

# off the record

a weekly way to stay in touch

a legislative  
update from

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Room 115, State Capitol, Juneau, AK 99801 \* 465-4947 \* 465-2108 FAX \* February 7, 2003

## Capitol Undercurrents

**See you latte**—Some legislators have an easier time settling in than others. Most bring little touches of



home like pictures and favorite books, some bring ironing boards. One of the newest senators, Ralph

Seekins from Fairbanks, is creating a (caffeine) buzz by adding a commercial grade espresso/cappuccino machine to his office.

**Farmed salmon future less rosy?**—The European Union is “taking the pink out of farmed salmon” reports the International Herald Tribune. The EU is demanding EU producers of industrial salmon cut dramatically the dosage of a pigment that turns farmed salmon flesh from pasty gray to the healthy pink of wild salmon. The pigment has been linked to retina damage. The EU decision is just another indication that the world is “getting it” when it comes to farmed salmon vs. wild salmon. A recent LA Times expose also noted the pigment issue, reported that farmed salmon has less of the heart healthy



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## Market and healthcare costs put squeeze on pension funds

I live on the water and often find myself sitting in a chair looking out over Favorite Channel wondering what’s going on beneath the surface. I know that big fish are eating little fish, that strange creatures with long Latin names live in the sea mud hundreds of fathoms below the surface, and that plankton blooms come and go—mostly unnoticed by me but integral to a healthy ocean ecosystem that supports all species strange and common.

There are hidden things, too, drifting and swimming beneath the surface of government. Things we don’t think about but that occasionally swim to the top and focus the attention of those on the bridge of the ship of state. A couple of those ‘things’ that could surface next month to catch the attention of policy makers are two of the state’s public employee pension funds—the Public Employee Retirement System (PERS) and the Teacher Retirement System (TRS).

Actuaries eyeball these two pension funds as assiduously as fish biologists study salmon ocean survival. And, just as it is difficult for biologists to predict sockeye salmon harvest viability when they return several years after leaving their natal streams, it is difficult for actuaries to predict the future financial returns necessary to maintain retirement fund viability out into the future—especially in this stock market/healthcare cost environment. But actuaries and fish biologists must watch and monitor, then make necessary adjustments to protect the harvest viability of their ‘charges’.

Here’s part of what we know about the PERS and TRS retirement funds: the funds rode the crest of an incredible stock market in the late 1990s but we’ve been rolled in the last few years. In the first three quarters of the 2002 calendar year, PERS and TRS domestic equities sank nearly 18 percent and the international stock portfolios were down nearly 20 percent. Going back even further, the PERS losses were nearly a half billion dollars in FY01 and the fund plummeted nearly \$450 million in FY02. The magnitude of losses is compounded when skyrocketing health care costs for retirees is mixed in—the health care costs act like beer chasers to the stock market losses and make the TRS and PERS funds even more tipsy.

Here’s part of what we don’t know: will the investment losses require higher contributions from PERS and TRS employers (government)? We don’t know now but we will next month when the boards overseeing the funds address the losses. By regulation, the PERS board cannot raise



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## pension funds squeezed...

employer rates by more than 5 percent (there is no similar restriction for the TRS board). A 5 percent PERS boost means employers, state and local governments, must kick in an additional \$68 million into PERS. About half of that would come from strapped state coffers and the other half from strapped local government coffers. Assuming the need for an additional 5 percent from TRS employers, the bite would be in the neighborhood of \$25 million from pinched government budgets.

The pension boards have several options. Among them are: raising employer contributions in FY05 to reflect current market hits, letting the losses ride and betting on a market turnaround; or phasing in higher employer contributions over several years. Another option would be changes to state statutes to compel higher contributions from employees but I don't think that is too likely.

The options are jolting—assuming risk by letting the losses ride or upping contributions with significant cost-to-government consequences. To put the potential budget costs in perspective, a 5 percent increase in employer contributions will hit the state's treasury harder than the first year of the last negotiated state employee contracts (you'll remember contract costs created significant angst in the GOP-dominated legislature and it took a special session to approve the contracts). Year one of the contracts cost the treasury just over \$32 million. A 5 percent hike in PERS contributions alone costs the state \$34 million. There are also state costs associated with higher TRS contributions.

We should not ignore, either, the additional costs to local governments if employer contributions are boosted. Most local government employees participate in PERS and local government costs are inflated if employer contributions must go up.

School districts, too, will be hammered by any requirement to increase employer contributions to TRS and PERS. The value of each education dollar has dropped 25 percent over the last decade because the legislature has not covered the erosion of inflation when fulfilling our constitutional mandate to provide adequate education to Alaskans. Increased employer contributions to hard hit retirement funds will divert even more money from classrooms.

The tough choices facing Alaska's retirement boards are not unique to our state. Federal Reserve data shows state employee pension funds across the nation lost more than \$150 billion last fiscal year. The State of Washington will probably have to pay over \$100 million, and possibly as much as \$200 million, over the next two years to cover market losses from employee pension funds.

In Alaska, policy makers seem to take the daily temperature of the state's massive permanent fund but most legislators have not spent much time cogitating on the health of our retirement funds. We've hoped the funds are out there in a nurturing environment: growing big and fat on a steady diet of employer and employee contributions and thriving in a stock market milieu as nourishing as a plankton bloom is for plankton feeders. When the market was bursting its seams a few years ago we were soothed into the notion that the pension funds would flourish on market investments and not need substantial contributions from employers and employees.

That notion has been swatted on its rear as the bears continue to growl on Wall Street.

**Note:** Now that the legislative session has begun, off the record will be published weekly.

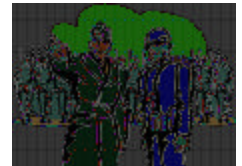
## Undercurrents continued...

omega-3 fatty acids, and outlined the negative environmental impacts of penned salmon aquaculture.

**Telling it straight**—A Mat-Su parent, testifying to the House Education Committee about education funding told lawmakers she wanted her cake (she defined 'cake' as increases to the per student formula that distributes state dollars to schools), and her ice cream (the 'ice cream', she said, is the Learning Opportunity Grants that have been add-ons to the foundation formula dollars) and she wanted to eat the cake and ice cream without getting fat (facing fiscal reality). That kind of candor is noteworthy.

**A sign of the times**—The chief of staff of the Alaska Command rescinded an invitation to legislators to join Lt. Gen. Chandler and members of the Alaskan Command at this year's edition of the Northern Edge joint field training exercise.

"Current world events have driven changes to the exercise, which no longer lends itself to conducting a Distinguished Visitors Day."



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