiscal situation, however, can easily obscure fundamental flaws in the state's underlying financial structures. Among these is the fact that California has a yawning unfunded teacher pension liability. Paying down this debt while continuing to fund the normal cost of benefits is expensive: In 2020, California spent about $10.5 billion, or 13 percent,[7] of its education budget on teacher pensions, and that's not counting the pension contributions that come out of teachers' paychecks.[8] Ten years before, California was spending just $3.5 billion on teacher pensions.[9]

In 2020, California spent about $10.5 billion, or 13 percent, of its education budget on teacher pensions.

These rising teacher benefit costs present a critical and often overlooked challenge to K-12 education funding in the Golden State. Unless California acts to fix structural issues like its unfunded pension liabilities, new revenues will not go as far as policymakers, families, and educators may expect. This poses a real threat to the quality of education California provides to its students and further threatens public confidence in the school system overall.

Larger required contributions to the state defined-benefit pension plan—the California State Teachers' Retirement System, or CalSTRS[10]—are driving the dramatic growth in pension expenditures. The higher expenditures, however, are not because the state provides more generous benefits to teachers. On the contrary, the value of the benefits has actually decreased. Expenditures are rising because of costs associated with CalSTRS's outsized unfunded liabilities, which stand at approximately $106 billion.[11] Indeed, in 2020 CalSTRS accounted for about 7.11 percent of the nation's public pension debt.[12]

To be clear, the high cost of teacher pensions is not the result of lavish benefits paid to teachers in retirement. Rather, CalSTRS is costly primarily because state policymakers have underfunded the system. In a state that spends relatively little on education per pupil as compared with national averages, the increase in pension spending pushes out other education spending, leaving fewer dollars for today's students and teachers.

Considering its impact on state school finance, reforming teacher pensions should be part of a broad effort to increase school finance equity and ensure that a greater share of K-12 funding reaches classrooms. California's teacher pension system can be restructured to draw a lesser share of K-12 funding, administer public finances more effectively, and meet teachers' needs better.

The goal of this paper is to help educators, policymakers, and stakeholders understand how teacher pensions work in California, provide critical history and context on the pension system, and describe the impact benefit spending has on K-12 funding in the state.

Teacher Pensions in California

Since 1913 California teachers have been enrolled in CalSTRS, a defined-benefit pension plan. Pensions are different from other retirement plans, such as a 401(k) or a 403(b). The value of those plans is based on how much the employee and the employer contribute to them and how much those investments return.

Pension value is instead derived from a formula based on years of service, a legislatively set multiplier, and a teacher's final salary, which is typically averaged across several years. Although employer and employee contributions to the pension fund are invested in the market, how well those investments perform does not determine—for better or for worse—the retirement benefit a teacher earns.

As illustrated in Figure 1, for teachers hired on or after January 1, 2013,[13] California determines their pension value using a 2 percent multiplier and their salary from their highest earning 36 consecutive months of work.[14] Consider a teacher who retires at the state's normal retirement age of 62 after 37 years of service with a final average salary of $80,000: Their annual pension benefit would be $59,200, or 74 percent of their salary. Although views differ on how much money constitutes a sufficient retirement benefit, a replacement rate greater than 70 percent is generally considered a quality benefit by financial experts.[15]

Figure 1: Calculating a Teacher's Pension Value in California at Normal Retirement

The Role of Social Security

In California, unlike the majority of states, teachers do not participate in Social Security.[16] As a result, teachers in California cannot count on collecting Social Security to supplement their employer-provided retirement benefit. Returning to the hypothetical teacher described previously, if they did participate in Social Security, they could expect around another 40 percent of their salary in retirement. That amounts to an additional $32,000 per year. In other words, if California enrolled teachers in Social Security without modifying CalSTRS benefits, a 37-year veteran teacher could expect to more than replace their salary once they reached age 62. Participating in Social Security does come with increased costs since employees and employers both contribute to the system annually. That said, it is reasonable to expect CalSTRS would change its benefit structure if the state joined Social Security, offsetting some of its cost.

In California, unlike the majority of states, teachers do not participate in Social Security.[16]

What about those teachers who divide their working years between the classroom and another profession? Or those educators who spend their careers teaching in different states? For them, the pension system and exclusion from Social Security are particularly damaging in two ways:

1. The pension benefit teachers earn after 10 or 15 years of service is modest: 20 percent and 30 percent of their salary, respectively.[17]

2. Teachers who leave the state or the profession also have to start from scratch in Social Security since they did not participate in the fund during their years teaching in California. They must work for at least 10 years to accrue the 40 credits necessary to qualify for Social Security. Moreover, since Social Security benefits are calculated based on the average indexed monthly earnings during their highest earning 35 years, California educators who leave the profession or state are likely to earn a less valuable benefit than if they spend their entire careers in a profession that participates in Social Security.

Which Teachers Receive a Pension Benefit in California?

Every teacher in California participates in the CalSTRS pension plan, but not every teacher receives a pension. Teachers must serve five years before they qualify for a pension benefit in California. A "vesting period" is a typical feature of public pension plans, and among plans across the country, California's five-year vesting period is fairly common. A few states have shorter periods, while several have longer.

But given that teacher turnover is highest early in a new educator's career, like in other professions, what percentage of teachers actually quality for a pension?

As a part of its actuarial valuation and planning to ensure that it has sufficient funding to meet its obligations, CalSTRS assumes annual educator turnover rates. The turnover rates differ by gender. This is important considering that most teachers in California and across the country are women. According to Table 1, the state assumes that 11.25 percent of female teachers will leave the system before beginning their second year. Another 7 percent from that cohort are expected to leave before starting their third year. CalSTRS assumes slightly higher turnover rates for men.

Table 1: CalSTRS-Assumed Annual Turnover Rates

Years of Service	Male	Female
0	12.25%	11.25%
1	8.50%	7.00%
2	6.75%	5.50%
3	5.40%	4.25%
4	3.75%	3.25%
5	3.10%	2.70%
10	1.65%	1.50%
15	1.05%	1.05%
20	0.75%	0.75%
25	0.50%	0.50%
30	0.45%	0.45%

Source: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677.

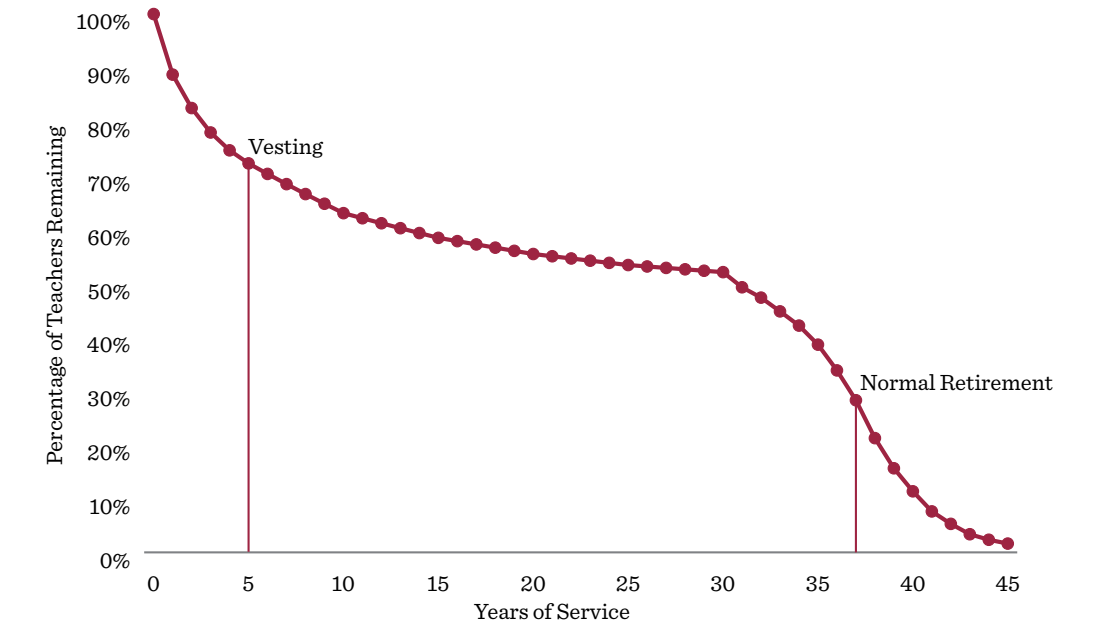
Note: The years used in actuarial assumptions are delayed by a year. In other words, year 0 refers to the period from a teacher's first day of service to the day before the beginning of their second year. For vesting purposes, teachers need to complete five full years to quality for a benefit. When a teacher begins their second year of teaching, they have one year of service. As such, completing year 5 in the table is when a teacher vests.

Considering that around three-quarters of all educators are women, it is common practice to analyze teacher retention based on female turnover rates. **These data reveal that among new female teachers, 28 percent are expected to leave the state or the profession before completing their fifth year and vesting in CalSTRS.**[18] In other words, CalSTRS anticipates only 72 percent of a cohort of new female teachers to vest in the pension system. That is a lot of teachers who will leave the profession without any retirement benefit. Yet despite more than 1 in 4 new female teachers failing to vest, California's system has one of the highest vesting rates among teacher pension systems across the country.[19] By contrast, the median retention rate for all public employees through five years is only 58.61 percent.[20]

Fewer than 1 in 3 teachers will retire with full benefits in California.

Teachers who do not vest in the pension system are only eligible to receive back their own contributions (excluding contributions on their behalf from their districts and the state) plus 2 percent interest. The 2 percent return on investment, while better than nothing, is far less than one would expect to earn in the market. Also, it is lower than the CalSTRS-assumed rate of inflation. In other words, if the rate of inflation rises only as much as CALSTRS expects, then a teacher who leaves the system before vesting will see the real value of their contributions actually decrease, even taking into account the 2 percent interest credit. This issue is particularly salient now for California's educators as the country faces fears of rising inflation.[21]

Figure 2: CalSTRS-Assumed Percentage of Female Teachers Remaining at End of the Year



Source: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677.

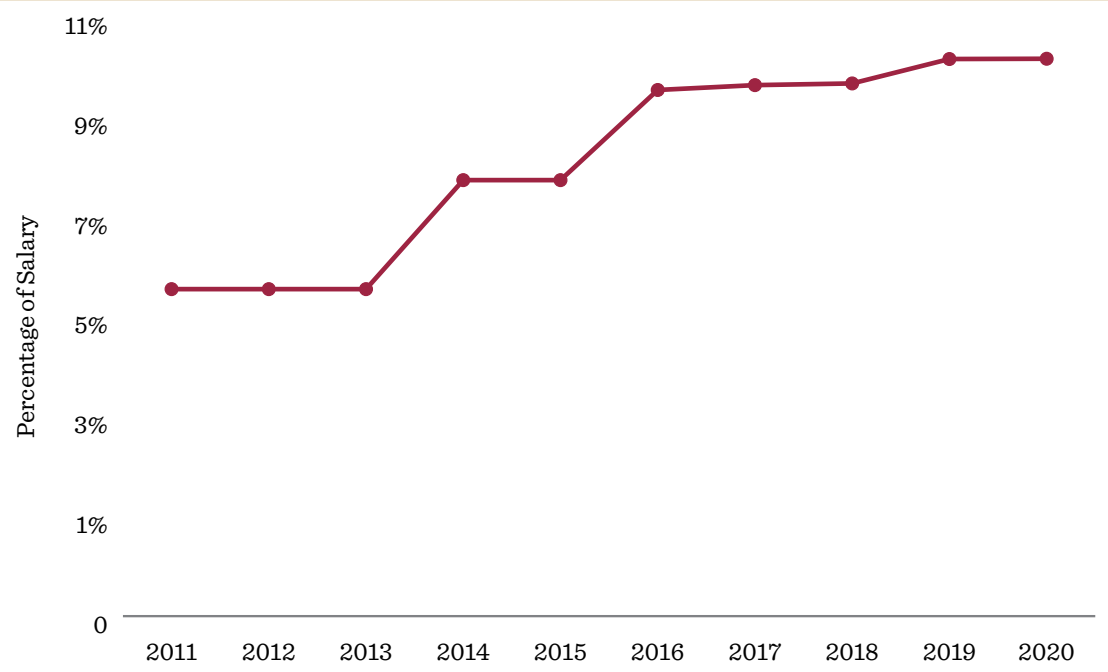
Note: This figure's data are based on those of a 25-year-old first-time female entrant into CalSTRS.

For a teacher who began their career at age 25, it will take 37 years of service to reach California's normal retirement age of 62. This is when a teacher may retire with full benefits. According to CalSTRS's expectations, 28 percent of new female teachers reach this point. Again, that is a fairly high ratio compared with other state teacher pension systems. That said, more than 70 percent of teachers do not reach the normal retirement age in California.

The Cost of California's Teacher Pension

As participants in the CalSTRS pension system, California teachers contribute a percentage of their salary each year to the fund. Over the past decade, the contribution rate has steadily increased. As shown in Figure 3, California's teachers spent 6 percent of their salary on their pension from 2011 to 2013. In 2014, teacher contribution rates began to increase rapidly due to the passage of Assembly Bill 1469, which raised contribution rates for districts and teachers.[22] By 2020, teachers contributed more than 10 percent of their salaries to CalSTRS.

Figure 3: Teacher Contribution Rates to California's Pension Fund



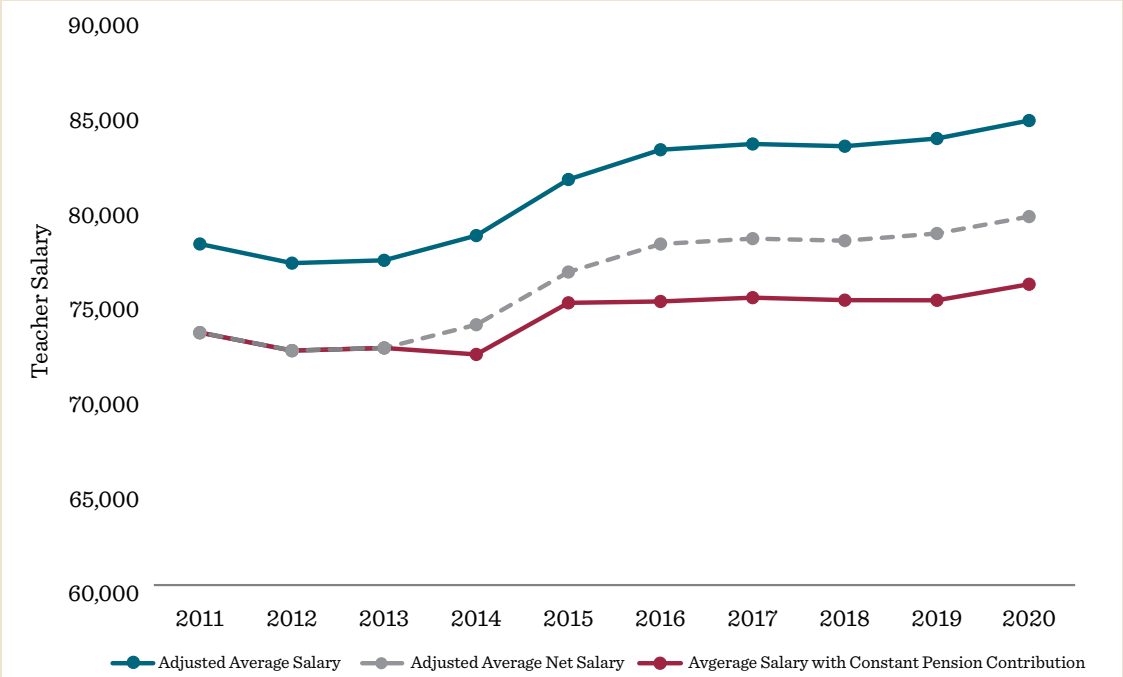
Source: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677.

Increasing teacher contribution rates are not, on their own, necessarily bad. For example, if teachers are paying more for higher quality benefits, then it might be worth it—to some of California's educators—to do so. Or if the higher contribution rates are offset by higher salaries so that total take-home pay is unaffected, the increased pension payment could be more palatable and manageable for teachers. Unfortunately, the value of the retirement benefit provided by CalSTRS has remained largely the same over this period, and the growth in teacher contribution rates has far outpaced the increase in average teacher salary.

Indeed, teachers' spending on their pensions has increased at nearly three times the rate of their salary increases. That disparity significantly affects a teacher's take-home pay. The average teacher in California, after adjusting for inflation (indicated by the blue line in Figure 4), saw their salary increase by 8.4 percent between 2011 and 2020. At the same time, the pension contribution rate increased by 70 percent, growing from 6 percent to 10.23 percent of salary. The greater pension contributions take an increasingly large bite out of teachers' salaries and cut into their take-home pay.

As illustrated by the red line in Figure 4, after removing the pension contributions taken out of their paychecks, teacher salaries have increased only $2,554 over the past decade: from $73,332 in 2011 to $75,886 in 2020 (all dollar figures are in real 2020 dollars). If the teacher contribution rate had remained a constant 6 percent over these 10 years, as shown by the gray line, net teacher salary would be $6,127 higher in 2020 than it was in 2011. This is a raise 2.4 times larger than teachers actually received. Over the entire 10 years, the average teacher would have earned an additional $19,588 in salary.

Figure 4: Pension Costs Eat Into Teacher Salaries, 2011 to 2020



Sources: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677; Education Data Partnership, Ed-Data, CDE, EdSource, FCMAT, Teacher Salaries, average all districts, available at: ed-data.org/state/CA.
Note: Inflation adjustments were made using CPI Inflation Calculator, U.S. Bureau of Labor Statistics, available at: bls.gov/data/inflation_calculator.htm. Annual adjustments are based on September in each given year, 2011 through 2020. Figures are presented in 2020 dollar amounts.

All of this does not even account for the higher pension costs facing districts, which may have reduced their ability to give teachers raises. That is, in the absence of districts' rising required pension contributions, the blue line in Figure 4 may have seen more pronounced growth.

Altogether, higher pension contribution rates have eaten away at wage growth for teachers—and that's before considering the effects of other rising costs, like health care and special education.[23] The erosion of teacher salaries by rising pension spending is likely felt unevenly across the state. For instance, lower wealth districts may not have been able to raise teacher salaries as much as the average district in California. Yet teachers in those districts still must pay the higher teacher pension contribution rates.

Assuming that teacher pension contributions could have remained constant over this period is not an unreal or

unachievable hypothetical. As is discussed in the next section, had California done a better job funding the system, it would not be necessary to raise contributions to CalSTRS to pay down the system's debts. Moreover, since state-level policy and funding decisions have led to ballooning unfunded liabilities, the state could have shouldered that burden without forcing teachers to pay a greater share of the cost of their own retirement benefits. Indeed, as shown later in the paper, teachers now pay more for their actual retirement benefits than their districts do. While teachers' employers pay a larger total sum, most of what districts are paying is debt—not the actual cost of the benefit teachers receive.

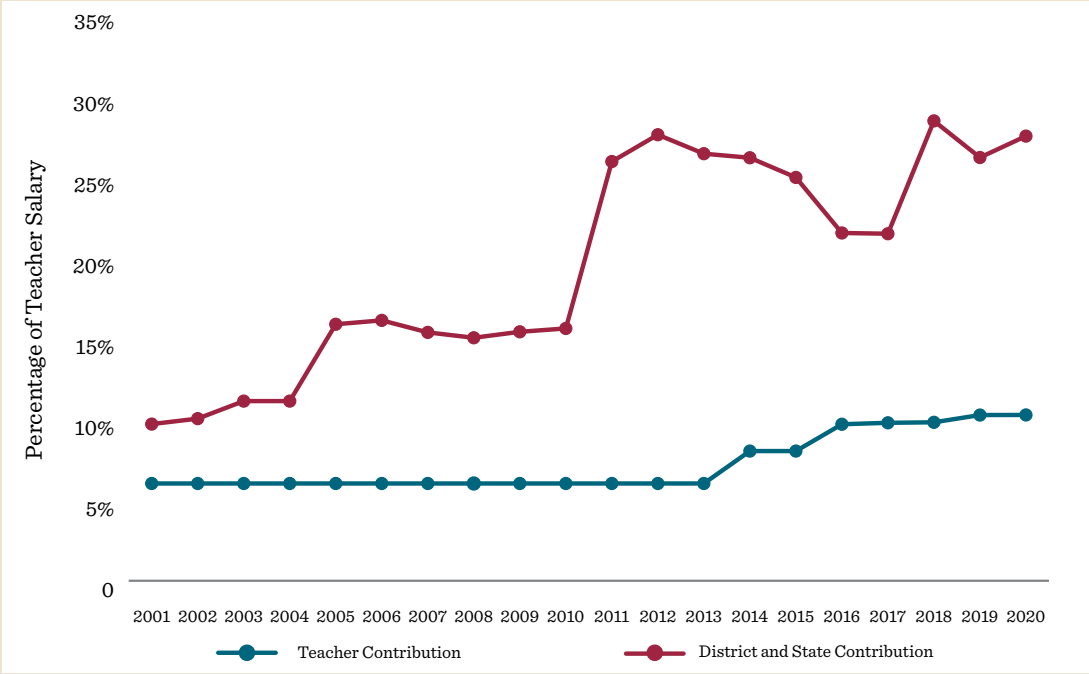
Unfunded Liabilities

Since teacher pension benefits aren't increasing in value, why are teachers paying so much more for them?

Debt.

Debt is the primary driver behind California's rising pension costs and increased teacher, district, and state contributions to the pension fund. In 2001, CalSTRS was 98 percent funded, which means it had most of the funding it needed to make promised pension payments.[24] But by 2019, the system was only 66 percent funded and the unfunded liability—the projected shortfall between the amount owed to retirees and expected capital—had skyrocketed from $2.2 billion to $106 billion.[25] In response, teacher and employer contribution rates to the pension fund increased significantly. As shown in Figure 5, the combined contribution to CalSTRS for the normal and debt costs from teachers, districts, and the state was 16 percent of salary in 2001. By 2020, that figure increased to 37 percent of salary. Teacher contributions increased by 70 percent, while employer contributions—from the district and the state—nearly tripled, increasing from 10 percent of salary in 2001 to 27 percent in 2020.

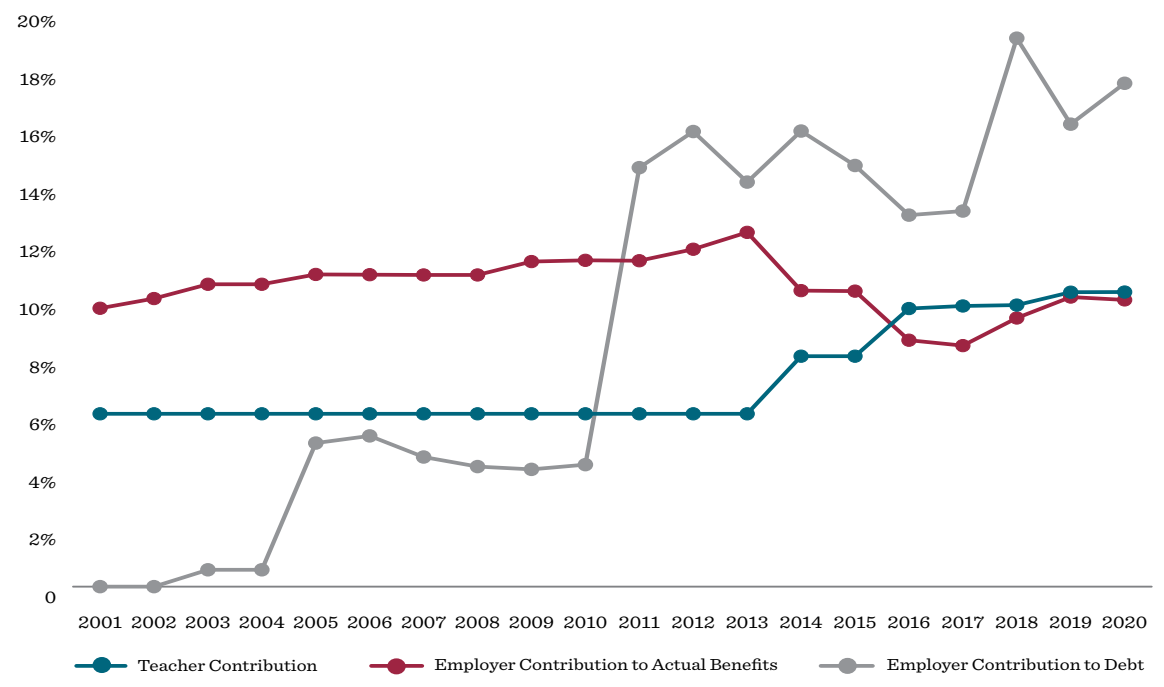
Figure 5: Change in Teacher and Employer Contribution Rates to CalSTRS



Sources: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677; Equable Public Retirement Research Database, available at: equable.org/equable-public-retirement-research-database.

The vast majority of the increased employer spending on teacher pensions went to pay debts rather than increase the value of benefits provided to teachers. As shown in Figure 6, from 2001 to 2004 very little pension spending went to pay down debts. This is because the system was well funded and the state annually met the actuarially required funding contribution necessary for the system to remain financially healthy. But in 2004, California paid only 62 percent of what was required to meet its obligations. This trend of underfunding the system continued until 2014. Over the course of that decade of underfunding, debt accrued rapidly. By 2011, employers—a combination of the state and school districts—were contributing more to pay down pension debts than they paid toward the cost of actual retirement benefits for actively working teachers.

Figure 6: How California Funds Its Teacher Pension System, 2001 to 2020



Sources: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677; Equable Public Retirement Research Database, available at: equable.org/equable-public-retirement-research-database.

Because of the schedule of increased contribution rates enacted in Assembly Bill 1469, 2016 marked a critical turning point in how California funds CalSTRS. At that point, teachers started paying more for their retirement benefits than their employers did. Previously, employers funded the majority of the cost of teachers' pension benefits. For example, in 2001 teachers accounted for 38 percent of the normal cost of benefits, which corresponds with the actual cost of the benefit that year excluding debt. But that trend switched in 2016, when teachers assumed 53 percent of the normal cost. And in 2020, teachers still paid more for their retirement benefits than their employers did: 51 percent to 49 percent, respectively.

From a cost perspective, California's pension system serves teachers increasingly poorly: Teachers pay more than their employers for their retirement benefits, teachers' own contributions to the system eat away at their hard-won salary increases, and the value of their benefits has not improved. In short, California's teachers take home less in salary because they pay more for the same retirement benefits—a benefit that 28 percent will never qualify for, and only 47 percent will reach a point where it is more valuable than teachers' own contributions.

Who Benefits and Who Loses in California's Teacher Pension System?

The unique structure of defined-benefit pensions serves some people better than others. For example, teachers who work in the same state for a full career are better off than teachers who move frequently or who change careers. The "winners" of California's teacher pension plans are not limited to teachers of varying tenures. Wealthier districts and politicians may also benefit from the design of the current system. That said, there are many people who lose out under the status quo. Indeed, the current system perpetuates and exacerbates inequities.

What follows is a brief rundown of who benefits from California's teacher pension system and who is losing out. As with any system, there are trade-offs. The question before education leaders, policymakers, and other education stakeholders is not how to build the perfect system but rather how best to meet the needs of schools, teachers, and the communities they serve.

Who Benefits?

- **Long-term teachers:** Given that the value of a pension is determined by a teacher's years of experience and final average salary, the longest serving teachers are well positioned to benefit from the system. And since the most senior teachers typically earn the highest salaries, career educators in California can earn a high-quality retirement benefit. Those who serve the full 37 years to reach normal retirement age can expect to earn an annual benefit worth 74 percent of their final average salary.
- **Principals and superintendents:** School principals and district superintendents rightly earn high salaries. Educators typically assume these leadership roles later in their careers, and the resulting salary bump is reflected annually in retirement since pensions are calculated based on late-career average salary. In other words, a teacher who becomes a principal for the last few years of their career will have their pension calculated based on their principal salary while paying into the system for most of their career based on their teacher salary. As such, their annual pension benefit in retirement will be far greater than a teacher with a longer career who remains a teacher and will greatly exceed the value of their own contributions.[26]
- **Affluent school districts:** In California, the employer contribution is shared between school districts and the state. Thus, when a school district increases teacher salaries to encourage retention and attract high-quality educators, it can do so without having to pay the full pension costs. In fact, the state pays about 39 percent of the employer's share of the pension contribution. This amounts to something of a state subsidy for districts that offer higher teacher salaries—and that tend to be wealthier.[27] Indeed, an analysis of 2018 data found that teachers in low-need California districts received almost $9,000 more in salary than did educators in high-need districts.[28] The effect of the state's role in subsidizing pension contributions, in combination with inequitable teacher salaries, is that relatively more state funding goes to wealthy districts.
- **Elected officials and other policymakers:** The structure of defined-benefit pension plans encourages policymakers to underfund plans in order to allocate additional resources to more politically attractive budget items. Since today's payments to the pension fund are not required to be spent for years (when teachers begin drawing their pensions), politicians have an incentive to kick the can down the road as they likely will no longer be in office when the bill comes due. Additionally, there are technical decisions that policymakers can make to reduce how much they need to spend on the pension system each year. For example, in states where

the legislature sets the assumed rate of return that a pension fund will get on its investments, increasing the assumed rate allows state policymakers to cut funding and still appear to meet state obligations. However, if a fund performs beneath those assumptions, the state will accrue more debt that can be pushed down the road onto future legislators.

Who Loses?

- **New teachers:** Pension contribution rates for teachers and employers have increased dramatically since 2014. As a result, recently hired teachers pay more for the same benefits, eroding their earnings. Moreover, the recent rise in pension costs can come at the expense of salary increases.
- **The 28 percent of teachers who will not vest:** California teachers need to work five years before they qualify for a retirement benefit, and CalSTRS expects that 28 percent of new teachers will not reach this critical benchmark. These teachers are eligible to take only their own contributions plus 2 percent interest when they leave the state or profession. And since California does not participate in Social Security, these teachers' experience in California's classrooms does not count toward the credit hours required to qualify for Social Security when they retire.
- **Teachers who move to a new state or switch careers:** When a vested teacher moves across state lines, they cannot take their pension with them. Because of the structure of the formulas used to determine pension benefits, holding two pensions is less valuable than a single pension from a single state. Indeed, a 30-year veteran teacher in California is significantly better off than a teacher who splits a 30-year career across two states.[29] There is an added challenge for California teachers: Once again, as the state does not participate in Social Security, a 15-year veteran teacher who moves across state lines will have accrued no credits toward a Social Security benefit. Teachers who switch careers face the same issues.
- **Students:** California's K-12 education budget has not kept pace with rising pension costs. From 2011 to 2018, district spending on CalSTRS as a percentage of total district expenditures increased by nearly 70 percent. Pension spending pushes out other expenditures, leaving school districts with fewer dollars to spend on salaries as well as services and resources for students, such as enrichment opportunities, after-school activities, access to critical technology, and supports for English language learners.[30] The problem has only gotten worse in recent years. And all of this has occurred during a prolonged period of strong economic growth for the state. When the next economic downturn comes, the situation will become more dire.

Pension spending pushes out other expenditures, leaving school districts with fewer dollars to spend on salaries as well as services and resources for students.

- **Taxpayers:** Debt is driving up the cost of teacher pensions in California. To meet that obligation, a greater and greater share of public tax revenue must be diverted from other education services to pay down that debt. Even in those communities that elect to levy higher taxes on themselves (e.g., in the form of parcel taxes), a portion of those new revenues will effectively be used for debt costs rather than the education services they likely aimed to purchase. As pension costs continue to rise, taxpayers may become aware of this "pension tax" and resist efforts to provide additional resources to schools. This could result in a loss of revenues as great as or even greater than the effective budget cut brought on by increased pension spending.[31]

What Can Be Done?

The California teacher pension system is in a precarious position. It is unsustainably expensive. The rising cost crowds out teacher salaries and vital education services to support students. While it provides a high-quality benefit to about one-third of teachers, it leaves the majority in poor financial shape. Moreover, the pension system is regressive and compounds existing funding inequities between high- and low-wealth communities.

Addressing these problems is critical to California's fiscal future, to teachers' retirements, and to the quality of schooling the state can provide to its students. There are a number of steps and policy reforms that California can take to improve the financial sustainability of CalSTRS, provide higher quality benefits to teachers, and address disparities among districts. Even if all of these steps are enacted, California will need to maintain annual payments to the pension fund to keep pace with its obligations and avoid creating another financial pitfall in the future. Although not always popular, making regular and sufficient payments to CalSTRS avoids greater financial pain down the road.

Deal With the Debt

- **Make supplemental payments.** In years of high economic growth, the state could make additional payments to CalSTRS to address the system's unfunded liability. This short-term cost, in a moment of prosperity, would have long-term benefits by decreasing the overall cost of the system and limiting the financial burden of the pension plan in times of scarcity.[32]
- **Reduce the assumed rate of return.** CalSTRS currently assumes a 7 percent annual rate of return on the funds the system invests in the market. That assumed return factors into how much funding the state needs to put toward CalSTRS annually. The higher the rate of return, the less funding the state puts toward the pension fund. Although the years since the Great Recession have had historic market gains, a lower assumed rate of return is a safer approach that protects against years of lower market returns. California can increase the financial health of CalSTRS by assuming a slightly lower rate of return.[33] In years of high economic growth like those seen recently in California, higher investment returns can offset the corresponding cost increases of lowering the assumed rate of return.
- **Implement a formal policy to ensure full annual funding for CalSTRS.** Each year, there is an actuarially determined employer contribution, or ADEC, necessary to ensure the state can meet its pension obligations. However, for a number of years California did not fully fund its ADEC, which led to the dramatic increase in unfunded liabilities. To avoid this in the future, California could adopt a formal policy requiring the legislature to fully fund the ADEC annually.

Provide Teachers Better Benefits

- **Increase the return on investment for teachers who do not vest.** As it stands now, teachers who leave the classroom or the state prior to vesting in CalSTRS receive their own contributions plus 2 percent interest. That return does not even match CalSTRS's assumed rate of inflation. Given that the state does not participate in Social Security and so many teachers leave before vesting, California could increase the rate of return it pays on teachers' contributions to at least match its inflation assumption.

- **Provide other retirement options.** California educators have no choices about their retirement. The majority of the state's educators will not serve long enough to truly benefit from this system. On the whole, most of California's educators get a raw deal under the pension system. To remedy this, California could consider developing alternative options, such as a hybrid plan that combines elements of a defined-contribution plan like a 401(k) and a traditional defined-benefit pension plan. Washington and Oregon, for example, offer hybrid plans. Indeed, in Washington many teachers elect to enroll in the hybrid plan rather than the traditional pension.[34] Additionally, the state could allow teachers to opt into a defined-contribution plan. These plans are better suited to teachers who do not plan to spend their entire careers teaching or those, who are for instance in military families, who expect to move across state lines.

- **Join Social Security.** Decades ago, California opted its teachers out of Social Security. The idea was that the state's pension plan provided an adequate retirement benefit. And perhaps in the 1950s that was true. Today, however, the majority of teachers do not earn a quality benefit through CalSTRS. By joining Social Security, California would diversify teachers' retirement wealth, likely reduce expenditures on CalSTRS, and potentially increase teachers' retirement benefits even after reducing the CalSTRS benefit formula.

Decrease Disparities

- **Limit state subsidies to high-wealth districts.** The cost of teacher pensions is shared by teachers, school districts, and the state. And since pension benefits are based on teacher salaries, those higher wealth districts that can afford to pay higher salaries receive more state funding for teacher compensation than lower wealth districts do. In other words, the state pension system invests most heavily in affluent communities. To become more equitable, the state could consider adjusting how the district and state share of the employer contribution is determined. Currently, a flat pension contribution rate is applied across all districts in the state. That could be changed and instead, much like the state school funding formula, the state could assume a greater share of the contribution in lower wealth districts. This would lead to a more equitable distribution of state pension funding.

- **Encourage differential pay opportunities in high-need communities.** Another way to address inequities in teacher pay, which echo in retirement benefits, among high- and low-wealth school districts is to create more financial incentives for teachers to work in communities serving concentrations of low-income students. The state has already made some progress toward this by reestablishing the National Board for Professional Teaching Standards Certification Incentive Program, which provides financial incentives to National Board-certified teachers who teach in high-priority schools. The state could sustain and extend these types of programs. The resulting higher salaries would, in turn, lead to greater state investments through the state pension system in those teachers and communities. This would lead to a more equitable distribution of state pension funding.

Endnotes

1 Due to an historic 27 percent investment return earned by CalSTRS in 2020-21, the unfunded liability is estimated to now be less than $106 billion. However, the decrease in the unfunded liability will disproportionately affect state-level debt financing due to the negotiated state-employer cost sharing agreement. Source: California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, 2021, available at: https://www.calstrs.com/sites/main/files/file-attachments/acfr2021.pdf?1639703955.

2 In 2020, K-12 spending in California, not including capital outlay, was $84 billion. U.S. Census Bureau, "2020 Public Elementary-Secondary Education Finance Data," 2020, available at: census.gov/data/tables/2020/econ/school-finances/secondary-education-finance.html.

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7 In 2020, K-12 spending in California, not including capital outlay, was $84 billion. U.S. Census Bureau, "2020 Public Elementary-Secondary Education Finance Data," 2020, available at: census.gov/data/tables/2020/econ/school-finances/secondary-education-finance.html.

8 California State Teachers' Retirement System, *Popular Annual Financial Report*, June 30, 2020, available at: calstrs.com/sites/main/files/file-attachments/pafr2020.pdf?1608579227.

9 California State Teachers' Retirement System, *Comprehensive Annual Financial Report*, June 30, 2010, available at: web.archive.org/web/20120511175643/http://www.calstrs.com/Help/forms_publications/printed/cafr_2010.pdf.

10 California State Teachers' Retirement System, Comprehensive Annual Financial Report, 2020, available at: calstrs.com/sites/main/files/file-attachments/cafr2020.pdf?1608578677.

11 CalSTRS, *Comprehensive Annual Financial Report*, 2021. Note that the unfunded liability at least in the short term, may be lower due to historic investment returns earned by CalSTRS in 2020-21.

12 Anthony Randazzo and Jonathan Moody, "State of Pensions 2021: Pension Trends in an Era of Accelerating Volatility," Equable Institute, December 2021, available at: https://equable.org/wp-content/uploads/2021/12/State-of-Pensions-2021_Dec-Update_Final.pdf.

13 Teachers hired before January 1, 2013, have a 2 percent multiplier, or age factor, if they retire at age 60. The age factor decreases to 1.1 percent at age 50 for those educators who retire before reaching age 60. The factor also increases marginally each year to 2.4 percent at age 63.

14 Since the passage of the California Public Employees' Pension Reform Act of 2013, teachers hired since January 2013 participate in a slightly different CalSTRS benefit structure. For these teachers, the 2 percent multiplier, or age factor, applies at age 62 and decreases to 1.16 percent at age 55 for those who retire before turning 62 years old. The age factor increases annually to a maximum of 2.4 percent at age 65 for those who retire later in life. California State Teachers' Retirement System, "Two Benefit Structures," available at: calstrs.com/post/two-benefit-structures.

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16 Internal Revenue Service, Federal-State Reference Guide, U.S. Department of the Treasury, 2020, available at: irs.gov/pub/irs-pdf/p963.pdf.

17 This assumes that the former teacher retires at age 62 to receive full benefits from CalSTRS. If they retire earlier, their benefit would be less valuable.

18 This analysis is based on a weighted average of the CalSTRS-assumed turnover rates by gender. This is necessary to reflect California's teacher workforce more accurately.

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Rising Pension Costs and Tax Revolt for Increasing Education Funding, Policy Analysis for California Education, November 2019, available at: https://edpolicyinca.org/publications/canary-gold-mine.

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