

SENATE FINANCE COMMITTEE
February 17, 2009
9:02 a.m.

[9:02:04 AM](#)

CALL TO ORDER

Co-Chair Hoffman called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Kim Elton
Senator Donny Olson

MEMBERS ABSENT

Senator Ellis
Senator Thomas

ALSO PRESENT

David Teal, Director, Legislative Finance Division.

SUMMARY

^Overview:

Legislative Finance of FY10 Operating Budget

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, explained the role of the Legislative Finance Division as analyzing the budget (LFD). He noted that LFD is a non-partisan agency. He reported that LFD provides assistance to the legislature as the governor's budget request is reshaped. The budget request is received by LFD on December 15th and the following month is dedicated to correcting details and reproducing the budget with the help of legal services. He noted that LFD produces appropriation bills and a series of reports that begin with a statewide summary.

Mr. Teal addressed four slides from the overview of the governor's request. Slide 1 described the "Fiscal Sensitivity" chart beginning at approximately \$5 billion with the sensitivity referring to oil prices. The state breaks even at \$74 per barrel of oil. The state possesses a surplus if the price of oil is above \$74 per barrel. Currently, the state is in the red (fiscal gap) for the first time since FY05. The state has \$8 billion in reserves. |

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Mr. Teal described Slide 2, the "Fiscal Sensitivity" chart for FY09, with the general fund budget at \$7.12 billion instead of \$5 billion. The FY09 budget is a result of the \$1.2 billion in savings and the \$750 million resource rebate.

Co-Chair Stedman asked when the resource rebate was implemented in the FY09 budget cycle. Mr. Teal answered that resource rebate was implemented in Special Session and the FY09 budget process was and is still in progress. Typically the budget is passed and then addressed with a supplemental request. Every year has two live fiscal years. When the legislature completes every supplemental bill then FY09 will end.

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Co-Chair Stedman suggested that many legislators view the budget cycle ending when session ends, with the supplemental budget acting as a measure to backfill oversights or changing economic scenarios. The legislature works to have a relative amount of savings put away in relation to spending. He maintained that it is difficult for the finance committee to do budgetary work with a supplemental appropriation of \$750 million in August.

Co-Chair Hoffman added that with lower than predicted oil revenues for FY09, the \$750 million supplemental, and appropriations to the Constitutional Budget Reserve (CBR) require a committee vote.

Mr. Teal illustrated that the break even point for FY09 requires oil prices of \$83 per barrel, yet the forecast predicts an average price of \$60 per barrel. He expounded that FY09 shows a deficit of \$1.8 billion. Revenue forecasts predict a deficit of closer to \$1.3 billion. He admitted that the chart (Slide 2) was not particularly accurate, but it gives the viewer an idea of how oil prices affect revenue and the ability to balance the budget. Even if the price of oil is up toward \$70 per barrel for the remainder of the year, the state faces a deficit. The Governor included a CBR provision in the supplemental bill, which means that drawing money from the CBR fills the gap.

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Mr. Teal addressed the "Fiscal Summary" (Slide 3). He stated that the Office of Management and Budget (OMB) and LFD met during the interim to develop a format that is clearer, simpler, and more informative. Growth was interpreted differently between LFD and OMB. The changes to the fiscal

summary include a division of agency operations, statewide operations, capital appropriations, and savings.

Co-Chair Stedman asked to address Line 23, direct appropriations to retirement accounts, on Slide 3. Mr. Teal answered that direct appropriations to retirement refers to the excess the state contributes to the retirement fund. The state contributes necessary funds above 22 percent of payroll. The state contributes the money directly into the retirement account rather than giving it to school districts and having them contribute the money. He stated that \$450 million dollars was contributed last year because the rate was 34 percent of payroll, which is a substantial amount above the 22 percent stated in law. This year the actuarial recommendations stated that the rate could drop to 27 percent of payroll, but the actuarial evaluation lags two years. Since that time there were substantial losses in the retirement accounts. The governor submitted a request for \$450 million which is approximately \$160 million more than the actuary's require meeting their calculated rate of required contribution. He opined that the contribution to retirement could possibly be reduced by \$160 million and still complies with the actuary's recommendations, but the retirement fund lost approximately \$3 billion last year, which will not show up in rates for another two years. It is the legislature's discretion as to which amount will be chosen.

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Co-Chair Stedman clarified that line 23 is comprised of two components, one being the addition above the 22 percent of payroll and the extra payment of \$160 million.

Co-Chair Stedman asked for an explanation of Line 25 and the oil and gas credits. Mr. Teal stated that Line 25 was an estimate for gas and oil investment credits. He revealed that the amount was \$400 million and began as a \$25 million estimate. The administration requested increases and bumped up to about \$200 million by March. In March, the administration requested another \$200 million. He opined that the administration had a difficult time determining how much money was needed for tax credits. He did not know if the difficulty was due to drilling or exploration activity. The governor recently lowered the amount of oil and gas credits to \$200 million.

Co-Chair Hoffman asked if funds automatically lapse if a budget is approved and the expenditure is not made. He suggested that there is no significance in reducing the budget from \$400 million to \$200 million because the money remains with the general fund.

[9:21:20 AM](#)

Mr. Teal agreed in the case of operating budget and the appropriations to agencies; any unspent money simply falls back to the general fund. He said that the difference in this case is that the appropriation is not drawn from the general fund, but instead deposited into an oil and gas credit fund. The unspent money sits in the fund. If the money is not refunded to oil companies this year, it sits in the fund and is available for future credits.

Co-Chair Stedman asked about the oil and gas credit referred to on Slide 3 Line 25. He asked about the 25 percent capital credit investment. Mr. Teal agreed that two different types of credit exist. The state is not privy to information about the amount of tax credit claimed by the major producers. These credits on Line 25 are the transferable credits earned by exploration companies and others who are not yet producing. The exploration companies do not have a tax liability and cannot net it out against their tax liability. Therefore the exploration companies receive a credit that they sell to an entity without a tax liability. The legislature requires an appropriation for the smaller credits.

Co-Chair Stedman stated that the committee struggled with this issue for some time. The revenue number discloses the value of the resource and how the amount of capital credit flows. He explained that the process remains challenging without an evident gross number. The Senate Finance Committee (SFC) asked the Department of Revenue (DOR) to organize the data for the public's benefit.

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Co-Chair Hoffman requested that Mr. Teal review the capital appropriations before the meeting's end.

Mr. Teal referred the graph on Slide 4, "General Fund Budget History." He explained that state savings from FY06-FY09 is greater than usual. The savings accrued in early 1980s was placed in the permanent fund. He informed that the state's savings are negative for the first time in FY10.

Co-Chair Hoffman noted changes in tax structure and tax progressivity causing the spikes in revenue observed in FY09 and FY10. Mr. Teal agreed that the progressive tax made a considerable difference in revenue. Tax progressivity is seen above \$60 per barrel of oil. He suggested that DOR provide details. He explained that in some years the capital budget nearly vanishes on the graph as it is merely the minimum amount to get a federal match. As revenue spikes the capital budget grows. The state-wide expenditures are not directly related to agency operations including retirement, oil and gas credits, debt service and other capitalizations.

During the early oil spike, a couple of loan funds were capitalized on.

Senator Huggins asked about the increase in the statewide operations budget graphed in light blue.

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Mr. Teal acknowledged the tremendous and sudden growth in the statewide operation budget. He explained that retirement morphed from a fully funded program to \$5 billion unfunded liability in one year, which required substantial changes to retirement systems. He elaborated that the state is now paying \$450 million per year into retirement costs where it used to pay nothing. Oil and gas credits were zero and are now \$400 million per year. The resource rebate was a one time \$750 million expense. The issue with the retirement cost had nothing to do with oil revenue, but resulted from the stock market downturn and increased health care costs. If oil had not spiked in price when it did, the state would still face the \$400 million cost of retirement systems without funds to cover it. The state faced a serious challenge buried by the high prices of oil.

Senator Elton asked where in the graph the prefunding for education was illustrated. Mr. Teal answered yellow because it was considered savings. He detailed that the color yellow represents savings of approximately \$1 billion into the public education fund, \$300 million into the (Alaska Housing Finance Corporation (AHFC)), \$1 billion into the Statutory Budget Reserve (SBR), and \$5.8 billion into the Constitutional Budget Reserve (CBR).

Co-Chair Stedman readdressed the light and dark blue portion of the graph and asked if minus the one time resource rebate, the remaining expenses were ongoing. He asked if every portion was a financial state obligation.

Mr. Teal answered that a reduction to the operating budget was possible but the dark blue line representing the agency operating budget grew rapidly with revenue and then flattened out as opposed to the savings and capital budget which declined. If revenue is flat, then the expectation is that the operating budget will flatten as well. Once the operating budget grows it tends to stabilize at the peak and then grow again with the return of revenue. He did not know how much the operating budget could be cut. The growth is between 10 and 14 percent. In 2010, growth drops to 2.7 percent.

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Mr. Teal addressed Line 11 on the spreadsheet. The operating budget for education has increased by \$92 million in 2010.

Of that \$92 million increase, \$85 million was predetermined. Legislation was passed last year that increased education cost by \$51 million. Salary increases were also approved of about \$31 million. One bill reduced business license taxes adding another \$3 million. He cautioned that there was more than \$7 million worth of growth in the operating budget. He mentioned two large FY09 expenses including \$23 million for Power Cost Equalization (PCE) and a \$44 million appropriation to agencies paying for high fuel costs. Both of these expenditures could back out of the FY10 budget.

Mr. Teal discussed statewide operations in line 20 and a reduction of \$840 million. He informed that \$750 million of the reduction included the resource rebate and another \$100 million was the oil credit. The capital budget for FY09 was \$670 million, which dropped to \$535 million. The Governor's budget is typically a starting point with the legislature adding capital projects.

[9:38:59 AM](#)

Co-Chair Hoffman asked for a comparison of the Governor's FY09 and FY10 requests for capital budget appropriations.

Mr. Teal stated that Governor's capital budget last year equaled the minimum required to obtain federal match. She had a small budget in her original request, which grew substantially during the legislative process both with governor amendments and legislative add ons. At \$535 million, the capital budget is substantial considering the fiscal situation.

Co-Chair Hoffman asked if the stimulus package, which equals approximately \$1 billion of which the vast portion is capital. Mr. Teal expressed uncertainty as to whether the stimulus package includes federal funds on top of general fund expenditures. He stated that it remains unknown whether the stimulus package will result in reductions to the general funds budget. He informed that major contributions to education are coming through the stimulus package. The state formula says that state aid is basic need minus federal funds. The stimulus education package could simply replace general fund dollars.

Co-Chair Hoffman countered that the funds identified in the Governor's FY10 budget of \$1.1 million of federal funds lack funds from the stimulus package.

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Mr. Teal agreed with Co-Chair Hoffman. The FY10 budget is the Governor's proposed budget as requested on December 15th, although substantial changes are expected as a result of the stimulus package for both the operating and capital budgets.

Senator Elton asked if LFD was working on rules for stimulus dollars and the substituting of stimulus dollars for general fund dollars. Mr. Teal stated that he read the stimulus bill recently and it gave little indication of what will happen with federal dollars. He understood that the money is designed to supplement as opposed to supplant general funds. The money cannot be referred to as stimulus if it only helps states in need. The LFD is working on the stimulus bill but much work is necessary. A large number of projects must be submitted and evaluated quickly due to severe time constraints on spending the money. Unless the legislature has some way of quickly analyzing the administration's proposals, the projects will not proceed to a bill. A new fund code was created for the stimulus package not only to track the stimulus money, but to ensure that legislature has some control over the money. He stated that the Department of Transportation and Public Facilities (DOT) has substantial federal authorization right now that allows them to approve projects because they have federal authorization to spend the money if it comes in.

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Mr. Teal suggested that with the new fund code, projects can not proceed without the opinion and evaluation of the legislature. Once projects are evaluated by the legislature, a bill is drafted. He stressed that a considerable amount of work exists prior to drafting the bill.

Co-Chair Stedman asked how the fund code is created and who is in control of the creation of the fund code. Mr. Teal answered that LFD creates the federal fund code and the legislature can use it as they use any other fund code simply by specifying that the code signifies the money spent in a particular bill. Normally federal projects are coded with revenue specifically related to the stimulus bill just passed. The stimulus money is a completely separate form of federal receipts giving the legislature complete authority over which projects receive money.

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Co-Chair Stedman clarified that LFD is the execution arm that places the legislature in the position of having review and authorization authority over a particular fund code, in this case the stimulus money.

Mr. Teal reminded that the legislature has the power of appropriation. The function of the legislature is to determine the amount and type of funds spent. Co-Chair Stedman agreed with Mr. Teal.

Mr. Teal addressed savings, which equaled approximately \$1.2 billion last year. This year the Governor pulls \$238 million from savings. The proposal is to spend money from the Alaska Housing Finance Corporation (AHFC) savings account and the legislature, again determines whether the governor is allowed to proceed. The legislature can change the fund code, delete the projects, and either way LFD observes the budget differently than OMB does. He stated that OMB says that the \$238 million does not appear in the general fund column, it appears as other expenditures and remains in the "other column." He continued that LFD interprets that the AHFC money was placed temporarily in the savings account. If the money is spent, it cannot be deemed non-general fund, but instead must be pulled out and placed into the general fund. In this case, the action is withdrawing money from a savings account and adding it to the general fund. He stressed that LFD disagrees with OMB on this point.

[9:50:33 AM](#)

Co-Chair Stedman states that the \$238 million out of AHFC was set aside for an event of revenue shortfalls. If the \$238 million was removed from general funds would this budget show a deficit?

Mr. Teal addressed line 46 and the pre-savings surplus of \$147 million dollars. He stated that LFD counted the projects proposed by the Governor from the AHFC account as general funds showing surplus of \$147 million. The Governor's fiscal summary shows the surplus as \$382 million, but LFD interprets the surplus as \$147 million. If the \$238 million is taken from the savings account the surplus can be seen as \$382 million, but really the surplus of current year money is \$147 million. The 2010 forecast is for the price of oil at \$74 dollars a barrel, but the revised forecast is due tomorrow and if it is below 70 dollars a barrel the state has a deficit in 2010.

Senator Huggins stated that he had seen oil priced at \$40 dollars per barrel that morning. He recalled that the AHFC savings had been set aside for gasline activities.

Mr. Teal answered that the money was set aside for gasline and other purposes.

Senator Huggins expressed confusion with the gasline as the number one priority, why would the money be appropriated elsewhere.

[9:53:41 AM](#)

Mr. Teal stated that if oil is priced at \$40 per barrel, then the state will show a deficit of \$3 billion. Fiscal summary is positive now, whether you look at pre or post

savings surplus, but it is likely to go negative tomorrow. The options are to increase revenue, spend less, or use reserves. He surmised that using reserves is the simplest option, but reserves will not last more than 3 years. He recalled that this was not the first time these predictions existed.

Co-Chair Stedman asked about the budget fund history. He asked when the state had faced revenue shortfalls of \$2-\$3 billion dollars in the past. He asked when the legislature should concentrate on a break even rate.

[9:56:18 AM](#)

Mr. Teal stated that the legislature may achieve some operating reductions. One option is to spend less. In the past, the legislature found it difficult to reduce the operating budget. The governor's operating budget was restrained with 2.7 percent growth. He opined that the legislature will have a difficult time removing the increments allowed because agencies probably requested much more than the governor passed on to the legislature. He assured that 2.7 percent is small, relative to past years. Changes in tax credits and retirement could cause rate decline.

Mr. Teal suggested that the capital budget could be reduced and is probably the simplest reduction. He noted that a reduction in the capital budget may also prove simple given the stimulus package. He asked about the FY07 budget presented by the previous administration. Mr. Teal responded that agency operations have increased substantially. Statewide operations have also increased substantially as a result of pre-retirement and pre oil tax credits. Expenditures have increased by \$800 million since 2007.

[10:00:16 AM](#)

Senator Huggins asked if the savings was going into the principal of the permanent fund. He requested review of this issue.

Mr. Teal replied that the Governor proposed making deposits to the permanent fund principal or to the earnings reserve. The savings would not be available if the deposits had been made.

Senator Huggins expressed appreciation. He asked for clarification on loss of money in the budget reserve or sub-account and he requested the impact on the reserve account.

Mr. Teal responded that the statutory budget reserve account neither gains nor loses because it is a sub-account of the general fund. The interest accrues in the general fund as

opposed to the reserve account. The sub-account has not declined with any losses; the general fund has in fact absorbed the losses.

Mr. Teal elaborated that the constitutional budget reserve account (CBR) is complicated because the Department of Revenue placed approximately \$4 billion of the CBR into a sub-account which then lost close to 30 percent or roughly \$1 billion. The state reserves declined by approximately \$1 billion.

[10:04:15 AM](#)

Co-Chair Hoffman stated that the committee will address the CBR discussion tomorrow.

Mr. Teal informed that there is approximately \$6.8 billion left in the CBR instead of the \$7.8 billion that might be expected.

Senator Olson queried the effect of change in defined contribution benefits and the effect.

Mr. Teal answered that a change in defined benefits would have very little effect. The change from defined benefit to defined contribution is something that takes years current employees are not affected only new hires.

Co-Chair Stedman recalled the interest in a sweep into the permanent fund, but an interest in an endowment created for DOT and some other endowment work which would contribute to the loss of liquidity if the proposal was implemented instead. In retrospect, he opined that the committee did make the right decision. He proposed that the calculations be run.

Mr. Teal explained that the third option is to increased revenue. The legislature has never been successful with personal or sales tax. He cited a recent legislative act to increase petroleum taxes, but anything done in terms of revenue changes would take a few years to implement. The most effective means of increasing revenue is to increase oil prices, but there is no guarantee that it will happen. The other option is to spend less. He suggested that it is impossible for the legislature to spend less and eliminate the deficit, which leaves no choice but to use reserves. He cautioned that the legislature must monitor the rate that reserves are spent and endeavor to minimize spending.

Co-Chair Hoffman recalled national school districts that are transitioning to a four-day school week, eliminating 20 percent of operating costs for education. Mr. Teal noted that some states have opted for four day weeks for state workers.

[10:08:16 AM](#)

Co-Chair Stedman recognized that the legislature can access the earnings reserve, but he asked the amount available for appropriations in the earnings reserve. Mr. Teal thought the amounts were \$3 billion in cash and \$13 billion in unrealized losses. The unrealized losses become realized losses as soon as soon as the legislature sells to generate the money. He suggested focusing on cash as opposed to the unrealized. The legislature may be left with \$1-2 billion of cash in the earning reserve account. The account depends on the market which could turn around rapidly or continue to sink.

Co-Chair Hoffman noted Line 61; the legislature will spend an estimated \$25 million more in the dividend program. He interpreted this as an increase in the amount of budgeted money for PFDs. Mr. Teal responded that the PFD is an open-ended appropriation. The appropriation follows the statutory formula, not the specific amount noted in Line 61.

[10:11:12 AM](#)

Senator Elton recalled the state fiscal summary and the governor's proposed capital of \$535 million in general funds. He asked what percentage of the \$535 million is necessary for federal match. Mr. Teal estimated \$150 million.

#

ADJOURNMENT

The meeting was adjourned at 10:11 AM.