

JOINT
HOUSE FINANCE COMMITTEE
SENATE FINANCE COMMITTEE
2008 January 17, 2008

CALL TO ORDER

Co-Chair Meyer called the Joint House Finance and Senate Finance Committee meeting to order at [1:09:16 PM](#).
Representative Reggie Joule
Representative Mike Kelly
Representative Mary Nelson
Representative Bill Thomas Jr.

SENATE MEMBERS PRESENT

Co-Chair Hoffman
Senator Huggins
Senator Dyson
Senator Elton
Senator Olson
Senator Thomas

MEMBERS ABSENT

Co-Chair Stedman

ALSO PRESENT

David Teal, Director, Legislative Finance Division; Senator Gary Stevens; Representative David Guttenberg; and Representative Bob Buch.

PRESENT VIA TELECONFERENCE

None

SUMMARY

OVERVIEW OF GOVERNOR'S PROPOSED FY 2009 BUDGET

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, stressed his aim was not to present the Governor's Budget, but to point out potential topics for discussion. Past Legislative Finance Division reviews of the Governor's budget have followed a simple format that showed the revenue available, the spending, the deficit, agency budget highlights, and some differences in presentation. He stated that in earlier days budgets were just a "statement of expenditures" for the upcoming fiscal year. This "bottom line" information is still available, as shown in the "State of Alaska Fiscal Year 2009 Governor's Budget fiscal Summary." (Copy on file)

He stated that the revenue for Fiscal Year 2009 was projected to be \$5.2 billion, with expenditures of \$5.6 billion, and a surplus of \$655 million.

Mr. Teal went on to explain that the present budget was different since it "looked backward and forward" as well as at the current year. He asserted that the "surplus" was what made the difference. He indicated that last year the Governor came in with what looked like a surplus, but after deducting \$500 million from the Public Education Fund and taking away \$150 million as an unallocated reduction, there was no surplus in the current account. Last year, the anticipated revenue for FY 09 was less than anticipated expenditures requested by the Governor. He maintained that this year's surplus was real and big.

Mr. Teal informed that he was not going to discuss the Capital Budget. He wanted to focus on the Governor's statewide policies, not the technical points. He mentioned two initiatives. The first was a three-year budget plan; the second was "savings" and how the Governor intended on using the surplus.

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Mr. Teal pointed to a graph from the Office of Management and Budget, dated December 10, 2007, (copy on file.) The graph reflected the Governor's assertion that the budget grew from \$2.2 billion in FY 03 to \$4.3 billion in FY 07, approximately 14 percent growth per year, and showed that the Governor planned to slow growth to limit the budget to \$4.7 billion in FY 11. He asserted that the point was that the FY 11 budget would be held to \$4.7 billion, which equals equal the projected FY 11 revenue. He expressed concern on how this could be achieved within the goal of transparency.

Mr. Teal observed that the FY 09 budget was already \$4.6 billion. The Governor's Education Plan called for increases of \$80 million a year, which surpasses the limit and does not include Medicaid growth (\$50 to \$100 million a year), nor the use of \$150 million from the Capitol Investment Income Fund. He maintained that when you pull from the Capitol Investment Income Fund, which is a savings account, General Fund spending is reduced. In order to maintain FY 09 in future years [and pull from the Capitol Investment Income Fund] general fund spending will need to be reduced. He mentioned that the \$300 million in bonds was the same sort of issue.

Mr. Teal thought the FY 11 budget would be closer to \$5.5 billion budget than \$4.7 billion, which left the question of how to make a \$5.5 billion budget look like a \$4.7 billion budget. He maintained that the Governor intended to achieve this goal by draining savings.

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Mr. Teal turned to the Public Education Fund handout, "Public Education Fund - Cash Flow Mechanics." (copy on file) The legislature made a one billion dollar deposit last year allowing FY 09 to start with \$922 million. He pointed to line 7, which explained that K-12 expenditures are \$832 million and Pupil Transportation added another \$53 million. He maintained that the Legislature reached the goal of setting aside enough money in the Public Education Fund to pay for education one year in advance. He explained that the Governor intended to deposit \$1.6 billion as a supplemental deposit, bringing the balance to \$2.5 billion, and spending a total of \$1,026.5 billion. The budget will then have a surplus of \$1.4 to \$1.5 billion, as shown on line 21 of the graph. There is also a \$141 million dollar fiscal note to fund the Task Force's recommendation and another billion dollar deposit, leaving a total of \$2.6 billion in the Fund, which the Governor does not expect to maintain. The Governor's budgets appears to be \$4.7 billion because they do not retain the \$1.2 billion needed per year to maintain the balance in the Public Education Fund.

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Mr. Teal referenced the Public Education Sheet with the legislative "intent". He reiterated that the FY 09 budget started with \$923 million. A supplemental appropriation was not needed, as enough money was available in the Fund to pay for education one year in advance. The Task Force fiscal note fixed what would have been a small deficit. The FY 09 deposit to the Public Education Fund should be \$1.1 billion, according to the anticipated needs in FY 10. In FY 10, \$1.2 billion would be put in the Fund for the anticipated need in FY 11. He believed this was clear, simple and sustainable.

He pointed out that the Governor's plan was simple for three years, but was not "clear" because it makes a \$5.5 billion budget appear to be a \$4.7 billion budget and that it was not sustainable. Mr. Teal maintained that there will be a big hole to fill in FY 12 under the Governor's version, unless future deposits are made

Mr. Teal observed that according to Karen Rehfeld, Director, Office of Management and Budget, the Governor planned to contribute more to the Public Education Fund to maintain the balance of one year's funding, but Mr. Teal believed that even by doing so the net draw from that savings account was \$1.6 billion. The \$1.6 billion, not deposited into the Education Fund, is money that can be spent somewhere else, to achieve a lower total. According to Mr. Teal, this reasoning reflects a \$1.6 billion distortion. He did not want his remarks to be viewed as an attack on the Governor's

budget and acknowledged that the budget was comprehensive and provided a good framework for discussions. He believed that the Governor and the Legislature share the same goals of containing spending, saving for the future, and maintaining transparency.

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Mr. Teal emphasized the "take away" point was that the presentation of the budget is critical to understanding the budget. The budget can not be measured if it can not be defined; it can not be contained if it is impossible to measure. He also maintained that it is impossible to measure growth without a common starting point.

Mr. Teal referenced a statement made at a previous meeting by Senator Hoffman that the "bottom line" is the same with the Legislative Finance Fiscal Summary and the Governor's Fiscal Summary. He pointed out that there are many common points between the different viewpoints toward the budget. He emphasized the need for a clean starting point to work together.

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Mr. Teal addressed a point made in a previous meeting by Representative Hawker regarding the definition of savings and how they were shown.

Mr. Teal cautioned that there is danger in showing deposits made to the Public Education Fund as "savings". Mr. Teal gave the example that if you deposited one billion a year into the Public Education Fund and classified it as "savings", then at the end of three years, \$3 billion would be expected in this account. But, in actuality, there would not be any money in the account because the money was pulled as soon as it was deposited, even though every year it was counted as "savings". He warned that legislators could mislead themselves in thinking there was more money available to spend than was actually available or that less was being spent. This could cause a relaxed focus on containing budget growth.

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Mr. Teal observed that in the previous meeting, there was a consensus among committee members for a more transparent budget. He emphasized that the present budget process puts the Legislature at a distinct disadvantage in the public relations perspective. This was due to the fact that if the Legislature were to adjust the Governor's budget to reflect the funding of the K-12 and retirement budgets as the Legislature intended, without taking it from a "savings account," the extra money would look like an addition. The

problem was that the Legislature would break the \$4.7 billion target for FY 11 and the budget would contain no new capital projects or services other than those the Governor has in her budget. Although no more state funds were being spent, the public will think the Legislature was spending more. It would be difficult to fix the budget without the Governor's cooperation in stating the budget the way the Legislature prefers. The presentation would be affected by the magnitude of the numbers.

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Mr. Teal went on to explain the second policy initiative which was "savings". He believed it was important to save now, while revenue was available. He stated that revenue would likely decline and the budget would grow in the future. He recommended a review of the State of Alaska Fiscal Summary to see how much money was available and how the Governor proposed to use it. He observed that FY 08 showed a surplus of \$84 million. The revised revenue forecast, which is up \$3.2 billion, took into account the \$614 million Public Education Fund balance as available spending. He reiterated the danger in counting Public Education balances as money available to spend. The danger is that the \$84 million dollar surplus only occurs if the \$614 billion is spent. The \$614 million was not spent. Instead of a surplus there was actually \$500 million deficit at adjournment, which was reduced by high oil prices. An addition \$3.2 billion in revenues came in, leaving a \$2.6 billion surplus, which is available to the Legislature. The Governor has identified supplemental needs of \$108 million in operating and \$34 million in capital. Mr. Teal observed that there are classification differences. The Governor puts retirement deposits as savings, but he would consider them prepayment of a liability that the State had accepted responsibility. There is also an energy endowment, which he would consider a grant/loan program. There would still be \$2.3 billion to save if these are considered supplementals. The Governor proposed putting \$1.6 in the Public Education Fund, \$500 million into transportation endowment and the rest into the Constitutional Budget Reserve Account (CBR).

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According to Mr. Teal, the FY 09 budget is a cleaner presentation because it did not show the balance of the Public Education Fund. This reflected true revenue coming in the fiscal year. He believed the surplus to be the root of the problem with transparency.

Mr. Teal talked about the "five-year plan", which was an attempt to contain spending but noted accusations that it gave the appearance money was just being shuffled around. The original target of the five-year plan was to reduce the

budget by \$250 million. Distortion was caused by conversion of general funds into other funds in the Capitol Income Fund.

Mr. Teal did not believe the problem was having a surplus, but how it was treated.

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Representative Hawker noted that putting numbers on paper often gave a false certainty; it developed an absolute certainty to that number. Representative Hawker inquired about probabilities and ranges of these numbers and where those numbers would really be.

Mr. Teal said he could guarantee that the numbers were wrong. There was a level of precision implied in the numbers that just does not exist. He pointed out that every dollar change in the price of oil affects the surplus by \$100 million or more. The \$2.6 billion dollar surplus in FY 08 was based on a price of \$72 per barrel of oil. The average year to date price was higher by \$10 or more, which could raise the \$2.6 billion dollar surplus to \$4 billion. Since oil has remained at or above \$90 per barrel it is more likely the surplus will be \$4 billion range.

Representative Hawker asked if a number could be put on FY 09, assuming oil prices stayed at the \$90 per barrel range.

Mr. Teal projected that if oil remained at the \$90 per barrel range, with the projected lower volume of output, it would provide slightly lower revenue and with expected expenditures higher, there would be a slightly lower surplus. The combination result would be about \$500 million to \$600 million, providing a surplus of approximately \$3 billion.

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Representative Gara requested a number projection if next year's oil prices were at \$70 per barrel range instead of \$90 per barrel range.

Mr. Teal responded that the projected price of oil for FY 09 was \$66.32 per barrel. The extra \$30 per barrel would translate into \$3 to \$4 billion surplus if the price of oil remained at \$90 per barrel,.

Representative Gara asked for the projected surplus for FY 09.

Mr. Teal projected a surplus of \$650 million at the \$66.32 per barrel price.

Mr. Teal added that having a surplus was not the problem, but how it was treated. He reminded the committee members that it was impossible for him to reclassify funding to the Governor's budget, but the Legislature could. However, doing so might give the appearance to the general public of spending more of the General Fund now and in the future.

Mr. Teal reminded members that the Governor had no intention on hiding how she plans to hold the budget to \$4.7 billion. He believed the traditional budget presentation reflected different times. In the past, revenue was irrelevant to budgeting when the Legislature planned for the needs of Alaskans. When funds were not available, money was drawn from the Constitutional Budget Reserve. With no money to save, budgets were simple. The first surplus appeared in FY 06, but the distortion problem was not recognized until FY 07. General opinion believed it would not last until FY 08, so only now, in FY 09, is there recognition that a problem exists that needs to be fixed.

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Mr. Teal concluded that to have a clear and simple budget, changes are needed. A simple choice would be not spending the money. Money not appropriated would automatically fall into the CBR.

Not wanting to focus on the problems, Mr. Teal offered the alternative of resurrecting and placing the surplus in the Statutory Budget Reserve Fund with no earmarks or designations. Although the general public might see this as hiding money, in reality, it is just saving money.

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Senator Elton remarked that when the Governor's term ended, the budget would rise by 15 to 20 percent. He wondered if the Legislature would be blamed for the dramatic spike due to spending down the Public Education Fund.

Mr. Teal remarked that the Governor presented a three-year plan to the end of her term, not a long-term plan. He agreed with Senator Elton that the budget increases by \$1 to \$1.2 billion at the end of the three years.

Mr. Teal continued talking about the Statutory Budget Reserve as a "savings account." Money going into the reserve would appear as a transfer, not an appropriation, so the budget does not increase. Money coming out would appear as general fund spending, without distortion, giving a clean, clear budget. The creation of one reserve savings account, showing a balance, would be easier to track. Money is being saved if the balance is growing; the balance drops when money from the account is spent, allowing the budget to be

measured. Mr. Teal stressed that a budget that can not be measured, can not be contained.

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Mr. Teal observed more input was needed from the Finance Committees on their recommendations. He understood the Legislature, OMB, and the Finance Committees sought a common starting point where all could agree on the budget in the Fiscal Summary and on a savings agreement to prevent budget distortion now or in the future.

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Co-Chair Hoffman agreed that everyone wanted a common starting point. He pointed out the confusion of spending money from a savings account while concurrently putting money back into a savings account. These inconsistencies barred a clear and transparent budgeting process. A comprehensible budgeting process is vital for the general public, not just to the Administration or Committees.

Representative Gara asked for clarification regarding the surplus in various funds. Mr. Teal noted that the surplus in the Public Education Fund is at \$923 million; the Constitutional Budget Reserve, \$30.3 billion; the Alaska Housing Finance Corporation, \$300 million (deposit plus interest); the Capital Income Fund, \$280 million; and the Power Cost Equalization Endowment, which is also a savings account, at \$200 million.

Representative Gara questioned the amount the Governor planned to deposit and to withdraw from the Public Education Fund.

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Mr. Teal responded that the Governor planned on placing \$2.6 billion into the Fund while withdrawing a little over one billion, leaving \$1.6 million in the Public Education Fund.

Representative Gara asked about the Governor's proposal for the CBR and the Permanent Fund. Mr. Teal said the Permanent Fund would not affect general funds since it came from the Earnings Reserve Account. Representative Gara questioned if the Governor planned to transfer Earnings Reserve Account money into the Permanent Fund, not surplus money. Mr. Teal agreed.

Representative Gara requested the amount in the Earning Reserve Account. Mr. Teal responded that \$4.5 billion is in the ERA. Representative Gara asked the amount the Governor proposed to deposit into the CBR. Mr. Teal answered that the Governor proposed a \$223 million deposit into the CBR in FY

08 and \$155 million in FY 09. Since these numbers were designed to get a zero bottom line, if the revenue forecast changed, the Governor's deposit to the CBR would be modified.

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Co-Chair Chenault asked Mr. Teal for clarification regarding the amount in the PCE Fund, which he believed was closer to \$400 million. Mr. Teal agreed that the amount was approaching \$400 million with last year's \$200 million deposit.

Representative Meyer wondered if the Governor's budget proposed creating new transportation and energy funds. He understood the Energy Fund had been established, but contained no funds, making the Transportation Fund the only real "new" fund. Mr. Teal believed that alternative energy legislation was still before the Body.

Co-Chair Meyer wondered about the classification of the Transportation and Energy Funds.

Mr. Teal answered that Representative Thomas would be the appropriate person to ask but that he personally believed it should be classified as "spending" since the Fund was a source of grants and loans not like an endowment, where the earnings are spent.

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Rep. Thomas answered that the legislation was still in committee, but he believed the earnings would be spent each year.

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Co-Chair Meyer asked for a historical prospective on some of the funds being mentioned. He questioned if Alaska Industrial Development and Export Authority (AIDEA) dividends, Alaska Housing dividends, and Student Loan dividends were used in the capitol budget, not the operating budget. He remarked that the fairly new Capital Income Fund, originally designed to capture the Amerada Hess dividends of \$28 million, grew larger than anticipated. Money saved by the Governor's vetoes moved into the Capitol Income Fund, enlarging it even more.

Mr. Teal answered that historically the dividends have been used many places. Before the five-year plan, prior to 1998, dividends were classified as general funds. Corporate dividends were classified as "other funds" as part of the Five-Year Plan, to show a savings. The dividend reclassified gave the appearance of a spending reduction. Dividends would

need to be used in the same budgets, capital or operating, if they were going to be measured and tracked correctly. In recent years, dividends have been used in the Capital Budget and deposited into the Capital Income Fund. He agreed with Co-Chair Meyer that the size of the Capital Income Fund was never intended to be as large as it has become.

He agreed that there were inconsistencies in the Governor's plan to remove money from one "savings account" and deposit it into a different "savings account." One could infer that the Governor did not like the Capital Income Fund for some reason, but this obviously was not the case since she did not spend the entire fund.

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Mr. Teal acknowledged that the Governor could say the \$95 million in vetoes reduced spending, but maintained that she could not claim to not reduced the budget. He explained that the unspent capital fund money became part of the surplus. The funds then became part of the Capital Income Fund, since the Legislature had a provision in the budget, which appropriated all FY 07 general fund surpluses into the Capital Income Fund. The Governor's \$95 million in vetoes was added to the \$155 million surplus and then the entire \$250 million fell into Capitol Income Fund.

Mr. Teal remarked that because [the transfer of the FY 07 surplus to the Capital Income Fund] happened in FY 07, it is "off the information page" and probably "out-of-mind." It will not be seen again until FY 09 where it will be spent as Capital Income Fund, not General Funds, making the budget appear lower. In order to maintain the same level of spending in FY 10, the Legislature will have to come up with \$150 million in general funds.

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Representative Hawker wanted to know if the cruise ship tax initiative receipts [Commercial Passenger Vessel Tax] collected now and again in FY 09, were accounted for in this budget, and if so, how.

Mr. Teal explained that the \$4 head or berth fee [from the \$46 per head], generates about \$2.3 million to environmental conservation where the entire anticipated revenue was being allocated to the Ocean Ranger Program.

Representative Hawker inquired about the placement of the additional monies [\$42 per head], which would be collected. Mr. Teal noted that the rest of the money would be placed into the General Fund, some of which would be distributed back to communities. Representative Hawker questioned if the redistribution money was listed in this budget since there

were significant federal restrictions on how the cruise ship head tax money can be spent.

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Mr. Teal agreed in the challenges of placing all funds into the General Fund. "Restricted" funds are bound to a precise use, while "unrestricted" are not. However, there are some who may want to assign a specific use to money from an "unrestricted" fund, for example those that wanted the monies from the Vehicle Rental Tax Income to be used only for tourism development.

Representative Hawker drew significant distinction between the income from the Vehicle Rental Tax Income and Commercial Passenger Vessel Tax. The money from the Vehicle Rental Tax Income, with no restrictions, could be designated for anything, but the Alaska state governing powers could not override a Federal government regulation on the use of the Commercial Passenger Vessel Tax money.

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Representative Hawker asked once more if this large amount of "restricted" money collected was shown in the budget as general fund revenues. He wondered if the unspent "restricted" money would fall into the CBR.

Mr. Teal noted it was hard to define general fund revenue, which was usually referred to as "unrestricted general fund revenue." A possibility would be to create a new "general restricted fund" category, but leaving it as "other" funds in the General Fund worked equally as well.

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Representative Kelly agreed that budgets can be a "little too creative." His concern was not how the Governor created the budget but where the actual "spent" and "surplus" money is reflected in the budget. His main desire was for a more straight forward budgeting process.

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Senator Huggins agreed with Representative Kelly in that he wanted to see this budget as clear and honest, without distortion, for the general public.

ADJOURNMENT

The meeting was adjourned at 2:12 PM