

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**January 31, 2007**  
**9:01 a.m.**

**CALL TO ORDER**

Co-Chair Lyman Hoffman convened the meeting at approximately [9:01:04 AM](#).

**PRESENT**

Senator Lyman Hoffman, Co-Chair  
Senator Bert Stedman, Co-Chair  
Senator Kim Elton  
Senator Joe Thomas  
Senator Fred Dyson  
Senator Donny Olson  
Senator Charlie Huggins

**Also Attending:** KAREN REHFELD, Director, Office of Management and Budget, Office of the Governor; DAVID TEAL, Director, Division of Legislative Finance

**Attending via Teleconference:** There were no teleconference participants.

**SUMMARY INFORMATION**

^Overview of Governor's FY 08 Budget - Office of Management and Budget

Overview of Governor's FY 08 Budget  
Karen Rehfeld, Director, Office of Management and Budget  
David Teal, Director, Division of Legislative Finance

[9:02:25 AM](#)

Co-Chair Hoffman acknowledged that 40 to 45 days would likely pass before the Palin Administration would submit proposals for the \$150 million spending reduction it intended to make to the Fiscal Year 2008 (FY 08) budget. This delay should not stop the budget subcommittees from undertaking efforts to determine funding recommendations.

[9:04:44 AM](#)

## Overview of Governor's FY 08 Budget

KAREN REHFELD, Director, Office of Management and Budget, Office of the Governor, introduced Office of Management and Budget staff members offering their expertise and announcing that they could provide "a valuable resource" to the Committee.

Ms. Rehfeld recognized the importance of the work of the Division of Legislative Finance in the budgetary process.

Ms. Rehfeld disclosed that the FY 08 budget proposal as submitted by Governor Sarah Palin was a "working project" and Ms. Rehfeld would appreciate efforts of Committee staff as well.

[9:07:44 AM](#)

Ms. Rehfeld expressed the Governor's budgetary goals and philosophy to spend less to "control the growth of government", to save surplus revenue and "to live within our means". Ms. Rehfeld interpreted this as reviewing the projected revenue in a given year and "building our budget within that projection."

[9:08:14 AM](#)

Ms. Rehfeld reported that, according to the Department of Revenue forecast of December 15, 2006, a projected \$3.9 billion of general fund revenue would be available for FY 08 based on a price per barrel of oil of \$51.25.

[9:08:42 AM](#)

Ms. Rehfeld noted that revenue is declining and expressed intent to continue to "balance the budget".

[9:08:55 AM](#)

Ms. Rehfeld told of surplus revenues of \$1.4 billion from FY 07 and \$500 million projected for FY 08, which the Governor's proposed budget would deposit into the Constitutional Budget

Reserve Fund (CBR). This would increase the balance of the fund to \$4.3 billion.

[9:09:17 AM](#)

Ms. Rehfeld continued that an additional \$1.3 billion of surplus revenues would be deposited into the principal of the Alaska Permanent Fund under Governor Palin's budget scenario.

[9:09:28 AM](#)

Ms. Rehfeld noted that \$1.7 billion would be available for the Alaska Permanent Fund dividend program and inflation proofing.

[9:09:39 AM](#)

Ms. Rehfeld outlined the appropriation legislation introduced at the Governor's request.

[9:09:57 AM](#)

Ms. Rehfeld began by explaining that SB 52 would appropriate funding for education. It would provide "full funding" of the foundation formula program and pupil transportation costs for FY 08. Additionally, it would appropriate \$35 million for expenditure in FY 08 for one-quarter of the Institute for Social and Economic Research (ISER) district cost factor study and school improvement grants as was allocated in FY 07 but specified at that time as a non-recurring appropriation. The Governor's budget does not propose to increase the base student allocation.

[9:10:45 AM](#)

Ms. Rehfeld furthered that SB 52 would also appropriate an estimated \$207.4 million to fund the Public Employees Retirement System (PERS) and Teachers Retirement System (TRS) costs for school districts.

[9:11:04 AM](#)

Ms. Rehfeld relayed Governor Palin's intent to pass this legislation into law as soon as possible so school districts could determine the amount of funding they would receive and subsequently avoid notification of staff of possible layoffs.

[9:11:34 AM](#)

Senator Olson asked the distribution of the PERS and TRS costs for the school districts.

[9:11:37 AM](#)

Ms. Rehfeld answered that approximately \$270 million would be TRS-related with the remainder attributable to PERS.

[9:11:56 AM](#)

Ms. Rehfeld next stated that SB 50 contained the FY 08 operating budget appropriation and SB 51 the Mental Health Trust Authority appropriation. The key elements of the operating budget included retirement system increases of \$77.5 million for local governments and \$178 million for State government, comprised of the Executive Branch, the Legislative Branch, the Alaska Court System and the University of Alaska. The Longevity Bonus program would be restored and an estimated \$33.7 million would be appropriated for its expenses.

[9:12:30 AM](#)

Ms. Rehfeld continued that the proposed operating budget would provide \$48.1 million for "local government support". Additionally, \$100,000 is included to fund an investigator position within the Alaska Public Offices Commission (APOC).

[9:12:53 AM](#)

Ms. Rehfeld pointed out that the budget proposal did not include intended efficiencies and spending reductions of \$150 million. These reductions had yet to be determined and would be submitted as amendments.

[9:13:01 AM](#)

Co-Chair Hoffman, returning to the education funding legislation, noted it would appropriate \$207.4 million for school district PERS and TRS expense increases. The obligation was the responsibility of the local school districts rather than the State's and the State did not provide for the increases incurred for FY 07. He asked whether Governor Palin intended to

include State funding for this purpose in the FY 09 budget as well.

[9:14:02 AM](#)

Ms. Rehfeld responded that the matter had not been decided. The Governor is committed to providing support for local governments, although the actual amount of assistance the State would provide in future years had not been determined.

[9:14:24 AM](#)

Ms. Rehfeld disclosed that agency personnel had been directed to review programs within their departments and advise the Governor of potential savings. The results of past efforts in establishing Missions and Methods as part of a performance based budget methodology would serve as a "key tool" in the current undertaking.

[9:15:01 AM](#)

Ms. Rehfeld shared that Office of Management and Budget had prepared a booklet for legislators titled, "Missions and Measures, Results at a Glance, State of Alaska, January 2007" [copy on file], which provides summaries of the agencies. A more detailed report of each department would be prepared and distributed to the budget subcommittees.

[9:15:45 AM](#)

Ms. Rehfeld informed that agencies were provided with "budget target" dollar amounts, and directed to identify increments and budget item reductions to meet those targets. The total of the targets exceed the \$150 million the Governor proposed for reduction in State spending. This over-calculation is intended to provide options in determining how the actual reductions would be accomplished. Governor Palin surmised that departments should be given "a target to strive for".

[9:16:47 AM](#)

Ms. Rehfeld admitted the process would be "difficult". The Office of Management and Budget and agency personnel would collaborate in deciding what reduction proposals would be forwarded to the Legislature. Final decisions would be made by

March 1, 2007. She understood the desire to receive these amendments sooner and assured that efforts would be made to accomplish the task as soon as possible; however she could not commit to an earlier date.

[9:17:26 AM](#)

Ms. Rehfeld relayed that the Governor had requested the Legislature, the Alaska Court System and the University of Alaska to assist in identifying budget reductions within those entities.

[9:17:41 AM](#)

Ms. Rehfeld then spoke to SB 53, the FY 08 capital appropriation legislation. In its current form, the budget is "very very bare bones" containing \$81.1 million general funds necessary to garner \$710 million in federal funds, and \$10.6 million for Mental Health budget projects.

[9:18:18 AM](#)

Ms. Rehfeld reported that \$134 million of general funds was available for capital projects. Governor Palin was interested in collaborating with the Legislature to develop priorities. The intent was to submit a list of those priorities by March 1.

[9:18:49 AM](#)

Ms. Rehfeld then directed attention to SB 61, which she characterized as an "early supplemental bill". It contains three budgetary items, which should be funded in a timely manner. The Division of Elections had submitted a request for approximately \$1.2 million general funds for the costs to conduct a special statewide election in April on the issue of benefits for partners of same-sex relationships. The Division is obligated to prepare for that election.

[9:19:36 AM](#)

Ms. Rehfeld listed the request of \$153 million for the Copper River/Prince William Sound Regional Seafood Development Association as another item included in SB 61. These funds have been collected beginning in FY 05 in the form of taxation on Association members with intended expenditure on Association

projects. However, authorization for such expenditure was not granted in the initial FY 07 operating budget and is necessary to allow the projects to commence in the upcoming construction season.

[9:20:23 AM](#)

Ms. Rehfeld stated that the third component of the early supplemental appropriation request is \$12 million for expenditure on potential litigation against the provider of actuarial services to the State. The funds would be comprised of \$8.271 from PERS and \$3.729 from TRS. The litigation process is anticipated to last two to three years.

[9:20:51 AM](#)

Co-Chair Hoffman reminded of the FY 07 appropriation of \$400,000 for this purpose. He requested an update on expenditure of those funds.

[9:21:04 AM](#)

Ms. Rehfeld replied that an investigation was underway. The total cost of the investigation is estimated to be \$850,000, which is included in the current request.

[9:21:24 AM](#)

Co-Chair Hoffman pointed out that expenditure authorization for the requested \$12 million would terminate in FY 09. He asked how complete the litigation process would be at that time and whether further appropriation requests should be anticipated.

[9:22:02 AM](#)

Ms. Rehfeld replied that the litigation could possibly be completed by FY 09 and that the Department of Law would make every effort to do so; however the actual time required could not be predicted. This would be a "large case" and would "take time".

[9:22:31 AM](#)

Ms. Rehfeld reported that efforts were underway to draft the FY 08 supplemental appropriation request of a targeted \$50 million.

The Governor intended to meet the statutory requirement to submit it to the Legislature by the 30th day of the legislative session, which in the current year is February 14. The process is complicated by the unanticipated expenses of "disasters beyond our control".

[9:23:10 AM](#)

Co-Chair Hoffman surmised the target amount was solely general funds and that the aforementioned \$12 million request for litigation expenses was not included.

[9:23:30 AM](#)

Ms. Rehfeld affirmed.

[9:23:34 AM](#)

Ms. Rehfeld next addressed other components of the Administration's budget "package" including SB 60, which would repeal the tax on studded tires. Governor Palin intended to remove this tax because it "affects the safety of families traveling on roads."

[9:24:05 AM](#)

Ms. Rehfeld then noted that SB 66 would reduce the fee for business licenses from \$100 to \$25 effective October 2008.

[9:24:33 AM](#)

Senator Dyson recalled intent that licensing fees for professionals be of an amount adequate to cover the cost to administer the program for which the license is issued. He asked if business licenses were included in this.

[9:24:52 AM](#)

Ms. Rehfeld understood the revenue generated under the existing business license fee structure is more than the cost of administering the license program.

[9:25:41 AM](#)

Senator Dyson asked if reducing the fees would require additional funding to operate the program.

[9:25:48 AM](#)

Ms. Rehfeld answered that general funds would be required to supplement the license fee revenues.

[9:25:58 AM](#)

Senator Dyson surmised that the program would therefore not be self sufficient.

[9:26:05 AM](#)

Ms. Rehfeld affirmed.

[9:26:08 AM](#)

Ms. Rehfeld continued explaining that SB 54 would appropriate \$1.3 billion to the principal of the Alaska Permanent Fund as she mentioned earlier in her testimony. This action would "leave" over \$1.7 billion in the earnings reserve account of the Fund to be available for inflation proofing of the Fund and payment of dividends.

[9:26:35 AM](#)

Ms. Rehfeld reiterated that Governor Palin was "committed" to working with the Legislature on the budget project to achieve a sustainable budget.

[9:26:52 AM](#)

Co-Chair Hoffman spoke to the reinstitution of the Longevity Bonus program and Revenue Sharing to local governments. The Longevity Bonus program would be recurring but that the Revenue Sharing program was not indicated as such. He asked if the intent would be to make both programs recurring.

[9:27:31 AM](#)

Ms. Rehfeld replied that the Longevity Bonus program would continue through its initially intended "phase out" in which no new recipients would be added. Currently, the Governor did not

plan to continue the Revenue Sharing program in FY 09, although the issue could be discussed.

[9:28:14 AM](#)

Senator Elton pointed out that the proposed spending reductions were intended for the upcoming fiscal year but he questioned whether the short term savings might only defer expenses. He gave an example of proposed reductions to the Department of Corrections programs, which could result in higher recidivism rates and subsequently higher costs in the future. He requested that potential long term costs be considered in conjunction with immediate savings during the budget subcommittee process.

[9:29:35 AM](#)

Ms. Rehfeld agreed. Reductions of some services to contain costs could be suggested; however other "ideas" would require more than one fiscal year to accomplish.

[9:30:26 AM](#)

Senator Huggins remarked upon the part of the budget proposal, which would eliminate the Education Fund. He predicted this would "cost us money" and suggested that this should be reconsidered.

[9:31:08 AM](#)

Ms. Rehfeld agreed to the importance of matter and relayed that the Governor would be "open to that conversation." Ms. Rehfeld expected that the deposit of surplus revenue to the CBR versus the Education Fund would be discussed and debated.

[9:31:31 AM](#)

Senator Huggins surmised that most Alaskans consider action in securing a natural gas pipeline project as a measurement of the Legislature's progress this session. However, he asserted that adequate infrastructure to facilitate the project was also necessary. Efforts should not be limited to workforce training. Funding for infrastructure projects must be considered "proactively" despite intentions to minimize the FY 08 capital budget appropriation.

[9:32:43 AM](#)

Senator Dyson emphasized the need to clarify that a \$150 million budget reduction would not be a reduction to the amount of the FY 07 budget. Instead, the proposed FY 08 budget is \$750 million higher than the initial FY 07 budget appropriation. This must be conveyed to facilitate the rebuilding of public confidence. Efforts are necessary to ensure that the spending cuts are not directed to the reduction of existing services.

[9:34:25 AM](#)

Ms. Rehfeld averred the Governor's "clear goal" to carefully consider funding decisions. A savings account must be maintained until increased revenue is generated from a natural gas pipeline.

[9:35:14 AM](#)

Senator Dyson understood that the Department of Revenue was unsure that the FY 07 budget with or without supplemental appropriations would be sustainable according to the revenue projections. He expressed concern that the FY 08 budget would not be sustainable. He cautioned against reliance upon a future increase in revenue.

Senator Dyson continued that previous gubernatorial administrations failed to prioritize budget items as required by statute. He acknowledged that the Palin Administration had not had an opportunity to complete this undertaking.

[9:36:42 AM](#)

Ms. Rehfeld agreed to the intent of prioritization and indicated that a process existed to accomplish this.

[9:37:13 AM](#)

Senator Dyson realized it would be difficult but stressed that if budget reductions were to be made, the opinions of department staff on what actions would have the least impact should be known. Additionally, many funding decisions "cross over" to other departments. Senator Elton gave the example of future impacts to the social system from reduced efforts to rehabilitate offenders.

Senator Dyson offered to assist in the prioritization effort.

[9:38:34 AM](#)

Co-Chair Hoffman furthered the concern of the Committee that sufficient funds be available to "carry through" until the natural gas pipeline increased the State's income. He was also uncertain about "locking away" funds in the corpus of the Alaska Permanent Fund.

[9:39:22 AM](#)

Co-Chair Stedman noted the multiple ways in which to save current surplus funding including the CBR account and school funding.

Co-Chair Stedman then pointed out that decisions would be made for a budget year starting in June utilizing revenue forecasts written six months prior.

[9:40:21 AM](#)

Co-Chair Stedman furthered that the funding source of the \$12 million appropriation for the litigation against the former actuary is proposed as being the "trust account" of PERS and TRS. The Committee would discuss whether this option is "appropriate".

[9:40:46 AM](#)

Co-Chair Stedman spoke to "formula drivers" impacting State spending. The increases in these formulas could not continue. One half of the increase was due to the retirement fund "issue" and the Committee would review the formula drivers of other programs. His intent was to maintain the operating budget until natural gas pipeline revenues were generated without implementation of an income tax or sales tax.

[9:42:08 AM](#)

Co-Chair Hoffman announced that although funding for PERS and TRS was included in the operating budget, which he oversaw, he would assign these programs to Co-Chair Stedman for review and to recommend a feasible plan to address the \$8-10 billion

unfunded liability. The previous Legislature passed SB 141 to change the retirement system for newly hired employees and to reduce new debt. Co-Chair Hoffman asked if the Palin Administration would also undertake this effort.

[9:43:13 AM](#)

Ms. Rehfeld replied that the Office of the Governor was collaborating with the Department of Administration and the Department of Law to identify potential options. She would include Co-Chair Stedman and the Legislature.

[9:43:37 AM](#)

Senator Elton asked how committed the Palin Administration was to the plan to save excess revenues, suggesting those revenues could be utilized to "buy down" the unfunded liability of PERS and TRS.

[9:44:18 AM](#)

Ms. Rehfeld relayed that the Office of the Governor would be willing to consider the suggestions. The budget requests as submitted were intended to "frame a starting point" in discussions; it would not preclude consideration of other options.

^Overview of Governor's FY 08 Budget - Division of Legislative Finance

[9:45:07 AM](#)

DAVID TEAL, Director, Division of Legislative Finance, introduced staff members recently added to the Division. His presentation utilized a handout titled "Putting the FY 08 Budget in Perspective" [copy on file].

[9:46:57 AM](#)

Page 1

1. Where have you been?
2. Where are we now?
3. Where are we going?

Mr. Teal stated that this presentation was intended to address the three questions.

[9:47:07 AM](#)

Page 2

#### General Fund Budget

[Bar and line graph showing Operating, Capital, Savings, Revenue and GF to CBRF for the FY 99 through FY 08 and projected for FY 09 through FY 12. A notation reads, Projections: The operating budget increases at 4% annually and the capital budget is a constant \$200 million. Other notations list dollar amounts from certain accounts as follows:

FY 05  
PEF (Public Education Fund): \$417

FY 06  
PEF: \$657  
ADRF (Alaska Debt Retirement Fund): \$26  
AHFC (Alaska Housing Finance Corporation): \$300

FY 07  
PCE (Power Cost Equalization): \$187  
PEF: -\$565  
ADRF: -\$26

FY 08  
PEF: -\$509]

Mr. Teal outlined the graph. The GF to CBRF line demonstrates the surplus or deficit for each of the fiscal years and would be referred to as the CBR draw or surplus. He spoke as follows.

Before 2004, draws from the CBR were routine. In fact that goes all the way back to '91 when the Reserve Fund was created. What that really means is that revenue here was less than the budget. There was a deficit - structural deficit.

Having a deficit like that puts pressure on you to hold the budget down; and in fact the budget was very flat from [FY 99] through FY 05. It ranged between two and 2.5 billion dollars.

Mr. Teal noted the increase of the budget from \$2.5 billion in FY 05 to a proposed \$4 billion for FY 08. He informed, "It began rising rapidly in '05. And you can see that we've gone from a 2.5 billion operating budget to a 4 billion capital."

Mr. Teal attributed the increase in part to expenses related to PERS, TRS and to other factors.

Mr. Teal emphasized that the budget is "a two-year cycle".

[9:48:53 AM](#)

Mr. Teal exemplified that during this legislative session, the Committee would address not only the upcoming FY 08 budget, but also supplemental appropriations to the FY 07 budget. At the time the FY 04 budget was adopted, it was unknown that a revenue surplus would occur. He spoke to the legislators' efforts during the FY 05 budget cycle saying the following.

Again, you didn't know a surplus was going to occur when you did the '05 budget. It was really in the '06 budget cycle that you were first aware of a large surplus from '05. That revenue resulted in a larger capital budget, and for the first time, some savings.

Mr. Teal reminded:

You put \$417 million in Public Education Fund. Then you came back in the '07 cycle and again had a large surplus. The capital budget grew again and you saved about \$1 billion.

Mr. Teal informed that a surplus of approximately \$1.35 billion would be available for the FY 08 budget cycle. He defined surplus as "money on the table now - the '07 surplus and the '08 surplus".

[9:50:40 AM](#)

Mr. Teal shared that future revenue would be "fairly flat", while the budget would be in the amounts established by the Legislature and the Governor. The four percent projected budget increase appears "relatively slow growth compared to the recent years." If growth continued at the current rate, the operating budget would amount to over \$7 billion by FY 12. Increases of

"that magnitude" would not be expected because "PERS/TRS is a big driver of these increases in recent years" and the maximum contribution rate had been reached. The expenses would continue but not at higher rates.

Mr. Teal informed that he selected a growth rate of four percent for the purposes of this presentation. He stressed, "Even at that lower growth rate, revenue is insufficient and again you're back to CBR draws."

[9:51:51 AM](#)

Co-Chair Hoffman referenced the \$207 million appropriation proposed by Governor Palin for school districts' obligation of PERS/TRS as well as the \$77 million proposed appropriation for political subdivisions' obligations. He asked if this expense had been factored into the projected budgets of FY 09 through FY 12.

[9:52:21 AM](#)

Mr. Teal answered that the appropriations were included in the calculation of future projections. The projections were based on the proposed FY 08 budget in its current form.

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Co-Chair Stedman requested an amended projection including "the imbedded drivers" of "formula driven programs" but not including the PERS/TRS costs. The purpose would be to determine the "forced" rate of growth excluding the PERS/TRS expenses.

[9:53:38 AM](#)

Mr. Teal estimated approximately "eight percent". He qualified that the State had "little option but to pay" the PERS/TRS costs of the school districts and of the State. However, the State has no legal requirement to provide "Revenue Sharing" to municipal governments. Additionally, the State has no legal requirement to reinstate the Longevity Bonus Program. These expenses "certainly cause budget increases" and could be considered formula programs. Such formula programs could be discretionary and thus the calculations Co-Chair Stedman requested would be difficult to ascertain.

[9:54:38 AM](#)

Co-Chair Stedman surmised therefore that a four percent growth rate would be considered conservative and would require effort to attain.

[9:55:00 AM](#)

Mr. Teal stated that the four percent equals approximately \$150 million to \$200 million annually. The increase of the FY 08 budget proposal was approximately \$600 million over the FY 07 budget. A four percent growth rate would be a significant reduction to the growth rates between FY 05 and FY 08. The level of future increases would be dependant upon the amount of federal funding allocated in the future. If the allocation was reduced, State general funds would likely be utilized to "replace" the loss.

Mr. Teal indicated that he chose the growth rate of four percent because he considered it "reasonable growth." Regardless of whether four percent was a conservative estimate, withdrawals from the CBR would be significant, reaching \$1.5 billion by FY 12. A deficit would still be incurred even if "you're able to hold the budget flat."

Mr. Teal gave a perspective of the current balance of the CBR of \$2.5 to \$3 billion. According to the data of the Department of Revenue 2006 Revenue Forecast and "this spending scenario", the balance of the CBR would be depleted by FY 12.

Mr. Teal clarified that the information presented reflected projections and was not intended to predict future financial situations.

[9:57:01 AM](#)

Co-Chair Hoffman asked if the projected depletion of the CBR by FY 12 included the Governor's proposed deposit to the Fund for FY 08.

[9:57:15 AM](#)

Mr. Teal answered it did not; however, the issue was irrelevant. Governor Palin's FY 08 budget request proposed a withdrawal from the Public Education Fund (PEF) in an amount greater than the

deposit to the CBR and therefore the savings would be negative. He qualified, "Negative savings only in the sense that you're pulling money from the PEF but that savings goes right into the CBR. So it's a net zero; it's not saving any more money it's just saving it in a different place."

[9:57:48 AM](#)

Co-Chair Hoffman clarified that the balance of the PEF would be zero by FY 08 and the CBR balance would be zero by FY 12.

[9:58:03 AM](#)

Mr. Teal affirmed this would occur under the provisions of the Governor's budget plan. He corrected his estimate predicting that the CBR fund would "last" until FY 13.

[9:58:17 AM](#)

Mr. Teal again posed the first question of the presentation, "Where have we been?" and answered, "Structural deficits." To the question "Where are we now?" he replied, "A temporary surplus." He emphasized "Temporary surplus - because if you look at where we're going, we're right back where we were, which is structural deficits."

[9:58:35 AM](#)

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#### The FY 08 Budget Cycle

- The Legislature's savings plan set aside nearly \$1 billion last year:
  - \$509 million to the Public Education Fund
  - \$300 million to a capital savings account in AHFC
  - \$183 million to the Power Cost Equalization Endowment
- The Governor's spending plan eliminates accumulated savings in the Public Education Fund and effectively transfers the balance to the Constitutional Budget Reserve Fund:
  - \$565 million in FY 07
  - \$509 million in FY 08
- From the FY 07 Base, the Governor's general fund operating budget adds \$750 million.

- Without depleting savings balances, the Governor's FY 08 budget shows a surplus of about \$140 million.
- This \$140 million surplus is based on
  - Achieving \$150 million in operating budget efficiency reductions.
  - Avoiding additional appropriations for K-12 education, Medicaid and other programs.
  - Holding the capital budget to \$92 million.

Mr. Teal overviewed this information.

[10:00:29 AM](#)

Page 4

Categorization of the Governor's FY 08 GF Increments  
(\$750.8 Million Total from FY 07 Base)

[Pie Chart showing the following:

Increments with Little Discretion		
\$496.8 million	66%	
School District TRS/PERS	\$207.4	29%
Agency Retirement, Health & Wage Increases	\$186.4	25%
Medicaid	\$46.8	6%
PPT Tax Refunds	\$25.0	3%
Prison Population	\$9.7	1%
Fuel/Utilities	\$21.5	3%
Governor's Promises		
\$159.3 million	21%	
Political Subdivisions PERS	\$77.5	10%
Local Government Assistance	\$48.1	6%
Alaska Longevity Bonus	\$33.7	4%
All Other Increments		
\$94.7 million	13%	

Mr. Teal noted this information reflected the operating budget and "categorizes the \$750 million increments from the '07 base." The increments are listed in order of "decreasing discretion" which he detailed as follows.

In that sense the School District TRS/PERS \$207 million - you have very little, if any, choice in whether to pay that. Similarly, the \$190 million that's going towards State employees' retirement, health care and wages

increases. These are not the contracts under negotiations now. These are the single class increases like nurse reclassification and some auditors - pretty small reclasses. Nevertheless, they're contractual arbitration awards so we put those in as this lump of State employee compensation.

That, as Senator Stedman pointed out earlier, is half, in fact more than half, of the total \$750 million in increases.

[10:01:49 AM](#)

Mr. Teal continued:

Moving to Medicaid - it's an entitlement program. While you have some discretion and some control over eligibility and other payments, the regulatory process to make those changes is very long. Any changes in '08 would be hard to reach. If you wanted to make savings in Medicaid it would probably take until '09 to do that.

[10:02:14 AM](#)

Mr. Teal noted that the \$25 million Petroleum Profits Tax (PPT) refunds increment was an estimated figure. The exact amount was unknown.

Mr. Teal characterized the Prison Population and Fuel/Utilities increments as "perhaps unavoidable".

Mr. Teal informed:

So all together, you have these increments with little discretion totaling two-thirds of the total increases - \$500 million.

[10:02:45 AM](#)

Mr. Teal listed the increments that he deemed more discretionary. The three items, Political Subdivisions PERS, Local Government Assistance, and Alaska Longevity Bonus, were included in the budget proposal submitted by Governor Palin.

Mr. Teal then remarked on the remaining section of the pie chart in the amount of \$94.7 million in which budget reductions could be made.

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Conditions for an FY 08 Surplus

1. Achieving \$150 million in operating budget efficiency reductions.

- A difficult task that will require reductions in existing programs-not merely denying increments

2. Avoiding additional appropriations for K-12 education, Medicaid and other programs.

3. Holding the capital budget to \$92 million.

Mr. Teal overviewed the situation.

[10:04:04 AM](#)

Co-Chair Hoffman, returning to Page 4, totaled the \$159.3 million Governor's Promises and \$94.7 million All Other Increments, and noted that the proposed reductions of \$150 million could only be taken from this \$253 million. If the entire All Other Increments portion were eliminated, an additional \$59 million would still need to be identified.

[10:05:18 AM](#)

Page 6

Issues Not Addressed in the Governor's Operating Budget

- Additional K-12 funding
  - o Base Student Allocation \$??
  - o District Cost Factors \$75 million for full implementation
  - o Medicaid Match \$37 million
  - o State Employee Contracts \$30 million??
  - o Retirement System Unfunded Liability \$??

Mr. Teal outlined this information, noting that the Governor's proposed budget would provide no additional "money in the classrooms."

Mr. Teal furthered that the proposed budget included a \$25 million appropriation to the "district cost factors", which

provide additional funding to school districts in areas with higher costs of living. This was the amount appropriated for FY 07; however, that budget was to fund the cost for the final quarter of the year. To fully fund the increment in FY 08 an additional \$75 million was necessary.

[10:06:16 AM](#)

Mr. Teal reminded that federal funding for Medicaid was scheduled to "decline" or be reduced for FY 07. A reprieve was issued, but the reduction had been rescheduled to begin this year. In discussions with Janet Clarke of the Department of Health and Social Services, he learned that another delay was less likely. This was due to the changes to the membership of the US Congress. The states that would benefit from a delay no longer had lawmakers in the majority party.

[10:07:28 AM](#)

Mr. Teal informed that eight of the 11 collective bargaining unit contracts for State employees were scheduled for renegotiation this year. The \$30 million amount shown on the page was an estimate of the addition costs the new contracts would incur.

[10:07:48 AM](#)

Mr. Teal also noted that Governor Palin's budget proposal did not include any additional appropriation for the unfunded liability of the PERS/TRS funds.

Mr. Teal warned that rather than a budget reduction of \$150 million, budget increases could be necessary.

[10:08:07 AM](#)

Page 7

Capital Budget  
"Bare Bones"

- Minimum level of state funds to maximize federal funding (\$92 million GF)
- Federal Funding Concern
  - o Potential Highway Trust Fund problems

- o Senator Stevens no longer Chair of Appropriations Committee

Mr. Teal outlined this information.

[10:08:44 AM](#)

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What's not addressed?

- Deferred Maintenance
  - o ">\$950 million and growing"
    - Buildings, Roads, Harbors, Rural Airports, Parks, AMHS Vessels
- State Funded Road Program
  - o Fed funds drying up?
- School Construction
  - o DEED's Construction and Major Maintenance Priority Lists total - \$921 million
    - Excluding the \$90 million from last year
- University
  - o Board of Regents Request - \$431 million
- Local Issues/Community Grants

Mr. Teal characterized the current capital budget proposal as a "work in progress".

Mr. Teal overviewed the items in which appropriations were not included.

Mr. Teal noted that of the University of Alaska, Board of Regents funding request, only approximately \$40 million was included in the Governor's proposed capital budget.

[10:09:45 AM](#)

Senator Elton asked whether an analysis had been done on the impact of "the continuing resolution issue in Congress and whether or not that's going to add additional costs or loss of services in this fiscal year and maybe in fact next fiscal year."

[10:10:09 AM](#)

Mr. Teal had not conducted such analysis and deferred pertinent questions to the Department of Transportation and Public Facilities.

[10:10:33 AM](#)

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How much is available to spend/save?

[Spreadsheet listing the following:

Available to Spend (unrestricted GF)		
Fall Revenue Forecast for FY 08	\$51.25	\$3,936
FY 07 Surplus (Fall forecast)	\$59.15	1,351
Total Available for this budget cycle		\$5,288
Spending		
FY 08 Operating		\$3,734
FY 08 Capital		181
New Legislation		25
FY 08 Supplemental Placeholder		60
Total Spending		\$4,000
Potential Spending/Savings		\$1,288

A notation reads: The amount available excludes \$509 million in the Public Education Fund]

Mr. Teal qualified that the Department of Revenue forecast would change. The amount available to "spend" included the FY 07 supplemental appropriation and FY 08 regular appropriations.

[10:11:54 AM](#)

Co-Chair Stedman asked the impact of a change in the price per barrel of oil by one dollar to the total revenue.

[10:12:26 AM](#)

Mr. Teal responded that such calculations had been simple, with \$1 per barrel of oil equaling \$60 million in State revenue. The relationship under the PPT method is not linear. Although higher oil prices generate increased gross revenue for the producer, net revenue must be determined. The credits and deductions are not known in advance. He estimated the "rule of thumb" to be nearer \$100 million increase revenue per \$1 increase in the price of oil.

[10:13:40 AM](#)

Co-Chair Stedman stated, "In a simplified world, which we don't operate in, that's pretty close to \$4 billion in revenue and \$4 billion in expenses, with just a slight variation in price." He asked, "The effect of the Petroleum Profits Tax ... on not only revenue but the potential impact of credits how is that being dealt with in the forecast? In the modeling forecast are they looking at a positive effect of that credit scenario or possibly a negative or are they ignoring it or how are they handling that in the modeling when it's so early in the implementation of that tax change?"

[10:14:34 AM](#)

Mr. Teal was unable to answer. He would be present when the Spring 2008 Revenue Forecast was announced and at that time he would discuss the matter with the Department of Revenue economists. Currently, the economists were "netting out" a portion of the refunds, \$25 million. He opposed this practice because the Legislature should be aware of the gross revenue, since payment of the credits requires an appropriation. If the Legislature appropriated these funds, legislators should know "exactly how much you're appropriating." He pointed out, "Right now, by netting it out of the revenue forecast it's difficult for you to see how much money you've got and how much money you can afford to give in refunds."

[10:15:35 AM](#)

Co-Chair Stedman agreed, "We need all the numbers on the table, and not netted numbers." The Committee should "pay close attention to the affect of that credit, not only in the refunds, the checks that we send back for it, but also the impact on drilling and exploration, which is the reason it's there."

[10:16:05 AM](#)

Co-Chair Hoffman also agreed. He furthered that 14 oil companies were active in Alaska, but only ten were eligible to receive those credits. Each year, those eligible companies could claim up to \$25 million in credits.

[10:16:29 AM](#)

Mr. Teal affirmed.

10:16:32 AM

Co-Chair Hoffman clarified that the current allotment was only \$25 million total.

10:16:42 AM

Mr. Teal affirmed. The estimation could be accurate; however, there was "no way of knowing".

Mr. Teal emphasized that significant savings for FY 08 would be unlikely. If the \$150 million in reductions were not made, if the capital budget were higher or other spending increased, the fiscal year would be a deficit.

10:18:33 AM

Co-Chair Stedman relayed that the production forecast for the Alyeska Pipeline for FY 08 was 782 million barrels per day at a forecasted price of \$51.25 per barrel. Revenue is therefore a combination of production rates and price.

10:19:39 AM

Senator Elton furthered that "large assumptions" were made about the effect of PPT on revenue and which credits and deductions would be applied. The producer's interpretation of the new tax laws, as well as the credits and deductions claimed, could become evident by April.

10:20:34 AM

Mr. Teal affirmed that the production and price determined revenue under the previous tax system. Under the new system, production, price and credits/refunds determine revenue. The impact of the credits and deductions on development activities would not be known "even in April". The Committee had requested from the Department of Revenue a report on the impact of the credits and refunds on development. This report should also include the amount of credits or refunds offered. He recommended the Committee request this information be provided in advance of the report deadline.

[10:21:45 AM](#)

Co-Chair Stedman informed that he had already submitted such a request.

[10:22:14 AM](#)

Mr. Teal then pointed out that the credits earned this year would not expire and do not need to be claimed in the year earned. They could also be sold. He stressed, "You don't know when they're going to hit; conceivably, a company could simply not turn in its credits for three years and then they'd all hit at once." He questioned why a company would do this, but advised that it is possible.

[10:23:00 AM](#)

Co-Chair Hoffman requested a brief summary of "the terms and the rates between communities in the State - who's paying for what over the past four or five years."

[10:23:45 AM](#)

Co-Chair Stedman directed attention to tables depicting the balance of the CBR on pages 18 and 19 of the Revenue Source Book. He recommended Members review past issues of the publication for comparison.

[10:24:31 AM](#)

Mr. Teal, returning to Co-Chair Hoffman's question, informed that local communities' PERS and TRS rates were "based on individual experience" and therefore rates range from 15 percent to over 180 percent. Rather than including the local rate in his presentation, he utilized the rate of 44 percent that applies to State government.

Mr. Teal reiterated that all the figures "are pretty rough". He detailed the following.

"But just to illustrate the point that you're trying to make is that: if 14 percent were the normal rate ... that's what communities and the State paid in FY 05. The State contributed nothing toward the local community payments.

[10:25:56 AM](#)

Mr. Teal continued:

Then in '06 was the first year of the increase. It was limited to five points. The communities paid the 14 that they had paid before and the State paid the increase if you recall that. In money terms, the State contributed about \$18 million. I don't know what the communities paid back then but probably something in excess of \$15 million.

In '07, you again paid five points. You picked up the increase but not the whole increase; you just picked up the increase from '06. So the communities' rate went from 14 to 19, the State still paid five for a total rate of 24. And again the State paid \$18 million or 78 percent of the total cost of the local government PERS.

In '08, the way the language is drafted is that you pick up the increase from '07. That total was 24 points. So it's not that you picked up the entire increase from FY 07. The communities again will get an increase from 19 to 24. The State picks up the difference and you can then see that the total local PERS cost is now near \$160 million.

Two sides of this - one is the State is paying much more than they used to, but so are the communities. In percentage terms, the community contribution has fallen from 78 percent to 51 percent.

[10:27:49 AM](#)

Co-Chair Hoffman noted Mr. Teal's explanation provided the Committee "a brief history of what happened" and is continuing to occur in "both percentages and in dollars on PERS and TRS for communities." The Committee should realize that \$77 million for PERS "is the smaller portion of the obligation" of the State's contribution in comparison to the \$207 million the State is contributing for school districts' costs.

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**ADJOURNMENT**

Co-Chair Lyman Hoffman adjourned the meeting at [10:27:47 AM](#)