

HOUSE FINANCE COMMITTEE
February 21, 2012
1:38 p.m.

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CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 1:38 p.m.

MEMBERS PRESENT

Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Co-Chair
Representative Anna Fairclough, Vice-Chair
Representative Mia Costello
Representative Mike Doogan
Representative Bryce Edgmon
Representative David Guttenberg
Representative Reggie Joule
Representative Mark Neuman
Representative Tammie Wilson

MEMBERS ABSENT

Representative Les Gara

ALSO PRESENT

Michael Bird, Senior Federal Affairs Counsel, National Conference of State Legislatures.

SUMMARY

HB 284 APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 284 was HEARD and HELD in committee for further consideration.

NCSL Presentation:

The Federal Budget Control Act and its Possible Economic Impacts on Alaska

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#hb284

HOUSE BILL NO. 284

"An Act making appropriations for the operating and loan program expenses of state government and for certain programs, capitalizing funds, amending appropriations, and making reappropriations; and providing for an effective date."

Co-Chair Stoltze handed the gavel to Co-Chair Thomas.

Co-Chair Thomas referred to and set aside HB 284.

HB 284 was HEARD and HELD in committee for further consideration.

Co-Chair Thomas disclosed that after attending the National Congress of State Legislature Conference in Florida, he recognized the possible huge impact on Alaska. Co-Chair Stoltze added that there is a short term false sense of security with the amount of money Alaska has now in reserve, due to the declining oil resource reserves and the expansion of new entitlements. Co-Chair Thomas agreed that Alaska, unlike most states, presently has a budget surplus, but in the long term, there is still the need for fiscal restraint.

^NCSL PRESENTATION: THE FEDERAL BUDGET CONTROL ACT & ITS POSSIBLE ECONOMIC IMPACTS ON ALASKA

MICHAEL BIRD, SENIOR FEDERAL AFFAIRS COUNSEL, NATIONAL CONFERENCE OF STATE LEGISLATURES, communicated his task to inform state legislatures about the federal budget, deficit reductions and the potential long and short term effects. He stressed that he does not present a policy preference, but his role is to share information and insights into what is going on the Washington D.C. regarding the imminent federal funding reduction to states and local governments. He noted his intention to break the PowerPoint presentation into a four parts: "The BCA's of Federal Funding, National Conference of State Legislatures," February 21, 2012 (copy on file). He referred to Slide 4, "Total Budgets Surplus/Deficit." He explained that in following the red and blue line, the blue line reflects President Obama's budget. The projected deficit is very steep. The current proposals are reflected in the black straight line moving

down to the right. The federal government remains in deficient mode which will conclude FY12 at \$1.2 to \$1.3 trillion. The problem will be persistent with no foreseen resolution at this time. He moved to Slide 5, "Budget Outlook." He pointed out that the deficits from FY13 to FY16 go from 900 down to 612 (numbers are not reflected in the Slide). The important number to watch is the bottom percentage GDP (Gross Domestic Product) that the debt limits is subject. He pointed out that the numbers are going up. It is on a track for the next decade to go into the mid-20s if nothing is done. There is no consensus in Washington as to what to do about the problem.

Representative Neuman questioned how the debt numbers are related to other numbers in the slide. Mr. Bird explained that presently for every dollar spent, 60 cents is brought in and the rest of the 40 cents is borrowed. In order to make spending work, the debt limit needs to be increased in order to borrow more money, otherwise the government defaults. The numbers are primarily driven by entitlement programs and the present tax codes. He suggested that both need to be revised.

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Mr. Bird continued with Slide 6: "Federal Debt Held by the Public Under Two Budget Scenarios." He explained that current law, the green line, is where spending is heading into the future. The current law will take spending as a percent of the GDP. He pointed out that the reality is reflected in the red dotted line that swings upward. He explained that the red dotted line reflects President Bush's tax cuts of 2001 and 2003 (with the extension in 2010), the alternative minimum tax, military overseas operations, and reimbursements to Medicare physicians. The Alternative Fiscal scenario "reality" is what the present and past administrations have not been able to resolve in the tax and spending policies. There has also not been a resolution of health driven entitlements, such as Medicare and Medicaid at the federal level. The obligation to spend continues in a very high arc if nothing is done. Slide 7: "Federal Spending Projected for 2020." Regarding deficit reduction, federal policy makers have only been able to discuss and decide upon what is reflected in the lower blue square under Discretionary Spending. One thing not reflected is spending generated through the tax code.

Representative Doogan noted on Slide 7, where it shows net interest at 14 percent, and asked if the deficit continues to climb and more money is borrowed, he assumed the net interest will increase. Mr. Bird responded, not necessarily. The number is suppressed because the federal government also borrows from itself at a low interest. The number may go up, but is dependent on what happens in the other squares. The Federal Reserve could decide to turn off the low interest rates then the net interest number would change. The number is artificially is low at this time. Representative Doogan questioned if any increase in the other squares would have a corresponding reduction in the last blue square. Mr. Bird agreed.

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Vice-chair Fairclough pointed out that 50 percent of all spending in the United States is on Social Security and health care. Mr. Bird indicated that was correct.

Co-Chair Stoltze asked about the Net Interest of 14 percent being artificially suppressed, if it was called the Debt Service would it remain the same percentage. Mr. Bird agreed.

Mr. Bird continued with Slide 8: "Nondefense Discretionary Spending." This Slide breaks down the blue square from the previous slide. For FY 13, everything listed on this slide is subject to reduction, except for the 15 percent for transportation and some of the veteran's benefits. He cautioned that these cuts alone would not balance the federal budget. The slide reflects were the money is appropriated at the federal level.

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Vice-chair Fairclough pointed out that some health care costs are also imbedded in other areas, such as Tri-Care in Defense. Mr. Bird agreed. He referred to the 10 percent reflected in the pie as the non-Medicaid world.

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Mr. Bird continued with the next part of the presentation, Slide 9: "A Brief History of Deficit Reductions Studies, Reports and Negotiations" and Slide 10: "Recent Reports to Curb the Federal Deficit and Potentially Re-craft the

State-Federal Fiscal Partnership." Mr. Bird explained that the National Commission on Fiscal Responsibility and Reform was President Obama's study commission chaired by former U. S. Senator Alan Simpson and former Chief of Staff Erskine Bowles, the Bipartisan Policy Committee and the rest of the commissions listed came to a variety of conclusions. The "Several Others" listed at the bottom included the President, Vice-President, Congress, Gang of Six (now 42+ in the Senate and 100+ in the House) who arrived at the conclusion that in order to get the federal deficit and national debt under control both spending and revenue reform needed to be on the table. In Slide 11: "Common Features Among Recent Reports," he noted that the missing ingredient in all the federal reports is the impact on the state and locals government. The cuts will present a real challenge to the states.

Representative Costello asked Mr. Bird if he was aware of other states efforts to understand and prepare for the impact. Mr. Bird responded that it depends on where the state is fiscally. He noted that last year, eight states enacted "just-in-case" funds to put aside in preparation if the federal government reduces appropriations to state and federal programs. Numerous states are trying to understand the possible impact from Washington DC. He noted that states often have subdued discussions on federal funds. He noted Alaska is number one in the nation receiving federal funds. Co-Chair Thomas asked if that will make Alaska a number one target in reduction. Mr. Bird agreed that it could affect the state hard.

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Co-Chair Thomas commented that the electric power used by the entire state of Alaska is less than Seattle Light produces daily.

Representative Wilson asked when "federal receipts" is seen in the budget, not "federal funds," would it be better not to have that in the budget. Mr. Bird asked why the state would not want to be aware of those federal funds. Representative Wilson replied that if the state gives the federal government a chance to go looking for the money versus actual money being here, then Alaska might have to go through another process to accept federal money.

Mr. Bird remarked that the federal government has talented people tracking all expenditures made in a variety of categories to all states, communities, counties and regions, and even to individuals. All of the information is included in reports entitled, "The Consolidated Federal Funds Report" or the "Federal Aid to States Report" which derive from the Department of Commerce. Unfortunately, the reports are no longer in the budget to continue.

[2:07:31 PM](#)

Mr. Bird moved to Slide 12: "Major Areas Addressed in Reports with Potential Repercussions for State-Federal Fiscal Partnerships." He stressed that all the items listed need to be looked at for reduction. He opined that although the administration and legislators agree reduction needs to be done across the board, partisan politics often stand in the way of reform.

Mr. Bird continued to Slide 13: "What happened? Why Should I care?" He referred to the Budget Control Act (BCA), legislation passed in August 2011, which sets the table for deficit reduction in both discretionary and defense spending for the next ten years. Slide 14: "Overview: BCA of 2011" sets up three components with the potential to affect future funding for state grant programs. Caps on discretionary spending were accomplished, but the Joint Select Committee on Deficit Reduction failed. He signified that now brings about a sequestration process which is mandatory across-the-board cuts. The states will be heading in the reduction direction over the next decade.

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Mr. Bird moved to Slide 15: "BCA Deficit Savings" explaining that there was a deal to increase the Debt Ceiling by \$2.1 trillion in exchange for two pockets of reductions. The debt ceiling can now go up to \$16.4 trillion. One reduction consisted of \$917 billion in discretionary spending over the next ten years. An artificial spending ceiling was also set up. Slide 16: "Super Failure." An opportunity for reduction was to set up a Super Committee to find another \$1.2 trillion in cuts over a nine year period. The Super Committee failed which triggered automatic cuts for FY 13-FY 21. He explained that the sequestration is about to happen at the beginning of calendar year 2013 or right after the federal fiscal year

2013. He stated that over nine years there is a mandatory cut of \$492 billion in domestic discretionary spending reductions and \$492 billion in defense discretionary spending reductions. The President introduced his own deficit plan that is under siege by opponents. President Bush's introduction of Medicare Part D and the escalations of the military operations in Iraq and Afghanistan were not paid for and the money was borrowed. The tax cuts in 2001 and 2003 which were extended again in 2010 meant there was not enough revenue to make up for the loss revenue.

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Mr. Bird pointed out in Slide 18: "What We Can Say about a Sequester- "Thing Two" (non-defense)." Sequester covers all mandatory and discretionary programs and 8 out of every 10 dollars are exempt from being cut which is 82 percent. When the federal government is looking over cuts for next year for \$45 to \$50 billion in cuts it will only be in the red "Covered" section. Slide 19: "What We can Say about A Sequester - "Thing Two" (defense)." On the defense side, 100 percent is covered. Mr. Bird pointed out the programs exempt listed on Slide 20: "Selection of Programs Exempt from Sequestration" and on Slide 21: "Programs Not Exempt from Sequestration." He noted the program cuts from the nonexempt section would have greatest effect on state budgets.

[2:20:20 PM](#)

Mr. Bird commented on Slide 22: "What We Can Guess About a Sequester." In FY 11, state federal grant money was reduced by 4.6 percent to cuts of 15.6 percent in FY 13. This is the easiest place for the Administration and Congress to go for cuts. Co-Chair Stoltze asked if it was the easiest place to get the money because of more money being there. Mr. Bird commented the area has the least available money, but politically the softest and easiest place to go.

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Mr. Bird disclosed in Slide 23: "Impact of BCA on Alaska - nondefense "Thing Two" (in thousands.)" Hypothetically over the next nine years Alaska could be subject to sequestration \$553 million, or for FY 13, \$48 million. Co-Chair Thomas asked if the number reflects what would be cut overall. Mr. Bird indicated that it will come from the 18

percent of the pie. He advised that many groups will be affected unless the law changes. Co-Chair Thomas reported that the state already has the fear of base closures in Alaska.

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Representative Wilson asked if education cuts would also involve federally mandated requirements. Mr. Bird responded that was a good question. He believed the government might look at the laws and see if more flexibility and administrative relief is possible for the state, but that approach requires some serious give and take. He suspected though that there would be basic reductions. He noted that the program No Child Left Behind is a non-exempt program on the table as well as special education grants.

Vice-chair Fairclough asked if the government was looking at trade agreements in order to compete in global markets and increasing exports. Mr. Bird opined that discussions between the Administration and the majority of Republicans in the House and Senate involved more about tax policy than about trade agreements. Three new trade agreements were enacted into law last year. Vice-chair Fairclough commented that if there was balance trade for Americans much of the 9 percent decline would go away immediately because of competition in a capitalistic market. She emphasized that restricting trade opportunities for individual states requires states to work within narrow confines.

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Representative Doogan asked if the 9 percent was an average rather than a prediction. Mr. Bird replied that it was a consensus number. He thought the states should be prepared in case there is a larger cut, instead of a smaller one. Representative Doogan indicated he was trying to make the distinction that the 9 percent is a target. He asked if it was possible that one state could be hit at a higher percentage than another. Mr. Bird replied that the 9 percent is a hard number that represents \$45-\$48 million in state grants. He did add that for states that are less dependent on federal grant money, but highly dependent on defense or procurement activities, then the percentage may not be the same across the board. He noted a survey of legislative leadership around the country and the issue of defense cuts came in the "Top Five" concerns.

[2:30:37 PM](#)

Mr. Bird reviewed Slide 24: "Thing Two (24)-Examples of Program Subject to Sequestration" that included a variety of funds, grants and programs.

Co-Chair Thomas remarked that LIHEAP was cut last year. Mr. Bird remarked that when the economy was high, the states looked to the federal government to backfill some state and local programs. The numbers have changed. He mentioned that states like Nevada and Rhode Island have a General Fund Budget that is one third to fifty percent lower than a few years ago, triggering serious cutting.

Mr. Bird referred to Slide 25: "Federal Deficit/Other Concerns" which summarizes some other financial concerns. He noted that many things will not get resolved until after the November 2012 federal elections. He continued to Slide 26: "Certainty" for FFY 2013" that referred to further discretionary spending reductions in Education, Energy, Environment, Health, Human Services, Housing, Justice, and Labor/Employment. There will also be Defense Reductions imminent if sequester holds.

Mr. Bird moved to Slide 27: "The Looming 'Crash' of '12." He signified that one of the largest discussions after the elections will be whether or not to extend the 2001, 2003, and 2010 tax cuts. The Debt Ceiling reaches \$16.4 trillion around November or December 2012 and another credit downgrade is possible.

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Slide 28 and 29: "Highlights of President Obama's FY2013 Budget" and Slide 30: "Likely Component - House Budget Resolution." The three slides list President Obama's budget proposals and the Majority House budget proposals. The President's budget eliminates sequestration with a Deficit Reduction Plan. It also ends tax cuts on high income individuals and has Medicare Savings of \$370 billion. There is also savings from winding down overseas military operations, as well as the termination in oil and tax preferences. He summarized that because the President's Budget eliminates sequestration, domestic discretionary spending and defense spending rise. The House bill overhauls Entitlement Programs, no tax increases anywhere,

major Medicare reform, cuts in domestic discretionary spending below BCA Cap, and corporate tax reform.

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Mr. Bird presented Slide 31: "Federal Government Expenditures Per Capita A by State, by Major Object Category, Fiscal Year 2010" including Retirement and Disability, other Direct Payments, Grants, Procurements and Salaries and Wages. The slide lists federal government expenditures per capita and, by state, Alaska tops the list at \$18,000, with the U. S. average at around \$10,000. He emphasized that is something for Alaska to be concerned about. Vice-chair Fairclough wondered if there was any insight of where the \$18,000 number was coming from. She indicated a third of Alaska's budget is based on military expenses. Mr. Bird referred to the next Slide 32: "State Rankings for Per Capita Amounts of Federal Government Expenditures: FY2010." He pointed out that a lot of federal money goes to Alaska for salaries, wages, procurement, and grants. He emphasized that those items were within the sequestration area for possible funding reduction.

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Representative Wilson asked how proportionate is the information to the fact that the federal government owns half the state. She mentioned that if the federal government would give back the state's resources, the state would come out ahead.

Vice-chair Fairclough indicated that, in looking at salary and wages. She wondered if that meant there were more federal employees in Alaska compared to other states. Mr. Bird responded that there was a significant federal presence. Vice-chair Fairclough mentioned that the population and how it is divided moves Alaska to the top. She wondered if it was looking at a ratio of federal employees versus the population in the state. Mr. Bird indicated he did not have that information with him, but could provide it later to Vice-chair Fairclough. Co-Chair Thomas agreed that would be helpful information.

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Representative Guttenberg agreed that the "Salary and Wages" portion was interesting and wanted to know if it was

higher because federal employees were paid more in Alaska due to the Cost-of Living Adjustment (COLA.) Mr. Bird agreed that would be part of it, but there are more factors in that equation. The most vulnerable thing for Alaska is the risk of federal funding cuts. Vice-chair Fairclough said as the state sets salary scales and tries to remain competitive, the number of federal employees in the state is important to how the state responds. It is hard for the state government to retain the same level of expertise when federal pay is so much higher. Mr. Bird suggested the information needs to be impressed on Alaska's congressional delegation. Representative Neuman asked for Mr. Bird's perspective noting that, although Alaska has funding reserves, the oil money from the pipeline is declining while the cost of government continues to rise. He emphasized that the state's economy is not very diversified and wondered what recommendations Mr. Bird would give to the state.

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Mr. Bird divulged some bad practices he had witnessed in another oil state. He pointed out that the state did not take any action to conserve when money was flush. He also mentioned that Alaska lacks a State Income Tax and Sales Tax which may need to change as less money becomes available. He believed planning is important for the state while it is still sitting on so much money. He also recommended exchanging ideas and information with other states. Representative Neuman acknowledged that the co-Chair has taken a lead in fiscal policy restraint and creating base line information to be better prepared for the future. Mr. Bird mentioned that there are some states that do not even appropriate federal money so the cut-backs will not affect them as deeply as Alaska.

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Co-Chair Thomas pointed out that Alaska receives \$2.4 billion from the federal government.

Representative Joule commented on gridlock in Congress and wondered what this costs the nation globally. Mr. Bird responded that some senators (now 43) are trying to arrive at some consensus, but the extreme far left and far right are not in that consensus group. The same exists in the House of Representatives where the majority party has all

the votes. The entitlement programs and tax codes need the greatest overhaul.

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Representative Guttenberg mentioned that there are lots of other relevant lines besides "Salaries and Wages" that are unique to Alaska.

Representative Edgmon agreed that Alaska has many unique characteristics from other states. He mentioned that Alaska is 70 percent owned by the federal government which translates to a large portion of federal employees and infrastructure. He commented on Alaska's large coastline, world class fisheries, military bases, tribal interests, and mining. He wondered if any of that sets Alaska aside as more unique than other states. Mr. Bird stated that western states do have a large federal land presence. Many programs under same title may be very different in each state.

Representative Edgmon said the premise is that the amount of money coming to Alaska is going to decrease, but understanding where the money is attached makes it hard to compare Alaska with other states. He indicated the need for having a better look at the numbers and their meaning.

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Representative Costello wondered whether there had been any guiding principles with regard to the list open for cuts. She mentioned the need for making up for the loss of federal funds for childhood immunizations. She asked whether there had been a decision to determine what the states could shoulder related to preventing childhood diseases from resurgence. Mr. Bird replied that the decision to exempt, or not, certain programs is traceable to the late 80s and early 90s when spending was reigned in before the economy took off in the later 90s. The decisions makers went back to the old reduction laws from the 80s.

Vice-chair Fairclough commented that as NCSL provided opportunities to reflect on what is pending before the states, there is a tendency to explain what our state should not be cut. She wondered whether it would behoove the state to set 10 percent aside in preparation of the loss of federal funding. She noted that the state would have a surplus in the upcoming year and wondered whether

the state should respond in order to provide the state's communities with the appropriate time to respond. She expounded that the issue was on top of price and production that had been discussed previously. Co-Chair Thomas indicated that the issue between what can be appropriated and what the people of Alaska want. There is always new legislation wanting more money.

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Mr. Bird pointed to the end of the presentation where there are five pages identifying what programs are covered and which ones are exempt. He emphasized that not every federal program is being cut. He agreed that regarding some federal programs and grants, the state must act on it and if some program or grant money is not spent, the money returns to the federal government. Vice-chair Fairclough suggested saving some of Alaska's own General Funds dollars in case the federal government withdrew support, which would give the state two years to respond to the situation. Mr. Bird recommended that legislative staff speak with members in Vermont, a state that has done the best job in setting money aside and planning.

Co-Chair Thomas explained that when the stimulus money was offered, the legislature told departments not to hire additional people or create any new programs.

Representative Doogan asked if he heard correctly that the 9 percent reduction would be applied to cuts for FY 13, but after that point there was no limit.

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Mr. Bird replied that after FY 13, it is all discretionary money in one pot. The cuts could come from one section or from both. If the reductions take place, sequester will be applied to the whole program. If a program has six accounts inside, then every account goes down, not just the overall spending number.

Co-Chair Thomas asked about federal formula programs that the state may have to financially support and wondered if the state can make the decision not to fund it.

Co-Chair Thomas thanked Mr. Bird for his information. He indicated that only seventy five people write operating

budgets for the states. Only thirty states were represented at the Florida NCSL conference because rest could not afford to go.

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ADJOURNMENT

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The meeting was adjourned at 3:20 PM.