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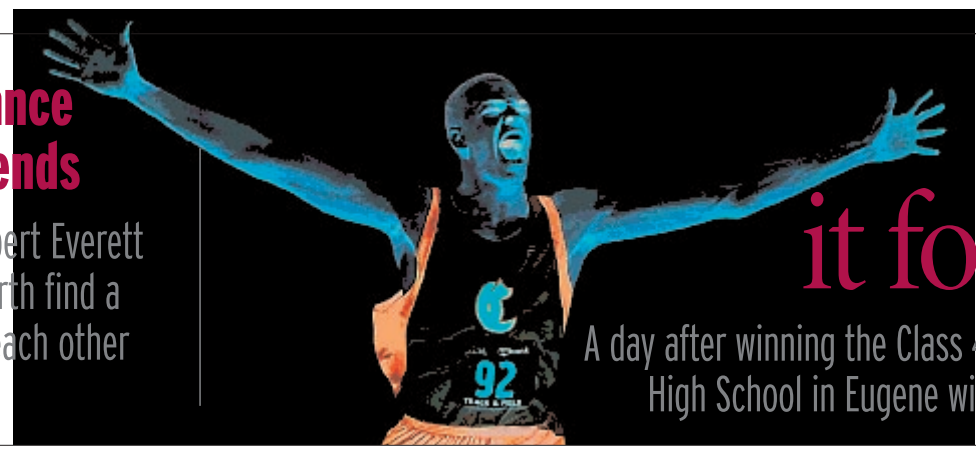
The importance of being friends

British actors Rupert Everett (left) and Colin Firth find a kindred spirit in each other **ArtsWeek, D1**



Kent makes it four state titles

A day after winning the Class 4A boys long jump, Jordan Kent of Churchill High School in Eugene wins the 100, 200 and 400 meters **Sports, C1**

The Sunday Oregonian

MAY 26, 2002 — 2001 PULITZER PRIZE WINNER FOR PUBLIC SERVICE ★★★ SUNRISE EDITION — PORTLAND, OREGON

Cost of PERS escalates, devouring public money

The government pension fund faces a shortfall, and the budgets of public agencies will have to fill the gap

By BRENT WALTH
THE OREGONIAN

Oregon's public pension system is out of control.

The Oregon Public Employees Retirement System was created to provide a reliable and generous pension to government workers, and today 294,000 active and retired employees count on PERS to protect their future.

But career public employees retiring today are getting pension checks that are on average 105 percent of their final salary — never what the Legislature intended — and the cost bleeds state agencies, local governments and school districts across Oregon.

The state's pension system is in no immediate danger of running out of money. That's because to close PERS' $8.5 billion shortfall — the gap between what the pension system has today and what it will need in the future — local and state government agencies, beginning in 2003, will pay an additional $260 million annually, or 37 percent more than they did this year.

That will mean pain for many state agencies and public budgets funded by taxpayers.

"We are still trying to understand the beast that is now eating us," says Pat Cochran, Benton County budget officer.

PERS is out of control because most retirement accounts are guaranteed to grow at least 8 percent a year, even if PERS doesn't have the money. The Legislature cut off the guarantee for workers hired after 1996, but the guarantee — upheld by court rulings — still drives up the pension system's costs.

PERS is also out of control because the Legislature and the PERS board — a panel dominated for years by public employees — have made matters worse.

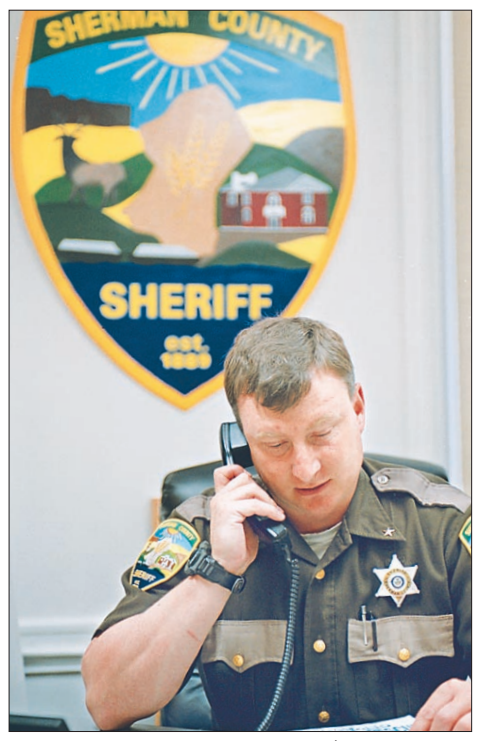
Billions of dollars worse.

◆ Most employees calculate their pensions using Money Match, which doubles an employee's account at retirement. But lawmakers never intended this to happen: They wanted to provide Money Match to a few special cases but instead wrote the law so broadly it now applies to all public employees.

◆ The Legislature in 1995 added

Please see **RETIREMENT,** Page A17

INSIDE

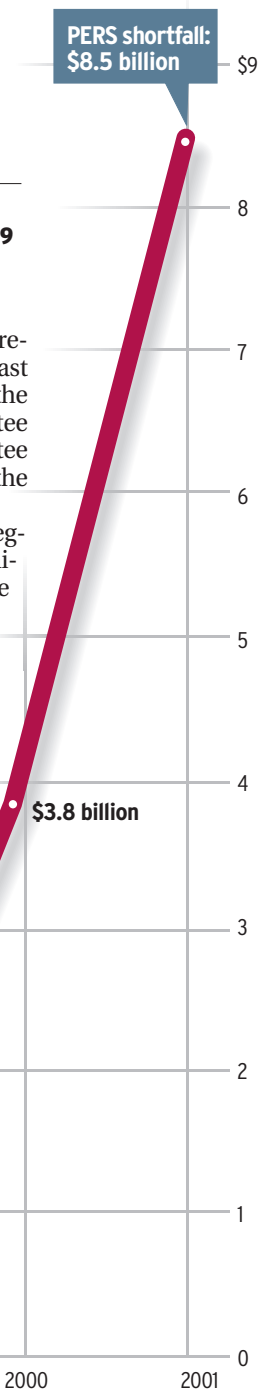


ROSS WILLIAM HAMILTON/THE OREGONIAN

Sherman County Sheriff Brad Lohrey has to juggle his time between the office and road patrol because the department can't fill a vacant deputy position. County officials say the high cost of the state Public Employees Retirement System is the chief reason for the shortage.

PERS' growing shortfall

The Oregon Public Employees Retirement System, fully funded in 1991, is now $8.5 billion short of what it needs to meet its future obligations.



Key factors that led to the problem

The 8 percent guarantee

Most PERS members' accounts grow 8 percent a year, no matter how the pension fund's investments perform. The PERS board has approved even bigger increases, making the cost of the guarantee grow faster than planned.

Money Match

Taxpayers must double the value of employee retirement accounts – a cost that PERS started accounting for only a few years ago.

Not enough in savings

The PERS board routinely violated its own policies by leaving too little money in its rainy-day account – now $2.5 billion in the red.

Legislature adds costs

Lawmakers have increased PERS costs – including a $1.3 billion tax settlement to members – without regard to the long-term impact.

STEVE COWDEN, BRENT WALTH/THE OREGONIAN

CHANG LEE/NEW YORK TIMES NEWS SERVICE

Calls for help from those trapped in the World Trade Center towers turned to panic, desperation and love as realization struck.

Captive voices from up high

Frantic phone calls from the trade center detail the final moments of victims

They began as calls for help, information, guidance. They quickly turned into soundings of desperation, and anger, and love. Now, they are the remembered voices of the men and women who were trapped on the high floors of New York City's twin towers.

From their last words, a haunting chronicle of the final 102 minutes at the World Trade Center has emerged, built on scores of phone conversations and e-mail and voice messages. These accounts, along with the testimony of the handful of people who escaped, provide the first sweeping views from the floors directly hit by the airplanes and above.

Collected by reporters for The New York Times, these last words give human form to an all but invisible strand of this stark, public catastrophe: the advancing destruction across the top 19 floors of the north tower and the top 33 of the south, where loss of life was most severe on Sept. 11. Of the 2,823 thought dead in the attack on New York, at least 1,946, or 69 percent, were killed on those upper floors, an analysis by The Times has found.

Rescue workers did not get near them. Photographers could not record their faces. If they were seen

This article was reported and written by Jim Dwyer, Eric Lipton, Kevin Flynn, James Glanz and Ford Fessenden of The New York Times. Because of the length of the account, The Oregonian is publishing it in three installments, today through Tuesday

Please see **TOWERS,** Page A6

PROSPERITY LOST
One in an occasional series

In the midst of national calamity, two who lost jobs find a calling

The heartache of Sept. 11 hits home for the Portland men, who seek training for work where they can help others as paramedics

By BOAZ HERZOG
THE OREGONIAN

For two men in their early 30s, Jeff Trittinger and DJ Thomas have amassed heavy emotional baggage: Their losses include family members, marriages and well-paying jobs.

That fateful day last September added more sorrow. Sitting in Portland-area living rooms, the two men watched TV with wet eyes as terrorists destroyed the World Trade Center, damaged the Pentagon and stole thousands of lives.

Yet out of the destruction has come revival for Trittinger and Thomas: Both men, whose jobs were among more than 43,000 lost in Oregon during the past 1 1/2 years, have found a new calling in life. The flickering images of crashing planes and injured onlookers struck them with a drive to help others — somehow, some way.

But they couldn't rush out to search for survivors or comfort the afflicted. So they did the best thing they could think of: They resolved to take on debt and train to become paramedics — harrowing work with modest wages and long hours.

If a recession can be characterized partly by the job tracks into which laid-off workers switch, then the 21st century's first down cycle may go down as the recession with a heart.

Many laid-off workers are

Please see **CAREER,** Page A14

ABOUT THE SERIES

"Prosperity Lost" is an occasional series that follows workers who have lost their jobs in Oregon's worst recession in 20 years.

TODAY: *The Sept. 11 attacks inspired some laid-off workers to seek lifesaving jobs.*

NEXT MONTH: *Hard-hit Oregon struggles for safety-net aid when the rest of the country isn't hurting as much.*

INSIDE

Vol. 151, No. 50,884
228 pages

A final gesture of love

As tombstone-maker Fred Bass grieved over the deaths of two of his four children, he agonized over what his last words to them should read. A child's gravestone deserves consideration, and, if handled correctly, can help heal a family.

Metro, Page B1

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WEATHER

Cloudy with showers

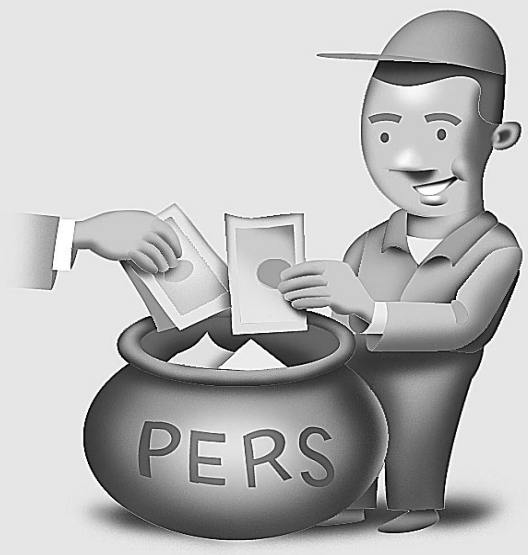
High: **70** Low: **54**

Complete weather, B8

How PERS works

1. Governments and employees contribute to pensions

PERS charges government agencies a percentage of payroll costs to fund public employee pensions. Employees contribute 6 percent of their salary. In some cases, employees, as part of bargaining agreements, have employers pay their contribution.



2. Money is invested

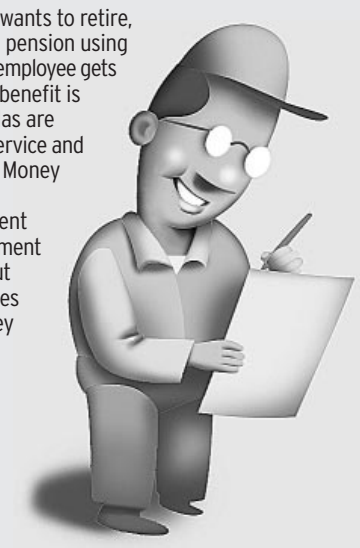
The pension fund is handled by the Oregon Investment Council. The council decides how to invest the fund. At year's end, the council reports the fund's earnings to the PERS board.

3. PERS board allocates earnings

The PERS board decides how to allocate earnings. If the returns are high, the board decides how much money to credit to accounts and how much to put into its rainy-day fund. If the returns are low, the board must dip into the fund to cover the costs of the 8 percent guarantee. The guarantee is offered to employees hired before Jan. 1, 1996. These employees' accounts are responsible for 99 percent of PERS' liabilities.

4. Employee prepares to retire

When an employee wants to retire, PERS calculates the pension using three formulas. The employee gets whichever pension benefit is highest. Two formulas are based on years of service and final salary. A third, Money Match, doubles the employee's retirement account. Fast investment growth means about 95 percent of retirees do best under Money Match.

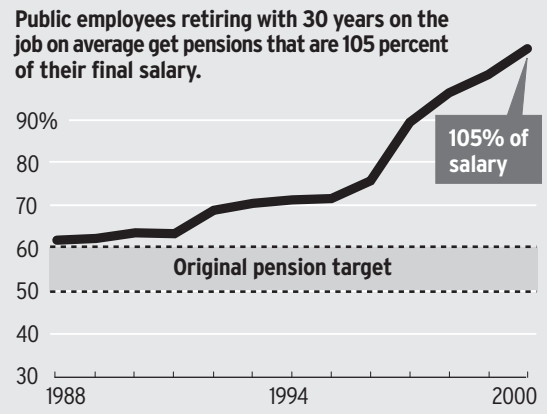


5. Employee retires

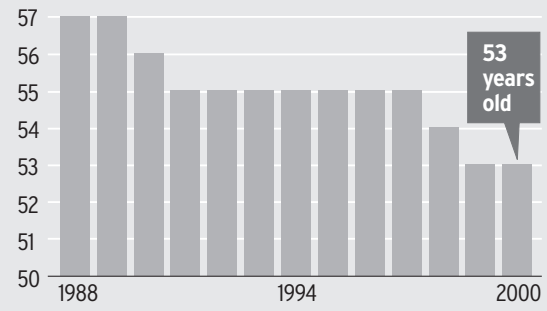
The retiree gets a monthly pension check for life. Pension payments grow 2 percent a year to cover cost-of-living increases.

PERS retirees

Public employees retiring with 30 years on the job on average get pensions that are 105 percent of their final salary.



And 30-year employees on average are retiring younger.



Source: Oregon Public Employees Retirement System

STEVE COWDEN, BRENT WALTH/THE OREGONIAN

How the PERS crisis occurred

Board's decisions combined with haphazard laws trip up fund

During the booming 1990s, pensions were increased rapidly with little thought of how to pay for them in harder times ahead

By BRENT WALTH
THE OREGONIAN

Randall Pozdena knew how rare it was to make $6.5 billion in a year. He had watched the state's pension fund do it in 1999.

He knew it couldn't last.

As chairman of the Oregon Investment Council, Pozdena, who was appointed by the governor, oversaw the state's pension trust fund as huge Wall Street investment returns poured in during the 1990s.

He also watched as another state panel, the Public Employees Retirement Board, each year took the investment returns and put them, billions at a time, into public employees' pension accounts.

The money by law belonged to public employees who are members of the pension system.

But Pozdena, an economist, knew accounts were being pumped up with paper stock profits, billions that could quickly turn to vapor. He believed the PERS board wasn't saving enough money for the inevitable day the stock market stumbled.

"That's a defiance of financial gravity," he told the board in January 2000, echoing earlier warnings.

PERS board members sounded concerned as they discussed Pozdena's warning — and then didn't heed it.

They dumped nearly all the $6.5 billion into accounts and left the system's rainy-day fund — intended to protect against downturns in the stock market — short by $1.8 billion.

"They knew what they had to do to protect the system," Pozdena says now. "They didn't do it. It turns out it was the last chance they had."

Today, Wall Street is getting the blame for PERS' problems. And PERS' financial tailspin certainly grew as the stock market fell in 2000 and 2001.

But it's not that simple.

Oregon's pension fund started the 1990s fully funded, raked in $23 billion from investments over the next decade and should have been fat for years to come.

Instead, PERS is now in the worst financial straits it has seen in decades, and it will cost, beginning in 2003, $260 million more a year of public money to make up for the lost ground.

How did this happen?

The answer lies with haphazard laws and the operation of an obscure but immensely powerful panel, the PERS board, that repeatedly acted to improve public employees' pensions with little regard to the system's long-term financial health.

It all went unnoticed for years, shaded by the historic days on Wall Street. Almost no one questioned how PERS operated. Pension officials assured everyone that they knew how the system worked and that it was under control.

This is the story of how that all changed, what happened when someone did raise questions, and why the answers mean bigger costs to Oregon taxpayers.

The making of Money Match

When a public employee retires, PERS calculates the size of the pension using three different formulas. Two of the formulas are based on the employee's years of service and final salary. The third formula is based strictly on the amount of money that's accumulated in the employee's retirement account. PERS takes the face-value of the account and doubles it. This formula is nicknamed Money Match, and about 95 percent of retirees now use it to calculate their pensions.

But Money Match did not turn out as planned.

When the Legislature created PERS in 1946, Money Match was the only pension calculation. But Money Match proved inadequate. Employers and employees both contributed to retirement accounts, but the accounts grew so slowly that too many public employees faced retiring with too little to live on.

So the Legislature in 1967 did away with Money Match. Lawmakers replaced it with a pension based in part on the employee's account but also based on final salary and years of service. Everyone agreed it was a richer deal for employees.

The next year, however, PERS officials discovered a few employees would have done better under the old system. The new formula cheated them.

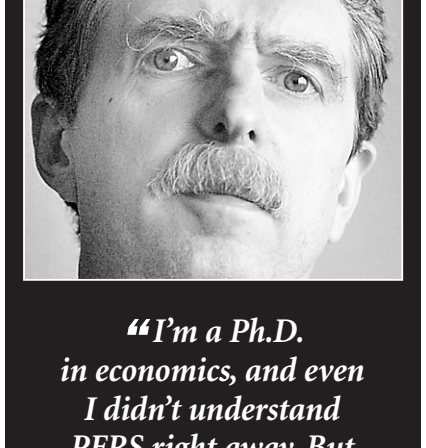
"(PERS) has found in one or two occasions that employees would be entitled to less money under the 1967 act than under the prior plan," according to minutes of the Joint Ways and Means Committee on May 7, 1969.

So lawmakers made what everyone thought was a technical and largely meaningless fix.

But they fumbled it. Instead of writing a bill that restored a very limited Money Match for existing employees — for the "one or two occasions" cited by PERS — lawmakers left the bill's language so broad as to cover every public employee in Oregon, then and in the future.

No one noticed. Not for a long time.

In the 1970s, the Legislature voted to guarantee that public employees' retirement accounts would grow every year, no matter what. The decision came after accounts took a beating from Wall Street investments. Today, most retirement accounts are guaranteed to grow annually by at least 8 percent.



"I'm a Ph.D. in economics, and even I didn't understand PERS right away. But something about how it worked didn't seem right."

RANDALL POZDENA,
FORMER CHAIRMAN OF THE OREGON INVESTMENT COUNCIL

In 1981, the Legislature decided to add another retirement formula, one based solely on years of service and a worker's final salary. Lawmakers set a clear goal with the new formula: Public employees with at least 30 years of service (25 years in the case of police and firefighters) should receive a pension equal to about 50 percent to 60 percent of their final salary.

Everyone — PERS officials, lawmakers and union lobbyists — saw this as another major improvement for public employees.

No one gave a second thought to the Money Match calculation still on the books.

"Everyone still believed the Legislature had never intended for Money Match to have any consequence," says Paul Hart, the PERS actuary who testified for the agency before the Legislature in 1981. "So no one talked about it or bothered to delete it."

Tapes from the 1981 Legislature bear that out.

When the pension bill reached the Senate floor, Sen. Keith Burbidge, D-Salem, read a statement that claimed this new formula — based on years of service and final salary — "replaces" the only other pension formula, also based on years of service and final salary. When the bill reached the House, Rep. Ed Lindquist, D-Gladstone, read the same statement.

The claims were inaccurate. No formula was being replaced; a new one was being added.

Moreover, the statements showed that lawmakers thought there were two — and only two — ways to calculate a PERS pension, and both were based on the employee's years of service and final salary.

No one said anything about a third calculation — Money Match — that required the doubling of employees' accounts and remained untouched by the new law.

With the Legislature rushing toward adjournment, not a single lawmaker rose to debate the bill or even ask a question. The Senate and House approved the bill and went home.

Money Match sat there in the law books, overlooked, ticking like a bomb.

Stock market surprise

Part of the reason that Money Match didn't alarm anyone was that the cash value of employee accounts still grew slowly, thanks to a moribund stock market in the 1970s.

What's more, employee salaries kept climbing, and — as the Legislature had intended — salaries played a major role in retirement benefits.

Then all that changed.

During the 1980s, many public employees went years without raises. Meanwhile, the stock market began a steady climb. The Oregon Investment Council started to take better advantage of the rising stock market.

Slowly, the way public employees' pensions were calculated shifted in favor of Money Match. In fewer cases, the calculation would depend on the employees' salary and years of service. In more and more cases, the calculation would be driven by what was happening on Wall Street.

The shift also gave the PERS board — with its members appointed by the governor — greater power to increase retirement benefits across the board.

In the years when the PERS fund had low investment returns, the board had to dip into savings to pay the 8 percent guarantee.

But in good years, the PERS board had a choice. It could put the extra money into employee accounts, increasing them by more than 8 percent. Or the board could take that extra money and put it in a rainy-day fund for those years when returns were low.

How much should the board save? As a rule, board members agreed that they should keep enough money on hand to meet the 8 percent requirement for 24 months. Doing so would mean putting less money in employee accounts.

But year after year, PERS records show, the board increased employee pension accounts by shortchanging its rainy-day fund.

PERS retirees are always offered the best retirement option under the system. But so few people used Money Match to set their pension benefits that PERS officials for years didn't even bother to mention it in the handbook for public employees.

That changed in 1988, when PERS officials — seeing the rapid growth of PERS accounts — began featuring Money Match in the handbook. By 1989, 21 percent of retirees used Money Match, and the numbers were growing. Today, about 95 percent of retirees use Money Match.

PERS records show the board was told as early as 1990 that increasing employee accounts above the 8 percent guarantee would accelerate Money Match and increase costs.

Still, many PERS board members saw it as their duty to increase retirement accounts as much as possible, even if that meant putting less money aside in reserves.

"If you put the money in reserves, then it wouldn't be there for someone who might be getting ready to retire," said Glenn Harrison, a retired Linn County math teacher who served as PERS chairman from 1993-94. "There was also a lot of doubt that we needed to have that much in reserves."

But other PERS board members grew increasingly alarmed at the practice.

"We realized very early on Money Match was increasing costs," says Peter Ozanne, a Portland lawyer who simultaneously served on the PERS board and the Oregon Investment Council.

By the mid-1990s, Ozanne said, the board heard reports of people retiring with more money than they were making while working.

"We knew that could not be maintained," he said.

PERS board minutes show Ozanne often tried to push the board to save more money. He was not successful, he says, because public employees controlled the PERS board.

Back in 1987, the Legislature had expanded the PERS board from five members to nine to create more seats for government managers along with union representatives. The number of seats for people from the private sector was cut from two to one.

"Eight of the nine people on the PERS board had a financial stake in the pension system, and that was the reality that drove the board's majority," Ozanne said. "It was to pass on as much as it could to current members."

Confusing system

Enter Randall Pozdena.

He had taught economics at the University of California at Berkeley and had served as vice president of the Federal Reserve Bank of San Francisco before coming to Portland as managing director of ECONorthwest, a consulting firm.

When Gov. John Kitzhaber named him to the Oregon Investment Council in early 1995, Pozdena still felt new to Oregon and had little at risk in the state's political scene.

"That allowed me to speak my mind," Pozdena says. "Which I did."

At first, Pozdena struggled to understand how PERS really worked.

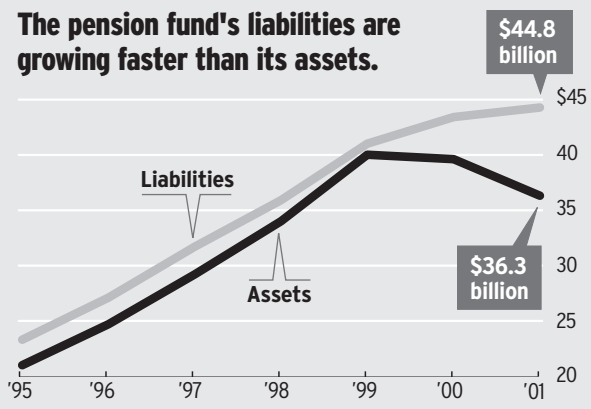
"I'm a Ph.D. in economics, and even I didn't understand PERS right away," Pozdena says. "But something about how it worked didn't seem right."

In January 1995, during one of his first investment council meetings, Pozdena listened as Mark Johnson of Milliman & Robertson, the PERS actuary,

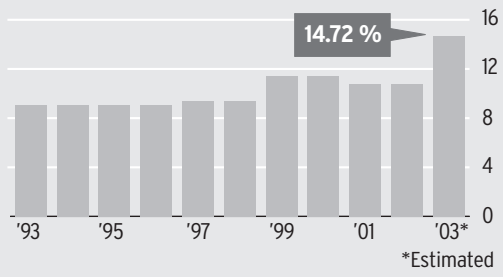
Please see **SHORTFALL,** Page A17

The PERS problem

The pension fund's liabilities are growing faster than its assets.

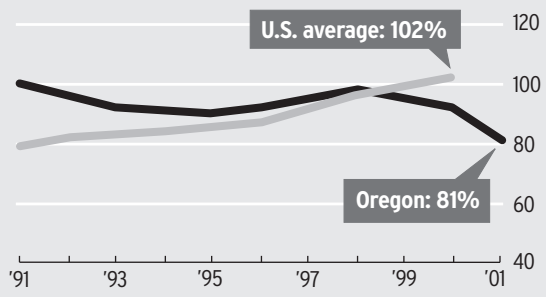


In the 1990s, the payroll rate PERS charged government agencies changed little even as the stock market increased. Now the payroll rate is growing sharply.



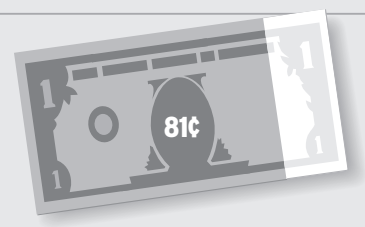
And while other public pension funds around the nation grew healthier, Oregon's didn't.

Percent of assets to liabilities



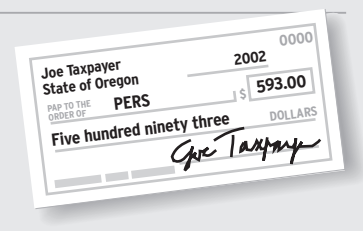
PERS only has 81¢ for every $1 it needs

The PERS shortfall, called the unfunded actuarial liability, has risen to $8.5 billion. Put another way, PERS in 1991 had enough money to meet its obligations. It now has just 81 cents for every $1 it needs.



Who's going to make up the difference

PERS levies a payroll charge on government agencies to keep the system funded. Taxpayers in turn fund the government agencies. Next year, the public's annual cost to fund PERS will hit $950 million a year, or about $593 a year for every Oregon taxpayer.

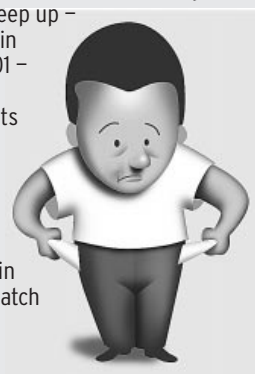


Why the stock market alone will not save PERS

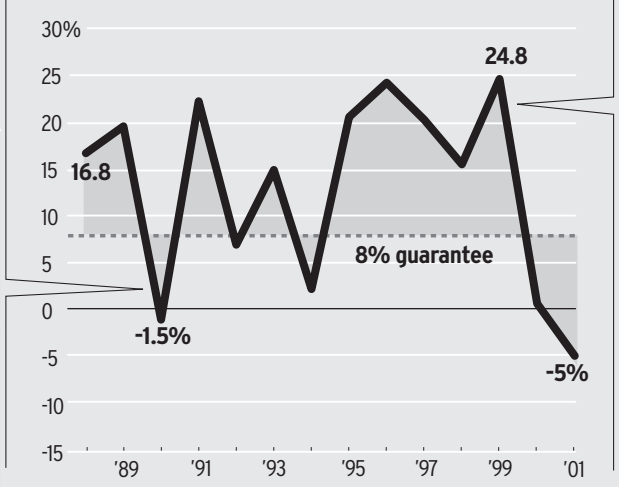
A falling stock market is blamed for hurting PERS. But a rising stock market won't necessarily help PERS recover. Here's why that no matter what Wall Street does, PERS can fall farther behind.

When the stock market falls, the public puts more money in

◆ Most employee accounts are guaranteed to grow 8 percent a year. If the PERS fund doesn't make enough in a year to keep up – as happened in 2000 and 2001 – the pension system uses its reserves to cover the shortfall. The public now must put more money in to help PERS catch up.



PERS investment returns



When the stock market rises, the public may still end up putting more money in reserves

◆ When the PERS board has more than the 8 percent annual increase it needs – as happened through most of the 1990s – the board has voted to increase employee accounts even more. But the system is geared to expect slower growth. As a result, taxpayers have to increase their contributions to catch up.

◆ PERS makes the accounts bigger at the expense of its savings, or reserves. Despite record earnings from the stock market, the PERS board repeatedly violated its own guidelines by putting far too little money into savings.

◆ The bigger PERS makes the accounts in one year, the bigger the 8 percent guarantee becomes the next year. If the stock market slows down, the size of the shortfall turns out to be larger than it would have been.

Sources: Oregon Public Employees Retirement System, Public Pension Coordinating Council

STEVE COWDEN, BRENT WALTH/THE OREGONIAN

Shortfall: Rainy-day fund cuts hurt PERS

Continued from Page A16

described how the pension system worked.

According to a tape of the meeting, Johnson explained that PERS assumed accounts would grow, on average, by 8 percent a year.

That troubled Pozdena.

He could see that PERS guaranteed employees 8 percent annually in their accounts. But he also saw that the PERS board often increased retirement accounts by more than that — and that the system's liabilities would grow faster than planned.

"Which means," Pozdena told Johnson, "the fund is less well-funded than it appears."

Johnson didn't agree, but he did note that PERS has a safety valve if someday it can't afford to meet the 8 percent guarantee: The rates charged to government agencies would be increased.

"There is something to fall back on," Johnson said. "And it is the taxpayer."

8 percent guarantee adds up

In 1995, the Legislature decided to end the 8 percent guarantee for employees hired after Jan. 1, 1996, creating a second "tier" of PERS members. In time, this second tier will begin to slow down the growth of the pension system's costs but not for 15 to 20 years, according to PERS estimates.

In the meantime, the 8 percent guarantee for previous members — called Tier 1 — will dominate and require PERS to put money aside to meet the costs.

And the actions of the PERS board have only increased that domination, compounding the costs of the 8 percent guarantee.

During the 1990s, as Pozdena had noted, the PERS board had increased pension accounts by an average 13 percent a year. Increasing the accounts faster meant the 8 percent guarantee would cost more later.

Even with that, Jim Loewen thought the PERS board could do more for employees.

Loewen, named to the PERS board in 1992 by Gov. Barbara Roberts, worked as a counselor at the state's MacLaren Youth Correctional Facility in Woodburn.

Loewen was a board member of the Oregon Public Employees Union, the largest union for state workers. He also served as chairman of its political action committee, helping steer campaign contributions.

Loewen had seen a few bad years on Wall Street that forced the PERS board to dip into its savings to meet the 8 percent guarantee.

Still, he questioned the PERS board's policy to keep 24 months' worth of money in the rainy-day fund.

"That two-year figure was just pulled out of the hat," he said.

So in 1996, Loewen suggested cutting the target.

The board settled on an 18-month cushion. Doing so freed up at least $1 billion a year for pension accounts.

But it also raised the odds the system could come up short and the rainy-day fund would dry up if the stock market turned sour.

PERS board members asked their actuary, Johnson, what the odds were of that happening. Johnson said they were about one in five.

"I thought that was a very significant risk to take," Johnson says now. Johnson says he warned the board about the risk but that he was asked primarily about the odds.

"I was asked a very specific question," Johnson says. "I gave a very specific answer."

Loewen liked those odds and lined up a majority on the board. Not everyone went along.

"We had some very tough conversations about this over coffee during breaks in the meetings," said one PERS board member, Bud Hakanson, who served as president of Umpqua Community College in Roseburg and Clark College in Vancouver.

"The union members were all over me about this."

Hakanson said his experience in running colleges had taught him to save money where you can. That meant you didn't reduce your savings.

"I didn't see the sense in it," he said.

The board approved Loewen's plan on Feb. 11, 1997. With other opponents absent, Hakanson was the lone vote against it.

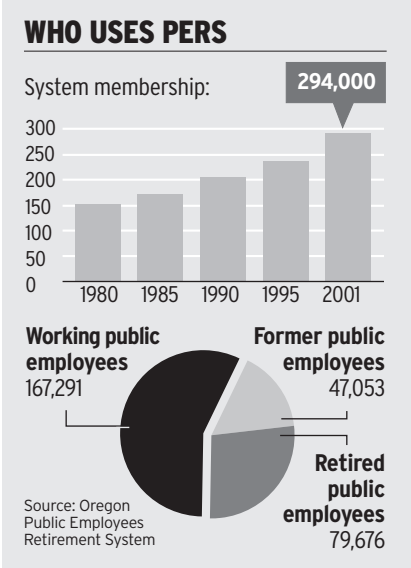
Today, Loewen acknowledges the decision looks different to him.

"In hindsight, one would probably not do that again," he says. Yet Loewen thinks the PERS fund can grow out of its current shortfall.

"I trust the American economy," Loewen says. "We trust our actuary. The entire economy runs on actuaries. Unless they have made a horrible blunder somewhere, the numbers in the end will balance."

"It shocked everyone"

But Money Match knocked the system off balance. In June 1998, Johnson, the PERS actuary, told the board that the stock market's growth in 1996 and



STEVE COWDEN, BRENT WALTH/THE OREGONIAN

> *"We didn't want to do the reserve all in one whack. We wanted to do it gradually. In retrospect, all of us wish we had done the whole thing."*
>
> **DAWN MORGAN, PERS BOARD CHAIRWOMAN**

1997 had increased the PERS fund by about 44 percent, an unprecedented rate. Money Match now was the formula most retirees used. PERS wasn't prepared for those costs.

"It shocked everyone," said Fred McDonnal, then the PERS executive director. "Money Match came along with big returns from Wall Street and upset the apple cart."

In 1999, PERS increased payroll charges to government agencies to cover the growing Money Match costs.

Today, government agencies contribute $69 million each year — on top of all the other PERS costs — to pay for Money Match.

It's a result Randall Pozdena had worried about.

For years, Pozdena sat on the Oregon Investment Council, unhappy about what he saw at PERS. He had no power to change it.

But in 1999, he became the investment council's chairman, and he gained the power to raise new questions.

Pozdena launched his own inquiry into the pension system's finances and asked a company under contract to the investment council, Frank Russell Co., to study the situation.

The July 1999 Russell report stunned everyone: PERS officials, investment council members and even Pozdena.

The report warned that if the stock market turned sour, there was virtually no way PERS could earn its way out of the hole.

The PERS board's actions to rapidly increase employee accounts meant the annual cost to meet the 8 percent guarantee had grown huge: $2 billion a year by 2000. Because the PERS board had in turn put away too little money, a flat stock market could send PERS spiraling downward quickly.

When the report was issued, the market hadn't faltered yet. The report presented a worst-case scenario in which the PERS fund lost money, and it predicted the shortfall could balloon to $9.7 billion in five years.

As it turns out, the stock market's decline pushed the current shortfall to $8.5 billion in just two years.

At the time, the report came as a blow to the PERS board; one member, Dawn Morgan, found the news so shocking she called it an "ambush."

Yet the sobering news led the PERS board in February 2000 to increase its rainy-day fund. Rather than keeping enough money to cover the 8 percent guarantee for 18 months, the board voted to increase the target to 30 months.

Then, despite having just raised the target — and despite all the warnings — the PERS board again violated its own policy. The board voted to increase retirement accounts so much that it left the rainy-day fund $1.8 billion short.

"We didn't want to do the reserve all in one whack," says Morgan, the PERS board's current chairwoman and a former president of the Oregon Public Employees Union. "We wanted to do it gradually. In retrospect, all of us wish we had done the whole thing."

Still, the PERS board's efforts to set any more money aside angered public employee unions. They also resented what they saw as intrusion by Pozdena and the investment council.

"We thought they were pushing buttons they had no business pushing," says Greg Hartman, lawyer for the PERS Coalition, a collection of the state's public employee unions.

In August 2000, the union coalition filed a court claim, alleging that the PERS board's decision to set aside more money was outside the board's "range of discretion."

The union coalition withdrew the claim when PERS commissioned a study that would determine just how much money PERS needed in the bank. PERS hired Pozdena's firm to do it.

The new study produced even more surprises for PERS officials: The pension system's costs could grow no matter what the stock market did, and the more volatile Wall Street was — the more stock prices swung up and down over the years — the bigger the costs.

Clock is ticking

What has been the cost of the PERS board's actions to date?

The Oregonian, using PERS financial records, reviewed how the PERS board has handled the system's rainy-day fund since 1995. The newspaper estimated what would have happened if the PERS board had not cut its savings targets and had fully funded the rainy-day fund.

The result: The PERS shortfall would be at least $2 billion smaller today.

When asked about the newspaper's analysis, Jim Voytko, PERS' current executive director, said that his agency has not performed a similar analysis and could not confirm the newspaper's results. "I'd say your conclusion is not all that surprising," Voytko said.

Estimates aside, what actually happened?

PERS has burned through its inadequate reserves and has driven its rainy-day fund into the hole.

Of the system's total $8.5 billion shortfall, an estimated $2.5 billion is the rainy-day fund's red ink.

The public has the luxury of years to close the system's overall shortfall.

But not so with the rainy-day fund.

The fund is supposed to help keep PERS stable. A little-known state law forbids PERS to carry a deficit in its reserve fund for more than five years.

The fund went into deficit this year. The clock is running. If time runs out, the law triggers an immediate bailout — even if it totals billions.

"Which means it will end up just as the PERS actuary said it would," Pozdena says today. "On the taxpayer."

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Retirement: PERS short $8.5 billion

Continued from Page One

$1.3 billion to the pension system's liabilities by using PERS to cover a court-ordered tax settlement to public employees.

◆ The PERS shortfall is $2 billion bigger today because the pension system's board failed to save enough money to protect the system against bad years in the stock market, according to The Oregonian's review of PERS financial records. PERS records show board members knew they were routinely violating their own policies by shortchanging the system's rainy-day fund in favor of increasing employee retirement accounts.

◆ The shortfall is another $1.5 billion bigger today because the PERS board continues to use life-expectancy tables that are 24 years out of date. Underestimating how long retirees will live, PERS pays out pension checks for an average of four years after the system calculates the payments should stop.

Filling the gap

Governments and employees contribute to the PERS fund, which has about $36.3 billion in assets. PERS then pays retirees out of the fund. To meet all its future obligations, PERS says the fund should have another $8.5 billion, or a total of $44.8 billion.

The shortfall has consequences for taxpayers, who foot the bill for public agencies.

When there's a shortfall, PERS levies a higher payroll charge to government agencies at a rate designed to steadily close the gap. Agencies say they will have to cut jobs or services to make up the differences in their budgets.

PERS board actions on two issues that increased the shortfall — using the old life-expectancy tables and failing to save enough money — have increased PERS' on-going cost to government agencies by $245 million a year, a review of PERS financial records shows.

It wasn't supposed to be this way.

PERS once stood as the pride of Oregon government, a pension system that sought to show how smart investing and careful management could secure the future for the people who carry out some of society's toughest jobs: firefighters and teachers, health care specialists and prison guards, social workers and police officers.

Don Morrow is one of them.

"I really consider myself lucky to have this benefit," says Morrow, 64, a laboratory technician who retired last year after 31 years at Oregon Health & Science University. "It's one of the reasons I stuck it out with the system, because I realized at least I would have something to retire on."

To be sure, recent losses in the stock market — where much of the PERS fund is invested — have widened the system's shortfall.

"If the stock market comes back, things can just turn around," says Pat West, president of the Oregon State Fire Fighters Council.

Growing pains

But a rebounding stock market alone will not save PERS.

The more money that comes into PERS from investments, the bigger employees' benefits grow, and most retirement accounts don't shrink. PERS' own studies show that the faster accounts grow, the more money it takes to meet the 8 percent guarantee when investment returns are low.

As a result, the stock market has a disproportionate effect. When the stock market rises, the cost of PERS falls slowly, if at all. But when the stock market falls, even a little, the system's costs grow rapidly.

"It may be one of the unintended consequences of the system," says Jim Voytko, executive director of PERS.

The stock market in the 1990s did wonders for other public pension funds. Most started the decade with shortfalls, national studies show, and they now on average have more money than they need.

Not so with PERS. Fully funded a decade ago, PERS now has just 81 cents for every dollar it needs to meet its future obligations.

And not all public employees see a windfall. Tens of thousands of older retirees never see the huge pension checks paid to recent retirees.

For current workers, rising PERS costs may also mean fewer pay raises, more layoffs and a shrinking of the very services they spend their lives providing Oregonians.

Gov. John Kitzhaber, a Democrat, and Republican legislative leaders already have announced they will form separate groups to study the issues.

"What we don't want is just another round of blaming public employees for something that is not their fault," says Mary Botkin, lobbyist for the American Federation of State, County and Municipal Employees.

But what many government officials say the state needs is answers — soon.

"We may end up with the worst roads in the country and the worst schools and the worst parks," says Frazier Rohm, a Vernonia Rural Fire Protection District board member.

"But we'll have the best retirement system."

The impact: Public programs, jobs and services could feel the squeeze of the PERS shortfall

The soaring demands of PERS benefits have to be fed, laying claim to chunks of budgets, especially in small communities

By KIM CHRISTENSEN and BRENT WALTH
THE OREGONIAN

ROSS WILLIAM HAMILTON/THE OREGONIAN

Sherman County Sheriff Brad Lohrey makes a traffic stop on Highway 97 in Moro. Lohrey spends much of his time on patrol these days because his department can't afford to fill a vacant deputy position. The rising cost of the state's Public Employees Retirement System is a major reason the department is short.

Sherman County has 1,934 residents, 823 square miles of land, hundreds of miles of roads and highways — and too few deputies to watch over it all.

For nearly two years, the sheriff's department has been unable to fill one of its five full-time positions, cutting patrol hours by 20 percent.

"One position in a city like Portland would probably be like, so what?" Sheriff Brad Lohrey said. "But here, having one person gone means a six- or seven-hour gap when there is no coverage. The impact is huge."

Sherman County officials say their budget woes — like those of local governments throughout Oregon — stem largely from the soaring cost of the state Public Employees Retirement System and rising health care costs.

Designed to secure the financial future of Oregon's public servants, PERS is squeezing the budgets of state agencies, cities, counties, public schools and hundreds of small service districts.

As a result, police and fire protection, jail staffing, juvenile-offender programs, mental health care, after-school activities, public health nursing and street maintenance are at risk in communities across the state.

"It's just murder," said Linda Modrell, a commissioner in Benton County, which recently borrowed $10 million to pay its PERS bills.

Although retirees' pension checks are not in jeopardy, the PERS funding crunch could affect current public employees. Some public officials say layoffs are unavoidable and money that could have been spent on pay raises will instead go to PERS.

Faced with an $8.5 billion gap between what the pension system has today and what it will need in the future, PERS next year will raise the payroll charges it levies on governmental agencies.

The current average charge of 10.7 percent of payroll will climb to about 14.7 percent. But some smaller local governments, which have few employees and are heavily affected when even one or two retire, already are paying as much as 41 percent of their payrolls to PERS.

The higher rates next year will divert $260 million to PERS from the budgets of state and local governments.

Benton County's debt to PERS — known in pension-fund parlance as an unfunded actuarial liability — rose to $11.5 million in 2000, nearly doubling from the year before.

PERS will cost Benton County nearly $1 million more this year than it did just a few years ago, said Budget Director Pat Cochran. As a result, 10 to 20 of the county's 400 full-time employees probably will lose their jobs, he said.

"In order to meet those costs, we will have to start reducing staff and services," Cochran said, predicting cuts in health education, outpatient mental health services and maternal-child health care.

Others face similar choices.

The city of Roseburg has seen its annual PERS rates rise nearly 50 percent in recent years, to 16 percent of its payroll. That translates to an additional cost of about $300,000 annually.

Finance Director Lance Colley predicts a PERS-related cut of 12 to 14 jobs, half of them in police and fire services.

"That would mean at least one fewer person on shift every day in each of those departments," Colley said. "We will still respond, but it may not be as quick."

In Lane County, where the unfunded liability in 2000 jumped from $4.6 million to $7.9 million, officials say rising PERS costs prevent them from hiring much-needed public health care workers. They also cut into nutrition programs for infants and efforts to curb domestic violence.

"Some really hard decisions will have to be made," said Anthony Bieda, government and legislative affairs manager for the county, whose PERS rate equals 16 percent of payroll.

Randy Bruegman, chief of Clackamas County Fire District 1, said his agency's $800,000-a-year PERS expense is roughly what it costs to operate a fire station.

His district should be able to keep personnel and services at current levels for another year, maybe two, he said. But with demand for fire services growing by 6 percent to 10 percent every year, Bruegman said, local governments can't keep up.

"It will bankrupt many public agencies if we don't fix this system," he said.

PERS' problems compounded

The PERS fund is invested in the stock market and other ventures.

Recent stock market losses have hurt PERS, but that's only one of several factors driving up costs for local governments.

Many public employees put some of their retirement funds in a variable-rate account, which goes up and down with the market, growing by as much as 30 percent in boom years.

Because of a provision known as Money Match, the agencies that employ these workers have had to match the huge increases in their variable accounts — and have come up millions of dollars short.

The Legislature also has made PERS' problems worse.

In 1995, lawmakers voted to increase pension benefits by 9 percent across the board to settle a legal dispute over taxing of state pensions. The move saved the state money but shifted nearly $1.3 billion in costs to local governments, according to PERS records.

Finally, people are living longer, but PERS doesn't account for it. PERS still uses life-expectancy tables from 1978, even though the agency knows they are out of date. In a lawsuit that's pending, several local governments have asked that PERS update its actuarial tables.

The agency uses them to determine a retiree's life span, then calculates a pension check based on that estimate. Because people are living on average four years longer than they did in 1978, they are outliving the money that's been set aside for their retirement. But the checks keep coming, and the additional costs fall back on local governments.

"Those PERS cost increases are more than two cycles of new textbooks."

JIM SCHERZINGER,
PORTLAND PUBLIC SCHOOLS INTERIM SUPERINTENDENT

Some have fought back.

In 2000, the city of Eugene and the Eugene Water & Electric Board sued PERS, alleging that the board that oversees the system has exceeded its legal authority to increase costs and benefits.

Seven other local governments have since joined the lawsuit, including Multnomah and Lane counties and the cities of Portland, Roseburg and Huntington.

THE OREGONIAN

Marion County Circuit Court Judge Paul Lipscomb has ruled that government agencies must live with the $1.3 billion tax shift the Legislature imposed on them.

Lipscomb also has ruled that PERS was improperly matching the gains in variable accounts, a practice that had left local governments in the hole for millions.

The variable accounts, actuarial tables and other issues will be aired at a trial set for June.

Schools feel the pinch

Oregon's public school districts also have been hard hit by the PERS increases. Jim Green, the Oregon School Boards Association's senior legislative advocate, said it is difficult to pinpoint the effects but that districts with declining student enrollments are likely to suffer most.

"When costs go up that dramatically and income is not coming in, you start cutting things," he said. "You eliminate programs at the district level. You eliminate extracurricular activity. Unfortunately, it probably also means elimination of some staff at all levels: administrative, certified and classified."

Jim Scherzinger, Portland Public Schools interim superintendent, said the proposed PERS rate increase of payroll charges could raise the district's annual costs by $8 million, at a time when state funding for schools is being reduced.

"Think of it in terms of textbooks," Scherzinger said, citing one example of how PERS costs can affect schools. "When we do a new textbook adoption, we estimate it costs $3 million for the books and the staff development and training. Those PERS cost increases are more than two cycles of new textbooks."

The state's 198 school districts and some local governments have sought to borrow their way out of the PERS problem, a tactic that at best will provide temporary relief.

A law passed by legislators in 2001 permits local governments and school districts to finance their PERS debt in the bond market. Bonds yield some savings in interest payments, akin to refinancing a mortgage at a lower rate.

Portland schools, with a $211 million unfunded liability, had signed on to a plan by the Oregon School Boards Association to issue bonds to help school districts and educational service districts dig out from a total unfunded liability of $1.7 billion.

The association planned to issue bonds in June but recently postponed the program because of possible changes in the way PERS handles payments. The association said such changes could have a negative effect on bond issues and will delay its bond program until PERS resolves the issue.

Other local governments already are in the bond market.

Multnomah County issued $180 million in pension obligation bonds in December 1999 to cover its unfunded liability, Finance Director Dave Boyer said.

The county paid off PERS with the proceeds and for a while had $74 million more than it needed to cover its PERS costs.

But that surplus "evaporated" because of PERS' investment performance in 2000, Boyer said, and the county now has an unfunded liability of $4 million.

Thanks to even bigger losses in 2001, Boyer said, he foresees the county's unfunded liability "going back up to a huge number" this summer and that service cuts, yet to be identified, are likely.

"It could very easily be $80 million," he said of the potential unfunded liability, "and it's more likely to be $100 million to $110 million."

At the end of 1999, the city of Corvallis had an unfunded liability of $12.5 million. A year later, it had nearly doubled to $22.7 million.

"It will bankrupt many public agencies if we don't fix this system."

RANDY BRUEGMAN,
CHIEF OF CLACKAMAS COUNTY FIRE DISTRICT 1

"When I saw that number I believe I went into shock," said Finance Director Nancy Brewer. "I didn't come out of shock until a couple of hours later when I was having dinner with my husband and said, 'Twenty-two million dollars. Twenty-two million dollars. I can't believe it's $22 million.' "

Corvallis, which pays a PERS rate of 14 percent of its payroll, also has issued bonds and will save $160,000 in interest payments this year, she said.

But that won't be enough to follow through on some planned projects, including a new fire station.

"We have the money in hand for construction costs," Brewer said, "but we don't have the money for the nine firefighters we need to staff it."

For larger government agencies — such as the state of Oregon and city of Portland — changes in PERS charges are easier to absorb because costs are spread out over many more employees.

Not so for smaller ones.

The Eastern Oregon town of Huntington, population 515, has been pushed to the brink of bankruptcy.

Huntington, which is about 100 miles northwest of Boise, had five employees when one suffered a career-ending injury and received full PERS disability benefits. That increased the city's PERS liability and has helped push its rates to 41 percent of payroll.

Donna Reedy, who serves as Huntington's city adminstrator, city manager, recorder and budget officer, said it costs Huntington $4,500 each month to pay her and the remaining two full-time employees and another $1,864 a month for retirement accounts.

Reedy cringes at the notion of cutting services. It's all Huntington can do now just to keep the streets in shape and the water lines working.

"We don't have enough as it is," she said. "We don't have any fat. In fact, we're skinny."

The 2001 Legislature made it possible for local governments such as Huntington to pool their liabilities, something that state agencies and schools had done for years.

Pooling helps smooth out sharp spikes in PERS rates but won't protect local governments from steadily rising costs.

Lohrey, the Sherman County sheriff, said he feels the impact of those costs every time the phone rings in the middle of the night.

When something big happens during one of those six-hour gaps in coverage, he or one of his deputies gets the call.

"We're still covering 24 hours even though we don't have the manpower to do it," he said. "We get called out a lot."

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The PERS decision-makers

THE PERS BOARD

The 12-member Public Employees Retirement Board oversees the state pension system. Members are appointed by the governor, confirmed by the Senate and serve three-year terms. Under a recent change by the Legislature, six of the 12 cannot be PERS members. By law, the board includes one state employee in a management position, one elected official not in state government and four members of collective bargaining units. Of the private-industry members, at least three must have experience in investing or pension management and one must also be a member of the Oregon Investment Council.

Current members are:

Dawn Morgan (chairwoman), training coordinator, Oregon Vocational Rehabilitation
Christine Brown, attorney
Steven Bjerke, investment representative
Patricia Brown, vice president, Standard Insurance
Janice Deringer, investment consultant
Elizabeth Harchenko, director, Oregon Department of Revenue
Mark Gardiner, businessman
Jeanne Garst, staff assistant, city of Milwaukie
Glenn Harrison, retired teacher
Emile Holeman, Umatilla County commissioner
George Russell, superintendent, Eugene 4-J School District
Todd Schwartz, firefighter, city of Springfield.

THE OIC BOARD

The Oregon Investment Council directs the PERS investment fund and hires money managers to handle investing. The council is made up of the state treasurer and four members appointed by the governor, subject to Senate confirmation. The executive director of PERS sits on the council as a non-voting member.

Current members are:
Gerard Drummond (chairman), businessman
Randall Edwards, state treasurer
Jerry Bidwell, brokerage president
Mark Gardiner, businessman
Diana Goldschmidt, consultant
James Voytko, PERS executive director

Source: Public Employees Retirement System; Oregon State Treasury

THE PERS CRISIS

Retirement benefits are hard-earned

Public workers say the promise of a good pension makes up for long hours, hard work and sometimes stagnant pay

By KIM CHRISTENSEN and BRENT WALTH
THE OREGONIAN

Chuck Corak spent 31 years as a teacher and coach, with no regrets. He loved teaching, he enjoyed working with kids and, when he looks back, he sees a career fulfilled.

But he also thinks about all those nights and weekends spent grading papers and rattling around on team buses, and he figures he'd have been a lot better off financially if he'd sold insurance for a living.

"If I had put in the same amount of time making sales calls throughout Oregon, I probably would've been in the Million Dollar Club versus the $40,000 teacher club," says Corak, 56, who spent most of his career in the Enterprise School District in northeastern Oregon.

What helped make it worthwhile, Corak says, was a pension plan that promised a comfortable retirement. He knew he'd never be rich, he says, but he didn't worry about being poor in his old age, either.

"There was always the understanding that, hey, PERS is a good retirement program," he says.

Oregon public employees with 30 years' service now retire, on average, with 105 percent of their pay, an unusually high payout that has helped spark calls for an overhaul of a system that covers 294,000 current and former employees.

Benefits experts say that public employee retirement plans elsewhere generally pay about 60 percent to 70 percent of workers' final salaries.

"It is really extraordinary" for public pensions to pay more than 100 percent, said Pete Neuwirth, an actuary who consults for Lane County and other local governments.

Designed to attract good workers to the public sector, PERS promised retirement benefits equal to 50 percent to 60 percent of pay. But that percentage has risen steadily over the years, driven by factors that include legislative changes and PERS board decisions that increased benefits.

The fatter employees' accounts grew, the better the benefits became, especially for those who were hired before 1996 and are guaranteed an 8 percent annual return.

It's a good deal for the employees but not necessarily for those who foot the bill.

"You can't fault people for taking money that's there for them, but the rest of us are paying for it," says Katharine Denckla, who sits on the board of the Columbia County 911 Communications District. "The taxpayer is the one that takes it in the shorts."

PERS retirees don't see it that way.

Don Morrow, a laboratory technician who retired last year after 31 years at Oregon Health & Science University, said he is grateful for his ample retirement benefits and he makes no apologies for them.

He said his lengthy stint in the public sector owes partly to the promise of a good retirement. And he thinks PERS will bounce back from its money problems, which include an $8.5 billion shortfall between what it has and what it will need to cover future benefit payments.

"Until the economic downturn, nobody was talking about PERS," Morrow says. "Since the economic downturn, more attention has been focused on it, but that will pass. Once the system gets solvent again, it will pay for itself."

In 1999, Dianne Mekkers thought she would work for a few more years as a safety enforcement manager for the Occupational Safety and Health Division of the state Department of Consumer and Business Services.

Then one day a colleague called her.

"She said, 'Have you seen your PERS statement recently?' " Mekkers recalls. The annual statements were just going out to PERS members, and when Mekkers' arrived, she was stunned to see what her pension would be: slightly more than what she was earning.

"My reaction was, 'I'm retired. I'm gone,' " Mekkers says.

After 32 years in state government, she retired at age 52 and now contracts for other state agencies and does volunteer work.

"I never intended to work until I was 65, and I knew I would do OK with PERS," she says. "But I basically learned that I could retire without changing my lifestyle."

Corak, who coached football and wrestling, said his benefits don't exceed the $40,000 or so he was making when he retired in 2000, and it irks him to hear people say the pension system is too generous.

What many don't realize, he says, is that the prospect of a healthy retirement package helped make up for years when there were no big raises for public school teachers.

And he doesn't think anyone should hold that against them.

"Personally, I feel I've earned my retirement," he says. "I put in a lot of hard years there."

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Unions are holding all the aces in PERS deal

Legal challenges and political fixes to the pension fund all must overcome resistance by unions to curtailing their lucrative deal

By BRENT WALTH
THE OREGONIAN

Greg Hartman brushes his hand across the table in front of him, as if sweeping it clean.

"If you could start over with a pension system," Hartman says, whisking his hand back again, "you probably would start fresh with a system that doesn't look anything like the one we have today."

Then Hartman, framed by the city towers beyond his Portland law office's 16th-floor window, folds his hands in front of him.

"But I look at it from the perspective we have the system that's here, and the courts have said public employees have contract rights under it. That's what we are trying to protect."

For Hartman and his clients — the state's public employee unions — the legal fortress built around the Oregon Public Employees Retirement System is the last defense of a pension fund facing growing calls for reform.

The state's next governor and the 2003 Legislature will confront the growing costs of a pension system now paying out benefits larger than lawmakers intended.

Public employee unions have proven to be one of the most formidable political forces in Oregon. State leaders proposing reform of PERS say that the unions' political influence and past court rulings make any quick and meaningful fix difficult.

But cracks in the walls have appeared. PERS faces a civil trial next month in Salem, which will test just how far changes in the way PERS operates can go.

In the unprecedented challenge, local governments — which largely fund PERS through payroll charges — allege the pension system has improperly increased costs to the public as it has increased benefits to public employees.

"We're not questioning whether public employees should receive a fair retirement," says William F. Gary, a former deputy state attorney general representing the government agencies against PERS. "We're simply saying PERS has overstepped its authority."

The trial arises from lawsuits filed against PERS two years ago by the Eugene Water & Electric Board, the city of Eugene and seven other local governments. Marion County Circuit Court Judge Paul Lipscomb rejected some of the local governments' key claims.

But in a pre-trial judgment issued in August, Lipscomb laid the groundwork for changes that could bring significant cost savings.

For example, Lipscomb ruled that PERS has improperly required taxpayers to match investment gains some public employees have made in variable accounts that fluctuate with the stock market. PERS says those variable-account gains total $2 billion, although the agency says it doesn't know how much of those benefits might be affected by the judge's final ruling.

The upcoming trial will also deal with PERS' continued use of out-of-date life-expectancy tables that underestimate how long retirees will live and, as a result, add $1.5 billion to the pension system's liabilities.

PERS defends its past actions, and the union coalition Hartman represents — including about a dozen unions and more than 100,000 PERS members — has entered the case as well.

"People want to know what can be done about PERS," says Dawn Morgan, the PERS board chairwoman and past president of the Oregon Public Employees Union, the biggest union representing state workers.

"Until the courts take final action, any action we take has the potential to be undone. Everyone should approach the solutions with that in mind."

What to do about PERS?

Court rulings that limit changes in existing pensions benefits give lawmakers and state officials little leeway in controlling PERS' costs. And no proposal for addressing PERS is either simple or guaranteed to work. Here are the current suggestions about what state officials might do:

Wait it out

Many public employee union officials say that the problems with PERS are nothing that a recovering economy and stronger stock market won't fix. Many analysts say, however, PERS' costs will consistently grow faster than any foreseeable Wall Street recovery.

A third class of public employees

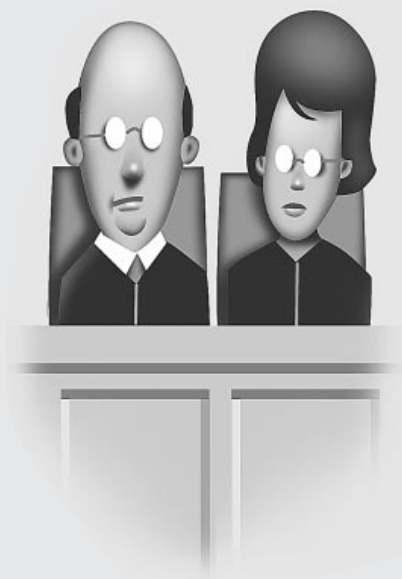
Otherwise known as a third tier, newly hired employees would be offered even smaller retirement benefits than those given the so-called Tier 2 employees hired after Jan. 1, 1996. A new tier does almost nothing to help PERS' health for decades.

Renegotiate employee agreements

Management might convince workers in the face of looming budget cuts to accept smaller pension benefits. But unions would likely demand something in exchange, which could cut into any savings. It's not known if such an agreement would withstand a court challenge.

Seek new court rulings

A ruling from an upcoming trial in Marion County Circuit Court could force PERS to change some policies and reduce public costs. Any verdict will likely be appealed to the Oregon Supreme Court, which in the past has ruled that key provisions of PERS are contract rights that cannot be rolled back.



STEVE COWDEN, BRENT WALTH/THE OREGONIAN

The force of numbers

Public employee unions gain much of their power through sheer numbers. They can mobilize thousands of members to campaign and contribute money.

"The public employee unions can essentially tell the Legislature what it can and cannot do," says Senate President Gene Derfler, R-Salem. "People here live in fear of what they can do."

But the unions' power has waned somewhat while Republicans have controlled the state House and Senate.

From 1990 to 1996, public employee unions gave $1 out of every $8 in Oregon political campaigns, state Elections Division records show. Since then, the unions' share has dropped to $1 out of every $13.

"We're on the defense in Salem now more than ever," says Mary Botkin, a lobbyist for the American Federation of State, County and Municipal Employees.

Botkin and other public employee union officials say the 2003 Legislature should leave PERS alone until it's clear whether the pension system can recover when the stock market bounces back.

"Will things turn around? Yes," Botkin says. "Will it happen quickly? No. Am I willing to ride the wave until then? Absolutely. Everybody should just take a break."

The 2001 Legislature took several steps to ease the growing fiscal pain of PERS. Lawmakers approved the use of bonds for local governments to pay off their PERS debt and allowed for agencies to pool their obligations to help smaller employers avoid big swings in their rates. Lawmakers directed PERS to do a better job of building up a rainy-day fund for future downturns in the stock market.

They also balanced membership of the 12-member PERS board between people who are members of the pension system and those who are not.

But public employee unions successfully fought off the biggest proposed change: creation of a third "tier" of public employees whose retirement benefits would be smaller than those already in the system.

Derfler, the Senate president, says a third tier would help control pension costs by promising incoming public employees a lower level of pension benefits than existing workers.

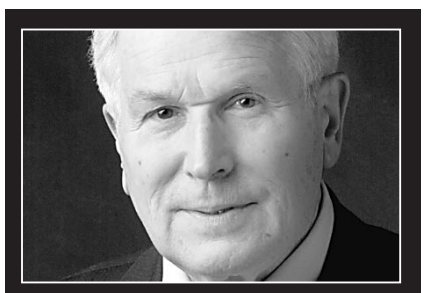
"The unions fight this idea," Derfler says, "but if we don't do it, none of it will matter because there won't be anything left in the system when they retire."

Yet government budgets would not see the effects of a third tier for decades. A second tier approved by lawmakers seven years ago already denies public employees hired after 1996 the guarantee that their retirement accounts will grow at least 8 percent a year.

PERS officials say the second tier won't slow the system costs for 15 to 20 years. Union officials say a third tier would create more inequity among public employees.

Derfler's plan was defeated in the GOP-run House in 1999 and made no progress last year. Derfler says defeat is inevitable when a veto is certain.

"The guy in the center office isn't going to sign anything the unions don't like," he says.



"The public employee unions can essentially tell the Legislature what it can and cannot do."

GENE DERFLER,
SENATE PRESIDENT, R-SALEM

The governor's response

The guy in the center office, Gov. John Kitzhaber, a Democrat, has said little about PERS publicly. In an interview earlier this month, Kitzhaber said he will form a task force to study PERS and may serve as its chairman.

Whatever its findings, the problem will be handed to Kitzhaber's successor.

The governor says that it's a mistake to look at PERS without looking at all other forms of public employee compensation, including salaries and health care costs, which he says are also rising.

Kitzhaber says unions and government officials should talk about public employees' compensation generally to see if they can agree on finding a way to cut PERS costs.

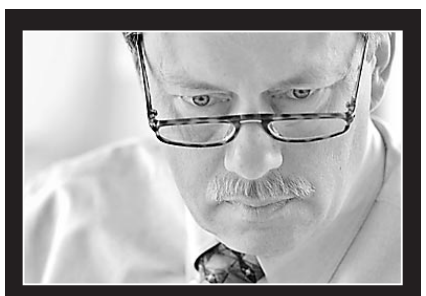
"I don't think it's too soon to begin having these conversations," Kitzhaber says. "Obviously there's a lot of mistrust out there. … There's a solution there, but I think the solution is ultimately going to be one between labor and management."

Reaching such a broad agreement would be a gigantic political task, and it's not one that Kitzhaber has taken up. He says his proposed task force is a start.

But even if the next governor could lead such an agreement, another court challenge would almost certainly follow.

Hartman, the unions' attorney, said that even if major unions agreed to a pension rollback, individual members would certainly challenge the deal in court.

He said unions would want a financial tradeoff for giving up retirement benefits. "I don't see such a global effort saving any money," Hartman says. "No union is going to give up something for nothing."



"No union is going to give up something for nothing."

GREG HARTMAN,
LAWYER FOR
PUBLIC EMPLOYEES UNIONS

Confusing PERS laws

A problem Kitzhaber's task force may be forced to confront is the chaotic laws that govern PERS.

Judge Lipscomb has said Oregon's pension laws are "like an old house which has been subjected to a series of additions and remodelings; the resulting overall floor plan, traffic flow and roof lines do not approximate either simplicity or elegance."

PERS officials say the laws governing the pension system run 76 pages and 64,000 words. Even though PERS has been around for 56 years, the officials who run the pension system admit they aren't sure how it all works.

The tangle of laws creates accounting headaches. PERS operates on 1980s-era software that's so decrepit that about 40 percent of all transactions for pension members must be done by hand.

After projecting that new software would cost about $30 million to $40 million, PERS spent $13 million in the planning stages, according to news reports and a state Information Resources Management Division review. When the total estimated price grew to between $53 million and $97 million, lawmakers stopped the software project last year.

PERS' complexity means that a pension system that's supposed to be looking decades into the future has trouble knowing what will happen tomorrow.

PERS Executive Director Jim Voytko says the pension system lives with "uncertainty over what our core statute requires us to do."

"Not having solid answers to these questions," he says, "is not an acceptable state of affairs."