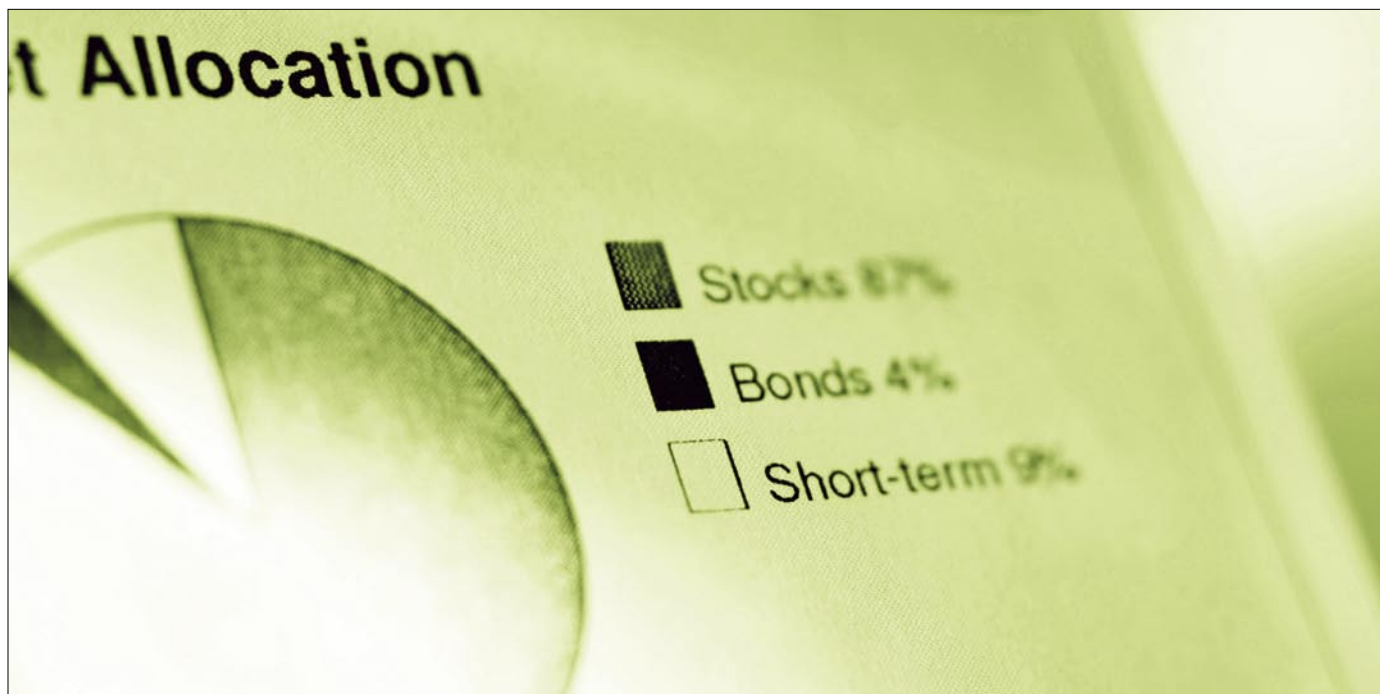


Teachers Can Be Millionaires, Too

Two economic educators outline strategies for wealth building — Mark C. Schug and William C. Wood



TEACHERS OFTEN REGARD themselves as unlikely candidates for financial success, chiefly because they earn low starting salaries. But people of modest means can build wealth over time if they adhere to certain simple strategies. Our goal here is to explain this point as it applies to K-12 teachers. We begin, however, by acknowledging the salary constraints that might make “wealth building” seem, at first glance, to be an impossible dream for teachers.

According to the Bureau of Labor Statistics (BLS), the average annual (2001) salary of a person with a bachelor’s degree in education after one year of full-time employment was \$27,600. The American Federation of Teachers made a somewhat higher estimate of the national average salary for beginning teachers in 2003-2004:

\$30,496. By both estimates, a teacher’s starting salary is well below the average starting salary for other professions. For example, the BLS estimated that the average starting salary of people with degrees in engineering was \$47,900 for 2001. For people with degrees in business and management, the average starting salary was \$41,000; for people with degrees in the health professions, it was \$39,400; for people with degrees in the social sciences, it was \$33,900.

These numbers don’t tell the whole story. Teachers enjoy some benefits that are uncommon in other professions. One is simply that as teachers gain experience, their salaries go up, predictably. According to the American Federation of Teachers, the average salary of a teacher in 2002-2003 was \$45,771. And apart from steady

salary increases, other factors also help to explain why people are willing to work as teachers despite the low salaries they earn at the outset.

- Many teachers work in school districts that provide defined-benefits pension programs. Such retirement packages are very rare in the private sector. Today, 92 percent of pension programs are defined-contribution programs whose value depends on the stock market. Unlike defined-benefit programs, they don’t guarantee any particular level of retirement income.
- Many teachers work in school districts that provide generous health insurance. In many districts, teachers’ direct contributions for health insurance amount to little or nothing.
- For teachers with children, teaching

schedules are family-friendly. Moms and dads who teach can be home to care for their children on holiday breaks. Many also spend their non-teaching time during the summer with their families.

- Jobs in teaching tend to be secure. Teaching positions are not much influenced by the business cycle. While teacher layoffs and dismissals sometimes occur, they remain rare.
- Many teachers are able to retire in their early or mid-50s. This is because teachers often are provided with good retirement and health-care packages.
- The work teachers do is often satisfying. While grading papers is often tedious and managing a classroom can be challenging, many teachers are able to teach courses they enjoy to students who, for the most part, enjoy learning. Teachers often work with colleagues who share a sense of commitment and community. Many people in other professions lack a similar sense of fulfillment.
- Teachers often earn other income from part-time jobs or businesses. Many teachers often work at non-teaching jobs during summers. Many manage to run their own businesses, farms, and ranches, even during the school year. Some teachers earn more income from their summer jobs and businesses than they do from teaching.

The Three Rules of Building Wealth

Still, salary issues loom large for teachers. Is it realistic to suppose that, on their salaries, teachers could engage in building wealth? How could they do it? And is building wealth something that teachers should care about? After all, many would assert, they didn't get into teaching for material rewards.

Wealth building is good for individuals, families, and society because it improves people's quality of life. Whatever goods and services you would like for yourself, your family, or nation—better housing, better medical care, or anything else—those goods and services can be more nearly within reach if you engage effectively in wealth building.

But how to do it? People have written

volumes about this question, and some details and intricacies associated with it can be complex. In fact, however, an effective approach to building wealth can be summarized in three rules:

1. Start early.
2. Buy and hold.
3. Diversify.

Let's look at the cases of Pat and Terry, as seen many years from now, when they retire.

A Tale of Two Teachers

When Pat was getting started in her first teaching job, she didn't know much about personal finance. She had never studied economics or personal finance in school, and she did not come from a wealthy family. Like many teachers, she was the first in her family to earn a college degree. But she was certain—since her teacher's salary wasn't all that much—that she would need to act prudently if she wanted to be financially successful. Pat actually became a millionaire. How?

Pat began her teaching career at age 22, earning \$30,496—the national estimated average salary for a beginning teacher in 2003–2004, according to the American Federation of Teachers. After she signed her first teaching contract, she met with the school district's benefits manager. The benefits manager suggested that Pat begin a retirement savings program separate from the teacher retirement plan provided by the state.¹ She advised Pat to have \$40 every week withheld from her paycheck and put into a mutual fund account. Pat had to think hard before making the decision. She was already in a lower-paid profession; how could she afford to save anything if it meant that she would have to get by on even less each week? But the benefits manager persuaded Pat that putting \$40 aside each week would be the best thing to do for her future.

When Pat retired, it became clear that her sustained program of investment had served her well. She had become a millionaire on her invested funds—over and above what she would receive from the state retirement fund. Her own retirement account was worth more than a million

dollars. Steady payments from that account enabled Pat to travel and visit her grandchildren, go to movies or concerts when she wanted to, donate money to charity, and live in comfort. She was even able to help with college expenses for next-generation members of her family.

Most people are skeptical when they're told that weekly contributions of \$40 could make them millionaires—but the math works. Figure 1 shows how the money kept growing, in this case, until Pat became a millionaire. Figure 1 assumes an average return of 8.5 percent each year, calculated on the average yearly balance and compounded once per year. The retirement age is set at 67, the Social Security retirement age for everyone born after 1959. Call Pat lucky if you want to, but most people could do what she did.

In getting her lifetime net wealth up to \$1 million by the time she reached Social Security retirement age, Pat followed the three rules:

1. **Start early.** Pat began saving when she turned 22, so she had 45 years in which her savings could grow.
2. **Buy and hold.** Pat automatically bought a tiny bit more in financial assets each payday with the small amount withheld from her pay. She never touched that account as it grew over the years. Most importantly, she did not withdraw her money and spend it even when times were tough.
3. **Diversify.** Pat's retirement account was invested in a broad variety of financial assets. It wasn't put into any one asset.

Let's look at the three rules she followed in more detail.

Rule 1: The Importance of an Early Start Rule 1 says, "Start early." Money that's saved early so that it can work for a long time counts for a great deal in wealth building.

An early start works well because of the magic of compounding. When you save money, you receive a return. In the case of bank savings accounts, that return is interest. If you leave the interest in the account, then the added interest also earns interest. In other words, savers earn interest on interest through compounding. The longer this process goes on, the more it works for you.

Figure 1
Pat Becomes a Millionaire—Accidentally

Year	Beginning Balance	Addition to Principal	Annual Return	Ending Balance
0	\$0.00	\$2,080.00	\$88.40	\$2,168.40
1	\$2,168.40	\$2,080.00	\$272.71	\$4,521.11
2	\$4,521.11	\$2,080.00	\$472.69	\$7,073.81
3	\$7,073.81	\$2,080.00	\$689.67	\$9,843.48
4	\$9,843.48	\$2,080.00	\$925.10	\$12,848.58
5	\$12,848.58	\$2,080.00	\$1,180.53	\$16,109.11
6	\$16,109.11	\$2,080.00	\$1,457.67	\$19,646.78
7	\$19,646.78	\$2,080.00	\$1,758.38	\$23,485.16
8	\$23,485.16	\$2,080.00	\$2,084.64	\$27,649.80
9	\$27,649.80	\$2,080.00	\$2,438.63	\$32,168.43
10	\$32,168.43	\$2,080.00	\$2,822.72	\$37,071.15
11	\$37,071.15	\$2,080.00	\$3,239.45	\$42,390.59
12	\$42,390.59	\$2,080.00	\$3,691.60	\$48,162.19
13	\$48,162.19	\$2,080.00	\$4,182.19	\$54,424.38
14	\$54,424.38	\$2,080.00	\$4,714.47	\$61,218.85
15	\$61,218.85	\$2,080.00	\$5,292.00	\$68,590.85
16	\$68,590.85	\$2,080.00	\$5,918.62	\$76,589.48
17	\$76,589.48	\$2,080.00	\$6,598.51	\$85,267.98
18	\$85,267.98	\$2,080.00	\$7,336.18	\$94,684.16
19	\$94,684.16	\$2,080.00	\$8,136.55	\$104,900.72
20	\$104,900.72	\$2,080.00	\$9,004.96	\$115,985.68
21	\$115,985.68	\$2,080.00	\$9,947.18	\$128,012.86
22	\$128,012.86	\$2,080.00	\$10,969.49	\$141,062.35
23	\$141,062.35	\$2,080.00	\$12,078.70	\$155,221.05
24	\$155,221.05	\$2,080.00	\$13,282.19	\$170,583.24
25	\$170,583.24	\$2,080.00	\$14,587.98	\$187,251.22
26	\$187,251.22	\$2,080.00	\$16,004.75	\$205,335.97
27	\$205,335.97	\$2,080.00	\$17,541.96	\$224,957.93
28	\$224,957.93	\$2,080.00	\$19,209.82	\$246,247.75
29	\$246,247.75	\$2,080.00	\$21,019.46	\$269,347.21
30	\$269,347.21	\$2,080.00	\$22,982.91	\$294,410.12
31	\$294,410.12	\$2,080.00	\$25,113.26	\$321,603.38
32	\$321,603.38	\$2,080.00	\$27,424.69	\$351,108.07
33	\$351,108.07	\$2,080.00	\$29,932.59	\$383,120.66
34	\$383,120.66	\$2,080.00	\$32,653.66	\$417,854.31
35	\$417,854.31	\$2,080.00	\$35,606.02	\$455,540.33
36	\$455,540.33	\$2,080.00	\$38,809.33	\$496,429.66
37	\$496,429.66	\$2,080.00	\$42,284.92	\$540,794.58
38	\$540,794.58	\$2,080.00	\$46,055.94	\$588,930.52
39	\$588,930.52	\$2,080.00	\$50,147.49	\$641,158.01
40	\$641,158.01	\$2,080.00	\$54,586.83	\$697,824.84
41	\$697,824.84	\$2,080.00	\$59,403.51	\$759,308.35
42	\$759,308.35	\$2,080.00	\$64,629.61	\$826,017.96
43	\$826,017.96	\$2,080.00	\$70,299.93	\$898,397.89
44	\$898,397.89	\$2,080.00	\$76,452.22	\$976,930.11
45	\$976,930.11	\$2,080.00	\$83,127.46	\$1,062,137.57

These statistics reflect investments made in a tax-deferred retirement plan.

Here is a different example that also shows the importance of an early start: Pat had a co-worker who didn't start saving early. Instead of starting to save at the beginning of his career, Terry held off for 10 years. Then, like Pat, he saved \$40 every week until he reached retirement age. Terry accumulated more than \$450,000 by saving as he did. (See Figure 2.)

That's a lot of money. But because Pat started early, she became a millionaire and Terry did not. This example shows why it is important to get an early start. But even if you don't get an early start, then (like Terry) you can still take big steps toward wealth building. You just have to save more (or settle for less) than if you had got off to an early start.

Rule 2: Buy and Hold

The second rule is "Buy and hold." This means that to build wealth over time, you have to hold on to your long-term savings. You can't be dipping into them frequently, or they won't compound over time in the same way.

To buy and hold, you have to have your finances in order. Here are two steps to take toward that end:

- *Spend less than you receive.* You do this either by earning more or spending less. You can help yourself to spend less by keeping track of where your money is going; then you can cut back in places where you can save small amounts. You take the small amounts you're saving and get them out of sight so you won't be tempted to spend what's there. Many families keep track of their income and spending by establishing a monthly budget. This allows them to identify ways they might be able to save more.
- *Manage your credit properly.* When you're managing your credit properly, you're limiting the number of credit cards you have. You're limiting your purchases to what you can pay off each month, without leaving a balance to accumulate interest that you'll also have to pay. As time goes by, your credit score goes up, making it possible for you to borrow when you have a good reason to borrow.

If you're doing all this, you can buy

and hold with confidence. Remember the case of Pat, the accidental millionaire? Surprisingly, one of the smartest things she did with her retirement account was to neglect it. She just kept having money taken out of her paycheck and put into financial assets, no matter what. When her financial assets fell in value because of normal ups and downs in the market, Pat didn't change her strategy. At down-market times, financial assets were relatively cheap, and her regular contributions bought more than they bought when financial assets were more expensive. And when financial markets went up, those inexpensively-bought financial assets grew in value.

Pat saw televised accounts of people who became rich overnight playing the stock market. But she didn't think she could play that game, so she just left her retirement fund alone. She held onto it and kept most of the gains, though she was aware that markets were always going up and down.

Over time, Pat came out better than many people who worked much harder trying to make more. They tried to jump in and out of the markets with their retirement money. They tried to "buy low" and "sell high," but in the end didn't do as well as people like Pat who stuck with the dull rule, "buy and hold."

Rule 3: Diversify

Somebody probably once told you, "Don't put all your eggs in one basket." This saying harkens back to the time when knocking over a single basket might wipe out a week's supply of eggs from the henhouse—if you had put all the eggs in one basket.

If you put all your savings into a new start-up toy company, you could get rich if the company succeeded. Or you could lose all your money if the company failed. That's like having all your eggs in one basket. The same point would apply if you were approached by someone proposing that you invest in a business opportunity. If you put all your savings there, you would again be putting your money at risk.

How can investors get a worthwhile return while managing the risk? The answer lies in diversifying. When we diversify, we take a lot of small risks rather than a single

Figure 2
Terry's Mistake: Waiting to Start Saving

Year	Beginning Balance	Addition to Principal	Annual Return	Ending Balance
0	\$0		\$0	\$0
1	0		0	0
2	0		0	0
3	0		0	0
4	0		0	0
5	0		0	0
6	0		0	0
7	0		0	0
8	0		0	0
9	0		0	0
10	\$0.00	\$2,080.00	\$88.40	\$2,168.40
11	\$2,168.40	\$2,080.00	\$272.71	\$4,521.11
12	\$4,521.11	\$2,080.00	\$472.69	\$7,073.81
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43	\$351,108.07	\$2,080.00	\$29,932.59	\$383,120.66
44	\$383,120.66	\$2,080.00	\$32,653.66	\$417,854.31
45	\$417,854.31	\$2,080.00	\$35,606.02	\$455,540.33

These statistics reflect investments made in a tax-deferred retirement plan.

large risk. The small risks don't add up to much, and they get smaller and smaller over time for an investor who buys and holds onto a variety of financial assets.

We might think of diversifying as a matter of buying small amounts of a lot of different stocks or bonds. But because it costs something to buy each asset, that approach would quickly get to be expensive. Fortunately, there are mutual funds that act to buy financial assets on behalf of individual investors.

A mutual fund gets a pool of money by accepting funds from thousands of individual investors. It invests its pool of money in a collection of assets. As that collection generates income, the mutual fund sends that income back to its investors in proportion to how much money they have put in. Because of its large size, a mutual fund can efficiently buy large numbers of different stocks and bonds.

Pat, the accidental millionaire, owes much of her success to mutual funds. The money in her retirement fund—as is true for most retirement funds—was invested in diversified mutual funds. Pat indirectly owned stock in a wide variety of companies. Thus when technology stocks boomed in the 1990s, some of her money was in technology stocks. Also, when automotive company stocks lost value, she didn't lose nearly as much as she would have, had she owned only automotive stocks.

Mutual funds are nowhere near as safe as bank deposits. When markets go down, mutual funds follow them down, depending on which stocks and bonds the funds are holding. Over time, however, mutual

funds have been an excellent investment, far surpassing bank accounts and bonds in their long-term returns. Many ordinary people have become millionaires by starting early, buying and holding, and using mutual funds to diversify.

Tax-Deferred Saving

Teachers like Pat and Terry can usually take advantage of a type of salary reduction plan called a 403(b) program, named after the section of the IRS code that permits it. A 403(b) plan allows the school district to deduct an agreed-upon percentage from your paycheck and deposit it in your account with an investment company you have chosen from a list approved by the school district. You may deduct between 2 and 10 percent of your annual salary for this purpose. The contribution is deducted from your paycheck before federal and state taxes and Social Security taxes are deducted. The money invested in a 403(b) account is allowed to grow on a tax-deferred basis. Taxes are paid when the money is withdrawn at retirement—a time when most people are in a lower tax bracket. When you retire you may take your payout as a lump sum or in monthly withdrawals. Until then, you decide how best to invest the money in your account, depending on your tolerance of risk. For example, most plans permit a teacher to choose from a range of mutual funds including combinations of stocks and bonds. There is a penalty for early withdrawal. For more information and advice, talk to the people in your benefits office.

Conclusion

Can teachers be millionaires too? Can they become financially independent? You bet they can! Since most teachers start out earning less than people in other professions, it is all the more important for you to get started and to get started now.

Our common-sense rules of (1) Start early, (2) Buy and hold, and (3) Diversify can help point you in the right direction. We don't mean to imply that building wealth is easy. It is hard to resist temptation and live below your means. It seems that everywhere you turn, people are encouraging you to spend, not save. But our advice is to buck the trend. Once you get started on a savings plan, you will notice how quickly your actions are reinforced. As your savings accumulate, you will be more and more grateful for deciding to put yourself on the path to a strong financial position. 📖

Note

1. The statistics in Figures 1 and 2 are based on the assumption that savings are invested in a tax-deferred retirement savings plan. The section "Tax-Deferred Saving" on this page describes one such option usually available to teachers.

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