



# ADVISOR



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SERVING OVER 325,000 MEMBERS

October 2009

## Long-Term Sustainability

By Marcus H. Reynolds, Jr.

The buzz word among public pension and health insurance plans these days is sustainability. Wracked by the second economic meltdown of the decade and the second worst in a hundred years, the value of investment assets has taken a major hit. In addition to the economic downturn, other factors such as increased life expectancies and retirement requirements enacted in the 1980s and 1990s have increased the liabilities of these funds. Obviously, a major loss of assets coupled with increased liabilities is not good news for public employees.

Virtually every state is being forced to take a look at their pension and health insurance costs. Most are finding that without some level of change the benefits are simply unsustainable. Many states have already enacted changes that reduce benefits for new employees. Nevada, New Mexico, Rhode Island, and Texas have increased the age and service requirements for retirement for new employees. Nebraska, New Mexico, Texas, and Illinois have increased contribution rates for employees. Georgia, Louisiana, and Nevada have reduced or eliminated their Cost-of-Living Adjustments (COLAs) for retirees.

### WHAT ABOUT ALABAMA?

A recent actuarial forecast shows the funded ratio of the RSA continuing to decrease in the coming years. Correspondingly, employer or state contributions continue to increase. No one can predict the future, but a string of five years of 20 percent gains in investment performance could see the system return to 100 percent funding – but that is not realistic.

A more realistic scenario is a return to normal market conditions and a funded ratio sliding to the 50 to 60 percent range as market losses are averaged over the next five years. The employer cost rate would approach 20 percent of payroll, before rebounding to a fully funded position over the next 10 to 15 years. While a large part of this predicament is caused by the markets, an equally large cause is a result of the design of our benefit program and unfunded retiree COLAs.

*Continued on page two*

## Bad News on PEEHIP Costs

By David G. Bronner

During the last Legislative session, PEEHIP's requested allocation of \$805 per month per active employee for Fiscal Year (FY) 2009-10 was "rolled back" to \$752, the amount appropriated for FY 2008-09. The reduction plus the federal stimulus funds were needed to prevent layoffs in public education. This placed the PEEHIP staff in a very uncomfortable position wanting, on the one hand, to comply with our state leaders' request to "save jobs" and, on the other hand, knowing our professional obligation was to provide a properly funded health insurance plan for our members.

After much analysis and reworking the numbers, it was determined that we could make the level funding request work, but cautioned that FY 2010-11 would see marked increases in funding requirements with no "wobble room" left. PEEHIP staff projected at that time, as was reported in the June issue of the *Advisor*, that FY 2010-11 would require: (1) an increase in state funding of \$157 million new dollars, or (2) cuts in benefits, or (3) significant increases in member contributions, or (4) a combination of the three. The actual numbers are now in for the current school year. Instead of maintaining education jobs at that level rate, PEEHIP now has 2,000 fewer active members than this same time last year.

Simply put, the active employee allocation which funds the benefits for both active and retired employees will be cut by 2,000 funding units, while the retiree membership has increased by 2,000, causing a major financial impact. PEEHIP expects to use up two-thirds of their reserves in the current year. We also expect that the required \$157 million increase for FY 2010-11 will increase to approximately \$282 million, for a total cost in FY 2010-11 of \$1.2 billion for the PEEHIP program. ■

### Dropout drag

Do the math for the cost of dropping out of high school in Alabama (it's easier to do if you don't drop out), and the numbers are eye-opening

- ▶ **Estimated graduation rate:** 61.4 percent
- ▶ **Projected number of nongraduates:** 25,136
- ▶ **Estimated difference in lifetime incomes between high school graduates and dropouts:** \$260,000
- ▶ **Total lifetime additional income if dropouts graduated:** \$6,535,360,000

Source: the Alliance for Excellent Education, using data from Editorial Projects in Education and C.E. Rouse of Columbia University.

# Reset in State Government

By Mitch Daniels, Republican Governor of Indiana, *The Wall Street Journal*

State government finances are a wreck. The drop in tax receipts is the worst in a half century. Fewer than 10 states ended the last fiscal year with significant reserves, and three-fourths have deficits exceeding 10% of their budgets. Only an emergency infusion of printed federal funny money is keeping most state boats afloat right now.

Most governors I've talked to are so busy bailing that they haven't checked the long-range forecast. What the radar tells me is that we ain't seen nothin' yet. What we are being hit by isn't a tropical storm that will come and go, with sunshine soon to follow. It's much more likely that we're facing a near permanent reduction in state tax revenues that will require us to reduce the size and scope of our state governments. And the time to prepare for this new reality is already at hand.

The coming state government reset will be particularly wrenching after the happy binge that preceded this recession. During the last decade, states increased their spending by an average of 6% per year, gusting to 8% during 2007-08. Much of the government institutions built up in those years will now have to be dismantled.

For now, my state's situation is far better than most...but, the state of Indiana will have fewer dollars to work with in 2011 than it did in 2007. Most other states face similar or worse prospects.

And, unlike the aftermath of past recessions, odds are that revenues will take a long time to catch back up to their previous trend lines—if they ever do. Tax payments have fallen so far that it would require a rousing economic rally to restore them.

...From 1930 to 2008, our national average annual real GDP growth rate was 3.49%. After crunching the numbers, my team has estimated that it would take GDP growth of at least twice the historical average to return state tax revenues to their previous long-term trend line by 2012.

I doubt even that would suffice to rescue most states. Instead, historical forecasting models need to be revised. One-third of state revenues (over half in seven states) come from sales taxes, but it's hard to imagine them snapping all the way back up to where they were just a few years ago. Americans are now saving much more than they used to relative to how much they are spending. This sudden shift

will mean that even in good economic times to come consumers will likely spend less and therefore pay less in sales taxes than they did during bubble years.

Even if Americans wanted to go back to their high-spending, high-borrowing ways, will anyone lend them the funds to spend like it's 2007 all over again? Consumer credit will remain tighter as a matter of both sound business practice and new government regulation. Home equity appreciation is gone as a huge source of collateral, even if lenders were either willing or permitted to loan freely against it.

The "progressive" states that built their enormous public burdens by soaking the wealthy will hit the wall first and hardest. California, which extracts more than half its income taxes from a fraction of 1% of its citizens, is extreme but hardly alone in its over reliance on a few, highly mobile taxpayers. Both individuals and businesses are fleeing soak-the-rich states already.

...And if we Hoosiers are realizing that we need to re-examine what we can afford to have our government do, what must they be thinking in Albany, Lansing or Trenton?

Truth be told, officials in those cities are probably not thinking about this at all. But they will because state governments will soon have to choose between a major downsizing or consigning themselves to permanent decline. Wishing for an improbably huge boom while chasing your own tail through self-destructive taxes won't prove much of a strategy.

Unlike the federal government, states cannot deny reality by borrowing without limit. The Obama administration's "stimulus" package in effect shared the use of Uncle Sam's printing press for two years. (Editor's Note: Republican Bush did about the same amount "stimulus" to bail out Wall Street.) But after that money runs out, the states will be back where they were. Even if Congress goes for a second round of stimulus funding, driven by the political panic of bankrupt Democratic governors, it would only postpone the reckoning.

The time to plan and debate is now. This is a test of our adulthood as a democracy. Washington, as long as our Chinese lenders enable it, can practice denial for a while longer. But for states the real world is about to arrive. ■

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## Long-Term Sustainability *continued from page one*

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Twenty-five year retirement at any age makes no sense for a pension program. In fact, it is not utilized by a majority of our membership. Yet, a substantial number of people retire in their late forties and early fifties with full retirement benefits and heavily subsidized health insurance. Add to that the practice of granting COLAs to those early retirees as done in the past and early retirement becomes extremely expensive.

A change in retirement eligibility to a minimum age of sixty with ten or more years of service and with eligibility for DROP participation at that time makes a lot of sense. A large segment of the membership would elect the DROP program, extending their ultimate retirement date to age 65. At that time, they would be eligible for Medicare requiring the state to only pay for 20 percent of their health care costs.

Members would receive COLAs as an active employee which is much less expensive than retiree COLAs, which must be funded up front. Retiree COLAs, assuming a COLA every two years, would decrease from 15 COLAs for a person retiring at age 50 to seven COLAs for a person retiring at age 65, assuming an average life expectancy of 80 years.

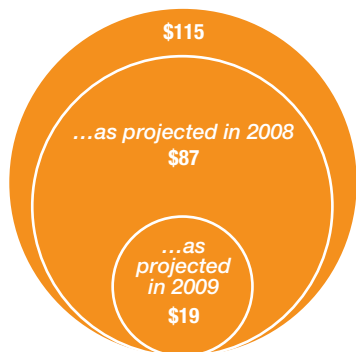
**Mandatory changes, of course, would only apply to new employees, so savings would accrue gradually as new employees replace older ones.** Eventually, costs would decrease and could provide funds for prefunded COLAs for the new retirees. More importantly, it provides a model which is sustainable and ensures a sound benefit at an age when members "truly retire." ■

# GOOD NUMBERS GONE BAD

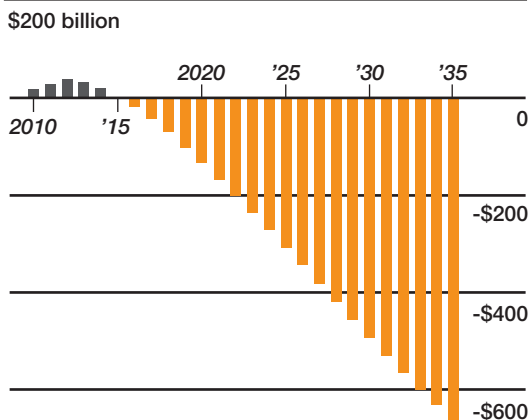
Social Security will soon take in less cash than it spends, partly because of rising unemployment. Its cash flow will shrink to a projected \$19 billion this year, down from the \$115 billion predicted seven years ago.

## Shrinking projections of Social Security cash flow for 2009 BILLIONS

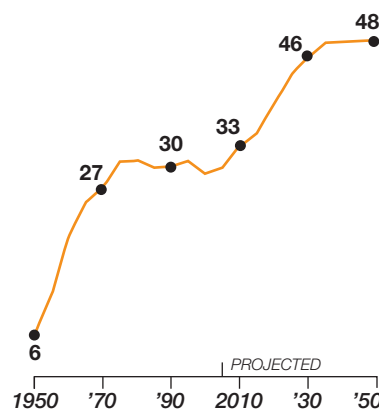
2009 cash flow as projected in 2002



## Social Security cash flow PROJECTED



## Number of Social Security beneficiaries per 100 workers



# Active State Employees — Save \$300

If you want to earn the \$25 per month wellness discount, **get your wellness screening completed before November 30**. Without this discount your monthly premium will increase \$25 effective January 1, 2010.

### Important points:

- This premium applies to all active employees—not retirees or dependents;
- This premium becomes effective January 1, 2010;
- The monthly payroll deduction begins in December—right around the corner!
- You can avoid the premium by participating in a free health screening offered by the SEIB or by having your health screening results certified to the SEIB by your physician.
- If we don't have your screening results, we will remind you by mail and enclose a provider screening form for your use.
- You can also visit our website at [www.alseib.org](http://www.alseib.org) to check for worksite wellness screenings in your area or health screenings provided at a Public Health Clinic. You can also sign on to your account at [www.alseib.org](http://www.alseib.org) to view your screening results and discount information.
- Your results must be received by the SEIB no later than November 30, 2009.
- No refunds will be allowed for failure to submit health screening results.
- For more information call the Wellness Department at 1.866.838.3059

## China

# Wind Turbine & Solar Power

Source: 13d

Alternative energy has been the rage for the last couple of years, but did you know that China is investing more than anyone around the world?

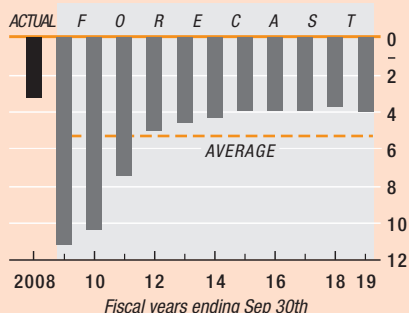
In 2009, China's wind power capacity is expected to double, thus having one-third of the new installations globally with U.S. companies, like GE, transferring technology being the key to rising quality.

China is the largest producer of photovoltaic solar panels and had push down prices by nearly 50% in the last year. Panels are being sold in the U.S. for less than cost in order to build market share.

The U.S. and others cannot compete with Chinese companies that use first-class technology with access to low-cost loans, electricity, and labor. ■

## The pain curve

Budget deficit as a % of GDP



Source: Office of Management and Budget

## Oh, My!

Dr. David Himmelstein, an associate professor of medicine at Harvard Medical School, is a co-founder of Physicians for a National Health Program and co-author of studies finding that medical bills are a leading contributor to personal bankruptcies in the United States.

**Q.** How many medical bankruptcies are there annually in this country?

**A.** Around 900,000 cases and each one affects about 2.7 people. That makes roughly 2.4 million people who will suffer from new medical bankruptcy filings in 2009 alone.

ENJOY YOUR FALL/WINTER  
A Special Deal  
FOR RSA MEMBERS

**The Battle House,  
A Renaissance Hotel – Mobile – \$89**

- Oct. 11–15, 18–20, 25–29
- Nov. 1–4, 15–30 • Dec. 13–27

**The Renaissance Riverview Plaza –  
Mobile – \$79**

- Oct. 11–15, 18–20, 25–29 • Nov. 1–4, 15–30
- Dec. 13–27

**Marriott Grand – \$89 plus a 14% resort fee**

- Oct. 4, 6, 11–15, 18–22, 28–30
- Nov. 1–3, 8–17, 24, 29–30 • Dec. 1–3, 16–23, 27–31

**Marriott Grand – RSA Golf Package – \$169**

- Ask for code – LOCD  
Includes: Deluxe Room, One Round of Golf for Two People.  
Call for Tee Times after booking package
- Oct. 4, 6, 11–15, 18–22, 28–30
  - Nov. 1–3, 8–17, 24, 29–30 • Dec. 1–3, 16–23, 27–31

**Marriott Shoals – Florence – \$79**

- Oct. 4–5, 11, 14–16, 25–29
- Nov. 1–4, 8–13, 15–22, 25–30
- Dec. 1–3, 6–8, 13–16, 20–29

**Renaissance Ross Bridge – Hoover – \$89**

- Oct. 1–12, 15–19, 25–27, 29
- Nov. 1–2, 4–30 • Dec. 1–31

**Opelika Marriott – \$79**

- Oct. 4–8, 11–12, 18–20, 25–27, 29
- Nov. 5, 8–25, 28–30 • Dec. 1, 4, 6–31

**Prattville Marriott – \$79**

- Oct. 6–7, 11, 22, 25, 31
- Nov. 5, 13–17, 22–24, 28–30 • Dec. 3–15, 17–31

**Renaissance Montgomery – \$89**

- Oct. 1–4, 7–13, 18–21, 24, 27, 30–31
- Nov. 1–11, 15, 17–19, 21–22, 24, 27–30
- Dec. 1, 5–7, 10–13, 16–31

**RSA Spa Package – \$159**

- Ask for code – LOCD Includes Deluxe Room
- Oct. 20–21, 27 • Nov. 3–5, 10–11, 17–18
  - Dec. 1, 10, 16–17

Rates available the 1st of the month and are not applicable to groups.

Code: RABM, 800-228-9290

Internet promo code: R2A on [marriott.com](http://marriott.com)

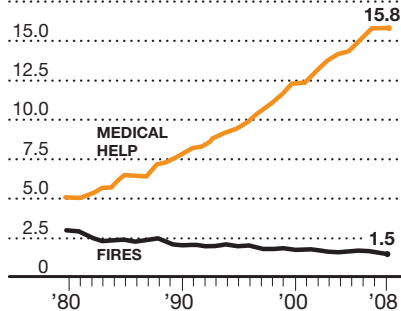
Book Online and Save RSA \$4.

**Fire Departments  
As First Responders**

In 2008, fire departments nationwide responded to more than three times as many calls for medical help as they did in 1980.

**Number of calls U.S. fire departments responded to**

17.5 million calls for...



Source: National Fire Protection Association

**Make your vote count!**

**ERS Board of Control Special Election Information**

The ballots for the Employees' Retirement System Board of Control Special Election were mailed out October 1, 2009. Ballots are due to VR Election Services on October 16, 2009. Information on how to vote by paper ballot, telephone, or online is included with the ballot. The candidates are Mr. Roger H. Rendleman, Mr. Ronald Byrd, and Mr. Steven W. Williams. Read the candidates' bios on the RSA Web site [www.rsa-al.gov](http://www.rsa-al.gov).

**TRS Board of Control Election Information**

The ballots for the Teachers' Retirement System Board of Control Election will be mailed October 15, 2009. Ballots are due to VR Election Services on November 20, 2009. The positions up for election are Teacher Position No. 2, Retired Position No. 1, and the Postsecondary Position. Read the candidates' bios on the RSA Web site [www.rsa-al.gov](http://www.rsa-al.gov) beginning October 1. ■



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