

SENATE FINANCE COMMITTEE
February 4, 2009
9:03 a.m.

9:03:11 AM

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Karen Rehfeld, Director, Office of Management and Budget, Office of the Governor; John Boucher, Senior Economist, Office of Management and Budget, Office of the Governor.

SUMMARY

^FY10 Budget Overview and FY09 Supplemental

KAREN REHFELD, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, initiated the general overview of the FY10 budget. She explained that the budget goals have been consistent:

- Slow the growth of government
- Live within our means
- Save for the future
- Focus on core services
 - o Constitutional and statutory responsibilities
 - o Invest in responsible resource development

Co-Chair Stedman questioned the phrases "slow the growth of government" and "live within our means." He wanted to better understand the expressed goals.

Ms. Rehfeld agreed that discussion about the goals was important. She referred to HB 125, the long-range fiscal plan [enacted in 2008]. The plan allows the state to continue providing important state services and to use responsible budgets and prudent reserves. The plan will allow the state to survive the next ten years until revenue from the gasline will be available.

Ms. Rehfeld explained that slowing the growth of government means providing critical state services with a reasonable amount of growth. The long-range plan released on December 15, 2008 recommended slowing growth to a three percent increase. She acknowledged the pressures on the budget, but the plan would allow management of the budget until the first gas revenue.

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Co-Chair Hoffman asked if slowing government down to three percent a year was in reference to the operating budget.

Ms. Rehfeld explained that the long range plan includes both operating and capital budgets. The starting point is the FY09 budget. Adjustments are made with information from the revenue picture and draws made from reserve accounts. She maintained that living within the state's means combines the fiscal discipline of slowing government agency growth and the wise use of reserves to advance the state when necessary.

JOHN BOUCHER, SENIOR ECONOMIST, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR explained that one critical aspect of the long range plan was the assumption of inflation at 2.75 percent and population growth at 1 percent. He described the important goal of ensuring that government spending was less than the sum of population growth plus an assumed inflation rate.

Co-Chair Stedman thought that the target of three percent increase was reasonable. He admitted having difficulty parsing out the government growth aspect concerning the operating versus the capital budgets or a combination of both.

Ms. Rehfeld advised that the three percent was based on a total of operating and capital budgets including all expenditures seen over time.

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Co-Chair Stedman commended his Co-Chair on his work with the operating budget. He expressed concerns that the operating budget would devour the capital account. The operating account has risen the past three years. He suggested dialog

on this issue. The operating account is a difficult entity to reduce. He hypothesized that he would not see an operating account below that of the previous year.

Co-Chair Hoffman shared concerns about the growth of the combined operating and the capital budgets. He stressed that a lean capital budget eases control of spending.

Co-Chair Stedman commented that the legislature must look beyond the money designated to the general fund. He suggested viewing total state spending, which includes "other state funds" or "Alaska funds." He discouraged moving funds between the general fund and other state funds to artificially present lower state spending. He judged this as a game, deceptive to the public.

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Senator Thomas asked if the concept of slowing the growth of government included the implementation of proven concepts in education, prevention, and intervention. Ms. Rehfeld replied that the administration was looking ahead for opportunities to improve in areas like education. Certain costs require attention. A modest increase of the budget is necessary for certain agencies and state public employees to maintain a reasonable amount of growth over time.

Ms. Rehfeld commented on the use of different fund sources. She commended the productive work done last session in discussing the use of different fund sources and how they were presented to the public. She stressed that the administration had attempted to address concerns presented by Co-Chair Stedman and improve their reporting of other funds. She pointed to Alaska Housing Finance Corporation funds, which were aligned in the fiscal summaries.

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Senator Elton commented on the supplemental budget request and the allocation of \$6 million for state parks, which was designated as other funds and classified as cruise ship gambling tax. He asked why the money was classified as other funds versus general funds.

Co-Chair Hoffman asked to postpone further questions regarding the supplemental budget.

Ms. Rehfeld explained that the differences between the method used to present the December budget and the Legislative Finance Division's budget analysis was the treatment of the gambling tax and use of the Alaska Housing Capital Corporation Fund. She stated that she and David Teal, Director, Legislative Finance Division agreed to disagree regarding the general funds column.

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Ms. Rehfeld explained that it was helpful to have the general funds column remain specific to the forecasted revenue and that confusion was avoided by adding or subtracting other items from that column.

Co-Chair Stedman referenced the Alaska Constitution, Article IX, Section 16 an appropriation limit, which addressed the growth of the operating account relative to the capital account. Article IX states: "Within this limit, at least one third shall be reserved for capital projects and loan appropriations." He requested the return of the administration for an explanation of Article IX, Section 16 and the appropriation allocation between operating and capital budgets.

Ms. Rehfeld agreed to return for the discussion. She proceeded to the discussion of the budget as a planning tool. The fundamental building blocks are:

- Focus on core state services
- Find efficiencies in service delivery
- Identify savings or reductions
- Redirect existing resources, where possible, to higher priority items, and
- Limit growth in operating budget.

Senator Huggins pointed out the allocation of capital money to the Department of Transportation and Public Facilities (DOT/PF). The account required reinforcement because the inflation rate was consuming the assets. Ms. Rehfeld admitted that the issue of reinforcement was a problem. She stressed that the administration was continually working with the departments to improve the method of business. Complexities result in lengthy processes, but the state government can do a better job of addressing the problems.

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Ms. Rehfeld reviewed FY09 revenues and expenditures. In December 2007, the administration estimated revenue of \$5.3 billion with oil prices at \$66.32 a barrel. The December 2007 request for budget and savings appropriations was \$4.6 billion. The revised forecast in May 2008 reflected the increased price of oil and \$7.5 billion in revenue. Energy challenges due to the increased price of oil were apparent and there was an expectation of more surplus available. Following the special session there was a rapid decline in oil prices that segued into the fall forecast projecting \$77 a barrel in 2009 bringing the revenue to \$6.8 billion. With

oil prices continuing to decline, the Department of Revenue (DOR) provided an interim forecast with oil at \$63 a barrel or \$5.5 billion in revenue.

Ms. Rehfeld referenced the supplemental bill introduced on February 3, 2009, which anticipated a shortfall of \$1.36 billion in the current fiscal year. The challenge is significant, but options exist to address the revenue shortfall.

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Ms. Rehfeld explained that Governor Palin signed the appropriation bills on May 23 2008, with instructions to the departments to achieve at least \$20 million in savings in the operating budget. She explained the hiring freeze implemented January 23, 2009.

Ms. Rehfeld delineated steps taken to address a revenue shortfall:

- Governor Palin signed the appropriation bills on May 23, 2008, with instructions to the departments to achieve at least \$20 million in savings in the operating budget.
- Freeze hiring and purchases issued January 23, 2009.
- FY09 supplemental bill proposes \$268.6 in reductions in current year authorized expenditures and the overall spending plan.
- Seeks legislative approval for use of reserves.

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Senator Huggins asked about the \$20 million savings. He asked if the administration received a savings forecast report. Ms. Rehfeld explained that the administration had asked the departments to report quarterly. During the second quarter the departments were on track for about \$11.3 million of the savings targets. The Department of Public Safety and the Department of Military and Veterans Affairs were held harmless from the savings targets. The supplemental bill is about \$17.5 million of the \$20 million target allocated to the departments as a result of the savings plans. She believed that this was a reasonable expectation given the plans put in place.

Senator Huggins asked for savings allocations at the end of the second quarter. Ms. Rehfeld agreed to provide the requested information.

Senator Elton asked if the hiring freeze included positions paid for with federal funds. Ms. Rehfeld answered no.

Co-Chair Stedman commented that he was also interested in the breakdown requested by Senator Huggins, because of the \$13.3 million in allocated reductions. He wanted to know where the \$20 million goal came from. He felt that a couple of key components were missing from the FY09 budget process. He recalled that \$245 million was vetoed out of the capital budget.

Co-Chair Stedman recounted a fall appropriation request for nearly \$1 billion to a special energy dividend in a declining oil environment. Spending would have been much greater if every request from the administration had been approved.

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Ms. Rehfeld answered that the picture looked significantly different when the one-time resource rebate was approved, due to the high price of oil. Many requests were related to gasline infrastructure. Given the revenue picture today, the administration has significantly modified their requests. The FY10 budget has a request for \$80 million to continue advancing the gas line project. She stated that the items that were not approved would not be brought forward at this time.

Co-Chair Stedman reviewed the FY08 budget cycle and requests for a public education endowment of \$1.5 billion, a transportation endowment of \$.5 billion, and an energy endowment of \$500 million. He thought the energy endowment was acceptable, but pointed out that if the administration's advice had been followed there would be a greater shortfall today.

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Ms. Rehfeld agreed that many ideas were brought forward for the legislature's consideration, including the education, energy and state funded transportation funds. She remembered agreements reached regarding savings proposals including savings appropriations to the Constitutional Budget Reserve (CBR), the Statutory Budget Reserve (SBR), and the Renewable Energy Fund

Ms. Rehfeld illustrated that the hiring freeze was an attempt to seek additional savings. Mechanisms exist within the hiring freeze for agencies to request a waiver. Many positions are exempt from the hiring freeze because they provide public service. Vacant positions include 844 general funded positions; of these, 291 are exempt from the hiring freeze; remaining are 550 state-wide positions subject to the hiring freeze or waiver request process. Savings achieved as a result of the hiring freeze will lapse into the CBR and reduce the draw amount at the end of the year.

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Senator Elton requested that the Office of Management and Budget (OMB) share the collected data with the committee.

Senator Huggins requested a copy of a document identifying the different departments and their hiring mechanisms for the subcommittee review process. He requested a monthly synopsis of requested waivers. He asked if half-time employees would be allowed to work full time within the hiring freeze criteria. Ms. Rehfeld surmised that a change from a part-time to a full-time position would not be subject to the hiring freeze. Senator Huggins thought that might be a loophole. He expressed interest in understanding the rule. Ms. Rehfeld agreed to provide information to the committee regarding the hiring freeze [see OMB letter dated 02/09/09 (copy on file)]. The potential yearly savings is \$12 million. The requests are logged and will be provided.

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Ms. Rehfeld explained that departments were asked to find further reductions, update savings plans and scrutinize existing appropriations for potential reductions. The total of general fund spending reductions is \$268.6 million.

Co-Chair Stedman addressed the supplemental budget. He asked for an explanation of the \$50 million placeholder and whether or not it was part of the budget.

Ms. Rehfeld explained that the place holders appear in both OMB and Legislative Finance's fiscal summaries. She informed the committee that the \$50 million place holder has remained consistent in fiscal summaries that roll into the calculation of the increase in the operating budget. The spending plan for FY09 includes a portion of the totals. The total expenditures, including the \$50 million, constitute the shortfall and require accessing the Constitutional Budget Reserve. The placeholder reduces the amount drawn from the CBR.

Co-Chair Stedman asked for further information regarding the \$200 million reduction of authorization for tax credits. He asked if the authorization allowed the treasury to purchase tax credits from small gas and oil producers that might not have the ability to sell tax credits to a larger producer.

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Ms. Rehfeld explained that \$400 million was included in the FY09 budget for payment of the tax credits. This is a new program. The Department of Revenue indicated that the full \$400 million would not be spent due to timing of the

applications from companies wishing to receive the tax credit and the payment of the tax credits. The administration intended to reduce the authorization. With a short fall of over \$1 billion, the administration felt it appropriate to accurately reflect the Department of Revenue's updated estimate for this fiscal year.

Co-Chair Stedman expressed confusion regarding the CBR and balancing the books. He concluded that the future budget looks worse than the current budget if \$200 million was intended as a call on the treasury this year, but instead was moved to FY10.

Ms. Rehfeld suggested that the legislature will have choices regarding the \$200 million appropriation. The administration deemed it appropriate because the money would stay in the tax credit fund. The administration does not anticipate that \$200 million worth of payments will be made.

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Co-Chair Stedman thought that the new amount would be \$19 million for the supplemental budget if the \$200 million was no longer in the tax credit fund and the \$50 million placeholder was not an issue. He asked if this was the difference in the treasury.

Ms. Rehfeld admitted that the supplemental budget was unusual. Typically, increases in the budget as a result of unanticipated expenditures are seen in supplemental bills. Agencies were asked to do things differently in the current fiscal year. The current request is a decrease in the authorization for the year and what will be spent.

Co-Chair Stedman asked for the impact on the treasury if the \$200 million and the \$50 million are not included.

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Ms. Rehfeld stated that placeholders and reduced authorizations have always been included as part of the overall spending plan. She suggested that both amounts are important to include in the overall picture.

Co-Chair Stedman asked for the total. Ms. Rehfeld stated that every proposed transaction with the backup was available on the internet.

Co-Chair Hoffman voiced that the \$200 million is an expenditure that is beyond the control of the legislature or the governor. He opined that it was not a savings. He pointed out that five months remain in the fiscal year exist to work the issue out.

Co-Chair Stedman understood that from the current viewpoint, a possibility exists that the credits could be put to the treasury in the next five months.

Senator Elton suggested that constituents are confused when they hear about a \$268 million savings. The committee has identified that \$200 million is not necessarily a savings. He appreciated the important discussion because the media portrays the governor as saving \$268 million, which has not happened.

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Ms. Rehfeld pointed out that spending is reduced if the \$200 million is not spent.

Senator Elton discerned that if the state does not spend the \$200 million this year then it will be spent next year, which is not a savings to the treasury. The action suggests that because the money is not spent this fiscal year, \$200 million were saved. He opined that describing the issue as a timing issue confuses Alaskans.

Ms. Rehfeld reminded the committee that authorization for spending is necessary for the access of reserves. Section 20 of the supplemental bill includes the request to utilize the CBR at the end of the fiscal year to balance the budget.

Senator Huggins asked what the anticipated amount needed from the CBR might be. Ms. Rehfeld answered approximately \$1.36 billion. The amount will not be known until the end of the fiscal year, when all of the actual expenditures are completed.

Senator Huggins asked if there were any other anticipated modifications to lessen the amount needed.

Ms. Rehfeld asked if Senator Huggins was referring to specific proposed reductions. She supposed that the supplemental bill traveling through the legislature provided the opportunity to change the budget, but at this point the next review will be of the FY10 budget.

Senator Huggins asked if the administration was accepting a \$1.3 billion shortfall.

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Ms. Rehfeld concurred that that was the current estimate. She pointed to the \$8 billion in reserve accounts. She suspected that there would be considerable discussion in the legislature and the public about the best use of the reserves. As of December 31, 2008, there was just under \$7 billion in reserve funds, split almost evenly between the

main fund and the sub-fund of the CBR. There is also one billion dollars in the Statutory Budget Reserve, \$1 billion in the Public Education Fund and \$342.3 million in the Alaska Housing Capital Fund. There will be additional discussion about the Alaska Housing Capital Fund because in the FY10 budget there is a proposal to spend about \$238 million of the \$342.3 million. These numbers may change when amendments are rolled out on February 18, 2009.

Co-Chair Hoffman asked if the SBR amount of \$1 billion suffered losses as of December 31st, 2008. Ms. Rehfeld answered that the balance received from the Department of Revenue was \$1 billion as of December 31st.

Co-Chair Hoffman asked why there were not losses. He wondered if they were invested or not. Mr. Boucher answered that the SBR was invested in the same manner as the general fund, which is more conservative and liquid. The SBR is not subject to as much volatility as the CBR. He did not have the exact numbers, but agreed to provide them.

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Senator Elton asked why budget deficits would be drawn from the SBR, where losses are minimized, rather than the CBR.

Ms. Rehfeld responded that the possibility of drawing from the SBR also exists. The administration sought authorization to access the CBR because it appeared that more than \$1 billion would be necessary to balance the budget.

Co-Chair Stedman requested more data from OMB regarding the main and sub-accounts of the CBR. He asked for market values as of the end of January as well. His major concern is the savings. He did not want yearly treasury draws necessitating a draw on the sub-account. He thought this would put the state in a position of falling back on a weak link in the savings.

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Senator Huggins asked about the Alaska Housing Capital Fund of \$342.3 million and the earmarking of \$300 million toward a pipeline provision.

Ms Rehfeld affirmed that the earmarking had been the subject of some debate. She stated that \$300 million was appropriated by a prior legislature into the Alaska Housing Capital Fund. The prior administration believed that the money was set aside for gasline expenditures. Many legislators believed that the money was set aside for capital projects. The \$342.3 million was the sum of the \$300 million plus accrued interest. The proposal in the FY10 budget is to spend a portion for gas line related projects.

Co-Chair Stedman requested the amount of money contributed to the CBR and those market values as of December 31st. He suggested subtracting the \$238.4 million from the \$342.3 million in the FY10 budget resulting in a net number for savings.

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Ms. Rehfeld explained that the presentation intended to display funds that were available in the current year. Adjustments to the FY10 budget would be necessary if the legislature or administration chose to appropriate the funds.

Ms. Rehfeld remarked that the economic stimulus bill was moving quickly. Resolutions are being discussed for submittal to Congress on this issue. Appropriations will be brought forward in a separate bill. Changes in the FY10 budget are expected in relation to the current version of the Economic Stimulus Plan.

Senator Huggins observed that railroad maintenance was not integrated into the stimulus plan. He would like to have stimulus money aid in railroad connections and readjustments. He opined that the railroad industry was not integrated into the stimulus plan, although there was time to make changes.

Ms. Rehfeld expected that the Department of Transportation and Public Facilities was the best department to address the query.

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Ms. Rehfeld proceeded with the FY10 Budget Overview.

- December 15 budget proposes to spend less general fund dollars in FY10 than we are spending in the current year- \$49 billion compared to \$5.2 billion (comparison excludes resource rebate).
- Budgeted \$389 million below the fall forecast of \$5.27 billion.
- Interim forecast will be provided on February 18 along with budget amendments.

Senator Huggins asked about the anticipated drop in oil prices and the administration's plan to initiate the process of reducing the FY10 budget.

Ms. Rehfeld explained that the administration is currently engaged in the process of reducing the FY10 budget. She

stated that changes will be provided on February 18, 2009. The Department of Revenue will provide the formal spring forecast. The department also provides interim forecasts.

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Ms. Rehfeld discussed Budget Highlights:

- Operating
 - K-12 Education \$1.05 billion
 - Revenue Sharing \$60 million
 - Retirement system unfunded liability \$451.2 million
 - Exploration tax credits \$300 million
 - State employee contract increases \$31 million
- Capital
 - Gas line projects \$82.1 million
 - Renewable Energy Fund \$50 million
 - School Major Maintenance \$40.5 million
 - Water and Sewer \$114.8 million

Senator Elton asked about school maintenance and the allocation of \$40.5 million. He asked if the major maintenance list was submitted to the federal government as part of the federal stimulus package or would it be accomplished using general funds.

Ms. Rehfeld thought that there were several different iterations in the development of the economic stimulus package addressing schools. She believed that the Department of Education did attempt to analyze projects on the major maintenance list that would meet those criteria, but she was not sure if that element was in the economic stimulus package as most funds come to the state as a grant or a formula.

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Co-Chair Hoffman asked about school construction and its absence from the capital list. He wondered why this area was ignored. He inquired about the Kasayulie case and a potential settlement eliminating it from the capital list. The case revolves around the issue of adequate schools in rural Alaska.

Ms. Rehfeld did not think that the case had been resolved. She recommended contacting the Department of Law. The current focus is on existing facilities and buildings rather than new ones.

Co-Chair Hoffman remembered the legislature authorizing school districts to indebt the state for school construction. The governor signed the legislation, but continues to ignore the Kasayulie case, which gave him grave concern. He asked that the message be conveyed to the administration regarding the need for approved spending for school construction in rural Alaska. He wished for the ongoing lawsuit to be settled.

[10:25:00 AM](#)

Ms. Rehfeld stated that she would deliver the message and find a way to resolve the issue.

Senator Olson pointed out that the George Morgan Sr. High School in Lower Kalskag burned down last week. He asked if there was consideration for new construction of the school.

Ms. Rehfeld recalled that the Department of Education and the Fire Marshalls office were evaluating the needs for the school including the insurance coverage. She stated that she would bring the information to the committee as soon as she had it.

Senator Olson asked if that meant that there would be a provision under the capital budget to include the school. Ms. Rehfeld answered that she had not received the request for a provision from the Department of Education.

Co-Chair Stedman discussed the retirement system with the contribution to unfunded liability of \$451.2 million. He was pleased to see this in the budget. He asked if the administration planned to review the status of unfunded liability and to adjust the number in the event of a substantial revenue decline. Ms. Rehfeld answered yes that the contribution would be preferred, but stressed that the revised forecast would tell more.

Co-Chair Stedman thought that it would be prudent to adjust the amount, although he was thankful to see it in the budget.

Ms. Rehfeld introduced a chart outlining the budget request and the provision of statewide programs and services (copy on file).

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Co-Chair Hoffman asked if there would be assistance in the Alaska Natural Gas Pipeline Development Authority (ANGDA) bullet line. Ms. Rehfeld stated that there is not a specific appropriation for the bullet line. She believed that \$5 million would be designated to ANGDA.

Co-Chair Stedman requested better understanding of the difference in the capital expenditures. He read \$1.7 billion on Ms. Rehfeld's presentation, yet understood that legislative finance had arrived at \$1.8 billion in capital expenditures. He asked if a portion of this amount was allocated to the legislature. Ms. Rehfeld stated that she could not answer the question. Co-Chair Stedman agreed to address the subject later.

Senator Huggins asked about money allocated for the ANGDA line. He asked if a portion would be allocated for a bullet line provision.

Ms. Rehfeld stated that there is not a specific appropriation for the bullet line. She understood that discussion was necessary to assist the development of that project. She did not have a request for funding for a bullet line, it required a piece of legislation to move forward.

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Ms. Rehfeld addressed the Permanent Fund Dividend (PFD) payment and inflation proofing.

Co-Chair Hoffman asked for the dividend amount with 675,000 people living in Alaska. Ms. Rehfeld did not know the amount of the PFD, and deferred the question to the Department of Revenue.

Ms. Rehfeld explained that the goal was to protect the economy and to move the state forward. Savings and efficiencies are sought. Budget reductions are made where practical. Management tools have been implemented through the hiring freeze and the restriction of purchases. Prudent use of reserves will be necessary.

Co-Chair Stedman commented on the complexity of budget reductions versus budget surplus.

ADJOURNMENT

The meeting was adjourned at 10:37 AM