

HOUSE FINANCE COMMITTEE  
January 23, 2015  
1:32 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:32 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair  
Representative Steve Thompson, Co-Chair  
Representative Dan Saddler, Vice-Chair  
Representative Bryce Edgmon  
Representative Les Gara  
Representative Lynn Gattis  
Representative Cathy Munoz  
Representative Lance Pruitt  
Representative Tammie Wilson

MEMBERS ABSENT

Representative David Guttenberg  
Representative Scott Kawasaki

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Representative Andy Josephson; Representative Sam Kito III.

SUMMARY

^FY 16 GOVERNOR'S BUDGET OVERVIEW: OFFICE OF MANAGEMENT AND BUDGET

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, commented about the previous administration's work-in-progress budget put forward as a place holder to meet the statutory deadline. She indicated

that the budget that she was reviewing with the committee at present was Governor Walker's endorsed budget.

Ms. Pitney introduced the PowerPoint presentation "FY2016 Budget Overview (copy on file)." She first turned to slide 3: "Budget Priorities":

- Opportunity for Alaskans
- Stable Economy
- Education
- Resource Development
- Affordable Energy
- Supporting Alaskan Families

Ms. Pitney remarked that the administration wanted to gradually decrease the state budget to avoid drastically upsetting Alaska's economy. She emphasized the importance of providing quality education, encouraging resource development, working towards affordable energy, and supporting Alaska and Alaskan families.

Ms. Pitney advanced to slide 4: "Budget Guidance: Limit Spending." She stated that the direction given to the commissioners was to avoid overarching and to limit spending. The departments' immediate instructions were to look for reductions of 5 percent to 6 percent in addition to the cuts in the FY 16 work-in-progress budget. She emphasized that every agency was asked to be part of the reductions due to the state's large budget gap and stressed that no department was immune from participation. She reported that the departments were asked to focus, first, on administrative structures, limiting administration without compromising the level of service. She also encouraged agencies to look at ways to do business differently in terms of privatization and partnerships with both non-profit local governments and tribal entities. She directed departments to examine which of the state's programs were not required by law. She called for an investigation of the costs associated with statutes passed in the previous five to ten years. The departments were also asked to look at older statutes costing the state money that were either no longer necessary or no longer a priority. The analysis of the statutes would not be available until later in the session or the following year. The last piece was to involve Alaskans. The choices the state was facing would be difficult. In evaluating

potential reductions she concluded that it would be essential for the state to keep everything as transparent as possible and to understand how Alaskans would be impacted.

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Co-Chair Neuman commented that he had asked departments to look at a multi-year approach to the budget, out three to five years. He mentioned that the governor had talked about a four-year plan. He stressed that major restructuring of services within the departments was necessary in order to address budget shortfalls. He indicated the finance committee would be working throughout the year to do so, alongside the administration. He believed private partnerships would be key in reorganization efforts and in creating jobs for Alaskans. He reported that he would be working with Representative Wilson and the Department of Labor and Workforce Development (DOL) on outreach efforts to private industry regarding training programs, particularly vocational programs. He recognized municipal representatives in the audience whom the legislature would be reaching out to for their input and assistance. He encouraged a collaborative effort with all Alaskans when addressing Alaska's budget and its future.

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Ms. Pitney pointed to the chart on slide 5: "FY2016 Budget by All Funds Sources." She explained that the chart showed the overall budget and all of the state's funding sources including federal funds, other state funds, designated funds, unrestricted general funds (UGF), and the Permanent Fund. She relayed that the state's budget for FY 16 totaled \$13 billion. She commented that the FY 16 budget was remarkably close to the FY 15 budget but the size of the pie pieces in the chart were different. The major difference was a reduction of \$550 million in the UGF, an addition of \$100 million in the Permanent Fund, and an increase of \$450 million in federal funds. Another difference was the \$3.3 billion taken from the state's reserves. The state's actual revenue was \$2.2 billion. The state would be using more reserves than revenues to fund the FY 16 budget very similar to FY 15. She reported that the FY 15 estimate was \$3.5 billion or \$3.6 billion in use of reserves. The FY 15 estimate dropped the reserves down

slightly. She continued to report that the UGF was expected to go down from the current year's projection.

Ms. Pitney explained that slide 6: "FY2016 Budget by All Funds Sources," was of value in better understanding the pieces of the budget that come from federal funding sources. She reported that the Department of Transportation and Public Facilities (DOT) benefited as well as Medicaid. The "All Other" category encompassed university research, Pell grants for students, and funding for the Department of Environmental Conservation (DEC) and the DOL. She continued with the Permanent Fund slice pointing out two main components; the dividend and inflation-proofing. She also mentioned that there was a small slice for operations.

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Ms. Pitney scrolled to slide 7: "FY2016 Budget by Category All Funds." She reported that the slide showed where the funds were allocated by category. She relayed that agency nonformula made up a large portion of the budget. She detailed that funds for the capital budget were \$1.4 billion, a much smaller amount than prior years. The statewide appropriations category consisted of tax credits, debt service, and retirement funding. The "Other Formula" category was primarily for health programs. In addition, there was the K-12 formula category.

Co-Chair Neuman recognized Representative Kito's presence in the room.

Representative Wilson referred to the tax credits in slide 7. She wondered if the administration thought about the possibility of spreading out the \$700 million in tax credits rather than paying the sum in one year because of the state's current lack of revenue. Ms. Pitney relayed that the law did not provide such an opportunity.

Representative Wilson clarified that the tax credits had to be paid in one year. Ms. Pitney responded affirmatively.

Ms. Pitney continued with slide 8: "FY2016 Budget by Category All Funds." She indicated that the solid pieces of the pie showed the state funding for each component. Agency nonformula consisted of roughly half UGF and half other funds. She relayed that the K-12 formula was mostly UGF. The health formulas were comprised of two-thirds federal

and one-third state funding. Statewide appropriations (tax credits and retirement) were almost entirely UGF. She referred to the Permanent fund. She also relayed that the capital budget was composed of a very small slice of UGF and the rest was primarily federal funds. The solid pieces reflected the distribution of the state's UGF.

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Ms. Pitney scrolled to slide 9: "FY2016 UGF Budget by Category." She explained that the statewide piece accounted for approximately 21 percent of the state's UGF. The FY 16 capital budget was very small relative to previous years at 3 percent of UGF. The remainder of the UGF were divided equally between formula programs at 38 percent and agency budgets at 39 percent. The state's UGF budget for FY 16 totaled \$5.5 billion.

Ms. Pitney advanced to slide 10: "FY2016 UGF Budget by Category." She relayed that K-12 accounted for more than half of the formula programs budget. The balance of the formula programs consisted of Medicaid, other health programs, and a few other smaller items.

Ms. Pitney continued to slide 11: "FY2016 UGF Spend: \$5.55 Billion." She indicated that the graph compared overall numbers for UGF spending from FY 13 through FY 16. She reported that in FY 13 spending was at \$8 billion, down to \$7.1 billion in FY 14, and down to \$6.1 billion in FY 15. She explained that the orange bar in FY 15 was the \$3 billion transferred into the retirement program.

Representative Gara commented that there was likely a larger reduction than reflected in the slide in FY 16 than in FY 15. He continued that the state took \$3 billion from the Constitutional Budget Reserve (CBR) to pay for some of the Public Employees' Retirement System (PERS)/ Teachers' Retirement System (TRS) debt which included approximately \$700 million that would have otherwise come out of UGF; it would have been a larger budget in FY 15 had the state not paid it with CBR monies. He wanted to know if the PERS/TRS debt payment was accounted for in the FY 15 box.

Ms. Pitney responded in the negative and explained that the chart reflected the budget sheet. She pointed out that the CBR contribution to the retirement program made it possible for the FY 16 budget to have \$262 million versus what would

have been \$700 million in retirement payments. She observed that it was a reasonable decision to have transferred the \$3 billion into the retirement fund and would be of more value in the future to bring the fund up-to-date. She indicated that it was difficult to get below the work-in-progress budget because it used pension obligation bonds, a move the current administration was not willing to make. The work-in-progress budget was \$250 million lower because the department did not agree with using a pension obligation bond mechanism. The endorsed budget included a cash payment for the retirement system.

Representative Gara surmised that the budget was likely cut more than shown in the graph due to millions of dollars that normally came out of the general fund alternatively being paid out of the CBR.

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Ms. Pitney reviewed the graph on slide 12: "UGF/CBR/SBR spending by category FY2013-FY2016." She elaborated on the various components over the time frame. She pointed out that the bottom two blue bars were the agency nonformula and formula programs and reported they were relatively stable components of the budget. The lightest blue bar represented capital based on available funding. The other statewide category mainly consisted of debt. The remaining bars represented the retirement system and tax credit pieces of the budget.

Co-Chair Neuman noted a reduction in capital expenditures in the current year's budget. He asked if the department had looked at the potential loss of federally matched funds for infrastructure projects around the state, projects that created jobs.

Ms. Pitney responded that when the department looked at the first stripped-down version of the capital budget submitted on December 15, 2014 it focused on identifying anything that leveraged significant other funds. The items that were identified and remained in the budget equaled \$106 million. She relayed a conversation she had with the governor about the fact that the base capital budget was only \$100 million. In the second assessment of the budget the few items that had federal funding or other match possibilities that had been removed from the budget were restored. The second round concentrated on maximizing the leverage

capacity in the capital budget. She offered that there was an insignificant amount the state would lose in federal matches.

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Co-Chair Neuman surmised that as operating expenditures decreased so would the number of state jobs resulting in less money to support the economy and more unemployment. He furthered that the economy would be greatly affected. He emphasized making sure projects were in play that would provide jobs and help fuel the economy well into the future. He posed the question, "How do we reduce this budget without collapsing our economy. Our economy is jobs?" He wanted to see what type of plan the administration had going forward. He asked Ms. Pitney for her comments.

Ms. Pitney acknowledged Co-Chair Neuman's comments and would provide the committee with the plan.

Representative Wilson asked if the governor would be looking at any other project that might be reinserted that did not have a federal match. If so, she inquired about the criteria.

Ms. Pitney responded that within the \$150 million there were a few projects that were reinserted that did not have federal matches, but had significant returns on investment. She commented that the projects were mainly energy and weatherization related as well as a few in the priority areas for teacher housing and other rural housing loan programs. Also, there were projects partially completed through the engineering phase that needed finishing and, there were deferred maintenance projects. She reported a much smaller investment was needed in deferred maintenance than in prior years. She suggested moving forward with it to avoid greater costs in the future.

Representative Gara mentioned that the legislature had passed a renewable energy fund bill with a non-binding commitment of \$50 million per year that would be deposited into the fund. The money would be used for building renewable energy projects across the state. He commented that Governor Parnell recognized that the state had a fiscal problem and reduced the fund from \$50 million to \$17 million in his place-holder operating budget. He asked if

the funds remained in the budget or if the state was ending the renewable energy fund.

Ms. Pitney responded that there was \$15 million in the budget for the renewable energy fund.

Representative Gara asked if the funds were in the operating budget or the capital budget. Ms. Pitney stated that the funds were capitalized in the operating budget and spent in the capital budget. She responded, "both."

Representative Gara commented that he did not think the committee had ever heard such an answer before.

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Ms. Pitney revealed slide 13: "All Agencies Contributing." She described the funding reductions for each agency between the FY 15 management plan and the endorsed budget. She reported that Judiciary [Alaska Court System] was virtually unchanged with the exception of a reduction level in the work-in-progress version of almost 3 percent. She continued that the governor's 30 percent decrement on the slide included the reductions of the one-time items for elections. It also included a reduction in domestic violence funding from \$3 million to \$1.5 million. The \$11 million reduction that Governor Walker previously spoke about had to do with his immediate office; operating expenditures for the Office of the Governor had been reduced by 11 percent.

Co-Chair Neuman clarified that it did not include the cost of elections. Ms. Pitney responded that the Division of Elections was in a separate office. The election's amount in FY 15 was inflated because it had been an election year. The governor's 30 percent reflected the election cost reductions.

Co-Chair Neuman restated that the reduction of 30 percent in the governor's agency budget was due to the fact that in FY 16 there would not be an election. Ms. Pitney responded affirmatively.

Representative Wilson stated that the governor had talked about removing \$25 million in education funding. She mentioned that she was the chair of the University of Alaska Finance Subcommittee. She stated that the reduction

percentage of the university's budget was not equal to that of the education budget. She opined that it did not appear that the percentage was taken out of the University of Alaska budget. She wanted to know why the state would take out more for education than for the university. She wondered if the governor intended to take out additional monies.

Ms. Pitney replied that there were three criteria. The first criteria had to do with how much an agency's budget had already been increased or decreased in previous years. The university took a \$16 million reduction in the prior year. The second criteria had to do with the elimination of the fuel trigger mechanism. The DOT and the University of Alaska were most affected by the change. The third criteria had to do with the areas the state most depended on for revenue. The Department of Natural Resources (DNR) was most likely to bring in revenue to the state helping to alleviate the state's fiscal crisis.

Representative Wilson wanted to better understand the third criteria. She emphasized that the development of Alaska's children should be the most important criteria. She was clear about the importance of developing the state's resources through DNR. However, she returned to education in comparison to the University of Alaska. Education could not raise the same kinds of funds as the university. She asked Ms. Pitney to speak to her concerns.

Ms. Pitney suggested that there were two components of education: the nonformula component and the formula component. The nonformula component was comprised of funding for the Department of Education and Early Development's (DEED) administration, the small grant programs, and Mount Edgecombe. The nonformula component had gone up significantly. The reductions reflected in the slide were the DEED programs outside of the K-12 formula.

Representative Wilson reported that the previous night the \$25 million was formula money, not nonformula money. She clarified that her question was about the \$25 million in the formula affecting direct education. She posed the question about what funding was more important; the university's budget or the formula funding for education. She was mostly concerned that the \$25 million came from the formula.

Ms. Pitney replied that the formula reduction was a 2.5 percent reduction in spending; it was not represented in the chart on slide 13. She emphasized the chart reflected only nonformula components. The 2.5 percent would fall between the DNR and the Department of Public Safety (DPS) if the formula had been represented on the chart.

Representative Wilson commented that education was being hit twice with two different types of cuts. She was still trying to understand.

Representative Munoz referred to the budget summaries in which there was a \$1.35 billion FY 15 Management Plan. It showed a \$91 million or a 6.8 percent reduction. She asked Ms. Pitney to explain the decrease.

Ms. Pitney recalled that she talked about the \$15 million energy fund monies being capitalized in one budget [operating] and landing in another budget [capital]. She indicated that the 6.8 percent had to do with the forward funding of education. The governor talked about a 10 percent reduction in the forward funding. She referred back to the FY 15 management plan. She explained that the \$1.3 billion included the \$90 million one-time funding.

Representative Munoz maintained that the one-time funding was approximately \$40 million for a period of three years

Ms. Pitney clarified that the one-time funding of \$90 million all in the FY 15 budget included \$40 million for FY 15, \$32 million for FY 16, and \$19 million for FY 17.

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Representative Munoz asked if two of the three years of one-time funding had been removed.

Ms. Pitney confirmed that two of the three years were taken out of the budget. She also explained that additionally the difference between forward funding education at 90 percent and 100 percent was removed.

Representative Munoz summarized that two years of one-time funding plus 10 percent of money that was already appropriated for forward funding was being removed from the budget.

Ms. Pitney corrected Representative Munoz's interpretation by clarifying that the state was taking the two years of forward funding outside the formula funding and then only forward funding 90 percent. She added that some options would be to forward fund at 100 percent, 50 percent, or not at all. If the state did not forward fund in the current year then the entire amount would have to be paid in the following year. The administration wanted to act prudently by forward funding most of the funds.

Representative Munoz asked if the state was taking 10 percent of the money away from what was forward funded for the current year.

Ms. Pitney responded that the state was forward funding again for the next year. She explained that forward funding for FY 16 adjusted for student numbers was left in the budget. The state was forward funding again for FY 17 at 90 percent.

Co-Chair Neuman interjected that normally the state forward funded education so that the education community knew its level of funding for the following year. The legislature allocated \$1.2 billion into the education fund. He recollected that the policy was implemented through legislation introduced by former Representative John Harris. He clarified that the governor wanted to fund at 90 percent which he estimated to be \$100 million to \$120 million less than at 100 percent.

Representative Munoz asked if the state was taking 10 percent less in FY 18.

Co-Chair Neuman indicated that the state would be forward funding 10 percent less in FY 17 than was funded in FY 16.

Representative Pruitt stated that by forward funding education at only 90 percent the state was placing a burden on itself in the following year. He stressed his concern with the state posing additional pressure on itself by slowly scaling back on forward funding education. He wondered about reductions to the percentage of funding into the future. He reemphasized his concern.

Ms. Pitney explained that the 90 percent forward funding was the amount being deposited into the bank for a year or

two. Co-Chair Neuman asked if the state made interest on the money.

Ms. Pitney responded that the money was in the short-term investment strategies.

Co-Chair Neuman commented that some of the 10 percent was made up in interest.

Ms. Pitney anticipated that there would be some interest earnings depending on the investment strategies. Her understanding was that the forward funding dollars would be placed into short-term investments. The legislature would determine at what level education for FY 17 should be funded once it received a report, anticipated in the summer of 2015, regarding the K-12 formula studies. She conveyed that the 90 percent funding monies were being placed in a separate account similar to a savings account. The state had the CBR, statutory budget reserves (SBR), and the education fund. Where the formula funding dollars were deposited did not dictate the education funding for FY 17. Simply put, it determined how much money would be placed in one bank account versus another.

Representative Pruitt opined that assumptions were being made about the formula and about how much the state intended to spend on education in the future. He thought the state was being presumptuous due to the fact that the legislature had not had the opportunity to discuss the formula and the next step. He reiterated his concern and hesitation about making assumptions about education and its funding.

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Representative Gara observed that the state had done a three-year education plan with nonformula funding of approximately \$42.9 million in FY 15, \$32.2 million in FY 16, and reduced by another \$12 million in FY 17. He asked if any of the \$32.2 million outside the base student allocation (BSA) monies designated for the FY 16 school year were going to be cut.

Ms. Pitney confirmed that all of the funding outside of the BSA was cut from the budget for FY 16.

Co-Chair Neuman clarified that all nonformula funding outside the BSA for year two and three would be reduced. Ms. Pitney responded affirmatively.

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Ms. Pitney turned to slide 14: "FY2016 Capital Budget." She explained that the slide summarized all of the funding in the capital budget. She reported that the majority of federal match and leverage capacity funds were primarily for the DOT and a small portion was for the DEC. She reported that after reappropriations for energy, weatherization, and housing projects \$15 million was left in UGF which would be used for the renewable energy fund. There was a small amount in maintenance and project completions. She reported that there were two reappropriations as part of the capital budget. The first reappropriation was \$22 million from Aerospace and the second was from the Mount Spurr geothermal project, a project that has ceased moving forward.

Co-Chair Neuman asked how much money was left in the account [for the Mount Spur Geothermal Project]. Ms. Pitney estimated \$12.5 million but indicated it could be more. Co-Chair Neuman asked if it was out of \$40 million or \$42 million.

Ms. Pitney commented that she thought it was out of \$25 million. She agreed to provide the committee with the correct figures. She continued to the category of safe communities in which two programs were funded through felon funds. Lastly, there was a small amount of funding for the U.S. chairmanship in Arctic Policy.

Representative Munoz asked about the \$15 million reappropriated to the renewable energy fund. She wanted to know if the reappropriation affected any projects currently underway or if the funds were excess monies from projects already completed.

Ms. Pitney responded that the only reappropriation from energy monies came from the Mount Spurr geothermal project.

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Ms. Pitney advanced to slide 15: "UGF Revenue Scenarios: FY 14 to FY 19 (return to \$100 oil)." She indicated that she

was going to provide three scenarios, the first of which was the most optimistic. In reviewing the graph she explained that the vertical bars depicted the UGF spending over the previous three years. The black line represented the state's tax revenue based on the current forecast from the Department of Revenue (DOR) that reflected a return to an oil price of \$100 per barrel. She proposed that even if oil prices returned to such a level the state would need to continue to size down.

Ms. Pitney scrolled to slide 16: "Reserves Projection at Forecast." She suggested that the state's savings would last through FY 22. In FY 22 there would be close to \$1 billion in the bank. The chart did not adjust for coming down 25 percent.

Ms. Pitney reviewed the next case scenario in slide 17: "UGF Revenue Scenarios: FY 14 to FY 19 (return to \$85 oil)." She indicated that the second example was more moderate. If the price of oil returned to \$85 per barrel it would satisfy 65 percent of the state's current spending.

Ms. Pitney turned to slide 18: "Reserves Projection at \$85 oil." She reported that at \$85 per barrel of oil the state's savings would last through the end of FY 18.

Ms. Pitney advanced to slide 19: "UGF Revenue Scenarios: FY 14 to FY 19 (\$50 oil)." She stated that the current oil price of \$50 per barrel was less than 40 percent of the state's spending level.

Ms. Pitney revealed slide 20: "Reserves Projection at \$50 oil." She reported that at the end of FY 17 the state would only have \$2 billion in reserves which would provide some bridging into FY 18.

Co-Chair Neuman observed that to be prudent the state would need to look more towards the conservative side of the price of oil. If the price of oil per barrel went up above \$50 that would be beneficial for state government. However, he was more concerned about the level of spending at which the state could afford to provide programs and services. He noted meeting state mandates, the state's current savings amount, and current oil projections. He opined that the governor was clear that everything would be on the table when looking at the presentation. If the state did not expect to have a gas project online before FY 22 or FY 24,

serious budget restraints would have to be imposed. He proposed that the state look to private industry where it could. Governor Walker talked about speaking with educators and doing the very best with the resources the state had.

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Vice-Chair Saddler asked if the governor had a floor for draws on reserves under any price scenario.

Ms. Pitney reported that a floor had not been set. The administration wanted to see the forecast hold true and have five years. However, she informed the committee that the state had to have a contingency in place in the event that the price of oil stayed at \$50 per barrel. The reality was that the price of oil was not very well correlated with the cost of services in Alaska. She offered that the state had to switch from a conversation about what price of oil supported the state's budget to what size government was right for Alaska. She alluded that the next slide in her presentation would address the question.

Co-Chair Neuman mentioned that early in the day he received news of a company new to Alaska investing up to \$1.2 billion to produce a considerable amount of additional oil into the Trans-Alaska pipeline. The price of oil was decreasing while more oil would be coming into the pipeline. He hoped to receive the best outlook on what the state had as far as investments. He also mentioned having a discussion on credits to see if they were working.

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Representative Edgmon pointed out that after hearing presentations from the Legislative Finance Division and from the Office of Management and Budget it was necessary to not only apply restraint on state spending, but to also apply limitations on cutting. He used the revenue sharing program as an example. He suggested that if revenue sharing was cut by 100 percent in one year the state would potentially incur more costs and problems than anticipated. He indicated he was not directly advocating for one particular program. He wondered if the Walker Administration had had the opportunity to talk to any of the bond rating agencies about balancing cuts and preserving programs that would continue the health of communities. He opined that it may help the state to better

transition to the point where the state had additional revenues or the state could downsize its spending at a more even decent.

Ms. Pitney addressed Representative Edgmon's bond rating question. She reported that the bond raters were concerned with the state's structural deficit of having only one source of revenue. They were also concerned with the sheer magnitude of the difference between the state's revenue stream and its expenditures. She indicated that they would be looking for a balance in the state's choices and actions regarding revenue and spending. In response to Representative Edgmon's comments regarding municipal revenue sharing she reported that it was a forward funding item similar to education. It ran on a three-year average of what was capitalized in the fund. All things being equal without capitalizing the fund in the current year \$57 million was available for the community revenue sharing program in FY 16. She estimated that in FY 17 the three-year average would be about \$38 million. The administration wanted to see revenue sharing funding at a higher level of \$50 million in FY 17. She was not sure if the state would have to change the three-year average stipulation or would have to add additional monies to the \$38 million figure. She mentioned that if the revenue sharing portion for FY 17 was \$38 million there would still be \$78 million in the revenue sharing fund going into the following year. The question about revenue sharing was advanced forward several years sooner than anticipated. She stressed that the governor and the administration were very supportive of local government and did not want to put municipalities at risk. She reiterated the numbers; \$57 million in FY 16, \$50 million in FY 17, with \$78 million remaining in the fund [Note: \$12 million added from capital to bring FY 17 up to \$50 million from \$38 million]. She hoped the circumstances would change after FY 17 such that oil prices would recover and enable the state to catch up financially. She was hoping the situation would change in time.

Representative Edgmon appreciated Ms. Pitney's explanation and the longer term vision she presented. If, hypothetically, the state reduced the municipal revenue sharing down to zero within a one-year period of time, villages in his district such as Koliganek or New Stuyahok would not have anyone in the city offices. He made it clear that it would be counter-productive.

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Ms. Pitney asserted the importance of preserving strong communities around the state. She maintained that it would take the state making conscious choices on how to manage its budget to avoid negatively impacting the smaller communities.

Co-Chair Neuman indicated that his office has had discussions with several departments about how important schools were to their community. He furthered that community activities ranging from funerals to basketball games took place in schools. He wanted to make sure schools continued to be central to their communities. He has had discussions across the board with multiple departments to ensure protecting Alaska's communities in the best way possible.

Ms. Pitney advanced to slide 21: "What's in an Alaska Budget?" She commented that there was a vast disconnect in valuing government based on oil prices. She admitted that although she knew a lot about the university, there were many things the state did that she was not aware of prior to being in her position. She relayed that there were 128 thousand students in K-12 schools, 500 schools, and 53 school districts around the state. She remarked that the breadth of what the state did and what the state depended on government to do was vast. She observed that Alaska had the largest airport system and the largest marine highway system in the world. She had considered how to rationally approach determining how much the state should spend on government. She stated that she would introduce two different approaches.

Co-Chair Neuman recognized Representative Andy Josephson in the audience.

Ms. Pitney scrolled to slide 22: "Average Total State Expenditures." She suggested that if the state looked at its population and it's spending relative to all of the other states in the country, the expected spending for Alaska would equal about \$5.3 billion. If the states with the largest expenditures (California, Florida, Texas, and New York) were removed from the calculation of the national average, then Alaska's projected spending would be about \$4.8 billion. She elaborated that the numbers did not account for Alaska having the largest airport system or the

largest marine highway system. Nor did it account for any cost of living adjustments or geographic adjustments. She reiterated that the predicted spending for Alaska based on the national average fell between \$4.8 billion to \$5.3 billion. She opined that the numbers differed drastically from the state's \$2.2 billion revenue stream on \$50 per barrel oil. She provided the information on the slide to give context.

Co-Chair Neuman interjected that the Legislative Finance Division provided information the previous year that reported the state was down to about \$7,200 per person.

Ms. Pitney added that the number included the Permanent Fund that she assumed the \$5.3 billion did not count the Permanent Fund.

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Ms. Pitney turned to slide 23: "Inflation and Population Adjustment Approach." She stated that there was another approach to determining the size of government in Alaska. She reported that in comparing the current operating budget adjusted for both inflation and population to those in the 1980s not much had changed. In looking at agency operations in 1998 at a time when Alaska's government operation costs were the leanest, the state's budget figures would be about \$3.2 billion if adjusted only for inflation. The figure would jump to \$4 billion if a population adjustment was added. The state's current proposed budget was \$4.26 billion, not remarkably far from the comparison and with a revenue stream of about \$2 billion at \$50 per barrel oil prices.

Co-Chair Neuman commented that in 1998 oil production was at 2 million barrels of oil per day.

Ms. Pitney concurred. She suggested that the question was not how Alaska's government should size into \$50 per barrel oil. Rather, the question should be what size government should Alaska have and then manage revenue accordingly. She maintained that the administration planned to attain additional revenues through resource development.

Ms. Pitney continued with slide 24: "UGF Revenue Scenarios and FY 16 Spend by Category." She explained the vertical bars on the chart. The orange bar [Titled:-25 percent below

FY 15] reflected a 25 percent reduction from the FY 15 budget in agency operations leaving a very small capital budget and the statewide components the state is obligated to pay. The light blue vertical bar [Titled: FY2016 UGF] indicated the current budget proposed with 6.5 percent agency reductions. The vertical bar with two colors of blue [Titled: FY16 Agency Ops] represented agencies, shown in dark blue, plus formula programs, shown in light blue. She offered that the difference between the FY2016 UGF bar and the FY16 Agency Ops bar was capital and statewide operations. The dark blue vertical bar [Titled: Nonformula] represented agencies, none of the formula programs. She proceeded to explain the horizontal bars included in the chart. The purple bar indicated revenue at the \$50 per barrel of oil price. The green horizontal bar was revenue at \$66 per barrel of oil, the price used for forecasting for FY 16. The last line, delineated in black, represented revenue if the price of oil per barrel returned to \$100. She relayed that even with a 25 percent reduction in the budget the state would be dependent on some level of savings even if oil reached a price of \$100 per barrel. She maintained that the discussion needed to be about the desired size of government necessary to serve Alaska.

Ms. Pitney concluded her presentation by referring to the additional handouts which included a summary of the total budget, a summary of the capital budget, and the project detail of the capital budget. She reported that she would be forwarding department details to the Legislative Finance Division within two weeks.

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Representative Gara expressed his concern about the cuts to education. He conveyed several reports from school districts in Mat-Su, Anchorage, Juneau, and Fairbanks about the impacts they face from the cuts in FY 15. The Mat-Su expected an approximate \$3 million shortfall. The Fairbanks Parent-Teacher Association estimated a loss of 35 to 70 staff members. Anchorage estimated a loss of 210 to 220 staff. He opined that the proposed reduction of \$32 million for FY 16 would result in even greater cuts. He commented that with the new administration there probably had not been time to properly comb through the agencies to find duplication. He wondered if Ms. Pitney would be willing to speak with the school districts prior to the amended budget

deadline of February 18, 2015 to try to avoid more cuts to education.

Ms. Pitney maintained that there were deep cuts everywhere in the budget. The reductions totaled \$140 million or 6.5 percent of the budget. She agreed that education was of value and a priority. She reported that the education portion of the budget was reduced to a lesser degree than in other areas and that she was open to working with the school districts. She pointed out that the state had to cut back and that all entities would have to be part of the downsizing.

Representative Gara reemphasized working with the school districts.

Vice-Chair Saddler wanted to hear that the administration planned to retain enough money in reserves for the AKLNG project. He opined that the state needed to put some money on the table for the project. He wanted her to make the assertion that the administration was going to maintain the ability of the government to pay for the project if and when the time came to make the investment.

Ms. Pitney reported that the gas pipeline was a very high priority. She stated that the funding model might be different from a GF cash model. However, she stressed that enabling the gasline to move forward was front and center of the administration's agenda. Resource development was the way in which the state could depend on a revenue source. She restated that it was the highest priority and that the administration would be looking for ways in which to fund the project outside of just a cash mechanism to move it forward. The revenue potential should make its feasibility possible.

Vice-Chair Saddler asked about the governor's number one priority. Ms. Pitney responded that the gasline project held the highest potential to increase state revenue. She furthered that other questions would become less pressing if the state increased its revenue with gasline development.

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Representative Pruitt asked about tax credits. He asked if Ms. Pitney could provide information detailing when the

credits would run their course. He wanted to know how much remained outstanding and if new credits were being added. He wondered about any outstanding credits under Alaska's Clear and Equitable Share (ACES).

Ms. Pitney relayed that she did not have any specifics but suggested over the following few years the projection was that the credits would come down. There were some sunset provisions at which time certain credits would drop off after FY 16. She asserted that Commissioner Hoffbeck would be speaking to the committee in the following week and would be able to answer Representative Pruitt's question. She signified that she would make sure the commissioner was prepared to answer the question.

Co-Chair Neuman assured the committee the question had already been forwarded to the commissioner. He added that the DNR finance subcommittee would be looking further at tax credits. He would be looking for answers to what drove the tax credits from 35 percent to 45 percent for two years.

Representative Munoz asked if the budget included additional monies for staffing for Medicaid expansion within the Department of Health and Social Services (DHSS). Ms. Pitney responded that there would be a reallocation of staffing. In looking at the proposed budget the DHSS was downsizing dramatically with program changes. If the Medicaid expansion passed, staffing would be paid with federal funds at 100 percent for the first year until December 2016. The funding would step down to 90 percent funded over four years. She intimated that it was a shift.

Representative Munoz asked about the number of staff needed to implement the expansion of the Medicaid program. Ms. Pitney did not have the immediate number but would provide it to the committee. She reported that there would be significant information sessions on Medicaid expansion.

Co-Chair Thompson referenced the governor's speech from the previous evening and asked about holding small community members harmless from retirement system penalties. He stated that currently, termination studies were required if an employee was terminated. He remarked that the studies were costly. He asked if the state would incur additional costs if municipalities were held harmless from the 22 percent requirement to carry a terminated employee. Ms.

Pitney responded that she was working on determining an answer.

Representative Wilson referred to slide 21 and estimated that (excluding K-12 students) 1 in 41 Alaskans were in custody or offenders. She opined that it was a high number. She gave another example related to state university and K-12 employees. She also observed that 1 out of 4 Alaskans were currently Medicaid beneficiaries. She gave additional examples and concluded that the state's budget was driven by circumstances that she felt were not being addressed. She suggested that privatizing the ownership of state land or developing the land could generate additional revenues.

Co-Chair Neuman responded to Representative Wilson's comments that he would be looking forward to upcoming legislation. Representative Wilson confirmed she would look into his suggestion.

Vice-Chair Saddler asked Ms. Pitney if she had seen anything seriously alarming about the state's budget or anything that had encouraged or disheartened her since taking on her current position. He wanted her to describe the best and the worst that she had seen.

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Ms. Pitney suggested that rather than being alarmed she was presented with the realization of the interrelationship between public defenders, the court system, troopers, corrections, and prosecutors. If a change was made in one area, there would be a trickle effect, potentially a dramatic one, in the other areas. For example, a court case that had to be tried within a certain amount of time activated so many other things into motion. The interplay between the agencies, her example in particular, and the cost drivers in one area and how they affected other areas contributed to her "ah ha" moments since she started her new position.

Vice-Chair Saddler asked if it was an, "ah ha!" or an "oh no!" Ms. Pitney responded, "yes!"

Representative Edgmon commented that from where he sat it seemed legislators would be back at the table in the following year making additional reductions and grappling with the same issues that they were faced with in the

moment. They would be making attempts to keep things viable in the short-term as well as in the long-term for the State of Alaska. He inquired if the administration had contemplated getting statewide feedback. He asked this because cutting the budget was the hardest thing to do in the legislature. He continued that it would be difficult anywhere including within the administration as well as within the legislature. He opined that to make cuts properly an understanding of the value of programs was essential. Understanding what was happening at the community level, the regional level, and the statewide level was important. He argued that it was very difficult to do in a 90-day session as the body that appropriates. He maintained that it would be challenging for legislators to dig into the state programs and services and to make judgments as to the true impacts of the program cuts. He asked if the governor discussed having some sort of statewide forum or partnering with other Alaskans to make the difficult choices.

Ms. Pitney relayed that some of the first phone calls she made upon starting her position were to entities that she knew communicated with larger audiences regarding the state's fiscal situation. She mentioned Commonwealth North and Common Ground, two social and economic research groups. The administration's plan was to begin engaging Alaskans for ideas. There was a website created to engage Alaskans for ideas. She emphasized that everyone involved in public policy needed to take the time to educate the broader public regarding the situation the state was in and the choices it was faced with. She opined that until the wide audience understood the sheer magnitude of the state's fiscal issue, Alaskans would have a difficult time accepting the cuts or revenue opportunity. Currently, she was uncertain if the larger public understood the cuts that were required. The current reduction would be significant across every entity and every service. She reminded the committee that this was only the first step, less than a quarter of a 25 percent targeted reduction. There were things the state would have to choose not to cut. The administration's preference was to choose the things that were of lower value. However, she claimed that everything that state government did had a value to someone. She said that the state would have conversations, whether in a forum or an Alaska summit. She acknowledged that the task would be hers after session. The governor and lieutenant governor would be helping. During session she would also be doing

some of it. She indicated that the task could not be up to just one person. She expressed her appreciation of Cliff Grove of Common Ground for coming up with an application, Common Wealth North for providing its fiscal policy studies, and the transition team for its help communicating with communities. Educating the state would be a huge priority and did not rest in one place. However, she stressed that the administration would play a huge role in it.

Co-Chair Neuman remarked to Representative Edgmon about having the discussion previously. He expressed that it was crucial that all of the finance legislators tell the state's story to the public about its budget circumstances. He remarked that Representative Munoz suggested sending committee members out to communities to relay the budget process. He commented about partnering with the public in creating a better understanding of what the state was facing. He stressed that the bottom line was that the state could not spend money that it did not have.

Co-Chair Neuman discussed the agenda for the following meeting.

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ADJOURNMENT

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The meeting was adjourned at 2:57 p.m.