

HOUSE FINANCE COMMITTEE
August 24, 2015
10:36 a.m.

10:36:09 AM

CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 10:36 a.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 David Guttenberg
Representative Lance Pruitt

MEMBERS ABSENT

Representative Cathy Munoz

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Gunnar Knapp, Director and Professor of Economics, Institute of Social and Economic Research, University of Alaska Anchorage; Representative Charisse Millett; Representative Lora Reinbold; Representative Andy Josephson; Representative Craig Johnson.

PRESENT VIA TELECONFERENCE

Representative Scott Kawasaki; Representative Tammie Wilson; Representative Chris Tuck.

SUMMARY

DISCUSSION: FISCAL SITUATION & ECONOMIC ANALYSIS

Co-Chair Neuman discussed the agenda for the meeting.

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^DISCUSSION: FISCAL SITUATION & ECONOMIC ANALYSIS

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET (OMB), OFFICE OF THE GOVERNOR, discussed that it was unusual to have a discussion on the budget in August; however, she believed the state's fiscal situation warranted early and frequent communications. The administration's intent was to provide an update on its actions over the summer, its plan going forward, and the framework it was sharing across the state.

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE introduced a PowerPoint presentation titled "Building a Sustainable Future: A Conversation with Alaskans" dated August 24, 2015 (copy on file). He explained that the presentation was essentially the same as the one the administration had presented throughout the state over the summer. He detailed that the message had begun in June with a fiscal sustainability workshop in Fairbanks. The intent of the Fairbanks workshop was to discuss the current budget shortfalls and revenue options that could be used to balance the budget; however, it had become very clear that people were not convinced that there was a problem. Therefore, the administration had been working to increase the public's understanding about what the administration and the legislature was facing presently. He shared that after the workshop concluded the administration felt that it had been successful and had received good feedback; however, in a taxi the following day a portion of his discussion had been playing on the radio, to which the taxi driver responded "that guy's an idiot." He stated that the experience had made him realize that there was a long way to go in getting the gravity of the problem out to the public.

Commissioner Hoffbeck explained that the presentation was a companion presentation to several items on Governor Walker's webpage. The website included a whitepaper on potential revenue and fiscal options. He noted the paper was not all inclusive, but provided a good background on

the issues. Additionally, the webpage included a revenue and expenditure model, which he would address later in his presentation; the model could be manipulated by a user to balance the budget. He acknowledged David Teal [Director, Legislative Finance Division] for many of the ideas. He added that there were several short videos he intended to show later in the presentation related to the Alaska fiscal situation. He read a quote by Teddy Roosevelt from 1910 (slide 3):

It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood.. who at the best knows in the end the triumph of achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat.

Commissioner Hoffbeck stated that there would be many people throwing stones in the current year. He believed the people who deserved applause were those who were willing to have an intellectually honest discussion about the state's situation. He noted that there may be disagreement about the solutions, but he did not think people should be afraid of the conversation. He had encouraged people throughout the state to support legislators who were willing to have the conversation; it was not helpful to throw stones at the people who were trying to put the situation on the table.

Commissioner Hoffbeck addressed that it was clear that the state had certain opportunities to work the process in a systematic and diligent way, given the savings set aside over the last few years. He communicated that there were real challenges that had only worsened over the summer including oil prices in the low \$40 range and a stock market that was beginning to correct. He elaborated that there was currently very little revenue coming into the state; if the current environment continued the revenue situation would actually be worse than it had been during legislative session. However, opportunities were also presented as well.

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Commissioner Hoffbeck stated that there was really not a crisis unless action was not taken. He relayed that if nothing was done, the state would be taken to the edge of the fiscal cliff and would not take advantage of the savings that had been established over the past several years. He emphasized the importance of acting immediately instead of waiting until the state was heading off the cliff.

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Ms. Pitney addressed that the administration had frequently talked with the public about the makeup of the state's budget. She pointed to a budget pie chart slide 5: "Fiscal Challenge." The budget was made up of 27 percent federal funds; 19 percent Permanent Fund inflation proofing and dividends; 13 percent other state and Designated General Funds (DGF); and 41 percent Unrestricted General Funds (UGF). She detailed that the problem primarily existed with UGF.

Co-Chair Neuman pointed to the \$3.3 billion in federal funds and asked if the administration had heard whether the amount would increase, decrease, or remain static. He had recently been in Washington D.C. and had been told that federal highway funds coming to Alaska were expected to maintain at the same level or increase slightly. He mentioned work on state matching funds.

Ms. Pitney responded that there were federal funds that ran through the state budget in addition to federal funds coming into the state through military and other, which impacted the greater economy. She relayed that there was continued pressure on federal spending due to the federal environment, but the amount running through the state budget would remain the same or increase slightly due to inflation. She elaborated that she did not anticipate growth or decline in federal funding. However, Medicaid expansion would increase the number by \$150 million or so in the near-term and slightly more in the long-term. The additional funds would only increase the federal funds to around 28 or 29 percent of the budget.

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Representative Gattis asked what portion of the 27 percent federal funds were dependent on state matching funds. Ms.

Pitney responded that about 70 percent or more was based on state matching funds. She expounded that there were different levels and types of matching funds. The federal money had a 90/10 match depending on certain things and health funds were 50/50 on existing and would be 90/10 on the Medicaid expansion population.

Representative Gattis observed that without the state matching funds, the 27 percent in federal funds shown on slide 5 could be reduced to as low as 10 percent. She noted that the state still had to participate if it wanted to access the federal funds. She believed one question going forward was how much the state had to participate and what it received from the federal government.

Ms. Pitney answered that Professor Knapp [Director and Professor of Economics, Institute of Social and Economic Research, University of Alaska Anchorage] would address the question about what federal funding meant to Alaska's overall economy. She stated that it would be a major driver in the health of the state's economy at the business level, even more so than it was at the state conversation.

Ms. Pitney turned to a pie chart on slide 6 titled "Fiscal Challenge: Unrestricted General Funds Gap." The largest focus was on the UGF gap (\$2.7 billion); the funding that the state had the choice to prioritize among all of the competing services it provided. The \$2.7 billion under an oil price of \$65 or \$66 per barrel of oil was the best case scenario. She furthered that under the current per barrel price of \$40 to \$45, the gap could increase up to \$3.2 billion to \$3.3 billion. She noted that the gap did not account for any supplemental budget needs, any gasline issues, or other.

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Ms. Pitney advanced to slide 7: "Fiscal Challenge: Executive Branch Agencies and Payments and Obligations - Unrestricted General Funds." She detailed that education, payments and obligations, debt, retirement, oil tax credits, and health and social services accounted for nearly 80 percent of the budget. In order to demonstrate the order of magnitude of budget costs the slide included the capital budget, which was the eighth bar on the chart. She noted that one of the major choices made in the past year was to reduce the capital budget; it had declined from

\$2 billion to \$118 million. She relayed that if the state wanted to assure its federal matching funds, the capital budget was not an area the state had to utilize. She noted that the remaining agencies shown on the chart were small in terms of expenditures.

Co-Chair Neuman wanted to better understand what portion of the funds for education, health and social services, and social security was made up of general fund (GF) grants. He requested the information divided by grants, grants with matching funds (and the match percentage), and what portion of the funds were required. He asked for the breakout of the different expenditures within the various departments.

Co-Chair Thompson wondered if the cost shown for health and social services (slide 7) was inclusive or exclusive of Medicaid expansion funding. Ms. Pitney replied that the chart was before and after Medicaid expansion funds because it represented FY 16 and GF only.

Co-Chair Thompson had read that other states with Medicaid expansion had seen significant acceleration in state GF costs. He noted that other states were having problems determining how to balance their budgets; a couple of the states had pulled out of Medicaid expansion. He addressed that the governor proposed adding 27 employees to cover the administrative side, but he noted that the federal government required the state to pay 50 percent of the administrative costs of expansion. He wondered how the issue fit into the budget picture. He wondered if the numbers available took everything into account.

Ms. Pitney replied that the administration felt comfortable that its numbers were real at the startup phase [of Medicaid expansion]. She detailed that as the match increased from zero up to 10 percent the numbers would move. Additionally, the administration was aggressive on reform efforts and hoped to see the changes translate into ongoing savings.

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Representative Gara asked for verification that the biggest portion of the Department of Health and Social Services (DHSS) budget related to the state match for regular Medicaid.

Ms. Pitney replied by directing attention to a bar chart on slide 10, which showed the top three UGF spending categories. She pointed to the third bar, which showed both formula and nonformula components of the DHSS budget. She detailed that the formula funds included Medicaid, senior benefits, foster care, and subsidized adoption (over \$600 million was related to Medicaid matching funds).

Representative Gara asked for verification that less than \$400 million in the DHSS budget was associated with non-federal match programs. Ms. Pitney agreed, but noted that some formula programs were driven by the state legislature.

Co-Chair Neuman requested a breakout of the costs. He discussed that when dental and other similar programs had been expanded, it had been made mandatory via legislation.

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Representative Gara followed up on Co-Chair Thompson's question related to administrative staff for Medicaid expansion. He wondered if the administration maintained that Medicaid expansion alone would save the state approximately \$6 million in the first year. Ms. Pitney replied in the affirmative; savings were expected to increase to \$16 million in the second year.

Co-Chair Neuman communicated that the committee would not delve into Medicaid expansion and related issues during the current meeting. The meeting was intended to address the state's fiscal situation.

Ms. Pitney continued to discuss slide 10. She addressed spending for the Department of Education and Early Development (DEED) and explained that the K-12 formula accounted for money that went to school districts and communities. Any reduction in the formula would mean a cost-shift to communities. She pointed out that the non-formula UGF spending was significantly smaller and had reduced in the last year due to tremendous reductions.

Co-Chair Neuman referred to a current education lawsuit with Ketchikan. He asked if the state would be expected to backfill the \$220 million to \$225 million if the law suit moved forward. Ms. Pitney answered that the plan was to cross the bridge when necessary.

Co-Chair Neuman remarked that the lawsuit pertained to a significant amount of money. He noted the issue would be saved for another day. He requested that the administration keep the committee informed on the issue.

Ms. Pitney continued to address slide 10. She reiterated that the K-12 formula was significant and DEED non-formula funds were declining. She detailed that roughly two-thirds of the non-formula spending went to grant programs and Mt. Edgecumbe; and one-third went to DEED administration. She referred to the bar associated with payments and obligations, which was broken into debt, retirement, and oil tax credits. The state's existing debt commitment was \$200 million; the figure was solid for the upcoming five years and would decrease slightly over time.

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Co-Chair Neuman believed the state had paid \$228 million in debt obligations the prior year. He wondered if any of the obligations were expected to be paid off in the near future, which would result in a decrease in the overall debt.

Ms. Pitney responded that debt obligations would not significantly decline in the near future. She surmised that the amount could decrease by \$1 million to \$2 million, but the range would remain between \$200 million to \$220 million over the course of the coming five years. There would be some sharp decreases 5 to 7 years in the future accompanied by some balancing opportunities.

Ms. Pitney continued to address slide 10. Retirement costs were \$262 million in the current year. She relayed that with a recent \$3 billion investment, retirement would be in the \$200 [million] to \$250 [million] range if a straight cash basis was continued. She elaborated that a pension obligation bond opportunity may provide some relief in the right environment. She stated that it would not be a "slam dunk" but it was a consideration that may be worthwhile in the event of a significant market correction. She stated that the commitment was ongoing and long-term.

Co-Chair Neuman remarked that when the legislature had appropriated \$3 billion out of the Constitutional Budget Reserve (CBR) in 2014 it had reduced the Public Employees' Retirement System (PERS) and Teachers' Retirement System

(TRS) retirement costs. He elaborated that actuaries had estimated the state's payments would have been between \$700 million to \$1.2 billion; however, [given the cash infusion] the state's payments were about \$268 million in the current year. He wondered if there would be any significant debt reduction if the legislature allocated another \$1 billion from the CBR towards the PERS and TRS pension obligation.

Ms. Pitney answered that OMB could price the scenario out for the committee. She stated that given that the state was burning \$3 billion annually in CBR funds, taking money off the table should be thoroughly considered.

Co-Chair Neuman observed that having \$700 million less to pay [towards the retirement liability] in the current year had been helpful. Ms. Pitney agreed that it had been tremendous.

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Ms. Pitney continued to address payments and obligations on slide 10. Another large obligation pertained to how the state continued with oil tax credits. She stated that the governor's veto of \$200 million was to start the discussion on the long-term. She expounded that the current unbounded program was unsustainable. She added that all of the "big ticket" items on slide 10 were tough to move.

Ms. Pitney moved back in the presentation to slide 8: "Fiscal Challenge: Agency Reductions FY 15-FY 16." She relayed that on a percentage basis, the most significant reductions (20 to 35 percent) had been made to: Department of Commerce, Community and Economic Development (DCCED); Department of Military and Veterans Affairs; Department of Labor and Workforce Development; Department of Natural Resources; and the Office of the Governor. She added that DCCED had grant programs, tourism, and Alaska Seafood Marketing Institute and some of the reductions had been to its grant program. She noted that the decrease did not translate directly to people. Reductions of 12 to 20 percent had been made to the following agencies, which were more people oriented: Department of Fish and Game; Department of Revenue; Department of Law; Department of Administration; Department of Transportation and Public Facilities (DOT); and Department of Environmental Conservation (DEC).

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Vice-Chair Saddler asked what portion of the 20 to 35 percent reduction in the Office of the Governor budget was based on one-time reductions from elections, redistricting, and other related items versus ongoing programs. Ms. Pitney replied that 17 percent of the reduction was associated with ongoing programs. One time reductions were associated with the Council on Domestic Violence and Sexual Assault and elections. She noted that the state would be entering an election year and the costs would increase again. She stated that the ongoing versus one-time reductions were about 50/50.

Co-Chair Neuman believed there needed to be better discussions on the numbers. He remarked that a portion of the decrease to DCCED was related to Alaska Travel Industry Association (ATIA) and had nothing to do with the day-to-day administrative costs of the department. He wanted to see the cuts associated with the departments' day-to-day operations not including other reductions. He stated that the 20 percent reduction to DCCED shown on slide 8 was meaningless.

Ms. Pitney continued to address significant reductions on slide 8. Compared to the prior year the DHSS budget had been reduced by \$88 million, the DOT budget had been reduced by \$34 million, the Department of Corrections (DOC) and University of Alaska budgets had both been reduced by \$20 million. The figures did not count the elimination of the fuel trigger mechanism that had an additional impact on each of the departments (primarily DOT). Although oil prices had decreased, the price of gas had not decreased to the same degree, which had resulted in another significant reduction.

Co-Chair Neuman remarked that the fuel trigger was a result of oil below \$80 per barrel. He stated that subsequently "you should be expected to pay less for the price of fuel whether it's heating fuel or transportation fuels for the cost of these departments as opposed to recall them in the reduction in the budget."

Ms. Pitney replied that the price of oil had not translated to the same reduction in heating and motor fuel costs.

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Ms. Pitney addressed efficiency efforts on slide 9. She relayed that the initiatives would not redefine the price of government, but they would increase its efficiency and effectiveness. She detailed that some of the efforts were further along such as smart justice reforms and Pew group; whereas others were at the beginning. She elaborated that the statewide information technology (IT) consolidation had begun in the spring and was moving forward. Procurement and lease contracts efficiencies had begun in late May. The remaining items on the list were in the development phase and would produce savings over a two to three year time period. She reiterated that the savings would not be major, but they would enable the state to manage attrition forced through cost reductions. Every agency was moving forward on internal savings efforts to absorb as much of the costs as possible. She added that from December 2014 to July 2015 there were 500 fewer full-time permanent state employees, which did not count the University of Alaska or the Alaska Court System.

Co-Chair Neuman asked for further detail on the smart justice reform efforts. He requested information on the cost to different agencies.

Commissioner Hoffbeck pointed to slide 11: "The Conversation: Options." He stated that four different options had been addressed. The first option was to do nothing. He believed there was a fairly large constituency who felt that doing nothing was the correct answer; that if nothing was done, eventually the problem would work itself out as it had in the 1980s, 1990s, and 2000s. The administration was working hard to try to convince people that the option was not workable. The option to continue making reductions to government spending was on the table. He stated that people had made it clear that additional expenditure reductions were needed; people were not convinced that government was as small as it could be or that it had the right focus. The administration recognized the option as a valid part of the process. He relayed that another option people brought up was that oil and gas would bail the state out again. Finally, the administration would discuss some potential revenue options.

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Ms. Pitney discussed a bar chart on slide 12: "Options (Cut Government)." She pointed out that the legislature had significantly reduced the size of government by roughly \$1 billion per year since 2013. The FY 16 was currently at \$4.9 billion; including transfers from one-time sources the FY 16 budget was closer to \$5.1 billion.

Representative Pruitt asked if the figure included capital. Ms. Pitney responded affirmatively. She detailed that the figure included all UGF commitments; the majority of the decrease was due to reduced capital budgets. The difference between FY 15 and FY 16 was about 50/50 capital and operating budget decreases.

Co-Chair Thompson acknowledged that spending reductions were necessary; however, he wondered at what point reductions would begin to cause the state's economy to crash. Ms. Pitney stated that Professor Knapp would address the question later in the presentation. She explained that he would discuss how each of the options would affect the economy.

Commissioner Hoffbeck added that the conversation was about more than just numbers. He stated that it was possible to calculate how to balance the budget, but the impacts of various decisions needed to be discussed. He furthered that each of the options had some impact and accompanying baggage.

Representative Gara asked Ms. Pitney how much state services would be cut due to population growth and inflation if the budget was kept at \$4.9 billion. Ms. Pitney used an inflation estimate of 2 percent. She stated that much of the discussion about population was about the choices the state made; there could be modest population increases similar to the past 20 years or the state could make choices that would impact the growth. She furthered that population was an important thing to consider when making choices that might impact it in the future.

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Vice-Chair Saddler asked for the Consumer Price Index (CPI) and the population growth in Alaska over the past ten years. Ms. Pitney did not have the data on hand.

Co-Chair Neuman noted that Mr. Knapp would have the information.

Vice-Chair Saddler asked what number OMB assumed for inflation in its budget. Ms. Pitney replied that OMB used an inflation of approximately 2.25 percent. She stated that the figure had been higher 5 to 8 years back and had been closer to 1 percent a couple of the years as well.

Commissioner Hoffbeck relayed that the long-term average inflation used in the budget was 3.25 percent, but the current number used was 2.25 percent.

Representative Guttenberg observed that the state had not begun to feel the impacts of the reductions. He wondered if the administration was tracking the impacts of the cuts on various things like the backlogs at the state Recorder's Office, or lines at the Division of Motor Vehicles (DMV).

Ms. Pitney replied that to a certain degree the administration would have the ability to talk about the differences. The administration was working diligently through streamlining and efficiency efforts to avoid direct impacts as much as possible; however, there would be impacts and programs that would be discontinued.

Co-Chair Neuman requested any information on potential delays for administrative services within the departments.

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Representative Gattis referred to the 500 fewer state employees discussed on slide 9. She wondered how many of the positions had been vacant. Ms. Pitney responded that the number pertained to 500 fewer full-time employees. She acknowledged that the deletion of unfilled positions did not mean a reduction in employees. The number shown on slide 9 accounted for an actual reduction of employees from December 2014 to July 2015. She stated that less than 60 people had been laid off; much of the reduction was associated with employees who retired or resigned. She stated that given the information systems it would be difficult, but she was working to move the conversation away from vacancies to address what reductions meant in terms of people delivering services.

Co-Chair Neuman recognized that government services would take longer under a reduced budget. He reiterated his request for information on potential delays.

Ms. Pitney turned to a graph on slide 14: "Options (Cut Government): Real State Budget, Adjusted for Population, in Thousands." The graph showed a significant reduction to the capital budget in 2016 (represented in green). She noted that the capital budget expenditure was so small it was almost nonexistent on the graph. She added that statewide operations continued to be a driver with all of the payments and obligations (shown in red). She highlighted that the budget was currently lower than most years during the post-pipeline boom. The budget picture looked considerably different when it did not factor in population adjustments (slide 13 compared to slide 14).

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Ms. Pitney discussed a chart on slide 15: "Options (Cut Government): Average FY2009-2013 Total State Expenditures by Population." She discussed that much time had gone into considering how Alaska looked relative to other states. A line on the chart represented overall government spending based on the national average. Alaska had been significantly above the line in 2009 to 2013; however, it would be touching the line in 2016. More time would be spent looking at other states to determine how they operated at their given levels. For example, 50 percent of the school funding in North Dakota came from its communities. The issue was important to explore because government spending in Alaska was a major issue in the public.

Ms. Pitney turned to slide 16: "Options (Cut Government): Governor Protected Life, Health, and Safety (\$2 Billion)." She discussed that the hope was to cut government to fit into \$2.2 billion for the year (if oil prices held at the predicted average of \$66 per barrel). She detailed that the administration had presented a new budget bill of roughly \$2 billion when the CBR [draw] was not passed [during regular session]. The bill had included funding for troopers, DOC, half of DHSS, and one-quarter of the funding for the education foundation formula. The bill had not included the retirement contribution, any oil and gas tax credits, and only included one-quarter of the funding for all other state agencies. She stated that "it's a big

difference between where we are and a \$2 billion revenue standpoint."

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Representative Pruitt expressed his concern that the discussion would fall short of addressing government reductions. He discussed that during his campaign the governor had stated he would cut government by 16.7 percent; however, the governor's amended budget had actually increased over the FY 15 management plan by 0.3 percent. He detailed that in the end, after the governor's veto, the budget had ended up with a 4.6 percent decrease. He believed the ideas for cuts had barely been highlighted. He observed that the issue had been generalized to how the cuts may impact people and that efficiencies would be looked for. He believed that before the state took money from its residents that it cut its own budgets sufficiently; he stated that there had not been a real discussion how to make it happen. He addressed what the administration would present to the legislature in the current year would allow the legislature to determine its comfort level with the size of government and with the discussion about what role the public would play and provide with its own pocketbook. He believed the presentation was glossing over the issue.

Commissioner Hoffbeck replied that when the presentation had been developed the administration had spent as much time on cuts as it did on the revenue aspects. The goal of the presentation was to outline the various options available. The administration recognized that cuts were a part of the discussion going forward; however, if the state became bogged down in cuts it would not get to the final answer. He stressed that it was not possible to cut government enough to get to the final answer. He acknowledged that although it was necessary to continue to have expenditure reductions and the discussions on the table, it could not be the only discussion because the numbers did not add up. He shared that the first day of the workshop in Fairbanks had been spent on discussions about what people were willing to cut out of the budget. He detailed that the participants had only been able to identify \$20 million to cut from government programs. He agreed that it was a pertinent part of the discussion going forward, but the answer would not be achieved without work in other areas.

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Representative Pruitt understood; however, he believed it was much easier to take money from someone else than it was "to look in your own life and determine whether you're doing the right thing with your own budget." He asked about the goal of cuts and the size of government. He wondered what the legislature should expect to see in the coming year. He was frustrated that in the past the governor had been willing to make a statement about what percentage he wanted to see cut from the budget and although that figure had not been met, the governor had not communicated how much would be cut in the future. He believed that there were two sides to the coin, but it appeared more focus was being given to the income side.

Ms. Pitney responded that the administration would likely have an early indication in the beginning of October. She detailed that the administration was into continued constraint. She stated that "16.7 percent is a number. We actually cut 19 percent in unrestricted general funds last year to this year." She relayed that the cut from executive agencies (excluding Medicaid, the education formula, courts, and the legislature) was an average reduction of 13.5 percent. She noted that the legislature and courts had not been cut quite as much. She pointed out that there had been some significant reductions, which were as high as 20 and 30 percent. She emphasized that the administration was interested in continued constraints. She conceded that there were some things working against the goal. For example, it would be difficult to keep the capital budget at \$118 million, which had been funded largely by reappropriations. Additionally, oil tax credits exceeded the amount of funding in the particular pot. She stated that there were many things and many drivers. She reiterated the administration's interest in continued constraints.

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Representative Pruitt clarified that he had been using figures that included total General Funds. He had found that in the past year the legislature had focused so much on UGF, that it had glossed over DGF, yet it had moved UGF into DGF. He had felt that it was not an honest

conversation with the public because he believed General Fund was the whole pot.

Co-Chair Neuman asked committee members to think about their operating budget questions in terms of what part of the budget was made up of grants, state General Funds, required, and additional due to legislation.

Representative Gattis referred to Ms. Pitney's statement about the plan to have budget information out in early October. She asked for verification that Ms. Pitney had stated the governor intended to have a budget out in the first part of October and planned another cut of 16.7 percent.

Ms. Pitney replied in the negative. She clarified that the administration planned to have a budget framework out in early October; it would not have a change record and other items. She detailed that it would include targets, revenue expectations, and so forth. The administration's interest was continued spending constraint; it would do everything it could to keep the budget as low as possible, hopefully below the current year's budget, but there were things that were tough to control such as the earned oil tax credits. Items with a General Fund obligation made the total number difficult. The administration planned to make continued reductions in agency operations; the cuts would not be in the 20 to 30 percent range from the prior year. The cuts could be around 2 to 5 percent; some could be larger based on a choice in the change of service.

Representative Gattis remarked that there were people in her district who believed the state had not even begun to scratch the surface of the problem.

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Co-Chair Neuman reported that he had recently met with the governor who had committed to try to get the budget to the legislature up to 30 days prior to the December 15 release date to the best of his ability. He noted the administration had done pretty well in its efforts to get the budget out early the prior year. He stated that the sooner the legislature received an indication on the administration's budget, the sooner it could begin its work.

Representative Gara recalled that the prior year the administration had stated that firing every state employee would only cut the budget deficit in half. He wondered about the status of the analysis given the state's current revenue and the expected budget. Ms. Pitney replied that the UGF component for state workers was in the range of \$1.4 billion to \$1.5 billion. There was a gap of \$2.7 billion or \$3.2 billion depending on oil price; the termination of all state employees would reduce the gap by less than half.

Commissioner Hoffbeck highlighted slide 17: "Options (Oil Taxes): FY 16 General Fund Revenue." The chart addressed whether oil and gas could bail the state out again. He detailed that the chart showed price and production sensitivity. The red portions of the chart showed prices and production that were not sufficient to generate enough revenue to balance the budget. The white cells in the chart indicated a balanced budget with little to spare; the green cells indicated a budget surplus. In order to balance the budget at the current production of 500,000 barrels per day the oil price would need to be \$109 per barrel. He stated that the most optimistic price forecast was \$60 to \$80 per barrel as a stabilized price. He detailed that at those prices shale oil and others started getting turned back on. Subsequently, the increase in supply capped how much the price could rise. The less optimistic forecast was for stabilized oil prices between \$40 and \$60 per barrel. He recalled speaking with a price forecasting agency the prior year that had projected a price of \$40 per barrel, which had been pretty accurate. He reported that there was nothing on the horizon indicating that oil prices would increase up to \$109 again in the near future. He reasoned an increase of that magnitude would not be a result of supply and demand, but would take an international disruption that would possibly create a temporary price spike.

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Co-Chair Neuman asked if DOR had a fall oil price forecast. Commissioner Hoffbeck responded that the revenue forecast would be substantially lower than the spring forecast. The department was preparing to generate the forecast in early October. He added that experts from "all over" would be brought in to get ideas on the prices.

Co-Chair Neuman asked for an oil price forecast estimate. Commissioner Hoffbeck believed that optimistically the oil price would be \$60 per barrel, but probably lower in the short-term.

Co-Chair Neuman asked for verification that the figure would be down from the current \$66 price per barrel. Commissioner Hoffbeck replied in the affirmative.

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Representative Guttenberg referred to slide 17 and believed 500,000 barrels of oil per day was the long-term production forecast. He asked where 600,000 to 800,000 barrels per day on the chart had been derived. He did not believe the numbers represented reality.

Commissioner Hoffbeck answered that the numbers had been included on the chart in response to the belief of some individuals that increased oil production would bail the state out. The goal had been to show what could be expected with various increments of additional production. There was nothing on the horizon indicating that production would increase to 800,000 barrels per day. He stated that when the chart had been developed, oil prices had been about \$55 per barrel; at that price it would take 1.6 million barrels per day to balance the budget. He stressed that production would not bail the state out.

Vice-Chair Saddler discussed that the state had seen reductions in oil throughput of about 6 to 7 percent over the past several years. He asked if tax credits offered to the oil industry to incentivize drilling exploration had made a difference in maintaining the production level.

Commissioner Hoffbeck replied that it was difficult to make a definitive statement on the effectiveness of the credits on the production level. He stated there was no doubt that the state had seen more activity due to the credits. However, he did not believe the state had seen the "big score" that would indicate it was on the winning side of the equation. He expounded that there were some potential oil fields that could be brought online that if attributed entirely to credits would indicate the credits had been successful. He added that the larger issue related to credits was about what the state could afford. He remarked

that there were a multitude of many good programs, but the reality was there was a limited budget.

Co-Chair Neuman relayed that the committee would have discussions on the credits in the future. He asked members to provide associated questions to his office or to Co-Chair Thompson.

11:38:13 AM

Representative Edgmon asked what amount would be needed to backfill the budget under the scenarios presented on slide 17. He noted that the FY 16 budget was based on \$66 per barrel. He spoke to a scenario in which the average price was closer to \$50 per barrel. He remarked the state was looking at \$3 billion for FY 17 to make things work; however, it may need to backfill the existing budget.

Ms. Pitney responded that \$50 per barrel would generate \$1.8 billion. The projected price was \$66 per barrel, which would generate \$2.2 billion. The difference was \$400 million. At a price of \$40 per barrel, revenue could drop by as much as \$700,000, which would need to be backfilled for FY 16 before a discussion on FY 17 even began.

Commissioner Hoffbeck added that revenue would drop approximately \$120 million with every \$5 decline in oil price (at the lower oil prices). He skipped over slide 18 titled "Options (Increase Revenue)," which showed a screenshot of the interactive budget balancing model.

Co-Chair Neuman remarked that the administration had used a model developed by LFD and had reworked it to fit their scenarios. The model had been brought to the public and looked at different prices of oil, different taxes, and generated revenue under the scenarios.

Commissioner Hoffbeck turned to slide 19: "Options (Increase Revenue): Modify Oil and Gas Taxes." He stated that at \$40 per barrel there was not significant revenue for anyone within the tax system. He stated that some of the items shown on the slide had more pertinence in the discussion going forward with various gasline scenarios. He noted that the list encompassed the main tax structures for modifying the existing oil and gas taxes:

- Base Rate

- Minimum Tax
- GVR (New Oil Rate)
- Cook Inlet Production Taxes
- Hazardous Release Surcharge
- Natural Gas Reserves Tax

Commissioner Hoffbeck noted that the hazardous release surcharge had been done in the past year and had been included because it provided an idea of how difficult the discussions would be. He elaborated that the surcharge was almost one penny, but nearly did not pass the legislature because it was a new tax. He discussed that there had not been a new tax in 10 years other than oil and gas taxes (10 years back the new tax had been on alcohol and cigarettes). The department recognized that the appetite for taxes in Alaska was not high.

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Representative Gara discussed one of the reasons he believed the state needed to take a look at oil tax reform. He pointed to GVR [gross value reduction] oil on slide 19. He explained that GVR related to fields unitized after 2002. When oil had been \$110 per barrel, Dr. Scott Goldsmith [Institute of Social and Economic Research, University of Alaska Anchorage] had put out a chart showing that the state's production tax for new oil provided a near zero or negative net present value. He surmised it would be a negative net present value at current prices. He wondered if the administration had done any analysis on the issue. He agreed with incentivizing new oil production; however, he wondered if it was a wise investment if the state was spending significant money to achieve a negative net present value under the oil tax.

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Co-Chair Neuman did not want to get too far into oil and gas during the current meeting.

Commissioner Hoffbeck replied that the analysis by Dr. Goldsmith was accurate.

Commissioner Hoffbeck turned to slide 21: "Options (Increase Revenue): Modify Non-oil and Gas Taxes." He relayed that Senator Cathy Giessel was currently assembling

a panel to begin an active discussion on the issue. He elaborated that the administration had done significant work on the topic over the summer; it had been meeting with the investment community and smaller producers/explorers to get an idea of some plausible answers. He relayed that it would be an active discussion in the coming year. He read the various non-oil and gas taxes shown on slide 21:

- Corporate Income Tax Rate
- Mining Taxes
- Fisheries Taxes
- Motor Fuel Taxes
- Sin Taxes

Commissioner Hoffbeck noted that the state's motor fuel tax was the lowest in the country at \$0.08 per gallon. He believed the average was approximately \$0.30 per gallon. He reasoned that there was some room to move some of the taxes without becoming onerous in the state's tax structure. He commented that no one liked taxes, but some of the taxes were substantially lower than those in other states. However, Alaska had some of the higher alcohol and tobacco taxes (sin taxes) in the country.

Co-Chair Neuman requested current information on how much each of the taxes (shown on slide 21) brought in and recent history related to any structure changes. Commissioner Hoffbeck agreed and relayed that the information was on the department's website and was included in the interactive model as well.

Co-Chair Neuman asked Commissioner Hoffbeck to provide the information to the co-chair offices.

Representative Gattis referred to Commissioner Hoffbeck's statement that Alaska's sin taxes were some of the highest in the nation. She asked if the department had compared the state's taxes to the average of those in the Lower 48.

Commissioner Hoffbeck asked for clarification. Representative Gattis clarified that she was referring to the non-oil and gas taxes shown on slide 21, excluding sin taxes. Commissioner Hoffbeck replied that it had done the comparisons where the data was available.

Co-Chair Neuman asked the department to include the information with the other materials he had requested.

[11:45:22 AM](#)

Representative Edgmon followed up on the statement that there had been no new taxes in the past ten years. He remarked that the previous year in particular had seen a multitude of license and fee increases within the agencies, including fees for the Whittier Tunnel, parks, and other. He added that the legislature had increased the gas tax by \$0.009 for the Spill Prevention and Response (SPAR) Fund.

Commissioner Hoffbeck discussed slide 22: "Options (Increase Revenue): Repurposing Financial Assets":

- Pension Obligation Bonds
- Permanent Fund Earnings
- Permanent Fund Dividend Cap
- Collateralization & Securitization

Commissioner Hoffbeck elaborated that the department was looking at pension obligation bonds in more detail as the market had begun to correct. He detailed that DOR had been looking for an opportunity within the market, which may have begun to form. He addressed Permanent Fund earnings such as a percent of market value (POMV) model that would require legislative action or use of earnings, which would be an appropriation. He stated that Permanent Fund earnings represented the biggest option available to the state in terms of bringing additional money in for government use. He stated that the use of earnings would be most effective as a cap, but could be done as a percentage to the state as well. He addressed collateralization and securitization, meaning the state would borrow against its existing assets to "supersize" the Permanent Fund and generate more revenues in order to spin more revenues off for state purposes. He noted that the option related to borrowing would come with some risk.

Representative Wilson wanted to clarify that the motor fuel tax included heating oil and not just gasoline. Commissioner Hoffbeck responded that a tax program had not been developed for the motor fuel tax; it had simply compared motor fuel tax to other places in the U.S. He furthered that if the tax was included in the package

brought forward by the administration, it would detail the information out.

Representative Wilson stated that if there was a conversation about heating oil it needed to include gasoline. She stated that some people did not heat their homes "that way" and she wanted to ensure things were kept on a fair level.

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Vice-Chair Saddler asked for clarification on what collateralization and securitization may look like. Commissioner Hoffbeck responded that the program discussed earlier in the year related to borrowing against the state's existing financial assets and reinvesting. The difference between what Alaska could borrow and what it could achieve in the investments would enable the state to increase the size of its revenues and/or the size of the Permanent Fund. Securitization would then mean selling the future revenue for a one-time infusion into the budget, but then the state would not pay out the ongoing revenues.

Vice-Chair Saddler asked if Commissioner Hoffbeck was talking about using the Permanent Fund in an "arbitrage play." Commissioner Hoffbeck replied that essentially that was how it would work. He communicated that it would not be a true arbitrage play, but because of the state's advantage as a government entity it could borrow taxable money against what it could return in investments. He reiterated that there was some associated risk; however, there was risk in doing nothing as well. He believed the lead option on slide 22 would be pension obligation bonds, which was a similar play.

Co-Chair Neuman requested an analysis of stock market projections. He remarked that the market was not very secure at present. He asked the department to provide the committee with its idea related to collateralization and securitization.

Commissioner Hoffbeck responded in the affirmative. He assured the committee that the concept would be vetted by the best minds before action was taken.

Ms. Pitney clarified that the options on the list were only options and did not mean the administration was endorsing them.

Representative Gara asked for an estimate on how much pension obligation bonds would help towards the deficit. Ms. Pitney answered that it depended on the myriad of assumptions and risk tolerance. Currently the state was paying roughly \$265 million in past service obligations. Additionally, the state was paying \$0.22 on every \$1.00 for PERS employees (including every municipality and school district). She stated that it would be helpful to the degree that either of the components' payment into the retirement system. She continued that the administration would look at what the state was currently paying, what it could offset in the ongoing operating budget, and the associated risk.

Commissioner Hoffbeck elaborated that whether the money was used to cover the state's "on behalf" payment or to allow a lower employer contribution depended on who would get the benefit.

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Co-Chair Neuman thought the state paid 24 percent as opposed to 22 percent [related to PERS contributions]. Ms. Pitney responded that each employer paid \$0.22 on every employee whether they were in the Defined Contribution or Defined Benefit plan. She noted she had forgotten to include TRS, which the state paid a larger "on behalf" payment on. The actuarial rate through the prior year was 35 percent and employers picked up 22 percent; the on behalf payment was the difference between the 22 and 35 percent for PERS. On the TRS side it was the difference between the employer payment for TRS of 12 percent and the roughly 30 percent.

Co-Chair Neuman interjected that the committee would delve further into the issue.

Ms. Pitney continued that the pension obligation bond option had more potential than other items, but it would require significant analysis and discussion.

Co-Chair Neuman noted that for many of the different issues it came down to how much of the load the state could continue to carry.

Commissioner Hoffbeck pointed to a chart on slide 23: "Options (Increase Revenue): Per-Capita Broad-Based State Tax Revenues, by State, 2014." The chart included various revenue generating taxes used by each state. For example, if the state implemented a state income tax at 15 percent of federal earnings, it would bring in about \$550 million. He estimated that at 700,000 residents it would increase the per capita state tax burden by \$800, which would be about \$1,300 per person. He explained that even with a personal income tax the state would be the second lowest taxed state in the nation. Additionally, residents would continue to receive a Permanent Fund Dividend. He stated that "the sky was not falling," the state taxes could look different, but it would not resemble a state like Connecticut [with very high taxes] in order to balance the budget.

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Commissioner Hoffbeck highlighted options for new taxes on slide 24:

- Health Care Provider Tax
- Business License/Gross Receipts Tax
- Income Tax
- Capital Gains Tax
- Payroll/School Tax
- Sales Tax
- Statewide Property Tax

Commissioner Hoffbeck elaborated that all of the options (on slide 24) had been talked about by the legislature within the past few years. He addressed slide 25: "Options (Increase Revenue): Lottery/Gaming":

- State Lottery
- Permanent Fund Lottery
- Gaming Rates
- Card Rooms
- Casinos

Commissioner Hoffbeck expounded that he had given two Powerball interviews in Fairbanks. He relayed that people were interested in the idea, but it did not generate significant revenue. He noted that it could generate between \$12 million to \$15 million in revenue.

Co-Chair Neuman asked what it would cost to operate. Commissioner Hoffbeck replied that initially the state would probably have a contract with the corporation that ran Powerball nationally. He surmised the cost would be a percentage. He did not have the information.

Representative Gara believed there was an unintended loophole in the state's corporate tax. He detailed that C Corporations paid a corporate tax, but S Corporations only paid a \$100 license fee and no tax. He wondered how much revenue would be generated if S Corporations were included under the corporate income tax. In the distant past he had heard that revenue would be approximately \$40 million.

Commissioner Hoffbeck did not have the information on hand; however, the administration was looking at what it would take to introduce an S Corporation or Limited Liability Company tax. He noted that the number was not huge.

Co-Chair Thompson relayed that his office was looking at S Corporations and was working with the administration. He offered to work on getting answers to questions committee members may have on the subject.

Ms. Pitney addressed a flow chart on slide 27 titled "Path to Fiscal Stability." She explained that the chart represented the administration's road map to session. She relayed that the administration was focused on raising public awareness. She moved to slide 28: "Sustainable Future Dialogues" and relayed that the administration had held 17 events to date. The largest had been the June 5 and 6 kick-off meeting. She noted that multiple department heads had been involved in the events including herself; Commissioner Hoffbeck; Chris Hladick, Commissioner, Department of Commerce, Community, and Economic Development; and Governor Walker. Additionally, there were a minimum of 25 upcoming events. She thanked members of the business community and public who were hosting events including Commonwealth North, Institute of the North, the Rasmuson Foundation, and others. She discussed the goal of developing a framework for discussion to provide more in

depth analysis about a proposal from the governor that was expected in early October. She noted that the proposal would not include detail on change records and the specific number of people, but it would include targets and levels it would propose to the legislature. She continued that the proposal could be refined throughout the fall; the administration intended to participate at the Alaska Federation of Natives (AFN) and Alaska Municipal League annual conferences to continue moving the dialogue forward. The formal submission would be made in December, which would not be a surprise. She discussed that there would be such a change for the state and the decisions would be impactful, but the more people who were on board the better.

Co-Chair Neuman referred to the final column in the road map on slide 27 pertaining to finalizing legislation and reporting to the legislative leadership for vetting. He asked if the administration was considering any specific legislation and what it would be. For example, a change to tax credits, a POMV for the Permanent Fund, or other.

Ms. Pitney replied that the information would be made clear in the October timeframe. She elaborated that the administration was actively having the conversations internally and wanted to bring a solid framework forward that would result in robust conversations.

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Representative Gara referred to the list of sustainable future dialogues on slide 28. He agreed that the groups on the list were all good; however, it was important to engage the general public as well. He asked if the administration had any focus on getting out to the general public who did not attend Chamber of Commerce, Commission on Aging, and other meetings. He wanted to hear thoughts from the public on everything, including oil taxes. He wanted the debate to include all options.

Ms. Pitney replied that based on the slides, all options were on the table. She communicated that the administration was working to engage the public in the discussion as much as possible. She stated that the Rasmuson Foundation was moving forward on a larger education campaign. The administration was committed to getting as much information out as possible; it was open to providing whatever it could

to legislators or groups to enable them to take the conversation to "their world."

Commissioner Hoffbeck added that the administration had not limited the discussions; it had worked to accommodate a discussion with anyone who had asked. He noted there were a couple of YouTube videos available for a "meeting in the box" idea for people to utilize in smaller group discussions.

Co-Chair Neuman commented that individual legislators had all be talking to their constituents. He detailed that he would work with finance committee members on visiting their communities to hear what the public had to say on the state's direction.

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Vice-Chair Saddler referred to slide 27, column 5 that related to finalizing a recommendation on a preferred option. He requested to receive the information as early as possible, which would benefit the conversation between the legislature and the administration. He asked the administration not to wait until it had "it all wrapped up in a bow" in October. He stated that receiving the information in advance would allow time to work out a better deal.

Co-Chair Neuman communicated Representative Pruitt's request for information on where the administration saw reductions in the current budget.

Representative Edgmon felt differently than the prior speakers. He was less concerned with the detail the administration would provide the legislature on what it proposed for the next legislative session because he did not believe any of the options would go forward until the public bought in. He discussed that the first part of the presentation had been titled "fiscal challenges" but in his world it could be labeled "political challenges." He stated that everyone involved understood that new revenue needed to come from someplace and that the legislature would not act until the general public felt the same thing. He recommended consulting AFN as he believed the federation planned to address the topic of a sustainable future during their upcoming convention. He thanked Co-Chair Neuman for holding the meeting and communicated his appreciation to

the administration for a presentation well done. He believed the approach would take time and would need to be a layer by layer method.

Co-Chair Neuman referred to recent news coverage related to the U.S. stock market. He remarked that the value of Chinese currency had significantly impacted the market. He stated that Standard and Poor's had recently provided thoughts related to downsizing Alaska's credit rating. He asked for information on how the situation impacted Alaska.

Commissioner Hoffbeck replied that there would be some impact, particularly if the state decided to begin using the Permanent Fund earnings as a source of revenue for state government. He detailed that Permanent Fund earnings would suffer like anything else in the event of a major downturn in the market. He relayed that the CBR was pretty well protected; money had been moved from the subaccount into safe investments in the main account in the preceding year in order to protect the funds. He qualified that the money would decline if the market went down, but it would not decrease as dramatically as the market. The state had very little revenue coming in at present due to low oil prices and a market that was appearing to correct, which would probably exacerbate the problem going into the FY 17 budget. However, a correction in the market provided numerous opportunities that were not available when the market was high; the correction would allow the state to be more aggressive with investing. He communicated that a couple of weeks earlier Standard and Poor's had let the state know it would take Alaska's bond rating back to its credit committee. He noted that the practice was concerning and highly unusual. Subsequently, the department had traveled to meet with the agency and had relayed that the state was on track with plans outlined by the governor the prior February. He furthered that due to substantial cuts made by the legislature the prior session, the state was ahead of expenditure reductions it had discussed. The department had shared that the administration had been traveling around the state preparing to bring a revenue package forward. He relayed that the agency was comfortable that the state was on track with its plans, but it made a strong statement that if they did not see a substantial closing of the revenue and expenditure gap that the state's bond rating was in jeopardy going forward. He believed the end of the legislative session would probably trigger another response from the rating agencies. He hoped that at

that point the agency would be comfortable that the state was continuing to move forward. He noted that the problems would not all be solved in the current year; the process would be ongoing.

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Co-Chair Neuman spoke to work committee members had done to reduce the state's operating budget. He believed the work had to be recognized by Wall Street. Commissioner Hoffbeck replied that it had been recognized.

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RECONVENED

^INSTITUTE OF SOCIAL and ECONOMIC RESEARCH PRESENTATION:
ECONOMIC IMPACTS OF ALASKA FISCAL OPTIONS: A STUDY ISER IS
STARTING SOME OF WHAT WE ALREADY KNOW

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GUNNAR KNAPP, DIRECTOR AND PROFESSOR OF ECONOMICS, INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH (ISER), UNIVERSITY OF ALASKA ANCHORAGE, provided a PowerPoint presentation titled "Economic Impacts of Alaska Fiscal Options: A Study ISER is Starting Some of What We Already Know" (copy on file). He discussed that there was significant interest as the legislature and administration spoke about all of the possible ways of dealing with the fiscal situation. He relayed that ISER was starting a study that would finish in the fall related to economic impacts of Alaska fiscal options. His primary message was making the study as useful as possible for decision makers; therefore, ISER was interested in any questions the committee may have about economic impacts. He added that if time permitted he would talk about what was already known from past ISER studies. He addressed that Alaska was facing difficult choices between difficult fiscal options (slide 2):

- We have been running very big deficits
- We have been using reserve funds to pay for the deficits
- Our reserve funds are running out

- Within a few years, we will have to reduce the deficits
- Our only options are:
 - More spending cuts
 - New revenues
 - Using Permanent Fund earnings

One of the issues in making these choices is how different options would affect our economy.

Co-Chair Neuman suggested making an addition to the slide. He stated that there were plenty of laws directing the state. He communicated that the committee would look heavily at passed legislation that increased the budget. He elaborated the intent to review the legislation to determine whether all of the projected costs had come to fruition and whether all of the employees were needed. He believed the legislature needed to take a look at taking some laws off the books and refining statutes guiding regulations.

Mr. Knapp agreed and viewed the option as a method to get spending under control. He would add the idea to the options considered in the study. He turned to slide 3 titled "ISER is doing a study of economic impacts of Alaska fiscal options":

- \$60,000 study funded by DOR and OMB
- Study is just beginning
- Timeline
 - Mid-September: Preliminary report
 - Mid-December: Draft final report
 - Early January: Final report

Mr. Knapp expounded that the preliminary report would summarize the past analyses on the topic and the draft final report would include new information. He turned to slide 4:

We welcome your advice about this study

- We want the study to be helpful to Alaskans
 - Particularly to the legislature which has to make the hard choices
- We welcome your advice:
 - Today or any other time

- o By email, phone, meetings
- o What fiscal options do you want to know about?
- o What economic impacts do you want to know about?
- We will form an informal study advisory group:
 - o Looking for a wide range of perspectives
 - o Will meet by teleconference two or three times
 - To advise about study design
 - To review preliminary and draft final reports
 - o We would welcome legislative participation

Mr. Knapp elaborated that ISER was interested in learning about the kinds of economic impacts that were of interest to the legislature (e.g. employment, jobs, and others).

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Mr. Knapp addressed slide 5 and emphasized that ISER was not advocating for or against any options. The goal of the study was to help inform the discussion and to compare impacts of different options in a consistent, objective way. He moved to slide 6 and relayed that the study would look at economic impacts of a broad range of fiscal options including spending cuts, bringing in new revenues, or using Permanent Fund earnings.

Representative Guttenberg asked if the ISER analysis was connected with DOR's view and analysis of tax credits. Mr. Knapp answered that the ISER study was independent of any analysis done by the department; however, it would try to use similar names and basic assumptions. He detailed that if the department looked at a specific income tax, ISER would analyze the impacts of the same kind of income tax. He explained that ISER would try to look at the same kind of thing if the department looked at how much a certain option may raise.

Representative Guttenberg referred to oil and gas credits and taxes. He wondered where new economic benefitted jobs went and who got the jobs when there was talk about new jobs and production. He wondered if the jobs would actually benefit the Alaskan economy. Mr. Knapp replied that the question was important and was of interest to ISER and many others.

Co-Chair Neuman replied that the committee would continue to explore the question. He relayed that he had spoken with Mr. Knapp about how the oil and gas industry would react to oil and gas taxes. He noted that there had been many applications for the current credits, which did not pay anything unless money was spent. He questioned how the oil and gas industry would react if the credits were discontinued.

Mr. Knapp answered that the specific issue was particularly difficult and complex with significant uncertainty. He elaborated that part of the economic impact of changing oil taxes or credits was related to how the industry may react, which was uncertain to start with. Secondly, if the industry changed its exploration or behavior as a result of the changes to taxes or credits, how it could impact future production was also uncertain. He stated that some of the issues were inherently complex or uncertain; therefore, ISER would try to lay out a way to think about the issues.

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Co-Chair Neuman asked members to consider any questions they may have related to the issues so they could be included in the presentation. He relayed that one of the concepts he had discussed with Mr. Knapp was what would happen if the influx of cash did not go into the state's economy under a POMV methodology. He explained that many businesses depended on the Permanent Fund Dividend for up to 30 percent of their annual revenue. He wondered what would happen if the money no longer went into the state's economy to private industry or small businesses. He wanted to spur committee members to come up with similar questions to refine the direction of the conversations the committee would have on the subject.

Co-Chair Thompson pointed to slide 6 and stated that he had heard that many people would prefer to see a sales tax instead of income tax. He believed there were already 90 communities that had a sales tax. He wondered how an additional sales tax would impact those communities.

Co-Chair Neuman added that the topic was of interest particularly with the loss of revenue sharing.

Representative Gattis addressed new revenues. She asked whether money taken from private business for government

operations would make it back into the hands of private industry. Mr. Knapp replied that ISER would definitely explore the topic. He noted that some of his slides addressed ISER's past research on the topic.

Vice-Chair Saddler wondered if ISER planned to create a complex model based on the interaction of all of the different options. He asked whether the impacts of a combination of approaches would be considered together. For example, spending cuts combined with the creation of an income tax. Alternatively, he asked if the study would only consider options on a one by one basis.

Mr. Knapp answered that the study would do two kinds of things. The first goal was to determine the relative effect different options would have on the economy. For example, if the goal was to reduce the deficit by \$500 million, the study would look at how various changes would impact the state (e.g. cuts to capital spending, school spending, through a sales or income tax, or through dividends). Secondly, the study would look at how utilizing various options simultaneously would add up together to impact the economy as a whole.

Co-Chair Neuman relayed that he and Co-Chair Thompson had been talking with ISER and OMB. He asked committee members to provide specific questions to the co-chairs and relayed that they would look at putting together a contract or proposal for ISER from the House Finance Committee. He wanted to ensure that members were as informed as possible on the economics. He had asked Mr. Knapp to look at the impacts of the budget reductions in terms of jobs. He elaborated that every \$100 million reduction in operating funds equated to about 866 jobs, whereas, every \$100 million reduction in capital funds equated to about 950 jobs. He stated that the reductions made the past session could mean 8,000 to 10,000 existing jobs. He addressed how the impact would affect the economy. He spoke to a long-term sustainable budget between \$4 billion and \$4.5 billion and how it impacted the economy.

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Representative Gara did not believe the state was close to fixing the problem. He noted there were many people looking at oil tax reform, income tax, sales tax, and cutting the budget; however, he believed the best thing the state could

be doing was to hear from people. He thanked Mr. Knapp for the work. He thought it was important to debate all of the options. He addressed income tax and asked Mr. Knapp to provide information on its impact. He provided a scenario of a 15 percent state income tax, which would be deductible from a person's federal taxes. He surmised that with the federal deduction the income tax may provide a smaller number to the state. He addressed oil taxes and credits. He discussed that Mr. Goldsmith had done a net present value (NPV) analysis the preceding year using a price of \$110 per barrel for new oil. He asked for an NPV analysis of what the production tax was bringing in for new oil at current expected prices. He remarked that the analysis on an oil price of \$110 per barrel was probably no longer relevant.

Mr. Knapp answered that the study would certainly include the first item mentioned by Representative Gara. He agreed that a state income tax was slightly offset by the reduction in the federal income tax. On the other hand, studies of things like the NPV of an income tax was a whole different topic. He recognized the importance of the topic, but it was not part of the planned ISER study. He elaborated that ISER was not studying how much money the different options would generate or whether the state was gaining or losing money from tax credits. The study was simply addressing how the changes would impact jobs and the economy in Alaska.

Co-Chair Neuman asked members to get questions to the committee chairs.

Representative Pruitt asked about the overall impact to the housing market in Anchorage if a person's income was affected by a change made by the state. He noted that any impacts would have secondary ramifications of affecting property tax values. He was interested in the "finer things" that could potentially have longer-term impacts.

Mr. Knapp answered that ISER had received a set funding amount from OMB and DOR for the study. Given the set funding, ISER had set its focus on jobs and income-type impacts. He agreed that the effects different changes would have on the housing market was clearly very important; however, it was beyond the scope of the current study. He relayed that if additional funding was provided, ISER could expand the study.

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Representative Pruitt wondered if the study included a discussion on salaries. He asked how changes in the state would trickle down through the economy. For example, if a person was currently making \$70,000, but changes in the state meant that jobs would remain albeit at a lower wage.

Mr. Knapp replied that he had not considered the issue. He observed that another effect could be on the labor market, which could end up impacting wages. He had not planned to study the topic, but it could be added on. He added that he would need to think about how the topic would be included.

Co-Chair Neuman stated that the presentation was aimed at inspiring the questions.

Representative Edgmon asked if the study would help him (as a representative of smaller communities) better understand the economic multiplier impact of budget cuts. He spoke to potential cuts of \$500 million to \$700 million by the legislature in the next legislative session. He stated that many of the cuts would hit smaller communities much harder. He believed that the state was currently in an unprecedented chapter in Alaska's history and if so, that the cuts would be sustained. He elaborated that it would not be possible to backfill a school that was shutdown, the Village Public Safety Officer (VPSO) that left, or a public radio station that was closed down. He noted that a symbiotic relationship existed. He asked if the relationship could be measured by ISER's analysis to the extent that many of the cuts would land statewide, but many would be borne proportionately more by small communities.

Mr. Knapp replied that it was the goal of the study to address the topic, albeit perhaps not as completely as Representative Edgmon would like. He referred to slide 7 and explained that the study would look at how various things like spending cuts, taxes, and cutting dividends would impact different sectors of the economy, industries, regions, and income groups. He pointed to cities like Juneau and Fairbanks where state government jobs made up a significant part of the economy. He pointed to rural areas where local government and school districts made up a big part of the economy; much of which was funded by state spending. The study would try to show how different kinds of places were affected in different ways. He elaborated

that [Permanent Fund] dividends were a much larger part of residents' incomes in rural areas of the state; therefore, a change in the dividend would be a relatively larger hit in those regions. Likewise, an income tax would be a relatively bigger hit in cities like Anchorage where incomes were higher. The study would address how different kinds of things would impact different communities in different ways.

Co-Chair Neuman asked for presentation highlights due to time limitations.

Vice-Chair Saddler remarked that there was distance between what was good for the state's economy versus what was good for the state's financial cash flows. He reasoned that making more jobs could be a good thing on one hand, but it could cost more services, schools, and roads on the other hand.

Mr. Knapp replied that the goal of the study was look at how different fiscal options might affect people, which the legislature and administration could then factor into their equation when making decisions.

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Vice-Chair Saddler had heard the "rhetoric" that the budget could not be balanced on the backs of state workers. He reasoned that it was also not possible to insulate state workers at the expense of the rest of the state's economy.

Mr. Knapp addressed how ISER would conduct the study (slide 9):

- Review major findings of past ISER studies
- Update past ISER studies using current data
- Review other studies
- Use "input-output" modeling" to estimate short-run job and income impacts of different options
- Use ISER's Alaska Economic and Demographic Model to estimate long-term economic and demographic impacts
- Use IRS income data to estimate how fiscal options would affect different income groups

Mr. Knapp discussed limits to the study on slide 10. He relayed that ISER could not provide precise answers about

exactly what would happen under different fiscal options. He communicated that there was significant uncertainty. For example, the effect of budget cuts depended largely on how the cuts were made (e.g. reduced employees, reduced rent, reduced photo copy bills, and other). Additionally, longer-term "feedback" impacts of fiscal options on investment, migration, and economic development were harder to project and analyze. He relayed that ISER would do the best it could to provide the information.

Co-Chair Neuman noted that the committee was looking at different administrative budgets by department. He wondered if there was a way to look at reductions in certain budgets and how they would impact the economy. For example, the Department of Natural Resources (DNR) was responsible for a substantial amount of the state permitting, which created more jobs.

Mr. Knapp replied that a function such as permitting was essential to the functioning of many different industries such as mining, construction, and other. He stated that if the budget was cut too much and permitting slowed as a result, it could slow a large segment of the state's economy. He believed it may a different effect than cutting a school budget, which may not have an immediate impact, but could slow the economy later. The study would try to address the issues, but it involved significant detail given the difference between each of the departments.

Co-Chair Neuman relayed that the committee members needed to know what the information would look like for the different departments in their roles as finance subcommittee chairs. For example, Representative Pruitt looked at the DNR budget to determine how it would impact other businesses and their ability to operate within the state.

Mr. Knapp replied that the items were outside of the current scope of the study. He relayed that an expanded budget would enable ISER to study additional things. He pointed to a 1987 ISER study on slide 11 titled "A comparative Analysis of the Economic Effects of Reimposing Personal Income Taxes, Reducing Permanent Fund Dividends, or Reducing State Spending." He communicated that ISER had been studying the issue for a long time. He pointed out that the topic of the paper was eerily similar to the questions the state was considering at present. He

addressed what had been learned in past studies on slide 13:

- There are no painless options
- All our fiscal options would affect Alaska's economy
- Different options have different economic impacts
 - Different impacts on industries, income groups and regions
 - Different effects on investment, development and future revenues

Mr. Knapp elaborated that any fiscal option would have economic impacts. He stated that it was a matter of "what kind of pain do you want to take." He referred to language from the 1987 study (slide 14): "...either reimposing income taxes or reducing dividends would reduce purchasing power of Alaskans and, therefore, cost the economy jobs and income." He expounded that because people had less money to spend, jobs and income would be impacted. The study had also considered whether implementing a personal income tax or cutting Permanent Fund dividends would have a bigger impact on the state's economy. It had found that a personal income tax would have a lesser impact on the economy than cuts to dividends because dividend money tended to go directly into spending, whereas, income taxes generally came from wealthier residents who tended to save more of their income. He explained that it was necessary to analyze whether the evidence still pointed to the same conclusion. Additionally, the 1987 study had found that cutting state spending could have an even greater impact on jobs than imposing taxes or cutting dividends, but it depended on the type of spending.

Mr. Knapp addressed a question on slide 17: "How many jobs are created by \$1 million in state spending?" He noted that the question could be run in reverse by asking how many jobs would be lost if \$1 million was cut from state spending. He noted that the estimates shown on slide 17 were from 1999. He pointed out that "you get the most jobs for your dollar from hiring people directly." He elaborated that state workers spent their income and injected it into the economy; therefore, in a job sense, cutting state spending would cost more jobs than cutting the dividend. However, there was a larger impact on residents' incomes if they were directly given a dividend because individuals tended to spend the money, thereby creating more income for other people.

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Mr. Knapp addressed how different ways of state spending impacted jobs (slide 21). He stated that how a cut was made to spending really impacted the effect. For example, if the number of employees were kept at the same level, but their pay was cut (jobs had not been cut, but income had gone down), the amount of money recirculating in the economy would decrease. Additionally, different types of options had very different distributional effects in terms of "rich people, poor people." He noted that Alaska residents had widely varying incomes. He pointed to estimates from a 1993 ISER study on slide 22. The study addressed how different fiscal options would impact how much income residents would give up. He elaborated that an income tax impacted wealthier people more, while eliminating dividends impacted poorer people more. Slide 23 illustrated that different parts of the state varied tremendously in how dependent they are on state and local government as part of their economy. For example, state spending cuts to something like education that supports a significant part of local government would have a different relative impact in different places. He remarked that all of the information needed to be updated for the present. He added that there were also many more questions to be answered in addition to information included in the past ISER studies. He reiterated that in addition to studying the information, ISER's goal was to help the legislature and administration answer questions that mattered to them.

Representative Gattis observed that federal government had not been included in the chart related to "State and Local Government as a Share of Total Employment" on slide 23. Mr. Knapp replied that the study could include the portion of federal government spending that was dependent on state matching funds. Representative Gattis believed "it makes a difference in different regions on what type of income that they have." She surmised that if state government was cut, the local and federal government would have to pick up the slack if available.

Representative Gara remarked that the past 20 years of ISER's work had looked at cuts and spending, income and sales tax, and dividend cuts; however, it had not looked at oil taxes. He hoped that would not continue and believed if it did that the public would become alienated.

Co-Chair Neuman asked Mr. Knapp to briefly address his second presentation.

AT EASE

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^INSTITUTE OF SOCIAL and ECONOMIC RESEARCH PRESENTATION: A FEW OBSERVATIONS ON ALASKA'S FISCAL CHOICES

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Mr. Knapp addressed a PowerPoint presentation titled "A Few Observations on Alaska's Fiscal Choices" (copy on file). He relayed that over the past six months he had been trying to figure out how to help explain the state's difficult fiscal challenge to Alaskans. He had recently given a presentation to the Fairbanks Chamber of Commerce and had taken several slides from that presentation to help frame some of the items under discussion by the legislature. He stated that it was well known that the lower the price of oil, the larger the funding gap became. He pointed to a chart on slide 2 illustrating what the funding gap would be based on different oil prices. At \$100 per barrel the funding gap would be \$1.4 billion, whereas at \$60 per barrel the funding gap would be \$3.2 billion; the lower the price the bigger the problem. He noted that the state faced two different choices (slide 3):

When will we fill the funding gap?
How will we fill the funding gap?

Mr. Knapp expounded that the state faced a tradeoff between acting later and acting sooner. The longer the state delayed, the longer the immediate pain and effect on the economy would be put off (slide 4). Additionally, there would be less unnecessary pain if oil prices recovered. However, there were negative repercussions of waiting to act (slide 4):

The sooner we risk draining our reserves
The bigger the risk of facing drastic immediate adjustments
The greater the risk to our credit rating

The greater the risk to investor confidence
The lower our future investment earnings from savings
The less savings we leave for future generations

Mr. Knapp addressed how the state would fill the funding gap on slide 5. He remarked that none of the options were easy or popular. He turned to slide 7 titled "How Much Could Spending Cuts Fill the Funding Gap." The vertical bars illustrated how much money the state may get from taking certain actions. Three of the bars showed savings that may be achieved from different levels of spending cuts and one showed what may be saved by some approaches to changes to oil and gas taxes that DOR had looked at. He mentioned revenue that could be generated from statewide income, sales, or property taxes (slide 10). He addressed different ways of using Permanent Fund earnings (slide 15). He stressed that if oil prices remained low, it would take a multitude of things to fill the funding gap.

Co-Chair Neuman remarked that legislators needed to look at how much government the state could afford. He stated that ISER and Institute of the North had both looked at a sustainable budget scenario where expenditures were \$4.1 billion to \$4.5 billion. He wondered if the amount was still accurate.

Mr. Knapp replied that the analysis had been done by Dr. Goldsmith who had determined that with all of the revenue sources combined (e.g. oil, gasoline, and investment revenues from Permanent Fund earnings) the state could sustain a spending level of about \$4.5 billion. He qualified that the state could only sustain the amount if it was willing to use investment revenues from the Permanent Fund, which had not been done in the past. Dr. Goldsmith updated the information annually based on the current estimate of future resource revenues and investment earnings. He communicated that the analysis was not an official ISER recommendation. He reasoned that the legislature could decide how useful the analysis was in informing its decisions about the direction it would take.

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Co-Chair Neuman stated that the information from organizations like Institute of the North and the business industry was helpful for the legislature find a target point.

Co-Chair Thompson observed that the estimates were all high compared to the current oil prices. He thought it was prudent to look at what would happen if oil prices did not increase. He believed contingency plans were necessary and did not foresee the situation being a short-term problem.

Mr. Knapp shared the concern. He was scared about oil markets and some of the recent analysis. He believed everyone had been hoping that low oil prices seen in the prior year were a very short-term phenomenon; however, recent news did not make it look like oil prices would increase.

Representative Gara bristled at the fact that Dr. Goldsmith's analysis always left out oil taxes when considering a sustainable amount of expected state revenue. He agreed that it was a number, but it was a number assuming that industry was not asked to contribute more of its share.

Mr. Knapp believed Representative Gara's observation was correct. The number [in Dr. Goldsmith's analysis] was based on assumptions about the way the state taxed oil and what would be possible. He believed that the observation was fair. He reasoned that perhaps a different sustainable number could be achieved if another way of taxing oil was assumed. On the other hand, changing oil taxes introduced how it would impact future production. He stated that of course how much money the state would have in the future depended on what kind of taxes the state had and how they were structured. However, he stated that "it doesn't mean that you could just sort of change the tax in some way and just choose a higher future number because there are limits to how much you can get."

Co-Chair Neuman wanted the presentation to spur different questions from committee members. He mentioned the possibility of entering into a contract or negotiations with ISER and was interested in the types of questions committee members may have. He noted that questions could be targeted to members' specific finance subcommittee budgets. He remarked that the committee had good regional balance. He relayed that he had asked Ms. Pitney to provide information on where a proposed \$30 million unallocated reduction that covered the cost of increases for salaries for union employees would come from. He wondered where the

various departments had taken the reduction. He asked if the reduction was really \$30 million or \$60 million. He noted that Representative Munoz had sponsored legislation that increased funding for the SPAR Fund under DEC. He communicated that SPAR Director Kristin Ryan had assured him that the increased funding had not been used to backfill reductions to the department.

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ADJOURNMENT

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The meeting was adjourned at 1:05 p.m.