

HOUSE FINANCE COMMITTEE
January 24, 2014
1:34 p.m.

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CALL TO ORDER

Co-Chair Austerman called the House Finance Committee meeting to order at 1:34 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 David Guttenberg
Representative Lindsey Holmes
Representative Cathy Munoz
Representative Steve Thompson
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division

SUMMARY

FY 15 GOVERNOR'S BUDGET OVERVIEWS:
Legislative Finance Division

^FY 15 GOVERNOR'S BUDGET OVERVIEW: DIVISION OF LEGISLATIVE FINANCE

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, introduced the PowerPoint presentation: "FY 15 Budget Overview (copy on file)." He explained that the Legislative

Finance Division (LFD) was statutorily charged with reviewing the governor's budget. He informed the committee that copies of the "Legislative Fiscal Analyst's Overview of the Governor's Request" were available to legislators and staff. He stated that Alaska was facing a deficit. He added perspective to the deficit with the first slide in his presentation: "Figure 1. December 2013 Revenue Forecast with Projected Expenditures (\$ millions)." He explained that the pre-FY 14 deficit transfer was \$2.2 billion with \$5 billion in revenue and approximately \$7 billion of spending. He pointed out that overspending occurred by approximately 45 percent. He added that both price and production of oil had increased slightly. He expected greater revenue than was projected in the forecast.

Mr. Teal furthered that the state would use approximately one-third of the Statutory Budget Reserve (SBR) balance to fill the deficit. He noted that FY 15 showed a deficit of approximately \$1 billion, prior to any capital spending added by the legislature.

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Mr. Teal stated that the deficit included \$700 million of retirement assistance that the governor proposed pulling from the Constitutional Budget Reserve (CBR) rather than general funds, the more traditional source. If the governor's proposal was not accepted for state retirement system contributions, a budget deficit of \$2 billion was projected. He stated that slide 1 depicted annual \$2 billion deficits through 2024.

Mr. Teal stated that the data on slide 1 assumed zero growth in the agency operating budget. A flat \$800 million capital budget was assumed annually. The budget displayed showed no growth other than state assistance to retirement. He explained that significant deficits could occur without an increasing budget. He acknowledged the difficulty in adopting a no-growth budget. Expenditure growth and agency operations were greater than 7 percent annually for longer than 8 years. The FY 15 governor's budget presented zero growth in agency operations.

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Mr. Teal discussed slide 2: "Figure 2. Budget Reserves (CBR and SBR) under the December 2013 Revenue Forecast and

indicated Expenditure Assumptions (\$ millions)." With annual deficits, reserves would diminish by 2014. He noted that the standard options were to cut approximately \$2.5 billion in one year, taxing Alaskans or eliminating or capping the Permanent Fund Dividend (PFD). Reducing the capital budget was another potential solution.

Mr. Teal noted that the \$2 billion deficit would not be repaired by elimination of the \$800 million capital budget. He mentioned the difficult decision of potentially eliminating some of the large capital projects. He suggested funding the capital budgets or pulling the plug on the projects. He acknowledged that the choices were difficult.

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Mr. Teal revealed the option of reviewing agency budgets. He stated that 60 percent of revenues went toward Medicaid, education and retirement assistance and was expected to grow to 99 percent of spending. He mentioned the subcommittee processes and commended the legislators on their efforts. He pointed out that modification of state contributions to the retirement systems offered promise. He cited the future deficits that would be reduced with the retirement plan.

Mr. Teal acknowledged that the committee was aware of the budget deficit. He understood the difficulty cutting education and Medicaid as formula and entitlement programs. He stated that opportunities to reduce expenses existed in retirement payments. The governor submitted a proposal that would reduce state assistance by \$200 million to \$500 million annually. He stated that the governor's plan would reduce future deficits, but also reduce state reserves upfront.

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Mr. Teal discussed the "Fiscal Outlook Model" spreadsheet. He noted that the adoption of the governor's plan would reduce the CBR by \$3 billion for use in retirement payments, leaving \$500 million for use annually in the future. The use of reserves would be flattened slightly by the modification, but the life of the reserves would not be extended.

Mr. Teal acknowledged different options to reduce future expenditures for the purpose of extending reserves. He opined that the options were insufficient. He added that sustainability could be achieved by lowering the capital budget while reducing the operating budget by one percent. A cut of two percent increased sustainability further. He was unsure about the viability of a two percent decrease in the state's operating budget.

Mr. Teal opined that decisions for FY 15 must be made with the future in mind. He noted that the surpluses seen in Alaska during the last few years would not be available in the near future. During times of surplus, the legislature could spend more easily. With the current deficits, the situation appeared "gloomier" and he encouraged a different viewpoint of FY 15's budget.

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Mr. Teal communicated that he felt optimistic despite the evidence of budget deficits. He observed the revenue forecast as conservative, listing inflation-only prices. He stressed that the division was willing to assist the legislators during the subcommittee process, with fiscal planning and evaluation of future state revenues and expenditures. He noted that the fiscal summary contained language for both operating and capital budgets along with detailed agency analysis.

Mr. Teal observed that the budget work was time sensitive. If the budget process was not altered this session the state would further deplete its reserves. Speed was of the essence as options were limited with deteriorating reserves.

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Co-Chair Stoltze asked about the proposed \$3 billion payment. He asked if the payment would stabilize budgets in terms of payments.

Mr. Teal replied that proposals involving the retirement system would be discussed further in future committee meetings. He stated that a lack of action regarding retirement would lead to payments of approximately \$7 billion of state assistance during the next 20 years. He noted that the governor's proposal, including the \$3

billion deposit cut the 20 year cost to approximately \$5 billion. He clarified that because the governor took \$3 billion from the CBR, the reserves were immediately reduced. Because the governor's proposal took \$3 billion from the CBR, the reserve balance was immediately lowered. The offset was less drawn from reserves annually. By 2024, the reserves would be depleted under the governor's plan.

Co-Chair Stoltze thanked Mr. Teal for the explanation.

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Vice-Chair Neuman asked about the use of reserves and the effect on the state's bond rating. He noted that bond rating was a tool for future infrastructure related projects. He stated that infrastructure would likely be the key to attracting money from private industry in the future.

Mr. Teal replied that the state's reserves played a large part in bond ratings. As reserves declined, bond rating agencies would likely show concern. He noted that the fiscal future relied on income generated by a future gasline and ownership of that gasline. The revenue forecast would change with the introduction of a state gasline. Bond rating agencies appreciated an effort to maintain the reserve balance and reduce the deficit.

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Vice-Chair Neuman expressed concern that the state's reserves would be depleted in 10 years unless action was taken to modify the state budget. He suspected that Alaska would be viewed differently on Wall Street in the very near future.

Mr. Teal pointed out that bonds were not free money. Debt service payments must be made and they may reduce the surplus or increase the deficit. Completed projects along with the accompanying jobs were prime advantages of utilizing bonds. Reserves were not free money either. He mentioned that ownership of a gasline would improve the revenue forecast substantially. In five years, the cash may not be available to buy a gasline. Bonding would force the state to make future payments.

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Vice-Chair Neuman asked about the \$16 billion worth of invested reserves. He asked about investment returns on the \$16 billion.

Mr. Teal replied that the SBR and the main account of the CBR were invested at 1 or 2 percent. The long-term portion of the CBR was invested with a longer term horizon and earned 5 percent.

Representative Wilson observed that the state would not be able to repay money taken out of savings in the near future.

Mr. Teal concurred.

Representative Wilson observed that the state had two options. The state could review the new revenue and compare past budgets with similar revenues.

Mr. Teal replied that the look-back graphs showed precisely that information. He suggested observing the program level. He stated that beginning in 2006, the graphs depicted program spending in each agency. He noted that statewide graphs could be used to compare FY 15 budgets with those of past years. In order to reference useful information from the graphs, they must be evaluated at the program level.

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Representative Wilson observed that the legislature must meet their constitutional mandate regarding the budget. She opined that government was tasked with addressing life, safety and education for citizens of the state. She stated that if a person was out of work, they would purchase only needs while wants would be secondary. She wondered if the same application would benefit evaluation of the upcoming budget.

Mr. Teal quoted Co-Chair Austerman by saying that "across the board cuts weakens everything." The only way to achieve basic needs was to cut programs. Constitutional mandates exist, but without mandated levels of spending.

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Representative Gara stated that the committee diligently scoured the budget for waste. He observed that glaring instances of massive overspending were difficult to find. He asked for suggestions regarding the discovery of ineffective or overfunded programs that could be cut from the operating budget.

Mr. Teal replied that cutting the budget was incredibly difficult. The governor made a terrific effort to decrease agency spending by eliminating vacant positions. He noted that the governor removed \$5 million in addition to other cuts amounting to \$20 million. Cuts forced agencies to make decisions. Agencies were not allowed to cut one aspect of their budgets for use elsewhere. The governor took the broad view, but agencies had limited perspectives. The difficult piece was the elimination of programs and the unforeseen impact. He noted that every cut would have some negative impact, which added to the difficulty.

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Representative Edgmon asked about the reported \$2 billion shortfall in revenue. He asked for further details regarding the individual components of the shortfall. He asked about the mentioned \$300 million increase in revenue for FY 14.

Mr. Teal discussed the acceleration of the production tax credits, which led to a difference in expected credits of \$600 million in FY 14, dropping to \$450 million in FY 15. He opined that the reduction of \$150 million was not a great concern as a dollar movement in the price of oil equaled approximately \$150 million. He stated that price was traditionally forecasted conservatively by the Department of Revenue, while production had an optimistic forecast. He pointed out that both price and production for FY 14 were lower than actuals. He hoped that the forecast for FY 15 was as conservative that of FY 14. He thought it was too early to see the production/revenue increases or decreases resulting from SB 21. Revenue fell because price and production were lower. Expenditures did not decrease in response. The governor's agency operating budget was less by \$15 million. He suggested that an additional \$30 million in agency reductions would hardly make a dent in the \$2 billion shortfall.

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Representative Edgmon clarified that the \$2 billion shortfall was built around projections of price and production. He asked if the committee could view potential modifications to the curve using different prices of oil.

Mr. Teal moved to the Fiscal Outlook Model where varying oil prices could modify outcomes. He offered to provide the committee information in a month or so.

Representative Edgmon recalled discussion about shale oil and potential for the price of oil to continue to decline to \$70 per barrel.

Mr. Teal pointed out that drowning in 10 feet of water was no different than drowning in 100 feet of water.

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Representative Munoz asked about the \$2 billion shortfall. She pointed out that \$700 million of revenue loss was due to a reduction in the price of oil, while the \$500 million reduction was due to SB 21's 35 percent credit on new production. Approximately \$400 million of the reductions resulted from tax credit pay-off for Alaska's Clear and Equitable Share tax regime. She stressed that the \$2 billion difference was not tied to SB 21 and the changes in Alaska's oil tax regime.

Mr. Teal agreed and stated that Commissioner Rodell would discuss the issue further during the Department of Revenue overview.

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Co-Chair Austerman discussed next week's schedule and the conversation about Public Employees' Retirement System (PERS) and the Teacher's Retirement System (TRS).

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ADJOURNMENT

The meeting was adjourned at 2:17 p.m.