

HOUSE FINANCE COMMITTEE  
FIRST SPECIAL SESSION  
May 8, 2015  
1:08 p.m.

[NOTE: Meeting was held in Anchorage, Alaska at the  
Legislative Information Office]

1:08:33 PM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee  
meeting to order at 1:08 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division; Sheldon  
Fisher, Commissioner, Department of Administration; Senator  
Cathy Giessel; Representative Andy Josephson;  
Representative Liz Vasquez; Representative Sam Kito III;  
Representative Harriet Drummond.

PRESENT VIA TELECONFERENCE

Representative Bryce Edgmon  
Representative David Guttenberg

SUMMARY

HB 1001 APPROP: OPER. BUDGET/LOANS/FUNDS/AM APPRO

HB 1001 was HEARD and HELD in committee for further consideration.

Co-Chair Neuman reviewed the agenda for the day. He relayed that Mr. Teal would be discussing the state's revenue and financial situation. He also let the committee know that Commissioner Fischer of the Department of Administration would be reviewing some information concerning union contracts.

#hb1001

HOUSE BILL NO. 1001

"An Act making appropriations for the operating and loan program expenses of state government and for certain programs, capitalizing funds, making reappropriations, making capital appropriations, and making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund; and providing for an effective date."

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Co-Chair Neuman recognized Senator Giessel and Representative Josephson in the audience.

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION (LFD), directed the committee's attention to the provided handout. He began his presentation with slide 1. He pointed the top chart showing unrestricted general fund (UGF) revenue and expenditures. The expenditure line [Budget] was depicted in red. It decreased from FY 14 to FY 17 and remained flat afterwards. He suggested that the spreadsheet was changeable; expenditure assumptions could be adjusted up or down. The baseline was shown on the slide. He continued to explain that the blue line represented the Department of Revenue (DOR) fall revenue forecast. He pointed out the gap between expenditures and revenue, referred to as the fiscal gap or the deficit. The deficit was close to \$4 billion in FY 15 and over \$3 billion or \$3.2 billion in FY 16. The deficit simply meant the state spent more money than there was revenue resulting in depleted reserves as shown in the lower graph on the slide. The Constitutional Budget Reserve (CBR) was shown in blue and the statutory Budget Reserve (SBR) in red. The SBR was expected to be depleted entirely

in the amount of \$2.8 billion in FY 15. In addition the state would be using some of the CBR balance. The CBR balance by the end of FY 15 would be about \$9.2 billion. Each year there was a deficit the reserves went down.

Mr. Teal continued that many people looked at the graph as if there was not a problem because reserves extended out until 2025. The state's fiscal problem became evident if the fall forecast for revenue was changed. He suggested looking at the spring forecast.

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Co-Chair Neuman welcomed Representative Vasquez to the meeting. He asked Mr. Teal to refer to the top chart pointing out the increase in revenue. He wondered about the price of oil per barrel assuming production of 500 thousand barrels per day.

Mr. Teal stated that production was currently about 500 barrels of oil per day but was falling. He referred to the third LFD chart in member packets (copy on file). He indicated that the chart showed the price of oil reflecting the spring revenue forecast. He surmised that part of the problem was that in looking at the fall versus the spring forecasts the fall forecast was higher. There was not a great deal of difference over several years. However, in the near future there was \$1 billion or more of a difference. The actual price of revenue was predicted to go from the low to mid \$60s for the forecast for FY 16, rapidly recovering and climbing higher than any prices Alaska had experienced previously. Looking at the graphs again where the fall forecast showed reserves declining and comparing it to the spring forecast that showed a minor change, adding them together resulted in the reserves no longer lasting beyond 2025; they would be gone by 2022. The prices in the forecast were at higher levels that Alaska had seen.

Co-Chair Neuman acknowledged Representative Kito III in the audience.

Vice-Chair Saddler asked about DOR's revenue forecast and the outlook for production for the following 4 years. He wondered if the department's numbers were known, proven, or probable.

Mr. Teal stated that DOR changed its forecasting methodology. The department used to be criticized for overestimating production and at the same time underestimating pricing. The result was that the production and price estimates canceled each other out. The overall forecasts were fairly accurate. However, DOR changed its forecasting practice 3 years previously. The forecast included known numbers and different probabilities for future production, depending on where producers were in their process. If they were making investments towards production it indicated high probability. If the producers simply found oil it did not factor into the forecast as heavily. The Department of Revenue did adjust for the probability of future developed fields.

Vice-Chair Saddler suggested that some people would say that every forecast was wrong. He understood that a person could not predict the future exactly. He asked if the forecasting was more accurate than in the past 10 to 20 years.

Mr. Teal believed the production forecasts were more accurate. Production was on the constant decline. He pointed to production figures on a page (copy not on file). He indicated that current production was about 500 [thousand barrels per day] and was anticipated to drop to 400 and below in the near future. He explained that even with high oil prices, the production decline caused total revenue to be lower than in other years with similar prices.

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Representative Gara stated that he did not want to engage in a debate about prior oil taxes. However, he was realistic about having to discuss ways to raise revenue including oil or other proposals. He wondered whether the chart seemed to show that at high prices (\$110 or \$120 per barrel of oil) the state used to be able to generate a surplus. He suggested that under SB 21 [Oil and gas production tax legislation which passed in 2013] at high prices the state was not able to generate surplus. He asked Mr. Teal to share his views on the subject.

Co-Chair Neuman remarked that Representative Gara was digressing away from the legislation before the committee.

Representative Gara was not trying to go backwards but forwards into the future. He mentioned firing every Juneau employee and still not being able to fund the budget. He emphasized the need to do something.

Mr. Teal indicated that from his perspective the oil tax structure currently generated more revenue than under Alaska's Clear and Equitable Share (ACES). It was more a philosophical or a political argument rather than a technical argument. Some people looked at the situation and said that high prices revenue remained low. It primarily had to do with the loss of production because the price of oil did not matter if there was not any to sell. He concluded that no matter what the tax was, the difference was between the tax mechanisms that change from one price to another.

Co-Chair Neuman redirected the committee to focus on the current legislation.

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Representative Gara remarked that it was an issue that would have to be addressed.

Co-Chair Neuman responded that the topic was the state's current fiscal situation.

Representative Gattis summarized Mr. Teal's previous statement. She thought he stated that with current prices the state was getting more for its oil than it would have without SB 21. She really wanted to be clear because of the current reality; the state had low oil prices and a budget the legislature was trying to balance.

Co-Chair Neuman acknowledged Senator Donnie Olson in the audience.

Vice-Chair Saddler referred to the second chart on the first page, "Budget Reserves by CBR and SBR." He asked Mr. Teal to differentiate the CBR from the SBR including their origins and balances.

Mr. Teal explained that the SBR was established prior to 1990. It was established in recognition of the fact that the state's primary source of revenue was oil and that it had a volatile revenue source. Prices were volatile and

therefore the revenue was volatile. In order for government to function reserves were needed. The state began setting aside money in the SBR. In 1991 there was a constitutional amendment creating the CBR fund. At the time the balance of the SBR was transferred into the CBR. The big difference was that the SBR was available to spend at any time at any amount with a simple majority vote. The Constitutional Budget Reserve required a super majority vote of three-quarters in each house in order to access it. Access was also possible with a simple majority under certain conditions; those conditions had not been met since 1990 when it was established.

Vice-Chair Saddler relayed the information that he was providing to his constituents. He discussed how the funds were specifically set up by the legislature and the people to provide savings that the state could draw on to pay the expenses of government when day-to-day oil income was no longer sufficient, a situation that the state currently faced. He asked if the CBR and SBR were established for the reasons he cited.

Mr. Teal acknowledged that Representative Saddler's was a fair assessment. He added that there were two reasons for having reserves. The first was to cushion short-term volatility such as with a short-term decline in oil prices accompanied by overestimated revenues in a given year. The reserves would be available as a shock absorber when forecasts were off. The second reason had to do with a prolonged shortage of revenue. The reserves would then be used as a long-term shock absorber. The reserves were never meant to be large enough to address a structural deficit. He clarified that a structural deficit was defined as a long-term deficit. The reserves were really established to address revenues below expenditures. However, when the state had excess revenues money would be added back into the reserves. He mentioned the difficulty of cutting positions and programs and trying to reestablish them when revenues recovered, hence the reserves. He reiterated that it was meant for bouncing the expenditure line around. It was a different issue when the state was constantly below the expenditure line.

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Vice-Chair Saddler commented that many people often thought that the legislature spent money and did not pay it back.

He asked for a brief history about how well the CBR was repaid for previous draws.

Mr. Teal responded that whenever money was removed from the CBR it implemented a section of the constitution that was referred to as a "sweep." Whenever the state took money from the CBR, the general funds and all sub funds were swept at the end of each year into the CBR to replenish the fund. The fund reached a higher balance in 2013. The state had reserves of about \$16 million in FY 14. However, the state had massive deficits burning the reserves quickly. As long as there was a gap in the budget the state would continue burning the reserves. In the end, once the reserves were gone and the deficits remained ongoing, there was no choice but to reduce expenditures all the way down to revenue levels or generate new revenues.

Representative Wilson understood the vote of 21 to access the SBR and that the account would be exhausted at the end of FY 15. She also understood that it took a three-quarter vote to access the CBR. She wondered if there was any provision in the constitution that anticipated a decline in oil production excluding price. She asked if any other savings accounts were instituted other than the SBR and CBR that could be accessed if needed.

Mr. Teal stated that the first of the accounts was the Permanent Fund. The Permanent Fund structure did not allow the fund's principal to be spent. However, the earnings of the fund were designed for use when oil revenues tapered off to the point that it no longer supported government. The expectation was that the state would begin using the Permanent Fund earnings. The state did not have any other large savings accounts unless endowments were included (e.g. Power Cost Equalization (PCE) fund). Co-Chair Neuman remarked that the PCE fund had a balance of approximately \$1 billion. Mr. Teal confirmed Co-Chair Neuman's figure. He also considered the Alaska Higher Education Investment Fund to be an endowment; the fund had a balance of about \$460 million. The last fund he looked at as an endowment was the Public School Trust Fund, which had about \$1.2 billion until it was emptied in the current budget cycle. He reported that there were no other funds that remotely approached balances of more than \$100 million or more.

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Representative Wilson wanted clarity regarding the Permanent Fund. She understood that the Permanent Fund basically had two pots of money, one from which dividends were paid and one containing earnings. She wondered if she was accurate. She wanted to confirm whether there were additional assurances put into place when the constitution was formulated.

Mr. Teal explained that the Permanent Fund had two accounts: the corpus account and the earnings reserve account. The corpus could not be touched as outlined in Alaska's constitution and the earnings reserve account held all of the earnings of the principle and the earnings reserve itself. In other words, all of the earnings of the fund accumulated in the earnings reserve account. Dividends were paid from the earnings reserve account, which had a balance of \$8.5 billion. Dividends were based on a five-year moving average of realized earnings, roughly \$1.4 billion in 2015, and the state paid inflation proofing. If the earnings from the fund were greater than dividend inflation proofing then the earnings reserve account grew. The growth of the earnings reserve account depended on the rate of return on investments of the Permanent Fund.

Representative Wilson had heard that the state could fire all of its employees several times over and not make up the state's deficit. She speculated that much of the state's issues had to do with formula programs, programs that the state paid out. She provided examples including Medicaid and the school formula (money the state paid out in grants). She mentioned the state previously capping some of the programs. She wondered if the state should be looking more at the cap approach versus an unlimited amount of money being paid out for programs.

Mr. Teal detailed that in the past there had been a number of formula programs that had been prorated. In order to prorate formula programs statute had to be in place to allow the state to do so. There was statutory language in the education formula regarding prorating. There was also statutory language regarding PCE. Some formula programs such as Medicaid were considered entitlement programs, meaning that if an individual was eligible and had need of the program, services would be paid. It was not a matter of prorating Medicaid because it would difficult to determine when to begin prorating. He suggested the hypothetical scenario of cutting people off saying that no one could get

sick after May. He emphasized that Medicaid would be a very difficult program to prorate. However, it did not mean that Medicaid was uncontrollable. It meant that there were other methods for controlling Medicaid costs such as waivers. Every state was allowed, to some extent, to design its own Medicaid program both in terms of who was covered and what services were covered.

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Representative Wilson remarked that the state had a complicated budget. It was not simply addressing one area of costs.

Co-Chair Neuman interjected that some questions were very important in order for the public to understand what legislators discussed regularly.

Representative Wilson asked about options the department might have in controlling costs versus changing or implementing statutes. She wondered if the department could make a change in formulas or if such changes would have to occur by changing the law.

Mr. Teal responded that both potentially applied. He referred to a time two years earlier when the legislature debated the permissibility of upper and lower ventures in one year. Under Medicaid rules the state could receive one per year. Most changes would have to come through statute modifications. There were regulations that accompanied the statutes. In the late 1990s and early 2000s the legislature was very concerned about Medicaid costs escalating rapidly and wanted better control of the costs. The department responded that while it implemented regulations the legislature would have to enact corresponding laws, potentially a two-year process. Assuming the legislature wanted to reform Medicaid, results would not happen rapidly.

Co-Chair Neuman suggested the committee would hear much more on Medicaid in the following week.

Representative Wilson used Medicaid as an example. She remembered having a discussion a few years earlier about the heating assistance program when the state was seeing high costs for energy around the state. The federal government had a limit on its funding. The state followed

suit by limiting the amount of assistance. After the first year of the program existing without a cap the state realized the overwhelming cost and initiated a limit. She believed there were several formula programs within different departments that could be capped. She indicated she was trying to look at the larger picture keeping in mind the history of oil price fluctuation. She understood that imposing caps in statute was not a quick fix but might be an example of one way to help with the deficit.

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Representative Gara asked about the governor's budget numbers. He asked Mr. Teal if he could plug the governor's budget numbers into a spreadsheet. Mr. Teal asked for clarification about which numbers Representative Gara was referring to. Representative Gara responded that he was talking about the governor's budget numbers filed for the current special session. Mr. Teal responded in the negative. He suggested the numbers would not show in his model.

Representative Gara asked Mr. Teal to show the current oil prices (approximately \$66 per barrel) and the decline in budget reserves based on the budget passed by the Majority. He wanted to know how quickly the state's savings would run out. Mr. Teal relayed that he had entered \$70 per barrel of oil into his model.

Representative Gara asked Mr. Teal to input \$66 per barrel of oil. Mr. Teal responded affirmatively.

Co-Chair Neuman recognized Representative Drummond in the audience.

Mr. Teal pointed out that the line hardly changed when inputting oil prices between \$65 and \$75 per barrel. He continued that at any price below \$80 per barrel, revenue was not very sensitive (the gap would be nearly the same with prices between \$40 and \$70 per barrel). He explained that at an oil price of \$65 per barrel the state had a very large, long-term, unsustainable, structural deficit. Reserves would be gone before FY 19.

Representative Gara asked Mr. Teal to move the budget up by \$79 and then down by \$79 in order to see the effect on the time in which the state savings were depleted.

Mr. Teal changed the line on the chart from \$20 to \$90 for the capital budget. It did not matter where the money was spent. It reflected an increase of \$70. He pointed to the line that moved on the chart.

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Representative Gara asked for verification that whether the chart moved up or down by approximately \$70 million the state reserves would decline to zero in about three years. Mr. Teal responded affirmatively.

Representative Gara directed attention to questions asked by Representative Wilson about using the earnings reserves of the Permanent Fund. He expressed that he was not a fan of the idea. He received a memo from Legislative Legal Services indicating that if the state spent from the Permanent Fund earnings reserve it would result in lower dividends. He wondered if Mr. Teal disagreed with the conclusion.

Mr. Teal responded that if that was all the state did, any money removed from the Permanent Fund on a perpetual basis would reduce dividends in the future. The reduction would be phased in over a five-year period.

Co-Chair Neuman welcomed Representative Pruitt to the meeting.

Representative Gara had an additional problem with using the earnings reserve. He suggested that even though people saw a high number of \$8 billion, the figure fluctuated. He relayed that in 2008 and 2009 when the stock market performed poorly the earnings reserve of the Permanent Fund was so low that the state came close to not having enough for a dividend payout. He continued that in high stock market years there was a significant amount in the reserves fund. He asked if it was fair to say that the reserves account went up and down based on market performance. Mr. Teal replied in the affirmative.

Representative Gara stated that some people thought the economy was in for a stock market retraction. If the Legislature began spending from the earnings reserve of the Permanent Fund there would be a chance that there would not

be enough money in the fund to pay a dividend and inflation-proof the fund. He asked if he was accurate.

Mr. Teal responded that the earnings reserves moved up and down no matter what the state did. If the stock market performed well then there would be plenty of money to pay dividends, inflation-proof the fund, and add to the reserves. If there was a bad year in the stock market the reserve balance could fall. He furthered that if inflation proofing and dividends exceeded the amount of earnings in a given year then the balance would fall. He believed it was in 2008 or 2009 that the state came very close to having an insufficient balance in the fund to pay dividends.

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Representative Gara referred to Mr. Teal's presentation on page 1. He asked about the top chart that showed a flat line of spending. He commented that with population growth and inflation, the flat spending line indicated less and less money per person in the state in real dollars. He asked if he was correct. Mr. Teal replied in the affirmative.

Representative Gara asked whether more cuts would be required if the state's spending remained flat. Cuts could include reductions to education on a per-person basis, to senior services on a per-person basis, or to other services. He wondered if he was correct.

Mr. Teal responded that Representative Gara was correct. He noted that if the budget remained flat and was not increased for inflation purposes, it would have the same impact on spending as a cut as large as inflation.

Representative Gara opined that the budget before the committee was not a sustainable budget unless the legislature did something to increase revenues. Options for generating revenues included imposing an income tax, raising sales tax, or adjusting oil taxes. He asked Mr. Teal if he agreed that the budget was not sustainable. Mr. Teal did not believe the budget was sustainable.

Co-Chair Neuman informed the committee that the governor had announced he would be having meeting in Fairbanks in early June 2015. The governor had invited some people to accompany him to discuss some of the fiscal issues. He

relayed that the governor was taking the lead on the discussions.

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Vice-Chair Saddler made reference to the comment made by the legislator to his left about the budget passed by the Majority. In actuality, the legislature passed the budget. He asked about Mr. Teal's comment about being surprised at the large reductions the legislature was able to make. He asked Mr. Teal to expound on his comment.

Mr. Teal pointed to Figure 3 [Page 5] of the packet. The chart showed per capita UGF revenue and budget history adjusted for inflation. It was directly responding to Representative Gara's comments about how much the state spent per person as inflation eroded the spending of the expenditure and as there were more people to serve. He highlighted that 2016 agency expenditures on a per capita basis were as low as they had ever been previously. In the early 2000s there were a few years where the state was fairly close. There were two or three years where the state was below current spending. There was always the question anytime there was a deficit as to whether the state had a spending problem or a revenue problem. The answer was one of the two or a combination of both. He turned to the chart and pointed out that when revenue increased in the 1980s expenditures followed. He explained that the big capital budgets were highlighted in yellow. Agency expenditures also grew. He confirmed that the same thing happened after 2005; revenue jumped resulting in larger capital budgets and agency budgets increased. They were presently on a downward trend but at its peak the real per capita expenditures were lower than in the 1980s. The state's current level of spending was high per capita; there were only 4 other years in history where the per capita expenditures were higher. He did not see the situation as an expenditure problem. He saw revenues as the problem. Revenues on a per capita basis were by far the lowest since 1975. In reading across the chart the state had deficits in the early 2000s with state revenues of about \$4 thousand per capita. He pointed to the \$5 thousand dollar mark and then at the mark of \$3 thousand per capita in revenue. Currently the state was at the lowest per capita in revenue.

Co-Chair Neuman remarked that when looking at the agency operations costs, represented by the dark blue lines, the day-to-day agency operations, the state paid the same as was spent in 1977 when the state likely had about less than half as many people as it did now. He thought the chart was interesting. He noted that when there was an assumption that the legislature or the government spent a lot of money per capita per person within the State of Alaska He asked Mr. Teal if he was correct.

Mr. Teal invited committee members to turn to the last two pages of the handout to further answer what the state was doing in the current year. He referred to the Senate version of the budget rather than the conference committee budget. For the purpose of review it did not matter which budget was being referred to. The point of the chart was to determine how many years of spending was unwound in the current year's budget. He highlighted in yellow, agency-by-agency, the budget closest to the FY 16 level of spending. He summarized that on an overall basis, four years' worth of spending was unwound. The state was back at spending levels of FY 12. Some agencies were three years back and some reached back as far as FY 08. He stated that there were some massive reductions. He referred to Representative Gara's question as to whether he was surprised at what the legislature had cut. He relayed that he would have been surprised to see a 5 percent reduction, but the actual reduction was 9.9 percent. If the amounts were adjusted for inflation, the legislature unwound approximately 7 years' worth of spending, back to FY 09 levels. He reiterated that some agencies were more and some were less. He reported that DHSS and DEED accounted for the largest expenditures. The Department of Education and Early Development Education took up over 30 percent of the state's budget, and DHSS followed closely behind. Together the budget for DHSS and DEED made up 60 percent of the state's available UGF. Budgets for the University of Alaska, DOC, and DOT were the only other ones exceeding 5 percent of the overall budget. Other departments were small in comparison.

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Co-Chair Neuman asked Mr. Teal to return to the chart on page 9 of the handout that showed agency operations adjusted for inflation 2014. He thought it was an interesting chart that basically described to the public what the legislature recommended for reductions in state

government for the current year. He asserted that the chart reflected a dollar-for-dollar evaluation adjusted for inflation. He suggested that the legislature rolled back agency operations worth more than half of the departments within the State of Alaska. He opined that it was a fairly dramatic reduction. At the same time the state lost 60 percent of its revenue stream in the previous fall within 5 or 6 months. The legislature reacted to try to slow down the burn rate of spending in order to ensure funding availability in the state saving accounts for government into the future. Many of the department budgets, almost half of them, were rolled back 7 or 8 years. He noted his concerns in reducing the budgets for DOC and DPS that might have long-range effects on the economy such as job losses. Even these budgets were rolled back 4 years. He indicated that the page told him more about what the legislature did to reduce agency operations within state government. He highlighted that it showed how many years were rolled back department-by-department. He emphasized the descriptiveness of the page.

Vice-Chair Saddler stated that people from his district had been telling him that the legislature should prioritize these items. As he looked into the audience he saw many of the people who had been authors of those messages. The chart before the committee showed clearly that the legislature had and continued to prioritize education and health and social services. He wished the press were present so that they could carry the message to their viewers and readers. He believed it was an important message Alaskans deserved to hear.

Vice-Chair Saddler told of his experience hearing from people that the state government was bloated and that it was spending more and more of whatever it had. The previous chart contained UGF revenues. He clarified that the state did not have a bloated government. The state generated the lowest revenue per capita in many years. He asked if he was correct.

Mr. Teal stated that Vice-Chair Saddler was correct that the state was at \$5 thousand per capita agency spending. He asserted that agency spending was discussed because of both the formula and non-formula funds running through the agencies. The other spending was capital in yellow and statewide expenditures depicted in light blue. The number equaled \$1.5 billion. Luckily half of the money was the tax

credits and \$200 million of debt service monies, and \$250 million for retirement.

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Vice-Chair Saddler referred again to the blue lines in the previous two year. He wondered what percentage of the solid blue line indicating agency operations actually accounted for DEED and DHSS expenditures.

Mr. Teal restated that DHSS and DEED had remained at about 60 percent of the budget. He added that the growth rates had been remarkably similar for formula programs and non-formula programs.

Co-Chair Neuman asked, "So, about two-thirds for that line?"

Vice-Chair Saddler interjected, "I call that a priority." He indicated that in the past some state leaders had wanted to limit the drawdown of the CBR balance to a certain level. He wondered if it was prudent to ensure that there was some amount left in the CBR to act as a cushion, a level below which the CBR should not be drawn. He understood his question might be a policy question that Mr. Teal should not answer. He also asked if there were any structural problems with drawing the CBR down below a certain level.

Mr. Teal remarked that it was a policy choice. He indicated he liked a certain level [Note: Mr. Teal referred to a level on a chart not specified]. He relayed that his job was to make sure the legislature did not get into fiscal problems. People who wanted to see a higher level of expenditures might be comfortable with a certain level during a year or more of a bad deficit. He suggested that the balance that was acceptable to the legislature should depend on the volatility of revenue sources. If the state relied on income tax, sales tax, property tax, and other taxes, more stable revenue sources, then a higher level of reserves would not be needed. Alaska currently had an extremely volatile revenue source, which lead him to conclude that the state also needed an extremely high level of reserves. He corrected himself by saying that Alaska did have a high level of reserves. He thought legislators had been to National Conference of State Legislatures (NCSL) conferences where reserve balances were discussed as a

measure of state fiscal health. In those presentations Alaska was typically removed because its reserves distort the entire nation's picture. He suggested examining why Alaska needed a significant level of reserves. He asked how anyone could budget when in one year the state had \$9 billion and within two years the state had \$2 billion. The volatility in the state's revenue was larger than the budget. Other states look at a 5 percent decline in revenue as a major crisis.

Co-Chair Thompson asked if DOR had made any projections associated with additional production as a result of increased activity occurring presently or estimates reflecting the effects of the expiration of tax credits at the end of 2016.

Mr. Teal suggested that DOR might have the information but he had not seen it. He relayed that DOR typically generated a single production forecast. The forecast was risk-based but included possible and probable production increases. He believed that the production increases the department was looking at were more than offset by the declines. The net loss was going down to 400 [thousand barrels per day] according to DOR projections. The Department of Revenue could certainly change risk measures; however, he did not have access to the numbers.

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Co-Chair Neuman believed that DOR forecasted \$450 million in small producer credits for the year, but the actual credits equaled \$700 million for the year.

Mr. Teal relayed that the small producer tax credits were expected to decline. They were stacked to some degree in FY 15 and FY 16. He explained that part of the reason for the decline from FY 16 to FY 17 was that the tax credits were supposed to be declining from \$700 million to about \$250 million in a certain period [Note: Mr. Teal pointed to an unspecified curve on a chart].

Representative Wilson wanted her constituents to understand the options the legislature had certain questions. She explained that her questions did not necessarily reflect her position on an issue. She maintained that there was a difference of opinion amongst committee members about certain issues. She believed that there were things that

could be done to further reduce spending while others preferred to spend additional money. She opined that Alaskans had the right to be informed about the state's different financial accounts, how they correlated, and the growth of the accounts. She expressed her displeasure with other members' interpreting the meaning of her questions.

Co-Chair Neuman did not believe anything was meant to offend Representative Wilson personally.

Representative Gara acknowledged that he had no idea about the views of Representative Wilson. He remarked that all members should be mutually respectful.

Co-Chair Neuman urged all members to do their best to be respectful.

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Representative Kawasaki brought up Representative Thompson's comments on projections for oil and gas tax credits. He noted that DOR released historical information on production tax credits. In his freshman year as a legislator the state did not have any refundable oil and gas tax credits. He continued that in the previous year preliminary numbers were about \$600 million in refundable tax credits, \$625 million in 2015, and \$700 in the coming year. He opined that the legislature should be reviewing the amounts of the credits and the total amount. He remarked that it was a "spend" and was within the state's tax code. He asked if it should be part of the discussion.

Mr. Teal thought it was part of the discussion. Tax credits were included in the forecast and were declining. The graph did not provide a history but it was available. He suggested that the tax credits had been fairly large. Another way to look at the tax credits was to view them as a loss of revenue rather than an expenditure. He explained that it was debatable how to treat a tax credit. Certainly the tax credits claimed by the major producers was a reduction of revenue. The tax credits that were refundable appeared as an expenditure. He asserted that both were really reductions in revenue. If the expenditure line was reduced by \$700 million in conjunction with reducing the revenue line by \$700, the deficit would remain the same.

Co-Chair Neuman commented that there were a multitude of tax credits involved.

Representative Kawasaki asked about the small producer credits under SB 21 [Oil and gas production tax legislation passed in 2013] amounted to \$44 million in the previous year, rose to \$50 million, rose again to \$60 million, then began to taper off. He asked about the credits used against tax liability and the refundable credits looked to be increasing in the following several years. He relayed that in FY 07 showed \$600 million in tax credits, \$1.4 [billion] in FY 15, \$1.2 [billion] in the following year, \$1.3 [billion], and \$1.8 [billion]. In terms of the sustainability of the budget whether credits used against the liability or refundable credits, which were actually expenditures, the numbers seemed to be increasing according to DOR. [Note: Representative Kawasaki referred to an unspecified document]. Mr. Teal indicated that he did not have the revenue forecast in front of him.

Co-Chair Neuman interjected that no one else on the committee had the information Representative Kawasaki was referring to.

Mr. Teal reported that when he looked at the information he focused only on the expenditure side. He furthered that LFD took the revenue forecast as a given. He had not looked at the detail to determine what was built in by DOR and how much was attributable to the regular tax credits for major producers. He added that LFD did track tax credits more carefully and relayed that they were projected to drop from the current level of \$700 [million] to roughly \$250 [million]. After looking at his paperwork he confirmed that the tax credits were supposed to drop from \$716 [million] to \$400 [million] to \$250 [million] in the future.

Co-Chair Neuman interjected that care had to be taken because some of the credits were done under ACES legislation and some were done under SB 21.

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Representative Kawasaki pointed out that when he first took office there were no costs associated with tax credits. The state did not have a refundable tax credit at all. It was a very significant expense. He also noted that the credits used against liability due to the per-barrel credit that

would come into effect soon seemed to keep growing off the chart. He asked the presenter to refer to figure 3. The light blue bars on the chart representing UGF revenue for statewide operating costs would be growing. Whereas, the dark blue representing agency operations such as funding for schools and troopers would be declining. He opined that it was alarming that the big blue line was not being looked at as part of the problem.

Co-Chair Neuman remarked that he believed the committee had. He explained that in looking at statewide operating costs a moratorium on school bond debt reimbursement was imposed, a statewide salary freeze was implemented for both union and non-union employees, and there was a freeze on education funding to name a few.

Mr. Teal responded that Representative Kawasaki was correct that when he took office the tax credits did not exist. However, the statewide operating costs in 2006 were less than \$300 million total. Statewide expenditures were comprised of debt service. The legislature had started issuing general obligation bonds. He reported that bonds had been paid off at a certain point in time [Note: Mr. Teal pointed to an unspecified place in Figure 3]. The bonds were issued and currently the debt service was over \$200 million per year.

Mr. Teal continued to explain that in 2008 both retirement costs and the tax credits began. The growth represented by the blue line was primarily retirement costs. Both went to \$700 million in the current year. Retirement costs had also climbed over \$700 million in the previous year. The legislature took action in the prior year depositing \$300 billion of state assistance to the retirement funds as well as applied the changes involved in re-amortization. These actions reduced the amount to \$250 million in the current year. He commented that it was a massive \$500 million reduction in retirement debt. Currently, tax credits made up half of the statewide budget. The legislature addressed the other major statewide expenditures: bond debt and retirement.

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Co-Chair Neuman added that the legislature reduced agency operations by \$444 million from the prior year to the

current year. Mr. Teal asked which document Co-Chair Neuman was referring to.

Co-Chair Neuman responded that he was looking at the spreadsheet numbered 1516.1 titled, Gas State Fiscal Summary. He relayed that the state had \$444 million in agency operations and about \$477 million in capital. He noted that Mr. Teal had stated that there was \$450 million to \$500 million less in retirement costs in the current year because about \$3 billion had been paid into the retirement finds. Instead of having to pay \$700 million in the current year, the state had to pay about \$200 million. The state reduced the statewide agency operations by approximately \$1.4 billion from the previous year. Mr. Teal agreed that what Co-Chair Neuman stated was true after correcting for the retirement.

Co-Chair Thompson reported that the tax credits were put in place due to declining throughput. The state had to do something to encourage new investment, new drilling, and new oil into the line. It was also done to encourage production in Cook Inlet. He thought the credits were working. All of a sudden the state went from brown-out practices in Anchorage and the possibility that the state would run out of gas to currently there was not a problem. He relayed that have of the tax credits applied in the previous year were associated with Cook Inlet. There were small producers on the North Slope drilling, exploring, and discovering new oil, confirming that the tax credits were working. Also, the amount of equipment the Alaska Railroad was shipping to the North Slope, such as drill stems, pipe, and equipment was at an all-time high over the previous ten years. He elaborated that there was three times the tonnage that was hauled to the North Slope in the current year compared to the prior year. The tax credits were also being reduced. The state reached \$750 million in tax credits in the current year, a surprise to the state. Both ACES and SB 21 credits applied. The state doubled up because there was an expedited amount of time for producers to submit them. The state was projected to payout \$250 million in credits. He reemphasized that the tax credits had worked. Once oil was found it took two to three years to build infrastructure before the oil hits the line. The state would not see immediate results. However, he felt that the state would see a turn-a-round and an increase in production.

Co-Chair Neuman noted that there would be plenty of discussions on oil and gas taxes in the future.

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Representative Munoz agreed with Co-Chair Thompson that there was a combination of tax credits for Cook Inlet and the North Slope under two different structures (one under ACES and one under SB 21) that equaled the \$700 million and were expected to go down in the following few years. She thought it was very fair to tell the entire story when discussing the tax credits.

Representative Gara agreed with Representative Munoz and Representative Thompson that smartly written tax credits encouraged production. However, the state had to have an oil tax that could afford the credits, which he thought was the problem. He commented that the state had probably saved itself roughly \$750 million by paying down the retirement debt. Had the state not chosen to do so, the current retirement payment would have equaled about \$1 billion rather than \$250 million. Although the savings did not show anywhere, the state had saved money by paying down the debt. He reemphasized a savings of about \$750 million in the current year and wanted to verify his number.

Co-Chair Neuman thought the retirement expenditure was going to be about \$700 million instead of \$1 billion.

Mr. Teal relayed that depending on the amortization method used (the Alaska Retirement Management Board preferred level dollar) the payments would have been just over \$1 billion in the current year instead of \$250 million that the state was paying.

Representative Gara gave credit to the good bi-partisan work that was done.

Co-Chair Neuman asked committee members to be mindful of the time as the Department of Administration was also present to discuss union contracts before the end of the meeting.

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Representative Gara stated that the cloud over everyone's heads was the impending government shutdown. He asked about

the state's financial status if the legislature remained at an impasse on the budget beyond July 1, 2015. He had heard from OMB that there was money available as a result of delaying payments to maintain government operations through August 27, 2015. He wondered if there was also a continuation budget for FY 16 to keep operations running.

Mr. Teal stated that the legislature was not like the U.S. Congress where there was an option to pass continuing resolutions. The legislature either passed a budget bill and made the appropriations or did not. Congress had an authorization and an appropriation process. If the state did not have a signed appropriation bill the state could not spend money from the treasury. He was uncertain of Representative Gara's reference to a plan, but there was not a continuing resolution that would take effect to enable spending if a signed budget was not in place.

Co-Chair Neuman remarked about previous votes on the House floor that failed. He discouraged members from entering into a discussion about those votes.

Representative Gara believed it was clear that without a budget by July 1, 2015, there would be no funding [for FY 16]. He asked if he was correct. Mr. Teal responded in the affirmative.

Co-Chair Neuman added, "If there is no money, there is no money."

Vice-Chair Saddler asked if there had ever been a situation in which the governor had introduced a new operating budget before signing or vetoing a budget bill passed by the legislature and transmitted by the legislature. Mr. Teal did not believe so; however, he could not swear that it had never happened.

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Representative Gattis cited that the legislature had been unable to get the votes to access the CBR to fully fund the FY 16 budget. She asked Mr. Teal if he was familiar with any other economists such as those at Commonwealth North, and at the Institute of Social and Economic Research (ISER). She relayed that in ISER's report there were some technicalities that, upon further research, may allow for access to the CBR and the use of income from the Permanent

Fund. Mr. Teal had not seen the report Representative Gattis was referring to.

Representative Gattis wanted to look at all of the options including those suggested by outside experts. She reported that the House was four votes short of passing a budget.

Co-Chair Neuman responded that there were many options and the legislature would be looking at every possible option available.

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Co-Chair Neuman reviewed the history of the union contracts. He reported that in the present year the legislature passed legislation that froze salaries at the current level eliminating increases in salaries for union and non-union employees. The changes were made in an effort to slow down the growth of government. Although the salary increases were frozen, step increases were not affected and equated to approximately \$32 million per year. The salary increases for non-union employees totaled about \$18 million and salary increases for union employees equaled approximately \$35 million or \$36 million. The discussion that was to pursue would focus on the governor's request in HB 1001 to finance a salary increase of 2.5 percent for union employees to honor year three of the state's union contract.

Representative Gattis asked the commissioner to explain some terms, such as "step", for individuals working in private industry.

Co-Chair Neuman suggested that the department provided definitions on the first page of the presentation.

[2:36:43 PM](#)

SHELDON FISHER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, expressed his thanks for the opportunity to appear before the committee. He explained that due to the time constraint he would be moving quickly through the slide presentation to allow time for questions at the end. He would focus on

the monetary terms and potentially the bargaining process if time allowed.

Co-Chair Neuman asked Commissioner Fisher to explain step increases. Commissioner Fisher indicated the answer to Co-Chair Neuman's question was part of the slide presentation.

Commissioner Fisher referred to slide 3: "Bargaining Units (BU)":

Contracts That Expired on June 30, 2014 (Number of Employees)

- IBU -Inlandboatmen's Union of the Pacific (624)
- MEBA -Marine Engineers Beneficial Association (94)
- MMP -Masters, Mates and Pilots (98)

Contracts That Expire on June 30, 2015

- ACOA -Alaska Correctional Officers Association (947)
- LTC -Public Employees, Local 71 (1,690)
- TEAME -Teachers' Education Association of Mt. Edgecumbe (29)

Contracts That Expire on June 30, 2016

- ASEA -Alaska State Employees Association (8,303)
- APEA -Alaska Public Employees Association (2,278)
- CEA -Confidential Employees Association (188)

Contracts That Expire on June 30, 2017

- AVTECTA -Alaska Vocational Technical Center Teachers (38)
- PSEA -Public Safety Employees Association (491)

Non-Covered -Exempt, Partially Exempt and Excluded (1,378)

Commissioner Fisher outlined that the state had 11 bargaining units (BU). Each BU negotiated three-year contracts. He pointed out that the first three BU contracts expired in the prior year and were negotiated the previous fall as well as the first contract for the Alaska Correctional Officers Association (ACOA). The monetary terms of these four contracts, representing a little over 12 percent of the state's workforce, were before the legislature for consideration. The department was currently in negotiations for the following two contracts for the

Public Employees, Local 71 (LTC) and the Teachers' Education Association of Mt. Edgecumbe (TEAME); the two units equaled about 11 percent of the state's workforce. He furthered that in the fall of the current year, negotiations would begin for contracts that expired on June 30, 2016 representing about 73 percent of the state's workforce). He pointed out that the contracts currently before the legislature in addition to contracts it would consider the following session, represented roughly 95 percent of the state's overall workforce. He would be discussing it further as he went through the presentation.

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Commissioner Fisher turned to slide 4: "Monetary Terms":

In addition to negotiated Cost of Living Adjustments, State employees receive:

#### Merit Increases

- Steps A-F (A-G for General Government Unit members) on the salary schedule;
- Represent an increase of approximately 3.5% every year providing the employee's performance is considered "acceptable or better;"
- Automatically awarded unless a proactive action is taken to deny the merit increase through a timely performance evaluation.

#### Pay Increments

- 3.25% increase awarded every two years providing the employee's performance is "acceptable or better;"
- For administrative purposes, pay increments are designated as steps J and above on the salary schedule;
- No limit as to how many pay increments an employee can earn.

Commissioner Fisher offered that there were two or three concepts related to the growth in wages for an individual employee. The first was a cost of living adjustment (COLA). There had been significant discussion about the adjustment, which he would detail in a following slide. The cost of living adjustment was intended to address inflation and to protect employees from adjustments in inflation.

Commissioner Fisher continued that there were two additional concepts that were referred to as step or merit increases and pay increments. He explained that merit or step increases occurred within the first five years of employment with the state. Each year, in addition to a cost of living increase, an employee received a 3.5 percent increase. Following the first five years and six years for the General Government Unit (GGU) pay increments kicked in. Pay increments were provided every two years and equaled an increase of 3.25 percent. He summarized that the salary increases an employee received in their lifetime was comprised of COLA increases (merit increases for the first 5 or 6 years of employment) and pay increments.

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Commissioner Fisher referred to slide 5: "Monetary Terms." He noted that there were other monetary terms relating to differential, travel pay, and training that factored into BU negotiations.

Commissioner Fisher continued with slide 6: "Sample Historical COLAs and CPI Comparison." The slide provided a sense of the Consumer Price Index (CPI) increases as well as the negotiated COLA increases for the previous 10 years. Over the past 10 years there had been an approximate 23 percent increase in the CPI. Each BU had a story associated with the CPI percentage. Sometimes the BUs wanted something else in lieu of receiving a portion of the COLA increase, for example. The slide depicted a range of 24 percent to 14 percent. Additionally, in the third column from the left, under the heading "Non-Covered", employees received 24 percent. Essentially the practice had been to give the state's non-covered employees the same COLA increase that had been negotiated with the state's supervisory union.

Commissioner Fisher advanced to slide 7: "Built-In Wage Escalation: COLA + Longevity." He suggested that the slide highlighted the salary increase that an employee received. He specified that the slide represented the GGU BU for a 10-year period from 2006 to 2015. Over the previous 10 years the combined COLA and merit increases resulted in a 63 percent hourly wage increase.

Commissioner Fisher moved to slide 8: "Average Yearly Base Salary for FY 14." He highlighted that the slide showed the average annual pay by the various units. It also accounted

for geographical differentials sometimes paid to attract and retain people in high-cost areas but did not include benefits.

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Commissioner Fisher skipped to slide 17: "Contractual Terms." He indicated that there had been questions about potential consequences if the legislature chose not to fund and to reject the contracts, something the legislature had the right to do. He explained that in each contract there was a period of negotiations. For example, in looking at the GGU or Alaska State Employees Association (ASEA) contract the state was contractually required to enter into negotiations.

Co-Chair Neuman asked for clarification about what type of employees were part of the GGU or ASEA. Commissioner Fisher replied that the GGU typically represented employees that were secretaries, clerical workers, and some environmental workers.

Co-Chair Neuman asked if GGU represented the majority of state employees. Commissioner Fisher confirmed that GGU was the majority of state employees. The GGU was the largest BU with over 8 thousand members. If an agreement was unable to be negotiated members could take a strike vote after a 10-day period of renegotiations. All of the bargaining units had some language in their contracts that required the state to enter into negotiations and renegotiate if necessary. He added that it was his interpretation that the department would not be negotiating on monetary terms because the legislature had already expressed its opinion. Instead, it would be attempting to find other areas of agreement that would continue to support the contract. He reiterated the department's position that it was very important to honor the contracts. He relayed that the contracts were entered into in good faith. The employees had relied upon them. He believed that if the legislature rejected the contracts (specifically those contracts that the legislature had previously approved the monetary terms) it would make it more difficult for the state to negotiate in the future, particularly if the state asked the unions to forego a current benefit with a commitment to some future benefit. The administration urged the legislature to honor the commitments that had been provided to state employees

Co-Chair Neuman asserted that most of what was covered in the remainder of the handout was individual BU summaries. He reiterated that all of the contracts were subject to appropriation. He reviewed that the legislation that passed reflected contract negotiations during a time when the price of oil was over \$100 per barrel versus the current price below \$50 per barrel of oil. The legislature chose to find ways to reduce the budget. He expressed the difficulty of making a decision not to fund the salary increases. Several legislators delivered heartfelt messages on the House floor on the issue. He expressed appreciation for all of the hard work of state employees. The decision not to continue to fund the increases had more to do with keeping as many employees in their current positions at their present salaries rather than people losing their jobs to fund another employee's increases. He reemphasized that the vote was very emotional for many House members.

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Vice-Chair Saddler referred to slide 2 [Note: Vice-Chair Saddler was actually referring to slide 4 of the presentation]. He asked whether the cost of living adjustment was a separate increase from the merit increase of 3.5 percent annually and the pay increment of 3.25 percent every two years. Commissioner Fisher responded affirmatively. He elaborated that employees saw both the cost of living adjustment and either the merit increase within the first five years or the pay increments thereafter.

Vice-Chair Saddler asked about the percentage of employees who did not qualify for merit or pay increases. Commissioner Fisher responded that the only employees that would not qualify for a merit or pay increase were those who had been rated below "acceptable." He thought the percentage was less than 1 percent.

Vice-Chair Saddler asked the commissioner to confirm that 99 percent of state employees received automatic increases. Commissioner Fisher answered, "Yes."

Representative Pruitt referred to slide 4 concerning the merit increase discussion. He understood the merit increase existed only for the first six years of employment. He

wondered if the term was set to zero again if an employee was promoted to a different position.

Commissioner Fisher offered that it depended on the position and the individual's circumstance. It may or may not start again.

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Representative Pruitt wanted to better understand the impact of not honoring the already-agreed-upon union contracts and how it might affect the state's ability to negotiate contracts in the future. He noted he was looking at slide 17 outlining contractual terms. He wanted to better understand the timeline.

Commissioner Fisher explained the process of negotiations. For example, the department would begin negotiations in the fall of 2015 for those contracts that expired at the end of June in 2016. The department would then come to the legislature with monetary terms during the following session. The monetary terms would be before the legislature for approval or rejection prior to the expiration of the contract. If the legislature accepted the monetary terms then they would go into effect. If the terms were not accepted additional negotiations would ensue. He opined that there was an important distinction between rejecting a previously negotiated contract approved by the legislature and rejecting a contract that was being presented to the legislature for approval for the first time. In the former scenario where a contract was negotiated in good faith and approved by the legislature, he felt it was important to honor and respect the contract in order for the state to maintain its credibility with the bargaining units.

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Representative Pruitt asked about what would happen if a vote was taken at the end of session and the contracts were voted down. He wanted to know what actions would follow.

Commissioner Fisher reported that the state would negotiate a revised set of terms. Assuming that there was no opportunity for the legislature to take action on it until the following session, the state would in all likelihood continue with the union under the current terms through July until the legislature reconvened. In the event the

state has agreed to terms that the legislature approved then a retroactive payment would be initiated to cover the period.

Representative Pruitt asked about the current situation. He wondered why "subject to appropriation" was included if it was really not a tool in the legislative toolbox when the state did not have money.

Commissioner Fisher responded that there was no question that the legislature had the right to reject the contracts. He agreed that it was a tool in the legislature's toolbox. He and the administration believed that there were consequences that would follow from the legislature breaking the contract. He continued that he believed the consequences would be more costly in the end. The governor had signaled to DOA and DOA had signaled to the BUs that the state intended to negotiate very aggressively any future contracts.

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Representative Gattis wondered why non-exempt [exempt] employees would not want to become union employees if the legislature honored only the union employee salary increases. She argued that the state was sending mixed messages when it did not honor all of its employees. She was concerned about sending a message to all Alaskans that one group of individuals would receive their increases while another group would not. She felt such an action would encourage employees to join a union. She opined that it was a poor message to convey. She also wanted to make sure that all state workers understood that the state was on a fiscal cliff. She stated emphatically that the state had to do something different.

Representative Wilson commented that the state negotiated the terms with what it had. She did not believe that the legislature was being disrespectful by rejecting the negotiated contracts. She expressed her appreciation to all state employees for the work they do throughout Alaska. She opined that she did not see the rejection of the negotiated contracts as a loss of credibility. She argued that it would be different if the state had a significant amount of money. She asked why the administration did not approach the unions in the prior months of December through April since it did not like the legislature's decision. The state

did not have money. She wanted to know why the commissioner had not approached the unions, rather than making the legislature do it.

Commissioner Fisher was uncomfortable with revealing any conversations with the unions. He did say that the governor had explored every possible option.

Representative Wilson relayed that in a previous discussion she had suggested that Commissioner Fisher or someone from DOA approach the unions with the question about what they preferred: increasing wages but losing employees, or keeping employees but not receiving increases. She wondered if anyone had gone to the unions with the two scenarios she suggested.

Commissioner Fisher indicated that there had been long conversations with the bargaining units about the consequence of maintaining the COLA's. The unions had been clear on their position that the contracts should be honored.

Co-Chair Neuman drew attention to the commissioner's comments about honor and respect regarding the contracts. He opined that, no matter what position a person took, every person in the legislature and in the administration honored the state employees.

[3:03:19 PM](#)

Co-Chair Thompson reviewed the agenda for the following week that were to be held in Anchorage at the Legislative Information Office.

Co-Chair Neuman thanked the members and the presenters for their participation.

HB 1001 was HEARD and HELD in committee for further consideration.

#  
ADJOURNMENT

[3:05:01 PM](#)

The meeting was adjourned at 3:05 p.m.