

HOUSE FINANCE COMMITTEE  
January 18, 2013  
1:30 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:30 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Mark Neuman, Vice-Chair  
Representative Mia Costello  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lindsey Holmes  
Representative Scott Kawasaki, Alternate  
Representative Cathy Munoz  
Representative Steve Thompson  
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg

ALSO PRESENT

David Teal, Director, Legislative Finance Division

SUMMARY

OVERVIEW OF THE GOVERNOR'S FY 2014 BUDGET:  
LEGISLATIVE FINANCE DIVISION

^OVERVIEW OF THE GOVERNOR'S FY 2014 BUDGET: LEGISLATIVE  
FINANCE DIVISION

[1:31:03 PM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, explained that the Legislative Finance Division (LFD) was statutorily charged with budgetary review. The division

published the "Legislative Fiscal Analyst's Overview of the Governor's Request" (copy on file) annually. The division's role in the budget process was primarily technical, but he and his analysts also tracked the process insuring that the appropriation bills accomplished their intended purposes. The division reviewed fiscal policy to identify important budget items. He explained that the division did not support or oppose policy choices, but instead provided the information necessary to make decisions. The fiscal summaries of the Office of Management and Budget (OMB) and LFD agreed "to the dollar."

[1:34:32 PM](#)

Mr. Teal referred to the FY 14 Fiscal Overview (copy on file). He discussed revenue projections for the current fiscal year, which were critical because of the changing fiscal situation. He pointed out that the past eight years saw revenue from high oil prices exceed spending. The fiscal summary showed a \$490 million surplus at the close of last session. Since April of 2012, production was more than 8 percent less than that of FY 12. The reduction for FY 10 was 7.2 percent, FY 11 was 6.4 percent and FY 12 was 4.1 percent.

[1:37:12 PM](#)

Mr. Teal noted that the legislature must withdraw from savings to fill the FY 13 budget gap instead of debating how much surplus to save or spend. The deficit situation provided a new experience for legislators elected after FY 05. He pointed out the fiscal summary on page 8 of the Overview. He referred to line 51 and the \$410 million deficit. He did not recommend trusting the figure because of the \$250 million deposit into the Statutory Budget Reserve (SBR) seen on line 45. He suggested that \$160 million might provide a more accurate deficit estimate. The difference was the result of action taken by the last legislature to actively save money by making a deposit of \$250 million. The surplus was predicted by a poor projection.

Mr. Teal spoke to the volatility of oil production and price, which lead to large impacts on revenue. One dollar change in the price of oil could impact revenue by \$135 million. Accurate revenue projections were difficult to obtain. He mentioned the governor's supplemental

placeholder of \$40 million. The average supplemental operating budget for the past three years was \$85 million. Surplus FY 13 funds were unlikely. Reserves were available if spending exceeded cash flow. Reduction of expenditures to sustainable levels provided another solution.

[1:41:12 PM](#)

Mr. Teal discussed the profound effects of the deficit on the FY 14 budget cycle. The legislature could either reduce expenditures or access savings in the face of declining revenue. He pointed out the surplus of \$508 million seen on line 51 in the FY 14 governor's request. The Department of Revenue (DOR) predicted that FY 14 oil production would decline by 2.7 percent from FY 13 with an increase in oil prices by \$1 per barrel. Projected revenue for FY 14 was calculated at \$510 million below the expectations for FY 13. If the budget for FY 14 equaled that of FY 13, the state would see a deficit of \$510 million in addition to the deficit seen in FY 13.

Mr. Teal observed that the budget was reduced substantially by the governor because of the decline in revenue. The total reduction in general funds from FY 13 to FY 14 was shown on line 37 as \$1.17 billion. He noted that the majority of the reduction was in the capital budget as shown on line 28. He opined that the proposed capital budget, at \$870 million was sizable. The average capital budget for the last ten years was \$875 million (including legislative increases). The FY 14 governor's request was approximately \$100 million below that of FY 13, making it the second largest governor's request in the last ten years.

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Mr. Teal discussed page 3 of the presentation, which detailed the governor's request as a percentage of the adopted budget. The average for the period was 49 percent, or twice as large as that requested by the governor. If the "historic share" was added by the legislature to the FY 14 governor's request, the state would encounter a deficit of \$654 million. Essentially, the legislature could safely add \$263 to the governor's capital budget without dipping into savings.

Representative Gara referred to the page 3 of the presentation and noted that the governor presented a capital budget addressing the needs of agencies. The legislature would then add the needs of the communities to the budget during the legislative process. He wished to clarify the process and stressed that the governor expected the legislature to add to his capital budget request the needs of the various Alaskan communities.

Mr. Teal agreed that the expectation was for the legislature to add to the budget. He noted that if the legislature added more than \$263 million, a transfer from savings would be required.

Co-Chair Austerman recalled a reduction of the governor's proposed capital budget by the legislature in years preceding 2005. Mr. Teal concurred.

Mr. Teal explained the fiscal summary (pages 2 and 3). The summary exhibited a surplus of \$508 million by subtracting a \$120 million withdrawal from savings as shown on line 46. He added that OMB had erroneously omitted a \$125 million deposit to the Alaska Industrial Development and Export Authority, (AIDEA) energy fund, which led to a surplus of \$263 million. If the legislature added \$263 million to the capital budget, no withdrawal from savings would be necessary. He pointed out that the surplus/deficit calculation included operating items as well as capital.

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Mr. Teal noted that the ability to spend \$263 million on the capital budget assumed that the operating and supplemental budget remained at the governor's request. The governor's request was less than 1 percent increase on operating expenditures. The average growth rate in the operating budget was approximately 6.5 percent. The potential to avoid a deficit existed for the next few years if the legislature could restrain spending to the proposed 1 percent increase.

Mr. Teal addressed assumptions on statewide expenditures shown on slide 4. The capital budget remained flat at an average of \$875 million for the past ten years. He stated that the revenue declined and deficits were projected in the near future. The six percent growth rate could not be maintained if the revenue forecast was accurate.

Mr. Teal explained that DOR expected oil production to fall by 5.5 percent annually. Oil might increase in price offsetting declining oil production and leading to a fairly flat revenue curve. He spoke about the drop in revenue, but the revenue curve exhibited in slide 4 followed the current tax regime. He noted that LFD did not analyze DOR's forecast, but focused on expenditures instead.

Mr. Teal furthered that the legislature would not spend the full \$263 million projected surplus in the capital budget without a withdrawal from savings because of the potential difficulty of holding the operating budget at the proposed \$52 million increase. He noted that the budget was lean in comparison to those of the past.

Mr. Teal cautioned that bargaining units for three major state unions were not included in the governor's proposed budget. The \$40 million supplemental budget placeholder might also prove questionable. Pressure to increase K-12 school funding was anticipated. Many unknown expenses might make the proposed 1 percent growth rate difficult to maintain.

Co-Chair Austerman asked if slide 4 exhibited a 1 percent growth rate.

Mr. Teal concurred. He added that LFD's projection was viewed as "gloomy," but he countered that the picture was positive when compared to other states facing cuts in operating budgets in addition to furloughs and lay-offs. Alaska could afford a sizable capital budget of \$875 million and was not forced to reduce the operating budget. In addition, Alaska had the luxury of large reserve balances. The major change might be the inability to contribute large deposits to savings. He reminded the committee that the LFD overview contained the fiscal summaries along with recommendations for capital and operating budget language. Copies of the publication were available in the documents room on the fifth floor of the Capitol and on the LFD website.

[1:58:19 PM](#)

Vice-Chair Neuman commented that the legislature could not typically maintain the operating budget recommendations proposed by the governor. He asked about the specific

savings employed to address a deficit. He asked about potential reserves in years past 2022. He asked how the reserve balance affected the state's rating on Wall Street regarding bonding abilities.

Mr. Teal responded that Alaska's bond rating was due, in part to the state's massive reserves. The state had approximately \$16 billion in reserves and a budget of \$5 billion. If the pipeline ceased activity and the state was left without revenue, the state could "coast" for three years. Budget reserves in other states were often less than 5 percent of their budget. He argued that reserves were a necessity because of the volatile revenue stream. The legislature was not obligated to spend \$875 million in the capital budget. He presented a chart including years 1975 - 2012, which illustrated that when the state did not have money, spending was curtailed, creating flat budgets for 20 years. The past proved that the legislature was not required to increase budgets by 6.5 percent per year. Bond raters observed reserves in addition to responsible spending and action on the part of the legislature. He opined that Alaska deserved its AAA bond reserve rating.

[2:02:26 PM](#)

Vice-Chair Neuman believed that the reductions in the reserves would affect the state's bond rating. The back-up was necessary.

Mr. Teal agreed that dipping heavily into reserves would affect the bond rating. The expectation was to respond to the declining revenue, by avoiding the rapid spending of reserves.

Representative Wilson asked for the annual percent increase in the formula programs.

Mr. Teal responded that Medicaid growth was approximately 8 percent for the past several years. The FY 14 proposal was a \$10 million increase in Medicaid, which lowered the growth rate to 1.4 percent. He added that the K-12 program included funding increases, changes to the formula, and annual appropriations making the growth rate difficult to predict.

Representative Wilson asked about the K-12 formula increase percentage minus an increase to the Base Student Allocation (BSA).

Mr. Teal responded that the proposed increase for education was \$14 million plus the governor's \$25 million one-time appropriation. The governor's intent was to retain the current BSA and provide the additional funding to the Department of Education and Early Development (DEED) of \$14 million. The funding would be targeted to school district spending.

[2:06:34 PM](#)

Representative Thompson asked about the projected \$2.9 billion in federal funds. He asked about the effect on the budget if the federal funds were not received.

Mr. Teal replied that Trinity Tomsic, Deputy Executive Director for Federal Funds would provide a presentation about federal funding issues to both the Senate and House finance committees. He stated that sequestration affected certain grants for education. Federal cuts might affect some programs. He stated that legislators might decide to reduce program funding or replace it with general funds.

Representative Gara asked if Medicaid growth was documented at 1 percent.

Mr. Teal replied that Medicaid growth was documented at 8 percent. He noted that the governor's increase for Medicaid in FY 14 was 1.4 percent.

Representative Gara referred to the graph on page 4 that depicted government spending with a surplus through 2022.

Mr. Teal stated that the same revenue projections were used. The difference was that the price and production, which determined the graph's revenue curve.

[2:10:18 PM](#)

Representative Gara asked about 2022 and projected price of oil. He wondered if the graph's bar was influenced by the price of oil.

Mr. Teal explained that the green background in the graph depicted the revenue curve, which was affected by the price of oil.

Representative Gara commented that the fall 2011 and spring 2012 Revenue Source Books exhibited revenue declines. The most recent Revenue Source Book illustrated an even greater decline in oil production. He expressed curiosity about the potential surplus or debt based on the production forecast provided by DOR.

Mr. Teal responded that DOR would provide testimony regarding the difference between the spring and fall forecasts.

[2:12:42 PM](#)

Representative Munoz complimented the division on the budget publications. She asked about the percentage increase in negotiated pay costs by bargaining unit from 2005 forward.

Mr. Teal replied that the bargaining agreements had a series of 2 and 3 percent increases during the past several years. He believed that the Department of Administration (DOA) could best respond to the question during their scheduled testimony on January 29, 2013 for the House Finance Committee.

Co-Chair Austerman disused the agenda for next week.

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ADJOURNMENT

The meeting was adjourned at 2:14 p.m.