Alaska Public Employee Pension Design: The Fiscal and Economic Effects of HB 78

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EXECUTIVE SUMMARY

House Bill 78 (HB 78) would increase total State retirement contributions by approximately $1.15 billion over FY27–FY39, or about $89 million per year, which is substantial. Yet the fiscal note—by law, design and function—does not incorporate broader operating budget effects associated with a change in plan design from Defined Contributions (DC) to Defined Benefits (DB). Workforce stabilization reduces premium pay and recruitment and training costs, and other vacancy-related inefficiencies. The narrow fiscal note also does not consider the relatively higher investment returns in Defined Benefit (DB) plans.

Approximately $216 million in identifiable annual instability-related costs, consisting of excess vacancy-driven premium pay ($140M), replacement costs ($62M), and investment efficiency differentials ($14M) are identified. After accounting for the projected $89 million annual increase in retirement contributions, the net fiscal impact under conservative assumptions is approximately $127 million in annual savings.

Based on assumptions, HB78 will likely reduce net annual operating costs if instability costs are causally linked to pension design. In addition, HB 78 incorporates structural risk-sharing provisions that limit downside exposure to the State by triggering Post Retirement Pension Adjustment (PRPA) decreases and employer/employee contribution rate flexibility, depending on the state of the funds.

I. Institutional Background and Policy Context

In 2006, Alaska transitioned from a DB retirement structure to a DC plan for new public employees. Under the DC model, employees are fully vested after five years of service and may withdraw accumulated balances upon separation. Administrative reporting from the Alaska Retirement Management Board (ARMB) indicates that DC withdrawals exceeded $160 million in the most recent fiscal year and approached $500 million when supplemental accounts are included. These data indicate significant separation activity among vested employees.

The design of a retirement system signals an employer's expectations regarding tenure. DB plans are structured to reward long service through benefit accrual formulas tied to years of service and final average salary. DC plans, by contrast, provide portable savings accounts that do not materially increase in value with extended tenure beyond contribution accumulation. The portability feature, while attractive to some employees, does not create retention incentives for occupations in which experience materially increases productivity.

This testimony evaluates the fiscal implications of workforce turnover associated with Alaska's current retirement structure. The analysis focuses on direct costs observable in administrative data, as well as indirect productivity and service-delivery considerations documented in labor economics and public administration research.

II. Premium Pay and Vacancy Coverage Costs

Premium pay expenditures—including overtime, hazard pay, standby pay, and differential compensation—have increased substantially in recent fiscal years. Premium pay has risen sharply and persistently over the past six fiscal years, reflecting chronic vacancies and the State's inability to hire and retain employees as quickly as they depart.

Total premium pay increased from $83.8 million in FY20 to $149.7 million in FY25, a 78.7% increase in five years. The Department of Administration reported that premium pay by January 2026 had reached $112.9 million, with a trajectory to exceed $200 million by the end of the fiscal year. The State has spent 186% of the $60.7 million budgeted for the full FY26.

The $60.7 million represents a structural baseline reflecting routine overtime, hazard pay, and operational differentials that occur even under stable staffing conditions. The difference between the projected FY26 premium pay total (approximately $200 million) and this enacted baseline ($60.7 million) is treated in this analysis as vacancy-driven excess premium pay. All premium pay estimates are expressed in nominal FY26 dollars and compared against the enacted FY26 baseline of $60.7 million.

There are many reasons that premium pay would have to be paid and has nothing to do with pension design. Employees leave for a variety of reasons, including retirement, death, injury, or alternative employment. The enacted budget serves as the appropriate baseline benchmark. The FY26 premium pay projection of $200 million is much larger than baseline of $60 million, and it is likely to exceed $200M.

Premium pay is soaring because of structural understaffing. Overtime, differential pay, and emergency coverage are expenses for just maintaining basic operations in the face of persistent vacancies. The fastest-growing premium pay categories are concentrated in frontline, mission-critical agencies directly responsible for public safety and infrastructure. Between FY20 and FY25, premium pay increased by 78.7% and much more in some of the largest agencies (e.g. Department of Transportation & Public Facilities and Department of Corrections.

Table 1: Premium Pay Growth, FY20–FY25 – Top 4 State Agencies

Agency	**FY20 Premium Pay**	**FY25 Premium Pay**	**% Increase (FY20–FY25)**
Transportation & Public Facilities	$28,041,998	$53,713,071	91.6%
Corrections	$20,517,829	$39,280,387	91.4%
Public Safety	$10,104,757	$17,392,554	72.1%
Natural Resources	$6,764,107	$10,999,071	62.6%
TOTAL (All Agencies)	$83,762,467	$149,693,080	**78.7%**

III. Direct Replacement and Turnover Costs

Turnover costs extend beyond premium pay to existing employees who fill in staffing gaps. The savings comes about because turnover generates measurable replacement costs.

Using conservative assumptions—approximately 30,000 employees, an average salary of $69,000, and a 6% annual turnover rate—estimated annual replacement costs equal roughly $124 million. These calculations incorporate recruitment, onboarding, initial training costs, and separation processing. Reducing turnover by half would yield estimated savings of approximately $62 million per year (Ghilarducci, 2024) for the state of Alaska.

Human resource research indicates that total turnover costs frequently range between 90% and 200% of annual salary when lost output, reduced quality, and supervisory training time are included (Society for Human Resource Management, 2017). When lost output, reduced quality, and supervisory training time are not included, the $124 million calculation is conservative. The estimate is even more conservative by assuming that the proposed pension design would reduce half of the turnover rates.

Evidence suggests pension design is implicated in causing excessive turnover. When states reduce the quality of their pension benefits scholars found that public-sector turnover increases.

Gorina and Hoang (2020) find that benefit-reducing reforms increase turnover by approximately 0.21 percentage points relative to an average 5% turnover rate, implying a 4% proportional increase. These findings are consistent with observed patterns in states that have shifted from DB to DC systems and consistent with Alaska's experience.

Alaska's real, meaningful and regrettable fiscal exposure lies in the accumulated costs of workforce instability. The projected additional retirement contribution of approximately $89 million per year must be evaluated against status quo. What Alaska has now is substantial current excess operating costs generated by turnover and vacancies.

Premium pay alone now totals roughly $200 million annually, compared to an estimated baseline of $60 million in FY26. That implies approximately $140 million in excess premium pay. This excess pay must be added an estimated $62 million in turnover-related hiring, separation, and training costs, as well as roughly $14 million in foregone investment earnings attributable to the DC structure earning lower returns than the DB trusts.

In total, identifiable instability-related fiscal exposure exceeds $216 million per year ($140M+62M+14M). The bottom line is that spending $89 million annually on a pension structure that stabilizes the workforce and earns more for every dollar earned is not a net fiscal loss. These components are additive and non-overlapping: premium pay compensates remaining workers; recruitment costs reflect replacing departing workers. Cost projections do not incorporate spending less to save more as a budget opportunity. Even partial reductions in premium pay and turnover-related costs would materially offset the projected increase in retirement contributions.

IV. Productivity Profiles and Experience Spillovers

Labor economics research consistently demonstrates that productivity in education and public safety occupations is experience dependent. Teachers often reach peak instructional effectiveness after 15–20 years of service, while policing effectiveness improves with tenure and accumulated situational knowledge (Owens & Ba, 2021).

High turnover alters workforce composition by increasing the share of early-career employees. This compositional shift reduces average productivity and increases training burdens on experienced staff. Supervisory and mentoring time diverted to onboarding reduces available service output.

In sectors such as Corrections and Public Safety, institutional memory and procedural familiarity contribute directly to operational stability. Replacing experienced employees with new hires may increase training costs and temporarily reduce operational efficiency.

V. Investment Return Differences Between DB and DC Plans

Defined benefit plans pool assets and invest collectively, allowing for diversified portfolios and lower administrative fees. Defined contribution plans rely on individual account management and typically incur higher fee structures.

Research comparing DB and DC systems indicates that DB plans earn approximately 0.7 percentage points higher returns on a risk- and fee-adjusted basis (Munnell et al., 2015). Applied to Alaska's reported DC asset balances exceeding $2 billion, this differential implies estimated annual return differences of approximately $14 million. Higher collective investment efficiency represents an additional fiscal consideration independent of turnover effects. Investment return differentials compound over time and influence retirement long-term system costs.

VI. Teacher Turnover Benchmarks and Education Stability

The Learning Policy Institute (2024) estimates per-teacher turnover costs ranging from $11,860 in small districts to $24,930 in large districts. These estimates include recruitment, training, and separation costs but exclude important long-term instructional disruption effects and the consequence it has on the education and future productivity of the students.

For almost a decade Alaska has been deeply concerned about how the DC design encourages teacher turnover and the harm high teacher turnover rates cause. In Alaska, turnover is now at 30% or higher in nearly every community type except the urban fringe where it is 20%. School principal turnover is higher still, reaching 44% in rural hubs and 55% in remote rural communities and about 20% in urban and urban-fringe areas. (Burke & DeFeo, 2025).

These turnover numbers are high; national turnover rates are less than half of Alaska's 16% for public-school teachers and about 17% for principals (National Center for Education Statistics, 2024a, 2024b; Burke & DeFeo, 2025). Teacher and principal turnover matters because high turnover is associated with significant negative student outcomes (Vazquez et. al., 2019). It is not just students who are harmed.

Education stability has downstream positive economic implications for a state. Research indicates that regions with stable educational systems are better positioned to attract skilled labor and private investment (Glaeser & Saiz, 2000). While pension design is not the sole determinant of teacher retention, retirement incentives influence long-term attachment decisions.

VII. Broader Economic Linkages

Similar to the positive effect of education stability on business climate, regional economic literature identifies public service stability as a contributing factor to business climate quality. Bartik (1991) demonstrates that public services may reduce private production costs and increase regional attractiveness. Similarly, Glaeser and Saiz (2000) find that skilled workforce concentrations correlate with economic growth resilience.

Prior comparative analysis indicates that if Alaska's Gross Domestic Product (GDP) had grown at Wyoming's rate over the past decade, it would be approximately $3 billion higher (Ghilarducci, 2024). While pension design alone does not determine macroeconomic performance, workforce stability contributes to permitting efficiency, transportation reliability, and educational quality. Positive state business environment factors attract and help expand private investment in the state.

VIII. COMPARATIVE FISCAL ASSESSMENT.

Fiscal notes are narrow actuarial calculations and by design do not include the total net costs due to workforce dynamics and other economic changes. An actuary is not trained to make dynamic predictions. The March 24, 2025, Gallagher's HB 78 actuarial report projects that State retirement contributions would increase by approximately $1.15 billion over FY27–FY39. This total includes $467.0 million in additional State contributions above statutory employer caps and $687.2 million in increased State-as-an-Employer contributions on State payroll. Annualized over the 13-year period, the projected increase equals approximately $89 million per year.

Yet, these projections reflect retirement-system contribution mechanics. These cost projections do not incorporate operating savings associated with improved employee retention under a DB structure and investment return savings necessary for a proper cost benefit analysis. The actuarial analysis explicitly excludes annual savings associated with improvements in workforce dynamics and investment returns. The annual savings include:

- Reduced excess premium pay: $140million (which is $200 million actual premium pay minus a normal baseline of $60 million).
- Lower recruitment and training costs: $62 million (representing a 50% reduction of the estimated $124 million annual turnover cost).
- Savings from the superior investment returns of DB plans compared to DC plans: approximately $14 million.

This does not include the positive benefits from productivity gains from improved retention (including morale improvement of remaining employees when overall employee turnover is reduced). When public employees are more productive, business climate improves, public satisfaction and safety increases, and residents are more educated.

In sum, HB 78 has the potential not only to improve workforce retention but also to reduce net annual costs for the State. Using FY26 premium pay projections and conservative, non-overlapping cost assumptions and after accounting for the projected $89 million annual increase in retirement contributions, the net fiscal impact under conservative assumptions is approximately $127 million in annual savings. This estimate is composed of four distinct elements:

- First, Department of Administration's reporting projects premium pay to cost $200 million in FY26 (even though current trends suggest the costs will far exceed $200 million). Premium costs reflect vacancy-driven overtime, differential pay, and emergency coverage and are separate from recruitment expenses.

- Second, direct replacement and onboarding costs include separation processing, recruitment, hiring, and initial training and are conservatively estimated at approximately $62 million per year, based on a 6% annual turnover rate applied to a workforce of roughly 30,000 employees with an average salary of $69,000. This estimate does not include overtime or vacancy coverage costs and therefore does not overlap with premium pay.

- Third, DB plans earn approximately 0.7 percentage points higher risk- and fee-adjusted returns than defined contribution plans; applied to Alaska's reported DC asset balances exceeding $2 billion, this implies an estimated annual investment efficiency differential of approximately $14 million.

- Fourth, improved employee productivity will have knock-on effects of a better business environment and a more educated workforce and a better served public.

Under conservative non-overlapping assumptions, excess vacancy-related fiscal exposure($216M) exceeds projected additional employer contributions ($89M). HB 78 saves $127M per year.

Component	**Amount**
Excess Premium Pay savings	$140M
Replacement Cost savings (50%)	$62M
Inferior investment differential	$14M
Total identifiable excess cost	$216M
Annual HB 78 Cost	$89M
Net estimated annual savings	**$127M**

Importantly, the actuarial projections for HB 78 assume asset transfers that result in zero unfunded liability for the new sub-trusts at implementation and incorporate structural risk-sharing provisions that limit downside exposure.

IX. CONCLUSION

The fiscal evidence indicates that workforce instability imposes recurring and measurable costs on Alaska's operating budget. Premium pay expenditures, recruitment costs, training burdens, and investment return differentials collectively exceed projected reform costs under conservative assumptions.

Importantly, pension design meaningfully affects employee behavior. Pay and benefits especially influence employees' attachment to a job. Job attachment is especially important in occupations in which employee productivity— "know-how", judgement, etc.—increases with experience and institutional knowledge. Highly productive employees improve quality and contribute to operational stability. Alaska's current DC retirement design is *not* retention-oriented compensation; DB pension design is a better recruitment and retention tool.

This testimony presents fiscal estimates for legislative consideration. The available evidence suggests that workforce stability has direct budgetary and institutional implications for the State of Alaska and the DB design would reduce overall net costs to the State.

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