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Teachers' Pensions and the Overgrazed Commons.

Amid bitter political battles over the rising costs of teacher' pensions, policy-makers typically overlook an important cost driver: the salary raises offered to late-career teachers.

Here's how it works: When a teacher retires, the highest few years (or, in the case of California, the highest single year) of salary determine the teacher's pension payout. Because of the highest-salary feature, the cumulative value of the pension payout is highly sensitive to even modest changes to late-career salaries. Give a raise in the final year of teaching, and the teacher gets a raise for life.

While most public-pension plans have rules in place to prevent the "spiking" of salaries just before retirement, it is still standard practice for school districts to award the largest dollar-amount raises to the most-senior teachers. Take San Diego Unified, where leaders awarded a 5 percent raise for 2014-15. For a veteran teacher set to retire at the end of the year and earning $93,900, this raise brought in a $4,700 boost. (For a junior teacher earning $40,000, the raise paid only $2,000.) Because a higher final salary means larger pension payments, the retiring teacher will see lifetime pension earnings jump by $101,000 as a result of the raise.

New analysis by Georgetown University's Edunomics Lab shows just how responsive pension obligations are to a teacher's final salary. A near-retirement teacher in California earns an average of $91,000, which triggers a starting pension of about $70,000. Every dollar increase of that teacher's salary during his or her last year triggers over 13 times as much in cumulative pension payments. The situation is the similar in other states: In New Jersey, every salary dollar awarded in the final average salary (based on the last four years) creates $9.96 in pension obligations; in Illinois (based on the last three years), the multiplier figure is $15.51.

Why aren't school-district leaders controlling pension debt by better managing final salaries? Because districts don't own the pension bill. States do. If the school district had to pay the pension costs for their employees directly, leaders might think twice about awarding big raises to teachers just before retirement. But the pension fund is a shared fund across all districts in the state.

And so districts behave as we'd expect, by maximizing their individual interests at the expense of the whole. In economics terms, this is called the "tragedy of the commons." Consider a group of ranchers grazing their cattle on open land. Each rancher, looking at his own costs and benefits, has an incentive to overgraze the land, even though collectively the group of ranchers is better off if no one overgrazes.

Similarly, each school district concludes that it can leverage more earnings for its staff by boosting the pay of senior teachers (at the expense of junior teachers) and "overgrazing" the state pension fund. The pension arrangement distorts spending choices, since younger teachers get no such subsidy. In the end, the pension debt takes a toll on all districts when state coffers have few funds left over for schooling.

This is not a critique of the defined-benefit pension plans that teachers typically enjoy. Social Security is a defined-benefit plan, but it bases the pension annuity on 35 years of earnings, so there are no incentives for this type of gaming.

What's the remedy for teachers' pensions? States could start by requiring school districts to pay their proportionate full share of the pension bill. Where districts' salary policies create more pension debt, those districts would pay that incremental portion directly to the pension fund. District leaders then would have to consider the full pension costs of raises as they negotiate them.

Where pension costs continue to be unsustainable, districts and labor organizations might start considering tradeoffs in salary and pension-calculation rules, including the number of years factored into the benefit calculation.

If nothing is done, we may be headed, as in the cattle-ranching example, toward a landscape of barren, overgrazed pension funds. That's a frightening prospect for taxpayers, school districts and educators alike.

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