

MINUTES
SENATE FINANCE COMMITTEE
February 19, 2003
9:06 AM

TAPES

SFC-03 # 4, Side A
SFC 03 # 4, Side B

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately 9:06 AM.

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde
Senator Ben Stevens
Senator Donny Olson
Senator Lyman Hoffman

Also Attending: SENATOR KIM ELTON; CORINA ECKL, Fiscal Program Director, National Council of State Legislatures

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

CORINA ECKL, Fiscal Program Director, National Council of State Legislatures (NCSL), accompanied her testimony with a PowerPoint presentation [copy on file], titled as follows.

State Fiscal Conditions

Presentation to the Alaska Senate Finance Committee
February 19, 2003

Corina Eckl
Fiscal Program Director
National Conference of State Legislatures

Ms. Eckl shared that Alaska is "not alone in dealing with budgetary problems and fiscal gaps. She assured "This is a widespread

national problem with practically every state reporting some kind of serious fiscal problem that has been going on for some years now and unfortunately is expected to grow and get worse before it gets better."

Background on NCSL

National Conference of State Legislatures

- Bi-partisan organization founded in 1975
- Serves all 50 states, territories and commonwealths
- Offices in Denver and Washington D.C.

Ms. Eckl gave a background of the NCSL organization noting that the office located in Denver, Colorado addresses state services and the office located in Washington D.C. tracks federal policy and budget issues. She added that the NCSL staff working in Washington D.C. lobbies the U.S. Congress and the Administration on behalf of states. She listed state sovereignty and ensuring that federal mandates are funded as some of the issues the NCSL lobbyists address.

NCSL is a Valuable Resource

- Information from NCSL
 - Non-biased research, publications, 50-stated data, special projects
 - Technical assistance on a wide range of topics
 - Meetings and seminars
- Bob Boerner is the NCSL liaison to Alaska

Ms. Eckl encouraged the Members to "make use" of the NCSL resources.

Summary of FY 2003 Budget Gaps

- The initial estimated gap for FY 2003 (prior to budget enactment) was \$49.1 billion (10.1%)
- At least 42 states reported initial budget gaps going into FY 2003

Ms. Eckl noted the organization regularly surveys legislative finance directors of states governments, usually after adjournment of legislative sessions, and that these figures are the result of a survey conducted in June 2002.

Ms. Eckl defined "gap" as "a shortage of revenues", i.e. revenue collections below projected levels combined with spending overruns.

Ms. Eckl reiterated that many states have been encountering fiscal problems for several years.

State Fiscal Update
(February 2003)

- State budget gaps have grown nearly 50% since November
- States now face at least a \$25.7 billion (5.2%) gap in FY 2003
- Thirty-six states reported gaps

Ms. Eckl informed that the budget gaps increased from \$17.5 billion in November 2002, when the previous survey was conducted, to the February 2003 amount of \$25.7 billion in only two months.

FY 2003 Budget Gaps

[U.S. map indicating the percentage of the budget gaps for each state, the District of Columbia and Puerto Rico.]

Ms. Eckl expressed that this map identifies the "magnitude" of the fiscal problems. She noted four states have budget gaps higher than ten percent. She stated that the cause of the large gap in three of the four states, Oregon, Colorado and California, is due to the significant reliance on state personal income taxes.

Ms. Eckl referenced a study conducted by the Fiscal Affairs Program at the Rockefeller Institute in Albany, New York, which examined "how vulnerable states were in terms of a correction in the stock market." She shared that the aforementioned three states were particularly vulnerable due to their tax structures. She qualified, however, that the vulnerability is present "across the nation."

Ms. Eckl next indicated the 15 states that report no budget gap at present. She stressed that some of these states "have already taken action to resolve budget gaps." She explained that these states did have budget gaps in FY 03 "post budget enactment", although some addressed the matter with such methods as holding special legislative sessions.

Revenue Growth Has Not Rebounded

- 30 states reported that revenues are below projections in FY 2003
- In 12 states, collections are failing to meet revised levels

- Aggregate state revenue growth was projected to be 2%

Ms. Eckl asserted the budget gaps are primarily due to state revenue performance. She pointed out that several states have revised their revenue forecasts, because performance has continually been below expectations.

Ms. Eckl opined that the initial revenue growth projections of two percent for all states, was conservative. She informed that several states increased taxes, which affected the national aggregate projection. Excluding those states from the aggregate, she stated, results in a projected growth of less than two percent.

Senator Bunde asked the number of states that had a fund surplus in the last five years, and whether the deficit occurred because the activities of states were "over expanded."

Ms. Eckl responded that some members of Congress argued that the states "brought this upon themselves." She countered that state lawmakers deposited "a record amount of money" into rainy day funds, funded a "full range of programs" including education, and also lowered taxes in some states. She reported that taxes were reduced by \$35 billion over a seven-year period. However, she stressed that the "magnitude of the problem" of the current financial situation "far surpasses" any actions of the states taken during the previous years. She referenced a study conducted by the Federal Funds Information for States, an organization operating in Washington D.C., to determine the states' responsibility for the current fiscal gaps. She cited that this study found that, excluding Medicaid expenditures, state and local spending, as a percentage of gross domestic product (GDP), has remained stable over a 15-year period.

Ms. Eckl remarked that a major contributor to the states' budget crisis are "soaring" health care costs. She listed Medicaid and health care plans for state employees as some health care related programs experiencing increases. She also noted the performance of the stock market and the lowest consumer confidence rating in 15 years, are factors. She reiterated that the states with the largest budget gap problem are those with a disproportional dependence on personal income taxes, explaining that layoffs in technology and other industries have reduced collections.

Ms. Eckl told of characterizations of the current fiscal situation as "the perfect storm", given the various factors involved, many of which are "outside the control" of state policymakers. She surmised that the national economy is "probably the single largest factor affecting the health of state economies." She commented that

state legislators could do little to impact the national economy.

Ms. Eckl emphasized that a possible economic stimulus of the proposed federal tax reductions would be counteracted by any tax increases imposed by state governments to meet balanced budget requirements. She noted that reduced state spending and increased taxes are both a "drag on the economy."

Senator Hoffman asked whether the proposed tax rebates would benefit states' economies.

Ms. Eckl qualified that the NCSL has not conducted research on this matter; although she relayed conversations she had with economists and the "sense" that the federal tax rebates would have "some stimulant effect." She cautioned that she also learned that recipients of these rebates would not utilize the funds for "new spending" but rather to pay down existing debt. She stressed that the current financial situation contains "so many problems" that significant federal input would be necessary.

Ms. Eckl recalled testimony recently given to the U.S. Senate by Alan Greenspan, Chair of the Federal Reserve Board. Ms. Eckl told of a question posed by a Senator asking whether the federal government should provide financial assistance to help states eliminate budget gaps. Mr. Greenspan, she noted, responded that because states must balance state budgets by June 30, Congress would not have an opportunity to assist states in FY 2003. Ms. Eckl agreed, but stressed that assistance could be provided for FY 04 and FY 05. She reiterated that those in the federal government should understand that actions taken by states would impact the national economic recovery and therefore a partnership is necessary between state and federal governments.

Co-Chair Green asked for further data indicating the various factors contributing to the current fiscal situation.

Ms. Eckl referenced a report available on the NCSL website.

Co-Chair Green requested this report be provided to the Committee.

FY 2001 State Own-Source Revenue

[Pie chart demonstrating the percent of revenue sources as follows.

Individual income - 37.1 percent

General sales and gross receipts - 32.1 percent

Selective sales taxes - 14.1 percent

Other - 9.2 percent

Corporation net income - 5.7 percent
Property taxes - 1.9 percent]

Ms. Eckl relayed national concern that states are "facing structural budget gaps." She defined this as "state revenue growth not growing sufficiently to cover state expenditure growth."

Ms. Eckl informed that the State of Oregon receives 70 percent of its revenue from personal income tax. She qualified that this chart does not reflect the revenue sources for the State of Alaska, but pointed out that corporate net income tax as a revenue source has become "susceptible and vulnerable in terms of its long term viability".

Ms. Eckl referenced a recent article titled "The way we tax" in Governing Magazine, published by the NCSL. She noted this article includes one page describing the particular taxation issues of each state.

Revenue Outlook for the Rest of FY 2003

- Optimistic: 2 states
- Stable: 11 states
- Concerned: 30 states and D.C.
- Pessimistic: 7 states

Ms. Eckl informed that survey completed in February 2003 asked state financial representatives their outlook of revenue performance.

Ms. Eckl noted some of the seven states with the pessimistic expectations, were those that increased taxes in past year

Expenditure Update

- 37 states report that spending is exceeding budgeted levels
- 32 states report that Medicaid or other health care programs are over budget

Ms. Eckl commented that although revenue is a major factor, expenditures are also considerations in state budget gaps.

States with Overruns in Medicaid Or Other Health Programs

[U.S. map showing that 32 states incurred the overruns]

Ms. Eckl concluded that those states not currently over budget were able to accurately predict the necessary expenses. She informed that the State of Massachusetts reduced the number of patients eligible for Medicaid benefits by 50,000, and still incurred \$300 million overruns in the Medicaid program.

Ms. Eckl also noted that New Jersey has incurred higher than budgeted expenses for emergency snow removal.

Ms. Eckl stressed that health care costs "is truly affecting the health of state budgets." She remarked that national experts predict "this has the potential to really squeeze other parts of state budgets if something isn't done and done soon."

FY 2002 General Fund Spending by Category

[Pie chart listing expenditures as follows.

Other - 37.8 percent
K-12 Education - 30.6 percent
Medicaid - 13.9 percent
Higher Education - 11.7 percent
Corrections - 6.0 percent]

Ms. Eckl noted that K-12 education has been affected by the economic downturn because it comprises a significant portion of the budget. She pointed out that the percentage of state spending allocated to Medicaid has steadily increased over the past several years.

All Other

What's in "other"?

- Public assistance
- Parks and recreation
- State police
- Employer contributions to pensions and benefits
- Information technology
- Environment
- Economic development
- Arts programs

Ms. Eckl gave the State of Oregon as an example of a state with "one of the most severe budget problems" remarking that the police force in this state has been reduced by 20 percent. She said funding for arts programs has decreased as well. She described this as "survival mode" necessary for maintaining principle programs,

such as education, public safety and Medicaid.

Senator Hoffman asked which category includes homeland security expenditures. He also wanted to know if these expenditures have been a significant portion of state budgets.

Ms. Eckl replied that homeland security spending is included in the "other" category; however these expenditures are difficult to track because of the many state agencies involved, including public health, environment, transportation, public safety, etc. She also informed that these activities are not necessarily funded with "new money" but rather with redirected funds. In addition, she said a portion of the costs is attributable to local governments, as these entities are likely the first responders. She indicated that the NCSL had considered undertaking a survey to determine the percentages of budgets allocated for homeland security functions, but decided against it after learning of the many factors.

Dealing with Shortfalls in FY 2002 & FY 2003

- Imposing budget cuts: 36 & 31 states
- Using tobacco settlement funds: 16 & 21 states
- Tapping rainy day funds: 23 & 14 states

Ms. Eckl explained the PowerPoint slide: the first figures (36, 16, 23) represent the number of states reporting for FY 02 and the second number (31, 21, 14) represents FY 03. She remarked this is to demonstrate that this is a multi year problem.

Ms. Eckl commented, "budget cuts have been widespread; virtually every state program has been affected." She furthered that rainy day fund balances are declining.

State Balances Fall
(billions of dollars)
[bar graph showing the following figures.]
FY 2001 - \$38.9
 Cash on hand - \$18.6
 Rainy Day Funds - \$20.3
FY 2002 - \$19.9
 Cash on hand - \$8.0
 Rainy Day Funds - \$11.9
FY 2003 - \$17.1
 Cash on hand - \$5.7
 Rainy Day Funds - \$11.4

Ms. Eckl pointed out that the "cash on hand" figures represent the

unobligated ending balance in the general fund at the end of the fiscal year. She stated that during years that revenue forecasts were perpetually underestimating the actual revenue, the ending general fund balances were large.

Ms. Eckl commented that in FY 01 states held "record amounts" in their rainy day funds and therefore, these states should be applauded because those funds are needed now. She anticipated the final balances of rainy day funds in FY 03 would be slightly below the current amount, as the funds are drawn upon more than was expected.

Co-Chair Wilken asked if the rainy day funds in this instance include Alaska's permanent fund or the Constitutional Budget Reserve (CBR) fund.

Ms. Eckl replied that the permanent fund is not included, although the CBR is included.

Ms. Eckl admitted that the "cash at hand" term might not be the most appropriate, although it is a term that non-governmental entities could understand easier.

Senator Bunde clarified that the State of Alaska has one-third of the rainy day funds for all states.

Ms. Eckl affirmed and shared that other states are "envious" of Alaska's permanent fund balance.

Ms. Eckl informed that although 47 states have a rainy day fund, they vary with some having larger balances than others.

Rainy Day Fund Balances for FY 2002
As a Percentage of General Fund Balances

[U.S. map showing the percentage range of each state's balance.]

Ms. Eckl pointed out that the states of Alaska and Wyoming have rainy day funds balances over ten percent of their general fund balances. She furthered that states that obtain a significant percentage of revenue from natural resources also have the largest rainy day fund balances.

Ms. Eckl added that the State of California has borrowed against its rainy day fund and now has a deficient.

Co-Chair Wilken asked if deposits into the State of Wyoming rainy

day fund are systematic or rather unrelated appropriations.

Ms. Eckl described the use of "mineral trust money" to create the State of Wyoming permanent fund. She explained that dividends are not paid to citizens from this fund and that the principle is not withdrawn. Rather, she said, a portion of the approximate \$100 million annual interest earnings is deposited into the general fund for operating expenditures.

Senator Bunde suggested that Alaska legislators could learn from this method.

Senator Hoffman noted the Alaska permanent fund is a "highly unusual" savings account and asked if other states have smaller permanent fund accounts.

Ms. Eckl replied that some states do have mineral trust endowments exemplifying the State of Texas, which utilizes these funds for higher education expenses. She noted that additional deposits are not being made to these endowments and that the withdrawals are of interest earnings.

State Year-End Balances
FY 1978 - FY 2003

[Graph showing the percentage balance for each year from 1978 through 2002 with a projected rate in 2003.]

Ms. Eckl detailed the historical perspective of the fiscal gap issue. She identified the national economic downturn in 1980s and early 1990s and the impact on state fiscal conditions. She attributed the significant increase of state year-end balances during the middle and late 1990s to the record performance of the stock market.

Ms. Eckl relayed that the Wall Street analysts who rate state-held bonds recommend states maintain a five percent balance to obtain high ratings. Because of this, she said that some states, including Delaware "live by" this rule to ensure a high bond rating.

Senator Hoffman asked if these funds were inaccessible because of state constitutional or statutory restrictions.

Ms. Eckl learned that some states assert that the reserve funds are "held hostage" by bond raters because the ratings would be lowered if these funds were used. She reiterated that the structure of rainy day funds vary significantly by state, some are established by constitution and others by statute. She furthered that access to

the fund in some states require a super-majority vote, while in other states an emergency declaration by the governor is adequate.

Co-Chair Wilken asked if the \$2 billion CBR balance less the \$2.2 billion operating budget comprises Alaska's year-end balance in relation to this chart.

Ms. Eckl explained the chart reflects year-end balances of all 50 states. She admitted that the CBR as well as the large rainy day funds of other states is likely "skewing" the national totals.

Dealing with Shortfalls in FY 2002 & FY 2003

- K-12 spending cuts: 17 & 24 states
- Higher education spending cuts: 26 & 20 states
- Corrections spending cuts: 24 & 17 states
- Medicaid spending cuts: 16 & 16 states
- TANF [Temporary Assistance for Needy Families] spending cuts: 6 & 8 states
- Cuts in local revenue sharing: 8 & 12 states

Ms. Eckl indicated that some states have implemented spending reductions to education in both years. She added that in some states, including Idaho, these reductions are less than reductions made to other programs.

Ms. Eckl noted that students and parents are bearing more of the costs of higher education. She learned that larger funding increases are usually appropriated to higher education in years of economic recovery to "make up" for the earlier reductions.

Ms. Eckl next informed that some states are releasing inmates convicted of nonviolent offenses earlier than their sentenced terms.

Ms. Eckl addressed the combination of restricted eligibility and curtailment of optional services in state Medicaid programs. She added that restricted eligibility has been applied to TANF programs as well.

Senator Hoffman asked the percentage of funding reductions to K-12 these programs in FY 02 and FY 03.

Ms. Eckl did not have that information, explaining that the survey only asked how the fiscal gaps were being addressed. She qualified that more details were provided from some states than others. She exemplified that in some states, budget reductions were made to

specific programs within K-12 education, such as after school programs, language programs, teacher mini-grants and energy subsidies, rather than imposing reductions to the foundation funding formula.

Dealing with Shortfalls in FY 2002 & FY 2003

- State employee layoffs: 11 & 9 states
- Employee travel bans/restrictions: 19 & 14 states
- Employee hiring freeze: 19 & 13 states
- Delayed capital projects: 9 & 10 states

Ms. Eckl asserted that state employees have been affected by the current fiscal situation.

Ms. Eckl noted that delayed and cancelled capital projects were some of the first actions taken when the fiscal problems began. She noted that in some states, debt has been issued to fund capital projects. She relayed that analysts are advising states to borrow funds at this time due to low interest rates.

Dealing with Shortfalls in FY 2003

- Raising taxes by more than 1% (18 states)
- Raising taxes by more than 5 % (Indiana, Kansas, Massachusetts, New Jersey and Tennessee)
- Hawaii was the only stated to cut taxes by more than 1%

Ms. Eckl stated that taxes were not increased in FY 02, although they did in FY 03. She remarked that almost every state held general elections in this past year and she ascertained that the legislators recognized the "magnitude and severity" of the fiscal situation and were willing to impose these tax increases despite possible election consequences.

Ms. Eckl qualified that the Hawaii State Legislature allowed a previously planned tax reduction to occur as scheduled.

Net State Tax Changes By Year of Enactment, 1990 - 2002

[Bar graph showing percentage of prior year collections and the amount for each year from 1989 through 2002.]

Ms. Eckl expressed the importance of understanding the "magnitude" of the issue.

Ms. Eckl commented that if a 5.4 percent tax increase, the amount implemented in 1991, was implemented in FY 04, approximately \$27 billion would be generated.

2002 Net State Tax Changes
(in millions)

Personal income	\$1,605.3
Corporation income	2,315.6
Sales and use	976.5
Health care	338.7
Motor vehicle	136.6
Miscellaneous	724.5
Alcoholic beverage	7.0
Cigarette and tobacco	3,018.1
Net Change	\$9,122.3

Ms. Eckl pointed out that one-third of the tax increases were imposed on tobacco products. She surmised implementing these increases posed "the path of least resistance." She noted the personal income tax increase figure is significantly influenced by actions taken in the State of Massachusetts. She furthered that the corporate tax in the State of New Jersey was "increased, modified and reformed" with the intent to generate an additional \$900 million.

FY 2004 Budget Projections

- The FY 2004 projected budget gap is \$68.5 billion
- 36 states are facing gaps:
 - o 33 with gaps >5%
 - o 18 of these with gaps >10%

Ms. Eckl remarked that the budget gaps continue to increase with 36 states incurring a \$70 billion aggregate budget gap. She indicated that 12 states have not reported the status of their budget gap due to the unknown costs related to passage of education-related ballot measures, including class size reductions, which would be significant. She informed that with the reporting from these states, plus others that have not yet responded, the national budget gap amount would increase.

Ms. Eckl stressed that many of the 18 states experiencing a budget gap of over 10 percent, have been in this situation for four years.

FY 2004 Budget Gaps

[U.S. map indicating the percentage of the budget gaps for each state, the District of Columbia and Puerto Rico.]

Ms. Eckl reiterated that this is a "widespread" and "severe problem."

Possible Tax Increases?

- 25 states have tax proposals under consideration
- Sin taxes are the focus of early proposals
 - o 14 states with cigarette tax proposals
 - o 6 states with alcohol tax proposals

Ms. Eckl noted that although tobacco taxes have been recently increased in some states, additional increases are under consideration in some of the same states. She also informed that some states are considering other types of taxes, such as sales tax increases in the states of Idaho and California. She surmised this is due to an understanding that excise taxes are unlikely to generate significant revenue.

For More Information

www.ncsl.org

Ms. Eckl invited Members to visit the organization's website for more detailed and updated information.

Co-Chair Green relayed recent reports that the governor of the State of Wisconsin would eliminate thousands of state employee positions. Co-Chair Green commented, "We are not alone."

Co-Chair Wilken noted the Alaska State Legislature has been restructuring the state budget over the past several years and he appreciated the assistance provided by the NCSL.

SFC 03 # 4, Side B 09:53 AM

Co-Chair Wilken continued sharing that he traveled to Illinois, Wisconsin, Washington and Arizona, prior to the start of this legislative session. He indicated that the headlines from a recent Phoenix, Arizona relating to budget difficulties and proposed solutions could be applied to any of those states. He listed lower revenue, increased Medicaid expenses and lack of economic development as the reported problems, and the suggested solutions to increase taxes, "steal from their neighbors", and "steal from

the corporations." He expressed that Alaska has the option of developing other resources, which the other states do not have.

Senator Hoffman asked if the NCSL has information about school construction occurring in other states. He admitted that budgets are tight, but stressed that population increases require additional facilities.

Ms. Eckl responded that her coworkers could provide detailed information.

Senator Bunde told of conversations from lawmakers in other states who assert that because the State of Alaska continues to pay citizens annual dividends, it is not experiencing the same fiscal crisis.

ADJOURNMENT

Co-Chair Lyda Green adjourned the meeting at 09:57 AM