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To: Donny Olson, Co-Chair, Senate Finance
Cc: Members of the Alaska Senate Finance Committee
From: Teresa Ghilarducci, Ph.D.
Re: Fiscal and Economic Impact of SB 88
Date: January 16, 2024

Executive Summary: Defined Benefit Plans And Alaska Public Employees

Alaska faces severe staffing shortages in teaching, public safety, and vital public services. The main cause of these shortages is high turnover, closely followed by limited recruitment. Cost savings from reinstating a defined benefit (DB) retirement plan for Alaska public employees would primarily be achieved by reducing turnover and secondarily by enhancing financial returns.

A defined benefit plan significantly decreases turnover, and a dollar invested in a DB plan yields a higher rate of return compared to a dollar contributed to the currently designed defined contribution (DC) plan.¹ The initial costs of reinstating a DB plan must be properly discounted and netted against the benefits of a DB plan.

For Alaska, the most conservative – and incomplete -- estimated cost savings created by switching to a DB plan is \$76M per year. This estimate is incomplete because it does not include direct employer contribution cost savings and the indirect, but real, gains to attracting private investment and economic development stemming from better public services. Nor does it include the indirect, but real, gains to higher quality teaching, police and fire, and other public services.

The reinstatement of a defined benefit retirement (DB) plan for public employees could lead to substantial and sustained benefits in raising the quality of Alaska public services and making the state an attractive place to live and invest.

In sum: the costs of reinstating a defined benefit retirement plan should be weighed against its benefits.

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Alaska's High Public Employment Turnover And Its Causes

Most states report increasing difficulties in attracting and retaining workers in vital professions in education, public health, and public safety. The problem of attracting and retaining firefighters, police officers, and teachers are especially acute in Alaska.²

The high turnover rate and associated costs in the ranks of Alaska's public employment are caused by several factors, yet chief causes are connected to the change in the Alaska State pension system in 2006 when Alaska departed from the standard U.S. and global public employment practices by replacing the traditional pension system for public employees with a 401(k)-type individual account plan.

Unlike defined benefit plans (DB), which are designed to attract employees to a profession and escalate pay for medium and long-term employees, the 2006 experiment with a defined contribution (DC), or 401(k) -design, allows individuals to take out their retirement savings from the state or cash them out after five years.

In public safety, the estimated annual cost of lost returns on training costs – assuming only a 1% turnover rate due to low pay and pensions – is over \$4 million.³ However, the estimate is far too low. Alaska public safety agencies are reporting up to 6% non-retirement separation rates. In public education, a 2017 University of Alaska Institute of Socio-Economic Research report quantified an annual loss of \$20 million in teacher recruitment and retention costs, or over \$20,431.08 per teacher.⁴

The total costs of turnover cannot be ignored when assessing the benefits of a new DB plan. Actuaries from Buck Consultants in a letter to Director Ajay Desai, acknowledged their cost assessment of the SB88-proposed-DB plan was incomplete without cost savings from reducing turnover being acknowledged.⁵

Cheiron Consulting report, also in 2023, reported an SB88–DB plan would save the State costs because current contributions in the DC plan are more than a future DB plan. The cost advantages of a DB plan would even be higher.

Both actuarial reports do not consider 1) direct savings in hiring and training costs; 2) direct savings from a higher return and less risky return on DB assets compared to DC assets; 3) indirect, but real, savings from improved productivity from reduced turnover; 4) indirect, but real, economic activity induced by more reliable public safety, public education, and public services.

The direct cost savings from switching to a DB plan is estimated with the most conservative assumptions of \$76M per year, which consists of the direct cost savings stemming from reducing hiring and training costs of \$62M per year, and the direct cost savings to earning a higher rate of return of \$14M.⁶

Switching to a modified defined benefit plan in Alaska could save taxpayers significant costs and improve the quality of life. Changing from a DC to a DB plan would lower the costs related to employee turnover and, more importantly, improve public services by keeping experienced and productive workers.

Further, it is important to keep public employee vacancy rates low. Public employees play a vital role in a state's infrastructure, contributing to regional economic growth by delivering high-quality public services. Quality infrastructure, in turn, supports regional economic development. Unexplained deaths in prisons; classrooms with no teachers; and public ferries moored for lack of staff impede growth and well-being.

Alaska public employee turnover increased noticeably after the 2006 pension reform when mid-career employees for the State of Alaska could transport their accumulated value without any more service or penalty. Wolfgang Junge, DOT&PF Central Region Director says of this period,

Our ability to retain employees, really much longer than four or five years anymore, and no more than ten years became largely impacted by trends and portability of those benefits.”⁷

James Harris, Alaska's 2017 Teacher of the Year, moved to Washington State citing the poor retirement system,

Unfortunately, the retirement system in Alaska, it was set up in a way that there was just absolutely no way for me to retire with any kind of dignity”⁸

The High Cost of Turnover and The Main Benefits of Reduced Turnover

The costs of employee turnover are especially high for employers who depend on experienced and engaged employees. When an employee leaves, the returns on training and hiring walk out the door. There are many benefits to increasing commitment and longevity on the job. Here are several major benefits of reducing employee turnover:

Lower employee turnover generally reduces employer costs of recruitment and hiring by extending the period of amortization of those costs.

The benefits of lower employee turnover are underappreciated because the benefits are not easily measured but are easily felt. Lower employee turnover raises the average level of productivity in careers where experience is associated with higher levels of productivity -- most public services are in this category. In other words, churn lowers average productivity.

Reduced turnover raises average productivity levels. Why does experience raise productivity? Employees with longer tenures often possess institutional knowledge and skills that are valuable to the organization. High turnover leads to knowledge loss.

In 2022 Alaska Correctional Officers' representative, Randy McLellan, testified to the Alaska Legislature that the agency's severe staffing crisis was partly due to ending the DB retirement plan in 2006. McLellan said older officers can work in Alaska and afford to retire, but after getting trained, the younger officers cannot so they leave. That means big losses for experienced workers.

Every time the DOC loses an experienced officer, we're forced to backfill that position with an inexperienced recruit." - Randy McLellan

The total costs of turnover cannot be ignored when assessing the benefits of a new DB plan. Actuaries from Buck Consultants in a letter to Ajay Desai, acknowledged their cost assessment of the SB88-proposed-DB plan was incomplete without cost savings from reducing turnover being acknowledged.⁹

Cheiron Consulting report, also in 2023, reported an SB88-DB plan would *reduce costs* for the Alaska Treasury because current DC costs are higher than the proposed DB contribution. Cheiron also computes SB88's cost savings without considering the significant savings from reducing turnover. The actuarial reports do not consider 1) direct savings in hiring and training costs; 2) direct savings from a higher return and less risky return on DB assets compared to DC assets; 3) indirect, but real, savings from improved productivity from reduced turnover; 4) indirect, but real, economic activity induced by more reliable public safety, public education, and public services.

Higher retention can raise morale, engagement, and peer-on-the-job mentoring. Remaining workers are burdened by having to adjust to new employees likely to leave.

Lower turnover lowers the direct administrative costs of processing resignations, conducting exit interviews, and managing paperwork related to employee departures.

Lower turnover in public employment improves relationships with the taxpayer who are the ultimate customers of the public services, public safety, and teaching. Newly- appointed leaders— a new police and fire chief, education superintendent, and even Governor – can do better if employees in police, fire, and education, etc. are experienced and not newbies.

Lowering turnover requires a host of factors often particular to an occupation and concerns cash pay, training, and good management. But all the research shows, including the recent Buck report on the costs of a DB plan,¹⁰ acknowledges, that DB plans lower turnover. The perceived value of a DB pension as a valuable long-term benefit comes from reputation and knowledge. Knowing about former employees, like ones with financial security in retirement, can positively influence how one perceives their overall compensation package. For example, if teachers know retired teachers who are financially comfortable that produces goodwill, motivation, and commitment.

DB Plans Help Recruit Committed Employees

DB plans help recruit new workers as part of an attractive and competitive compensation offer.

Many factors determine whether people view an occupation as a good career. Employment security matters to workers. In choosing a job employees look for signals that employers are committed to their employees. The form in which retirement benefits are delivered is a key way employers signal commitment.

A 401(k)-type plan pays the same amount (relative to pay) to a long-standing employee as to a recent arrival. That long-standing employees get no premium from a DC plan projects the message that the employer has a low commitment to a longstanding employee. In contrast, defined benefit pension plans – whose value increases the longer an employee stays attached to the employer (and profession) -- are highly effective tools to signal to potential employees that they care about experienced workers.¹¹

Alaska has not been able to encourage its residents to be teachers, which signals a chronic supply problem. Three-fourths of Alaskan teachers were from out of state; in contrast, students in New Jersey and New York are attracted to the profession. These states have some of the highest-paid teachers in the nation and strong defined benefit pension plans (with retiree health benefits).

These states issued effectively no initial teaching credentials to teachers with credentials from out of their state and were able to attract their residents into the profession. Teaching is a good job in New York and New Jersey.¹² A large part of the attraction in New York and New Jersey for teachers are the generous DB benefits, retiree health plans, and Social Security.

Defined Benefit Plans Help Retain Productive Employees

As mentioned above, retention is a key factor in increasing the productivity of teachers, public safety officers, and most other employees in public service and DB plans are key factors in increasing retention.

Teaching is a good example because the research is extensive and excellent, for a profession in which retention is an especially important factor in delivering effective education. Studies of teacher effectiveness and productivity converge on the finding that teaching effectiveness (or in the language of an economist, “productivity”) grows with teacher experience.

The key finding is that teacher productivity levels peak at about 15 – 20 years and decline after about 30-35 years. (I am using a range estimating the years of experience needed to achieve peak performance because measuring teacher effectiveness is complex. The rates of return on productivity for every year of experience – “experience -productivity profiles” -- are approximate).¹³ Offering a retirement plan whose value peaks at 5 years is wholly inappropriate for this type of employment. A successful private company would not survive this misalignment with compensation and needs of the employer and customers.

We also have good data on public safety experience-productivity profiles.

The productivity profiles of public safety (police and fire) are similar, experience and training lead to better performance.¹⁴ Police productivity is enhanced by longer-serving police officers. Rookies make mistakes. For both police and teaching decreasing turnover has enormous benefits in the form of highly productive workers, who not only deliver good teaching and policy work but who are also available to demonstrate and teach good practices to new employees.

The following quote from an experienced police officer in a guide for ‘rookies,’ illustrates the role of experience,

Too many young police officers want to move on and up before they really have a good foundation. They think that because they have graduated from the academy and completed the field training program, they know the job. I think that most veteran officers would agree with the statement, ‘They have only begun to know the job.’ The lack of a solid foundation will come to hurt these new officers in the long run. - Paul Verrecchia, Chief of Police/Director of Public Safety at College of Charleston¹⁵

The high benefits of retention must be weighed against the cost of a new DB plan. The cost of retention may include more pay and transition costs of switching to a defined benefit plan from the current DC plan. The benefits come from having enough and more experienced Alaskan public employees.

In short, the cost of retention with a DB plan must be weighed against the benefits of retention.¹⁶ Since a DB plan helps provide experienced workers the *rate of return* of a DB benefit plan is positive productivity, lower turnover costs (more below), and workers available to train new employees.

More evidence that defined benefit plans decrease employee turnover follows. Buck Consulting Company found the cost to Alaska of converting from a DC design to a DB pension design is primarily caused by a predictable increase in job tenure and decreased turnover. Buck recognizes, with its expertise, that DB plans reduce turnover.¹⁷ Reducing turnover is precisely the goal of a strategic compensation arrangement for a state needing the most efficient ways to attract and retain public safety and teaching professionals.

Economic research shows that “public trust” is a vital element of good police work. Public trust is also important in determining the quality of fire services and education. The public trust in police officers, teachers, and firefighters rises when these workers have long-standing relationships with local systems and populations. Therefore, low turnover, more experience, and longer job tenure significantly increase productivity in these professions.

The combination of pay and benefits is called the “composition of compensation” and refers to how an employer balances cash, tenure-weighted benefits – employee benefits whose value increases with years of experience, for example, vacations and DB pensions.

Aligning compensation and benefits with productivity is consistent with the principles of strategic human resource management. Integrating HR practices with overall organizational goals – in the public sector the goals are experienced employees with knowledge of Alaska and the human needs of people living there and to optimize employee pay and benefits to maximize their productivity.

Organizations strive to design compensation packages that are competitive in the labor market and tailored to the specific needs and characteristics of their workforce, special factors of the job, skill, and, importantly what the school, public health, and safety are trying to achieve. A good compensation package structure attracts, motivates, and retains the right talent, to help the employer succeed.¹⁸

Tenure-weighted benefits significantly increase tenure on the job. Conservative economists from the University of Chicago and Columbia University developed the field of “Strategic Personal Management or Strategic Human Resources.” The late Professor Edward Lazear is the economist most recently associated with this concept and he served as President George Bush’s Chair of the Council of Economic Advisors.¹⁹ Lazear argued DB plans help retain workers.

Economist Stuart Dorsey and colleagues have also shown that defined-benefit pensions lead to more training, which leads to higher productivity.²⁰ Economists Stephen Woodbury and Richard Ippolito²¹ arguing the structure of employee benefits must match the personnel goals of an organization. The DB plans help meet the goals of employers who want a low-turnover and high-commitment workplace. In contrast, if an employer wants essentially day labor (new workers every day) -- all cash -- and a form of cash which is represented by a 401(k) contribution would be the optimal composition of compensation.

In other words, the research finds a DB plan is best in a situation where an employer needs a trusted and experienced worker, in part because the kind of work the person does is not easily monitored and quality is not measured hour by hour, day by day. A DB plan pays for experience. 401(k) plans, in contrast, treat public safety workers and teachers like day laborers. Occupations requiring public trust and complex learning are occupations that need institutions that encourage experiences and low turnover.

Experienced Public Employees Create Spillover Benefits To Entire Economy

Lower levels of turnover mean more experienced teachers, public safety employees, and others. An experienced public sector workforce boosts the quality – and thus the public’s perception of that quality – of Alaska’s education and public services. When more Americans, including incumbent Alaskans, view Alaska as a good place to educate children and pursue a career, Alaska’s private investment, population, and economy will grow.

In sum, DB pension plans reduce public employee turnover. More experienced public employees provide better public services. Better public services spill over to improve the economic dynamics of the state.

In Alaska, a DB plan for Alaska state employees will improve overall economic growth. DC plans for Alaska public employees likely suppress Alaskan state and regional economic growth.²² The pathway of causation is that DC plans reduce public employee loyalty and productivity. This lack of trust shifts voters away from supporting resources that help boost innovation in the public sector. Also, private capital steers away from areas with low education quality.

DB plans also boost a state’s income and wealth equity. When inequality gets too high inequality can impede economic growth. The predominance of DC pension plans increases income and

wealth inequality in a region and boosts poverty rates. How do DC plans create more inequality? DC plans produce inadequate balances mostly because of cash-outs before retirement. Also, DC plans, compared to DB plans, are managed by amateur individuals choosing their own investments from a host of sometimes high-fee and high-risk options. Unsophisticated investors in DC plans garner a lower return than those who have professional money management in a DB plan. Workers with DB plans garner lower risk and fee adjusted returns on their pension dollars.

A 2023 Congressional Budget Office 2023 study ²³finds that between 1989 and 2019, the shift from defined benefit to defined contribution plans accounted for about 20% of the increase in inequality – measured by the Gini Coefficient. According to a 2019 Federal Reserve study²⁴ the national shift to DC plans away from DB plans was associated with the share of retirement wealth going to the bottom 50% of Americans greatly reduced.

Nations with the lowest share of seniors receiving public pension income had the highest levels of income inequality.²⁵ U.C. Berkeley researcher Nari Rhee linked public defined benefit pension plans to a more equal distribution of retirement income and defined contribution plans to more inequality. DB plans play an outsized role in securing retirement income for women and nonwhite workers.²⁶

DBs Earn Higher Rates of Return Than DCs

Moreover, reinstating a modified defined benefit plan will bring considerable savings to the Alaska Treasury because a DB dollar earns a higher rate of return than a dollar contributed to a DC plan. ²⁷DC plans earn a lower return for each dollar Alaskan taxpayers pay for public employee pensions. DB assets are pooled and professionally managed. Pooling allows for lower fees and for professional money managers to adopt an optimal portfolio. Individuals who direct their own 401(k) – type plan, pay higher fees and react idiosyncratically to market changes and asset choices. Therefore, DB plans earn a higher risk-and-fee-adjusted rate of return than an individual DC account.

Mistakes in Assessing the Costs of SB 88 – DB Conversion from DC to DB

Healthcare costs will not increase under SB88. The assertion that public safety workers will early retire if a DB plan is implemented and immediately access healthcare benefits and increasing costs is wrong. Public safety workers must use their accrued HRA account funds to pay for health plan insurance premiums until they are 65 years of age and eligible for Medicare.²⁸

Contribution costs will fall with SB88. For PERS, SB 88 replaces a 5% DCR employer contribution with a lower 4.13% DB employer contribution, and for TRS SB 88 replaces a 7% DC employer contribution with a lower 6.93% employer contribution.²⁹

Transition costs from a DC to a DB should be discounted. The Buck report³⁰ projects “\$1.2 billion in future unfunded liability” to be paid off by 2039. The present value of that money should have been discussed, which is less than one-half of that amount, \$682.58 million. ³¹

Alaska Public Employee Compensation Should Align With the Goals and Values of Alaska

High rates of accidents and illnesses in Alaska’s prisons, high rates of school dropouts, poorly performing public transit, and other disintegrating public services conflict with the State of Alaska’s mission to provide a flourishing place for its residents to thrive and work.

Another important goal of Alaska state government is efficiency. State government is obliged to manage public goods and services with efficiency, and to get the maximum productivity for the least costs. No successful employer would keep a compensation package that did not meet its goals.

Alaska needs to change the composition of compensation for public employees in order to reduce turnover and attract committed workers. By reconfiguring pay and employee benefits Alaska can save money by lowering vacancy rates, lowering turnover, increasing productivity, and increasing the quality and quantity of public service delivery. Doing so will help Alaska deliver on the mission of providing quality public services and stop the collapse of nearly every public service agency.

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ENDNOTES

¹ Munnell et. al. (2015), Rhee and Fornia (2014).

² There are many references to shortages in Alaska public services. I refer the reader to the recent reports supporting Governor Dunleavy’s order to drop requirements for many state jobs in order to boost the number of applicants for state employment. *The Hill*, (2023).

³ In public safety, the estimated annual cost of lost returns on training costs – assuming only a 1% turnover rate due to low pay and pensions – is over \$4 million. I need the citation for this fact.

⁴ DeFeo et. al (2017).

⁵ “The study does not include other costs/savings that may be incurred/realized by employers outside of the DB and DCR plans (e.g., costs associated with potential anti-selection issues that may arise when individuals are presented with a choice between the DB and DCR plans, or savings in recruitment and training costs due to expected higher retention under the DB plans). The study also does not assume any subsequent changes in asset allocation or investment strategy that might support a different investment return assumption. “ Buck, pg. 5, 2023.

⁶ A turnover rate of 6% for 30,000 employees with an average annual salary of about \$69,000 per year yields an annual loss of \$124 million. Reducing the turnover by half would result in substantial savings, \$62M. DB plans earn a conservative .7 percentage point higher return than DC plans, for example, if DC plans earn 6% then DB assets likely earn 6.7% Total DC account balances are over \$2 billion.

⁷ Quote from Alaska State Senator Cathy Giessel’s presentation on SB 88 on March 13, 2023, Senate Labor And Commerce Committee.

⁸ A high school teacher, Corrine Marks, also cited the loss of defined benefits as a main reason so many teachers are leaving Alaska, she said, “I’ve had more teachers come and go just here in Juneau, which is an easy place to stay, comparatively, right? Because they have nothing holding them here.” Stremple (2021).

⁹ “The study does not include other costs/savings that may be incurred/realized by employers outside of the DB and DCR plans (e.g., costs associated with potential anti-selection issues that may arise when individuals are presented with a choice between the DB and DCR plans, or savings in recruitment and training costs due to expected higher retention under the DB plans). The study also does not assume any subsequent changes in asset allocation or investment strategy that might support a different investment return assumption. “ Buck, pg. 5, 2023.

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HOW DEFINED BENEFITS FOR PUBLIC EMPLOYEES IMPACT THE ALASKA ECONOMY

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EXECUTIVE SUMMARY

Alaska's economic future depends heavily on the strength and stability of its public workforce, including essential workers such as teachers, healthcare professionals, and public safety employees. These public employees provide critical services that support Alaska's residents' daily lives and bolster private sector operations. Reliable public services like education, transportation, and safety reduce business costs and create an environment conducive to growth and investment.

If Alaska's GDP had grown by the same amount as Wyoming's GDP Alaska's GDP would be \$3 billion higher. Indeed, \$3B more GDP would have yielded more local revenue. The DB plan is not the entire solution to sluggish growth, and the pay system that encourages people to leave teaching or the state is not the sole cause of business and population decline. But DB plans help boost the quality of public service and the decline in public service reduces economic activity.

In 2007, Alaska shifted from a defined benefit (DB) pension system to a defined contribution (DC) system. This shift has negatively impacted the state's public workforce by increasing turnover, reducing public employees' long-term commitment, and weakening the overall quality of public services. Under the DC system, public employees can cash out their retirement savings after just five years of service, leading to a short-term outlook among workers and incentivizing them to leave their jobs sooner. This high turnover has strained the delivery of critical public services and created challenges for recruitment and retention.

DB plans help recruit the right kind of employee by signaling high commitment. In contrast, DC plans signal low commitment because loyalty is not rewarded in DC plans. A DB plan pays for experience. In contrast, 401(k) plans treat public safety workers and teachers like day laborers.

Research consistently shows that DB pension plans, which guarantee retirement benefits based on years of service, provide long-term financial security and incentivize employees to stay in their jobs, and helps with recruitment in teaching, public safety, and other vital public services.

By restoring DB plans, Alaska can reduce turnover, improve public service quality, and support the public and private sectors. This report analyzes how restoring DB pensions would strengthen Alaska's public workforce and drive economic development by improving public services that are essential for private businesses.

This report also examines how public services impact economic growth, explores the importance of high-quality services in offsetting Alaska's geographic and weather-related challenges, and argues for restoring DB pensions as a cost-effective solution to Alaska's workforce challenges.

THE FISCAL CASE FOR A ROBUST PUBLIC WORKFORCE AND DB PLAN

Given all that we know about the economic linkages between good public services and business investment (see below) I estimated a number to quantify how much bigger the state economy would be, and how much tax revenue would have flowed in state revenues if the business climate was better. Business investment triggers more aggregate demand, more employment, and higher private sector wages. No economic model can independently isolate improving public services independent effect on new startups.

If Alaska's GDP had grown by the same amount as Wyoming's Alaska's GDP would be \$3 billion higher. Indeed \$3 B more GDP would have yielded more local revenue. Therefore, the DB plan for state employees generates more positive effects than \$76 million (Ghilarducci 2024) of annual direct savings (by reducing public employee turnover and saving on pension costs) but the additional amount is not possible to quantify. A DB for state workers will help the Alaska economy.

It is not possible to directly link GDP growth with Alaska State fiscal revenue. Lost GDP stemming from poor management of state employees does not directly affect State revenue. Therefore, a proper dynamic model cannot be constructed. But the indirect link is real. Any responsible analysis of the Alaska state economy acknowledges private business needs stable and highly qualified state employees. DB pension plans for state employees promote employment stability, commitment to task, higher productivity, and higher state capacity. There is a significant and positive link between defined benefit pension plans for state employees and the health of the Alaska state economy.

The decline in defined benefit pensions leads to a reduction in state capacity. This, in turn, affects the ability to serve the public and support businesses, which results in a decline in population and a decrease in business activity. The chain reaction continues with a decline in state GDP, followed by a decrease in local property taxes and, ultimately, a deterioration in the quality of life in Alaska.

This report demonstrates the vital link between state capacity and economic growth.

A state not able to attract and retain teachers is a state that will be unattractive for many private sector investors.

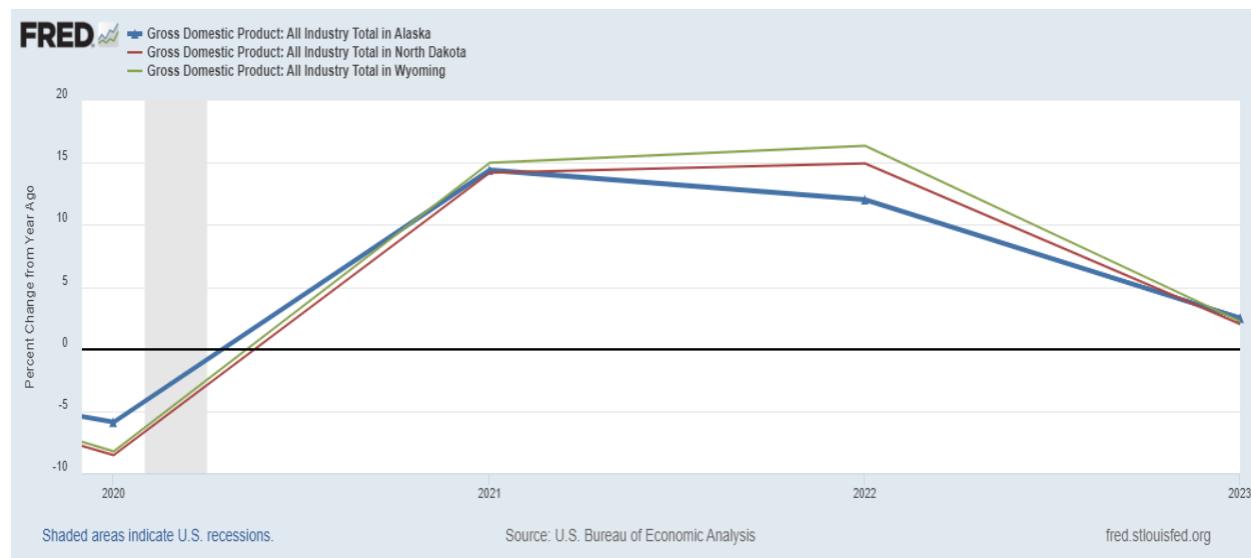
Pension reform aimed at improving the capacity of education and public services signals to business investors that the state welcomes high value-adding and developmental private commercial activity. The state understands that a pension system that encourages outmigration needs to be fixed to make the state attractive for private sector investment. Reinstating the defined benefit pension plan for state employees is proposed to help Alaska's economy by shoring up the quality of public services.

Alaska GDP Lags

Despite all three states' dependence on the energy sector, from 2017 to 2023, Alaska, North Dakota, and Wyoming experienced significant variations in GDP growth. Alaska's GDP declined by 1.02% over this period. North Dakota's average annual growth rate was approximately 1.92% from 2019 to 2023, and Wyoming outperformed both states, showing consistent growth with an average rate of about 2.1% per year from 2019 to 2023.

This means while oil price volatility affected these three similar states Alaska has grown about 27% since 2008 and Wyoming grew by 32%. If Alaska's GDP had grown by the same amount as Wyoming's, its GDP would be \$3 billion higher. (The percentage change in GDP growth from a year ago of the three oil-dependent states, Alaska, Wyoming, and North Dakota are displayed in the table below¹.)

Table 1: Alaska GDP Lags



A larger GDP does not add to state revenues, because of the Alaska "disconnect"² -- it certainly adds to local government capacity. It also helps attract more migrants and the increase in

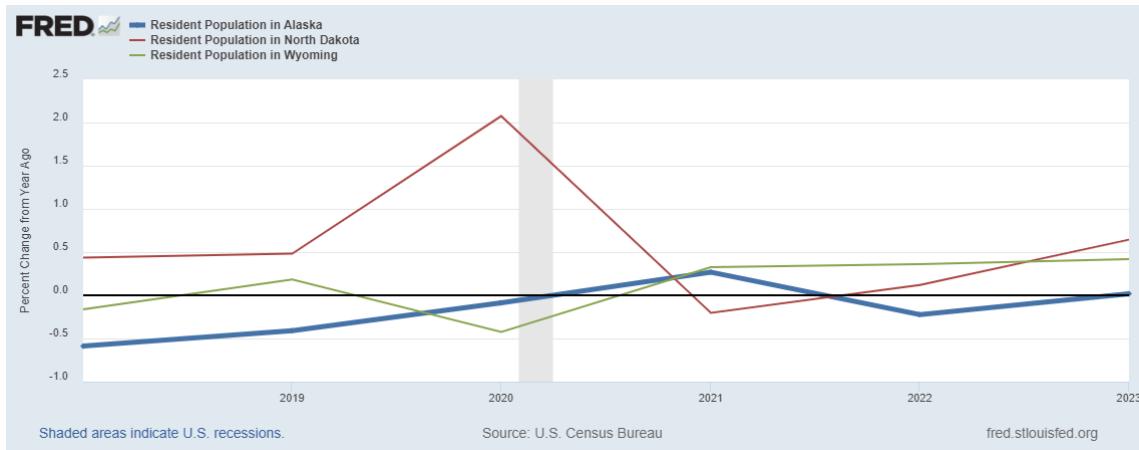
aggregate demand helps workers get higher wages and provides more opportunities. I am confident that the state of Alaska would get more tax revenue from increased economic activity that comes about when Alaska provides a friendly business climate with better public services.

Alaska Population Lags

Between 2013 and 2023, Alaska's population decreased by 0.57%, falling to 733,406, largely due to the outmigration of teachers and young workers, especially in rural areas where high turnover among educators has strained local communities. Alaska experienced significant outmigration, with more people leaving than arriving, marking a prolonged period of negative net migration caused by few new residents.

Comparatively, Alaska's peer states like South Dakota, Wyoming, and Louisiana have faced less pronounced outmigration trends. For example, South Dakota saw positive population growth in this period, partly due to migration inflows, which contrasts to Alaska's stagnation (Brooks, 2023).

Table 2: Alaska's Population Lags



ECONOMIC GROWTH AND PUBLIC SERVICES: THE CRITICAL CONNECTION

Republican Glenn Youngkin, Governor of Virginia explained why Virginia ranked number one in business climate. Not surprisingly goods and services the public sector provides, Youngkin says a state can quickly deliver what companies require to make investment decisions. “These include sites, permitting confidence, workforce development, utilities, and ancillary factors that enable companies to meet their schedules for becoming operational.”

Numerous studies have demonstrated what Youngkin says is right. Public services play a key role in regional economic growth. Quality public services such as education, transportation,

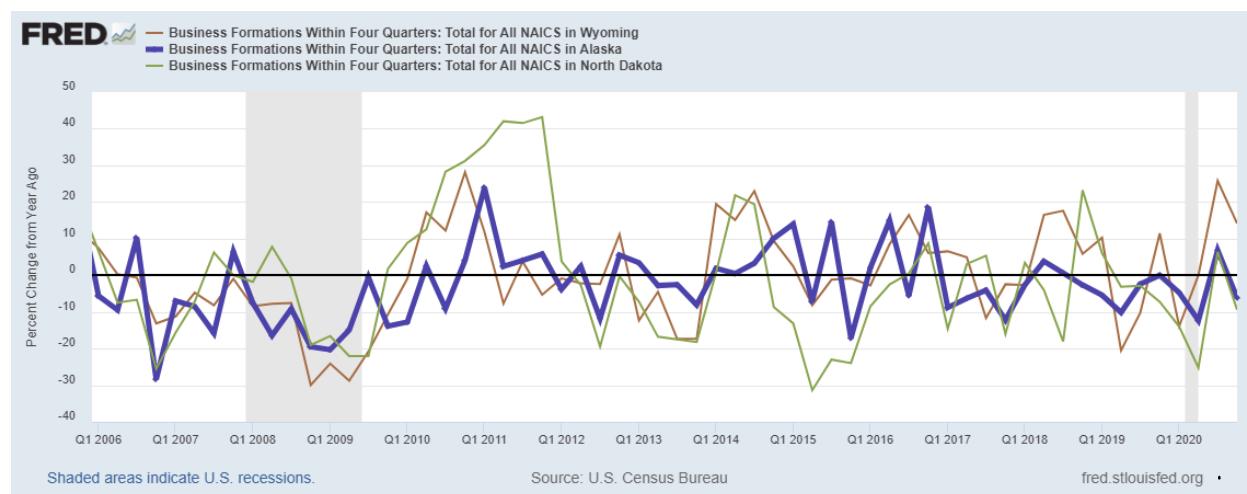
healthcare, and safety provide businesses with essential infrastructure, reduce operational costs, and improve workforce productivity (Bartik, 1991). For Alaska, where geographic isolation and harsh weather can deter both businesses and workers, excellent public services are even more critical to ensuring long-term economic success.

Supply-Side Benefits of Public Services: Reducing Business Costs

Public services are vital for reducing costs for businesses. Public services that are especially useful for private business are high-quality, publicly provided transportation, communication infrastructure, public education, and public safety. Also, the ordinary processing of business permits, if bogged down can discourage private investment.

Business formation may be stymied in Alaska because permits can't be processed in a timely fashion. Evidence that business formation is stymied in Alaska is shown in the laggard record of business formation in Alaska compared to Alaska's peers. See Graph 3 which shows Alaska lagging behind in business formation. The data is from the St. Louis Federal Reserve.

Graph 3: Alaska Falls Behind Peer States in Business Permits



There are many factors determining business formation; easy processes are one of them.

Other public services besides permitting and regulatory processes include public infrastructure businesses need to operate efficiently. For example, a robust public transportation system enables businesses to move goods more easily, while well-maintained roads and ports reduce shipping times and costs. Similarly, well-funded public education systems provide businesses with a steady pipeline of skilled workers, reducing the need for expensive training programs. The connection is straight forward. Businesses benefit from not having to compensate for inadequate public services, such as poor education or safety or transportation.³

Economist Timothy Bartik (1991) highlighted the direct connection between strong public services and regional economic growth. His research showed that regions with better public services, particularly transportation and education—are more attractive to businesses, leading to increased private investment. For Alaska, where businesses often operate in remote and

challenging environments, the importance of quality public services cannot be overstated. Poor infrastructure and public services increase operational risks and costs, making the state less appealing to potential investors.

This issue has become especially pressing in Southeast Alaska, where reductions in ferry services through the Alaska Marine Highway System have had a profound impact on local businesses. Owners like Greg and Donica Jerue, who run J&S Freight in Juneau, have reported increased operational costs and delays due to reduced ferry services. Without reliable transportation, businesses in remote communities such as Kake and Haines face logistical challenges that disrupt supply chains and drive up costs (Schijvens, 2023).

The decline of Alaska's ferry system has had a profound economic impact on the state, driven in part by inconsistent funding and management by the State of Alaska. The shift from a defined benefit (DB) pension system to a defined contribution (DC) system further exacerbated the challenge of staffing critical positions within the marine highway. While not the sole cause of understaffing, the DC system's encouragement of employee turnover has made it harder to retain workers in these vital roles (Alaska Policy Forum 2023).

Education, another critical public service, directly influences the availability of skilled labor for businesses. Harvard economist Edward Glaeser and co-author Albert Saiz (2000) found that regions with high-quality education systems are better able to attract and retain a highly skilled workforce, which is essential for sustaining economic growth. Their research showed that when public schools produce more high school graduates and college-educated workers, local economies experience higher rates of job creation and wage growth.

For Alaska, where industries like oil, gas, and fishing increasingly require a more technically skilled workforce, investment in education is vital for long-term competitiveness. The findings are obvious. Intriguingly and potentially poignant for Alaska's future is that Glaeser stressed the resiliency regions need to grow. Outside shocks, out of Alaska's control – like worldwide changes in fishing and processing – require Alaska to innovate. A skilled workforce is more important than government grants and subsidies for a resilient economy.

The link between public education and workforce readiness is particularly important in Alaska, where teacher turnover rates are among the highest in the country. The Center for Alaska Education Policy Research (CAEPR) found that rural districts often lose between 20% and 33% of their teachers each year, leading to instability in the classroom and declining student performance (DeFeo et al., 2017). Addressing these challenges requires improving teacher retention, which can be achieved by restoring DB pension plans. These plans would provide financial security and incentivize long-term commitment from teachers, reducing turnover and stabilizing the education system.

Demand-Side Pathways: Shaping Economic Expectations

In addition to reducing business costs, public services influence the expectations and behaviors of residents, creating demand for local goods and services. Quality public services enhance the overall quality of life, which makes regions more attractive for both residents and businesses. For

example, regions with well-funded healthcare systems and public safety services provide residents with the security and stability they need to invest in their communities. This, in turn, encourages businesses to invest and grow.

Public employees themselves also generate demand for local businesses by spending their earnings within the state. A well-compensated public workforce contributes to the local economy by purchasing goods and services, buying homes, and supporting local businesses. Moreover, retirees who remain in the state continue to contribute economically through their pension income. By contrast, high turnover and outmigration among public employees reduce demand and deprive local economies of essential spending power.

A particularly relevant example is the oil and gas industry, which creates demand in a surprising sector – computer services. A dollar increase in natural extraction creates almost a dollar increase in the demand for high tech services. Transportation and business services are also needed, and those sectors require a stable, educated workforce to operate effectively. Without robust public services, including education, healthcare, and transportation, it becomes increasingly difficult to attract and retain skilled workers in these sectors. If Alaska's public services continue to deteriorate, industries that are critical to the state's economy will face labor shortages and reduced productivity (Fisher, 1997).

THE BUSINESS CASE FOR A ROBUST PUBLIC WORKFORCE

Alaska's business community is acutely aware of the connection between high-quality public services and economic growth. Business leaders have repeatedly expressed concerns about the state's declining public services and the impact these issues have on their ability to attract and retain skilled workers.

Jenna Wright, CEO of the Anchorage Economic Development Corporation (AEDC), has publicly emphasized that the low quality of Alaska's public education system is one of the primary obstacles to attracting skilled professionals to the state. Wright argued that without improvements in public education, Anchorage and the rest of the state will struggle to compete with other cities that offer better schools and infrastructure (Wright, 2024). This sentiment is widely shared by business leaders across the state, who recognize that attracting talent is essential for economic growth, particularly in high-tech industries and healthcare.

The Alaska Statewide Mentor Project found that high teacher turnover—particularly in rural areas—has had a devastating impact on the quality of education in the state. In some rural districts, as many as one in three teachers leave their jobs every year. This instability in the classroom negatively affects student achievement and contributes to high dropout rates, both of which have long-term implications for the state's labor market (DeFeo et al., 2017). Addressing these challenges requires reducing turnover and stabilizing the public workforce—goals that can be achieved through the restoration of DB pension plans.

Public transportation is another key area where Alaska's business community has expressed concerns. Cuts to the Alaska Marine Highway System have left many businesses in Southeast Alaska struggling to manage supply chains and increased operational costs. Business owners like Greg and Donica Jerue, whose company relies on the ferry system to transport goods, have seen their trucks idled for extended periods due to service reductions. This has caused severe delays and increased costs for businesses that rely on the ferry system to move goods and services across the state (Schijvens, 2023).

COUNTERING ALASKA'S WEATHER AND HIGH COST OF LIVING WITH EXCELLENT PUBLIC SERVICES

Alaska's geographic challenges, including its remoteness and harsh weather, create significant barriers to economic development and population retention. The state has experienced steady outmigration over the past decade, with more than 75,000 people leaving between 2012 and 2022 (Alaska Department of Labor, 2022). The reasons for this outmigration are complex, but one key factor is the difficulty of living and working in such a remote and often isolated environment.

Public services, however, can play a critical role in offsetting the negative effects of Alaska's geography. High-quality public services, particularly in education, healthcare, and transportation, make the state more livable and attractive for both residents and businesses. By ensuring that residents have access to reliable services, the state can encourage people to stay and invest in their communities, even in the face of challenging weather and remote locations.

In their influential study, Glaeser and Saiz (2000) demonstrated that regions with excellent public services are better able to retain residents, even in areas with less favorable climates or geographic disadvantages. Their research showed that public services like education and healthcare can make up for deficiencies in weather and geographic location by providing residents with the support they need to build successful, long-term lives in the region. For Alaska, this means that investing in public services can help counteract the state's natural disadvantages and reduce the outmigration that has plagued the state for over a decade.

Alaska's public services must also play a role in attracting new residents. With industries like oil and gas increasingly dependent on skilled workers, the state must ensure that it can offer a high quality of life to attract professionals from other regions. The Alaska Chamber of Commerce has repeatedly emphasized the importance of attracting a highly skilled workforce to the state's economy. However, without strong public services, including high-quality schools and reliable healthcare, the state will struggle to compete with other regions that offer better amenities and infrastructure (Glaeser & Saiz, 2000).

Furthermore, the weather and remoteness of Alaska increase the importance of a stable public transportation system. Cuts to ferry services have left many of these communities isolated and vulnerable to supply chain disruptions. Restoring ferry services and investing in public transportation would not only reduce operational costs for businesses but also make life more manageable for residents in remote areas (Schijvens, 2023).

HOW DB PENSIONS IMPROVE RETENTION AND REDUCE TURNOVER

One of the primary issues facing Alaska's public workforce is high turnover, particularly in sectors like education, healthcare, and public safety. Since the state's switch to a DC retirement system in 2007, employees have been able to cash out their retirement savings after just five years of service. This feature encourages short-term employment, as workers have little incentive to stay in their jobs long-term.

By contrast, DB pension plans provide financial security over the long term, incentivizing employees to remain in their positions throughout their careers. Under a DB plan, retirement benefits accrue over time, meaning that the longer an employee stays, the more valuable their pension becomes. This structure creates a strong incentive for employees to remain committed to their jobs. A study by Naff and Crum (2000) found that public employees with access to DB pensions were significantly less likely to leave their jobs compared to those with DC plans because the value of the pension increases with tenure. This loyalty reward structure helps reduce turnover and stabilizes the public workforce.

In Alaska, the negative impact of high turnover is particularly evident in education. The Center for Alaska Education Policy Research found that rural districts, which already face significant challenges in recruiting and retaining teachers, experience some of the highest turnover rates in the country. This constant churn of teachers undermines the quality of education, as schools must continually spend resources recruiting and training new staff (DeFeo et al., 2017). The lack of DB pension plans exacerbates this issue, as teachers have no long-term incentive to stay in Alaska, especially given the high cost of living and the lack of Social Security benefits.

Restoring DB pensions would provide teachers, as well as other public employees, with the long-term financial security they need to remain in their jobs. This would reduce turnover, improve morale (Naff and Crum 2000), and lead to better public service delivery across the state. For Alaska's businesses, this would mean access to a more stable and skilled workforce, particularly in industries that rely on public education to provide the next generation of workers.

THE COST-EFFECTIVENESS OF DB PENSIONS

My previous report revealed the direct cost saving of \$76 million per year if the DB plan was restored. The savings came about from reducing hiring and training costs and earning higher rates of return due to a transition back to a DB plan. This was a conservative estimate because the wider economic impacts beyond just those cost savings were not calculated. This report finds considerable evidence that the defined benefit pension plan would increase the quality of public services, and the quality of public services attracts private commercial business activity. Commercial business activity improves the quality of life in Alaska.

To repeat some of the findings in the previous report, Alaska could reduce costly and sporadic efforts to attract workers in the form of bonuses and other one-time incentives that spike costs. Since DC plans are more expensive to administer than DB plans, Alaska saves investment costs

with a DB plan. DB Plans earn higher returns.⁴ Earning a higher risk and fee-adjusted rate of return in a DB plan compared to a DC plan is a cost savings of \$14M per year.⁵

While some opponents of DB pensions argue that they are too costly for states to maintain, research has shown that DB plans are often more cost-effective than DC plans over the long term. Although DB pensions require an upfront investment, they lead to long-term savings by reducing turnover, increasing employee productivity, and lowering administrative costs.

DB pension plans typically provide higher investment returns than DC plans, due to their ability to pool resources and invest in diversified portfolios. DB plans also benefit from lower administrative costs, as they are managed by professional investment firms that can take advantage of economies of scale. In contrast, DC plans often have higher administrative costs and lower investment returns, which can erode retirement savings over time.

In Alaska, the cost of high turnover is particularly significant. The state spends millions of dollars each year recruiting and training new public employees, particularly in education and public safety. These costs could be significantly reduced by restoring DB pensions, which would incentivize employees to stay in their jobs for longer periods and save the state money on recruitment and training, while also improving the quality of public services.

Furthermore, DB pensions provide long-term financial security for retirees, reducing the likelihood that they, or their family members, will need to rely on public assistance programs in retirement. We already know that retirement insecurity creates an intergenerational transfer of financial fragility and stress.

Family care is a big deal, especially for extended families in Black and Hispanic communities. New research at The New School (available by request) shows about 6 – 18% of elders receive care from a grandchild. Mothers are more likely to receive care from their daughters—43% of mothers compared to just 19% of men because men are much more likely to receive care from their spouse than women are—60% versus 29%. Family care has a palpable impact on younger family caregivers' ability to work and save for retirement -- daily caregiving significantly reduces labor force participation and does intergenerational damage.

Retirees who receive DB pensions are less likely to lean on their family members for financial support and need Medicaid, food stamps, or other public support. In this way, DB pensions not only provide economic stability for retirees but also create long-term savings for the state.

OPPONENTS OF DB PLANS

DB funding can be erratic, and Alaska had a bad experience with unstable funding obligations in the mid-2000s. The reform bill creates funding rules that will avoid the kind of funding instability from the past. The proposal to reinstate a version of the defined benefit pension has funding safeguards for the State of Alaska.

The proposed pension reform under Alaska Senate Bill 88 (SB 88) seeks to stabilize how the state funds its defined benefit (DB) obligations, making them more predictable for the Alaska treasury. The past bad experience was caused by Alaska assuming the pension funds would generate very high returns. This allowed the state to contribute relatively low amounts to the fund each year. However, when those expected high returns did not materialize, Alaska had to inject significant sums to maintain the fiscal health of its DB plans, leading the state to shift to a defined contribution (DC) system in 2006, which promised more immediate stability in funding.

The downside of the DC system was predicted, based on decades of economic research, and did indeed come later in the form of unstable public employment. Employee turnover in the Alaska DB is lower than under the DC plan: 70% of those leaving Teachers Retirement System (Alaska) and 63% of those leaving Public Employee Retirement System DB plans were retiring or dying, not quitting. Meanwhile, only 1% leaving the DC plans were doing so because they were retiring, 99% quit to take jobs elsewhere (Doonan 2023).

High public employee turnover creates costs of training and replacement and diminishes the capacity of the state to provide basic services for private business.

SB88⁶ seeks to stabilize DB funding with improved safeguards, potentially attracting higher-quality workers while satisfying credit rating agencies concerned with the state's ability to meet its financial obligations. SB88 provides safeguards like adjustable employee contribution rates (8-10%) to ensure financial stability (Alaska Senate 2024).

Opponents of DB pensions for Alaska public sector workers often argue that DB plans were financially unsustainable, particularly in states facing budget shortfalls. However, this argument overlooks the long-term savings generated by DB plans. Research shows DB pensions boost employee productivity *and* lower administrative costs, all of which reduce state spending (NIRS, 2014).

Finally, some critics argue that DB pensions are outdated and do not reflect the modern, mobile workforce. However, public sector employees, particularly those in education, public safety, and healthcare, are more likely to remain in their jobs for longer periods. And almost every family in the United States is concerned about their retirement security. People often get pushed out of their jobs before age 60, making the specter of funding retirement with voluntary savings precarious. DB pensions align with the needs of public employment, where long-term commitment is essential for delivering high-quality public services.

CONCLUSION

The economic future of Alaska depends on the strength and stability of its public workforce. Public employees provide essential services that support businesses, reduce operational costs, and improve the quality of life for residents. However, the switch from DB pensions to a DC savings plan in 2007 has led to high turnover, reduced service quality, and increased costs for recruitment and training.

Restoring DB pensions would provide long-term financial security for public employees, reducing turnover and improving the quality of public services. For Alaska's businesses to thrive, they need a stable and dependable public workforce, supported by high-quality public services. By investing in its public workforce, Alaska can create the conditions necessary for long-term economic growth and prosperity.

The decision to restore DB pensions is not just about improving compensation for public employees, it is about ensuring the future stability and success of Alaska's economy. By providing financial security to public employees, the state can improve public service delivery and create a more favorable environment for private sector growth. This, in turn, will help attract new residents, retain skilled workers, and create a strong foundation for Alaska's economic future. There is a business case for public employee pensions.

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ENDNOTES

¹ The source for the graph is found at the Bureau of Economic Analysis and the table was constructed by the tool available at the Saint Louis Federal Reserve Bank.

² Alaska's unique reliance on the Permanent Fund for state revenue creates a disconnect between economic activity and state financial benefits. Unlike other states that generate revenue through taxes on businesses and income, increased economic activity in Alaska—such as more business investment and employment growth—does not directly translate to higher state revenues. This system means that while the economy may expand, the state's financial gains remain relatively insulated from this growth, limiting its ability to reinvest in essential services and infrastructure.

³ As Fisher (1997) writes “Bartik (1991) identifies three ways in which public services might influence economic growth or development through an impact on business inputs. Public services may be an unpriced input to production; expansion of public services may reduce the prices paid by business for those services; and some public services may work to reduce the cost of private inputs used by business. Examples seem obvious. Public highways provide an input (usually unpriced) to many businesses; expansion of public airports may reduce the full price business must pay for air transport; and public education may reduce quality adjusted prices of labor by increasing the supply of workers of a given quality (either by increasing average skills everywhere or by attracting additional workers to a specific location). In all of these cases, the idea is that the public input reduces production costs directly or increases the productivity of a private input and thus increases output. The underlying model is one in which firms are passive recipients of public services.”

⁴ In an April 26, 2023, presentation of the Reason Foundation presentation to the Alaska legislature they drastically underestimated future rates of return for Alaska's PERS and TRS pension funds. Their complex analysis predicted a return rate of 5% and 8%. The State of Alaska announced in 2024 in the press release of the Department of Revenue Wednesday, August 21, 2024 (Anchorage, AK) – The Treasury Division of the Alaska Department of Revenue closed a strong fiscal year 2024 with overall gains of \$4.6 billion across the State's Retirement System of \$43B -- the defined benefit retirement systems rate of return was 9% for this past year.

⁵ DB assets are pooled and professionally managed. Pooling allows for lower fees and for professional money managers to adopt an optimal portfolio of diversified assets-- buildings, stock, bonds, etc. Individuals who direct their own 401(k) – type plan, pay higher fees and react idiosyncratically to market changes and asset choices. DB plans earn a conservative .7 percentage point higher return than DC plans, for example, if DC plans earn 6% then DB assets likely earn 6.7%. Total DC account balances are over \$2 billion. The recent performance of the Alaska DB plans in 2023 emphasize the cost savings to the state for switching over.

⁶ Alaska Senate Bill 88 (SB88) is described in multiple legislative documents. SB88 (including fiscal notes and presentations) Alaska State Legislature website <https://www.akleg.gov/basis/Bill/Detail/33?Root=Sb88>