

HOUSE FINANCE COMMITTEE
January 22, 2016
1:32 p.m.

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CALL TO ORDER

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

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Randall Hoffbeck, Commissioner, Department of Revenue; Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Representative Andy Josephson, Representative Dan Ortiz, Representative Louise Stutes.

SUMMARY

OVERVIEW OF THE GOVERNOR'S FY17 BUDGET & 10-YEAR PLAN:
OFFICE OF MANAGEMENT AND BUDGET

Co-Chair Neuman announced that the committee would be hearing an overview of the governor's 10-year fiscal plan.

^OVERVIEW OF THE GOVERNOR'S FY17 BUDGET & 10-YEAR PLAN:
OFFICE OF MANAGEMENT AND BUDGET

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "New Sustainable Alaska Plan: Pulling Together to Build Our Future." He indicated he would be talking about the new sustainable Alaska plan and distinguishing it from the Permanent Fund Protection Act. He would be clarifying some of the confusion and complexity in trying to understand how they fit together in terms of balancing the budget in both the short-term and the long-term.

Representative Gattis asked if the new sustainable plan was different from an old sustainable plan. In other words, she wondered if there was an older plan that was updated.

Commissioner Hoffbeck replied in the negative.

Representative Gattis surmised the new plan was the old plan. Commissioner Hoffbeck indicated Representative Gattis was correct.

Commissioner Hoffbeck moved to slide 2: "Fiscal Challenge." He relayed that the state was looking at a shortfall of around \$3.6 billion to \$3.8 billion in unrestricted general funds (UGF) for the FY 17 budget. The question was how to close a gap of such size.

Representative Gara commented that the legislature had been talking about a \$3.5 billion deficit and the price of oil currently was at \$28/bbl (per barrel). He wondered if, for the current fiscal year, the state was at a projected \$3.5 billion deficit based on the average price of oil through the present day or from an old projection of oil prices.

Commissioner Hoffbeck answered that the deficit was growing because of the reality of the price of oil. The Department of Revenue (DOR) forecast was based on \$50/bbl. The state was at the forecast at the end of the year. However, since then, the price of oil has dropped to \$25/bbl or \$30/bbl. The department was projecting less revenue than when the official forecast was projected.

Representative Gara asked if the state was really projecting more than a \$3.5 billion budget deficit for FY 16.

Representative Thompson corrected Vice-Chair Gara by clarifying that he meant FY 17.

Representative Gattis clarified that he was talking about FY 16 because the year was not over.

[A technical issue occurred requiring the committee to take an "At Ease"].

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AT EASE

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RECONVENED

PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, introduced herself. She answered that based on the fiscal summaries provided by Mr. Teal, director of the Legislative Finance Division, if the state chose to do nothing remaining with the status quo, then the FY 17 budget deficit would equal \$3.5 billion. She explained that the budget deficit for FY 16 was \$3.8 billion. The projected revenue for FY 16 was \$1.6 billion. However, in the previous spring, revenue had been projected at \$2.2 billion. She furthered that \$3.8 billion was compounded by the drop in oil prices not counting transfers and other items.

Commissioner Hoffbeck discussed the graph on slide 3: "Fiscal Challenge." He noted that the chart was very simplified. However, for the point of discussion, the chart showed what happened if the state did nothing. By FY 18 the Constitutional Budget Reserve (CBR) would be depleted. By FY 20 the Permanent Fund (PF) Earnings Reserve Account (ERA) would be depleted. The state would be in a place where its revenues would not be sufficient to provide basic public services. He added that the Permanent Fund Dividend (PFD) would no longer exist. The question was how to solve the problem of insufficient revenues to sustain service and depleted savings.

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Representative Munoz asked, in reference to slide 3, if the commissioner had calculated the projected rate of return on the corpus of the PF and the state's ability to use the PF earnings beyond the slide's four-year projection.

Commissioner Hoffbeck responded that the chart showed the status quo approach. The earnings had always been used to pay dividends. Going forward there would be a balance between using the funds to continue paying dividends and funding government. He thought that status quo money flowing out of the corpus and into the ERA would equal about \$1 billion to \$2 billion.

Representative Munoz stated that the corpus generally earned around \$3 billion per year. She did not see that amount reflected in the slide. She wondered how far out the projection would stretch into the future if the state were to use excess earnings on an annual basis.

Commissioner Hoffbeck clarified, "Before it would be depleted?"

Representative Munoz responded if DOR had done some analysis on the subject.

Commissioner Hoffbeck responded that it would not affect the depletion; however, there would be additional revenues going forward. He reported that the slide needed to be cleaned up; it was for visual purposes only.

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AT EASE

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RECONVENED

Co-Chair Neuman invited Commissioner Hoffbeck to continue. He added that he suspected the committee would engage in discussions on the PFD in greater depth.

Commissioner Hoffbeck scrolled to slide 4: "Fiscal Challenge":

- Take action now, not later:
 - Government must be cut further
 - Protect essential services

- Use of Permanent Fund earnings is acceptable if:
 - Protect the Permanent Fund Corpus
 - Preserve a Dividend Program

- New Revenues are acceptable if:
 - They support right-sized government
 - The burden is shared equitably

Commissioner Hoffbeck explained that the administration had taken the information from the slide and discussed it with the public over the prior summer. The administration had been looking for feedback as to what people were willing to do to solve the state's fiscal problem. He relayed that he and Ms. Pitney had conducted over 50 community meetings throughout the state. There were certain clear messages as a result of the meetings. First, after attending the meetings, people understood the state's fiscal situation needed to be addressed immediately rather than later. Attendees also made it clear that that they were not convinced the government was operating efficiently. The individuals were clear they wanted to see further cuts to the budget, but they also wanted to protect essential services. He noted that different groups had different ideas about what essential services were. There was a balance between protecting services and smaller government. Attendees had also made clear they understood the necessity of using the PF earnings but they believed the corpus of the fund had to be protected no matter what. He explained that people were not willing to spend the state's future to balance the budget.

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Representative Gattis remarked that the commissioner had glossed over the point that government needed to make further cuts. She did not believe the state had made further reductions. She wondered why the state had not made additional reductions.

Commissioner Hoffbeck replied that the administration had made cuts in the amount of \$140 million and about \$40 million in new investment. Reductions were selected in such a way that the services people were asking for could remain intact.

Representative Gattis understood that some cuts were made but other items had been added back into the budget, resulting in a larger overall budget. She had a problem with the administration not making further reductions even after receiving feedback from people around the state that government needed to make additional cuts.

Commissioner Hoffbeck appreciated the comment and would discuss the subject at another time. He continued to report on the messages the administration had received from people throughout Alaska's communities. People were willing to talk about new revenues, but only after "right-sizing" government. They also conveyed that they wanted to see the burden shared equitably rather than falling on one particular constituency or industry.

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Commissioner Hoffbeck advanced to slide 5: "Fiscal Challenge: Alaska Permanent Fund Protection Act - Defining the Problem." He posed the question as to what the state was facing in its current challenge. Some of the responses included the belief that: the enemy of fiscal stability was oversized government; the oil and gas industry was not paying enough; the legislature was not doing its job in controlling spending; and, the administration was not controlling government spending. He suggested the real enemy of fiscal stability was not having a solid plan on how to move forward. He commented that the state never really had a plan for declining oil prices. Currently, the state saved 25 percent to 30 percent of the royalties moving it into the PF. Any monies left over at the end of the year went into the CBR which was intended to bridge short-term oil revenue fluctuations. He added that the state had been chasing oil prices up and down. The slide depicted state revenue versus petroleum revenue. He noted that with a one year lag there was a significantly strong correlation between oil price and the state budget. He suggested there were always people wanting to use available monies. The governor had advocated that there was no reason to blame anyone for the condition Alaska was in, except to attempt to replicate the situation. He paraphrased President John F. Kennedy that it was not a time for despair, it was a time to act. He underscored that the right solution was needed.

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Co-Chair Neuman asked the commissioner to return to the slide. He thought the problem was that there was only one line representing revenue from petroleum. He thought the state had not diversified its economy enough. The state depended on one revenue stream: the development of its

resources. He wanted to know how the administration evaluated the effects the bill would have on the state's economy. He maintained that what was getting lost was the financial impacts on Alaska. He asked the commissioner to respond. He wondered if there was a program that could produce revenue and if the administration had considered it more carefully.

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Ms. Pitney replied that one of the considerations in developing the budget was looking at bringing in more revenue to the state. The administration looked to programs within the Department of Natural Resources (DNR) for possibilities. However, the state had one main revenue stream, oil. Although the administration was examining the economy and the impacts every decision it made would have on each sector, the reality was that the change in the state's economy was due to the change in the price and production of oil. Part of the recommendation in the overall plan was to begin to link broader economic diversity and broader gains in industries outside of oil to state revenue.

Co-Chair Neuman remarked, "I am sure we will see more of them coming."

Commissioner Hoffbeck indicated there had been research done on the "resource curse." There were other countries and states that had a single resource base that supported a large portion of services. Alaska was really no different than any other state that had been in the same situation.

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Commissioner Hoffbeck turned to slide 6: "The New Sustainable Alaska Plan":

- Alaska Permanent Fund Protection Act
- FY17 Budget and Future Spending Reductions
- Revenue Increases

Commissioner Hoffbeck relayed that there were three components to the new sustainable Alaska plan. He would spending some time clarifying the Alaska Permanent Fund Protection Act. He had included the slide to clarify that the act did not include budget line items or revenue

increases, which were contained in separate bills. The act created a structure for how to use the state's earnings in a sustainable fashion. All three items made up the new sustainable Alaska plan.

Representative Edgmon commented that from a mathematical point the state had more than one year's worth of reserves left to continue business as usual assuming the state had the same budget level as it had in FY 16 and into the future. Looking at the sheer numbers the state had up to four years of reserves if the earnings of the PF were included. However, the legislature continued to hear that it was paramount to act in the current session for the betterment of Alaska's fiscal future. He commented that the legislature was discussing state government spending as well as the overall confidence of the Alaska economy. He wanted to hear about why it was absolutely paramount the legislature acted in the current session and about potential repercussions of not acting right away. He asked how savings and Alaska's economy would be affected.

Commissioner Hoffbeck responded that the more savings the state spent, the less it would have to invest to generate income. The sustainable draw would shrink with less of a base for earning. He suggested that it would have been better to have implemented the plan two years prior.

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Representative Edgmon suggested Commissioner Hoffbeck only partially answered his question. He provided the hypothetical scenario where the state could reduce the budget by \$500 million and still have enough in reserves to continue for two more years. He felt there was a sense of urgency being generated. The average person could see that the state had \$15 billion or \$16 billion in savings and could conclude that the governor's plan did not have to be executed in one year. It could be implemented in a span of two to three years. He was trying to open up the discussion.

Commissioner Hoffbeck believed the presentation would clarify the reasons for avoiding spending down the state's savings.

Co-Chair Neuman stated that he thought most members echoed Representative Edgmon's sentiments about wanting a

sustainable plan but wanted it to be right. He asserted that it was important to inform the public and make sure they are part of the discussion.

Commissioner Hoffbeck remarked that there were separate bills for each of the elements of the plan. There would be extensive analysis on how the administration reached the draw amount and what would happen without the savings behind it.

Commissioner Hoffbeck turned to slide 7: "Alaska Permanent Fund Protection Act":

- A fiscal framework for using our wealth to:
 - Help resolve this year's fiscal challenge
 - Sustainably fund government operations into the future
 - Provide the maximum benefit to the broader economy
- Main components of the framework:
 - Royalties and production taxes into the Permanent Fund
 - Endowment draw
 - Royalty dividend
 - Periodic review

Commissioner Hoffbeck relayed that one of the messages the administration had heard from businesses was that wild swings impacted their ability to invest. He reviewed the main framework components of the Alaska Permanent Fund Protection Act. He noted he had a slide further in the presentation that detailed the first component: royalties and production taxes into the PF. He offered that the second component was an endowment draw - a fixed draw for government spending. The third piece of the framework was a royalty dividend, which would be tied to royalties rather than PF earnings. The last piece was a periodic review to ensure that the plan remained sustainable over time.

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Commissioner Hoffbeck pointed to the flow chart on slide 8: "Alaska Permanent Fund Protection Act." He referred to the slide as a plumbing picture. He raised the question about what the plan did. First, if the state was going to rely on

earnings from the PF corpus as the primary funding source for state government, the state needed to strengthen the corpus of the fund. The plan proposed to change the flow of revenues coming in. All production taxes would flow into the corpus of the PF rather than flowing directly into the General Fund. Half of the royalty revenues [50 percent] would flow into the corpus of the fund; currently, it was only 30 percent. The corpus of the fund would be built up in order to sustain government expenditures into the future. It placed the volatility into the PF and took it out of the budgeting process. Essentially, the PF was a \$50 billion money-sink that could absorb fluctuations in revenue from year-to-year. He reported that when the administration modeled it they looked at both high and low projected years of earnings to determine the sustainable draw. He continued that the other 50 percent of the mineral royalties would flow into the earnings reserve and eventually drop out to pay dividends. He furthered that 50 percent of the prior year's royalties would pay the dividend in any given year. Monies would then flow out of the PF corpus into the earnings reserve as they did currently with statutory net income - realized gains such as royalties on investments, rents on state properties, or the sale of assets at a profit.

Commissioner Hoffbeck explained that the administration had looked at more of an endowment model - a Percent of Market Value (POMV) model - but thought it would create more of an obstacle in passing legislation. He believed people were comfortable that the proposed plan protected the corpus of the fund and provided a strategy they were accustomed to. He reported that the earnings reserve account was currently at about \$7 billion. Approximately \$2 billion would flow into the ERA. The earnings reserve would also earn money on its investments. However, the amount was not quite large enough. The administration was asking for was a \$3 billion transfer from the CBR into the earnings reserve to bring the balance to about \$10 billion. He detailed that the state should be able to transfer \$3.3 billion annually into the General Fund for government services if the ERA balance was \$10 billion (resulting from money that flowed in on an annual basis and the earnings of the reserve itself).

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Representative Gara asked if the \$3.3 billion was flat or in real dollars. Commissioner Hoffbeck responded that the

figure was flat through 2020 and then it would begin to grow with inflation.

Representative Gara asked if the plan would require cuts to the budget every year for 20 years in real dollars. Commissioner Hoffbeck responded through 2020 (three years).

Co-Chair Neuman commented that there were sweepable and non-sweepable funds that got mixed. He asked the commissioner to expand on the topic.

Commissioner Hoffbeck explained that concerns were raised within the Legislative Finance Division as to whether monies that were deposited into the earnings reserve would be swept back into the CBR at the end of the year. Part of what the administration was trying to accomplish was to create the stability of knowing how much could be withdrawn each year. Ultimately, the state was spending savings whether from the CBR or the ERA. A steady fund draw was possible if the money was in the ERA. There was concern that the character of a fund draw would change if an annual sweep to repay a debt to the CBR was required. He shared that he had spoken with the attorney general's office to confirm what would happen with the funds. The attorney general's office had the opinion that both the ERA and the PF corpus would not be swept back into the CBR.

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Co-Chair Neuman wanted to make members aware of the discussion.

Representative Kawasaki asked about the predictability of putting money in the PF corpus. He mentioned that the PF value over the previous two months was fairly volatile. He thought it sounded like the state would be changing one volatile system for another volatile system - the price of oil versus the stock market activity. He asked the commissioner to comment on the topic.

Commissioner Hoffbeck responded that there was volatility in the investment earnings. However, in the model, volatility would be accounted for in both investment returns and in oil and gas production and price in establishing a \$3.3 billion sustainable draw. Most of the volatility would reside in the corpus of the PF. As money moved into the ERA there would be less volatility. In other

words, all of the oil and gas volatility would be taken out. There would still be some investment volatility in the ERA but the earnings reserve would be managed for an annual withdraw of \$3.3 billion. The administration would do a couple of things to deal with the volatility going forward. The first would be to set the goal of having four times the annual draw residing in the earnings reserve. It would take away a portion of the volatility because even if there was a low return year there would still be enough money to pay the \$3.3 billion draw.

Co-Chair Neuman suggested covering the information later.

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Commissioner Hoffbeck reiterated the robust modeling which included an ERA balance of at least four times the amount of the draw, and a periodic review. There would be a review in the following calendar year, another review in 2020 to see if the administration's assumptions were still valid, and a review every four years after that. He asserted that both measures took away some uncertainty. He noted there was a toggle within the bill that if the ERA balance went below the equivalent of four times the amount of the draw the production taxes in all but the constitutionally mandated royalty payments would flow into the ERA. Only 25 percent would go into the corpus until the ERA balance was up to the required amount. He relayed that when DOR did its modeling it found that \$3.3 billion draw had a 30 percent failure rate by 2040. A failure rate meant the earnings reserve would reach a balance of zero. He emphasized that a failure rate meant that the earnings reserve balance would go to zero rather than the corpus of the fund. The earnings reserve would go to zero 30 percent of the time which was why a review process every four years was necessary to eliminate the possibility of failure. After a review process the state could adjust as necessary to avoid failure.

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Representative Kawasaki asked if Commissioner Hoffbeck had stated there was a 30 percent failure rate in the modeling conducted by the department.

Commissioner Hoffbeck explained that if the state launched the modeling in the current year and did not touch it again

until 2040 there was a 30 percent chance of failure. He confirmed that the \$3.3 billion draw could take the ERA to zero, 30 percent of the time which was the impetus for having a four-year review.

Representative Kawasaki asked how the dividend would be calculated if it was based on 50 percent royalties. Commissioner Hoffbeck answered that if the state saw a recovery in oil prices in the \$60 range the dividend would likely bounce between \$800 - \$1,100, whereas, if oil prices remained at \$25/bbl then the dividend could drop to about \$400.

Co-Chair Neuman asked for information about the assumptions DOR had used to run its model (including assumptions that worked and ones that did not). Commissioner Hoffbeck answered that he would provide the information.

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Representative Kawasaki commented that in looking at the model it appeared that all of the production tax went into the corpus of the fund. He understood that there would not be any more drawn from the corpus to the ERA; it depended mostly on the mineral royalty, a fixed rate. He asked if he was accurate.

Commissioner Hoffbeck responded that the PFD would be 100 percent based on the mineral royalties.

Representative Kawasaki commented that the dividend was independent of the price of oil. Commissioner Hoffbeck disagreed. He explained that the royalty was a percentage of the sale of oil; as the price increased, the percent paid in royalty was worth more.

Representative Gara understood the administration's reasoning in its approach without having a constitutional amendment. The Legislative Finance Division concluded that the modeling did not work. He furthered that by putting all of the money into the ERA to spend on general government, the state faced a situation where the money in the ERA would be swept into the CBR annually. He furthered that every year a three-quarter vote would be necessary. The constitution was very clear; it stated that the amount of money in the General Fund available for appropriation at the end of the year would be deposited in the CBR. He

stated that the bill turned the earnings reserve into a spending fund. It was no longer a Permanent Fund and inflation proofing fund, but rather a spending fund used for schools, roads, etc. He continued that the Legislative Finance Division in its overview had stated that money available for general appropriation went into the CBR at the end of the year. He believed it was clear that a three-quarter vote would be needed annually to get the money out of the CBR to make the plan work. He was uncomfortable with a plan that was going to require an annual three-quarter vote to fund basic services.

Commissioner Hoffbeck explained that he had posed the same question to the attorney general. He deferred to the attorney general's explanation to provide more assurance that the sweep would not occur. He added that in reality, the ERA had always been a spending fund and had always been available for expenditures.

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Representative Gara mentioned a court ruling that was based on a time where the ERA was only used for dividends and inflation proofing. He noted that it would change with the bill. He wanted a plan to work but he thought that LFD was in a much stronger position in its analysis than the attorney general at present. He expressed concern with the need for an annual three-quarter vote to fund basic services. He was aware of what was stated by the attorney general, but he reasoned that the constitution stated what it stated.

Commissioner Hoffbeck answered that he would make sure someone came before the committee to walk through the analysis.

Co-Chair Neuman agreed that it was a critical piece of the governor's legislation.

Vice-Chair Saddler understood the investment guidelines and directions to the PF were different regarding whether funds were aimed at being available immediately or invested for the long-term. He asked if the current guidelines appropriate to the model or would there have to be changes to those.

Commissioner Hoffbeck responded that a certain amount of PF investments were short that were in cash or cash equivalents, characteristic of a balanced portfolio. In the previous year \$1.4 billion was used to pay for the PFDs; it was a larger draw. He thought it would take an adjustment, but indicated it would likely be more in the allocation than in a mandate.

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Vice-Chair Saddler asked why the raw number of \$3.2 billion was used rather than a percentage.

Commissioner Hoffbeck commented that the administration found that a fixed draw provided the most sustainability. If the draw became larger in high return years it would take away building up the size of the corpus of the fund and potentially would leave more volatility in the budgeting cycle.

Vice-Chair Saddler asked, given inflation and increases in health care costs, whether the model allowed for any systemic increase in the cost of government. Alternatively, he asked if the four-year renewal was the state's opportunity to allow for inflation.

Commissioner Hoffbeck responded that after 2020 it would grow with inflation. Government expenditures that grew faster than inflation, such as medical costs, would have to be addressed with additional reductions or other revenue sources. He reported that one of the goals was to extract as much as possible annually moving forward. The amount of \$3.3 billion was as much as could be pulled out of the system for funding government services. He asserted that if the state tried to chase expenditures with the draw eventually the corpus would start to be depleted. The issue remained that Alaska had a very limited number of resources feeding government services. The current structure of the bill was that \$3.3 billion could be reduced in order to preserve sustainability. However, the toggle switch to go higher was purely inflation, even on the four-year review. An exception would be some sort of quantum shift in the state's economy.

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Vice-Chair Saddler asked the commissioner to reiterate how the structure allowed for inflation.

Ms. Pitney explained that 2.25 percent was the assumption on inflation.

Representative Pruitt asked about the balance of the PF corpus in 2040 based on the analysis. Commissioner Hoffbeck responded that the balance would be at whatever the current corpus was plus inflation. He offered to provide a chart that would show an amount.

Representative Pruitt asked about the 30 percent failure rate and the periodic reviews. He thought the state had limited its choices around dealing with failure especially since 50 percent of the production taxes and mineral royalties would go into the corpus and the remaining 50 percent would go to the dividend. He wondered what the plan was to adjust if the state were to get to the point of failure rate. He asked how the state would adjust and pay for government under the proposed plan.

Commissioner Hoffbeck relayed that it depended on the level of failure. If there was a short-term cash flow issue due to multiple bad years in a row, the toggle would place production taxes and all constitutionally mandated royalty payments into the earnings reserve to bolster the account and to enable further payments. If it appeared that the long-term forecast of returns on invest and oil price and production would not support the draw then the administration would recommend to the legislature reducing the size of the draw. He noted that the administration would not want to take more out of the ERA than it could provide.

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Representative Pruitt asked about the \$3.3 billion draw. The proposed budget was about \$5.2 billion. He pointed out there was a \$1.8 billion gap. He asked whether the state had enough revenues to fill the gap without having to go forward with some of the newly proposed revenue sources such as an income tax.

Commissioner Hoffbeck responded that on slide 8 the barrel labeled "All Other Taxes" represented taxes and fees the state currently collected - about \$850 million per year.

The administration expected the state would be making some return on the CBR investments. He relayed that \$3.3 billion plus \$850 million, plus \$135 million totaled approximately \$4.2 billion to \$4.25 billion. The state was about \$1 billion short. He asserted that the other parts of the new sustainable Alaska plan, revenues and reductions, would help to fill the remaining gap.

Representative Pruitt concluded that the state would be about \$1 billion short. Commissioner Hoffbeck concurred. He reiterated that revenues and reductions, the other parts of the new sustainable Alaska plan, would help to fill the gap. In other words, the state could get within \$1 billion using its existing financial assets. The Permanent Fund was not large enough to fill the gap alone.

Representative Pruitt asked if the administration was done making cuts. He wondered if the legislature would have to find other sources of revenue in the current year and in future years such as a sales tax, income tax, or other things. He wondered if the administration would continue with cost reductions and resizing. He also wondered about inflationary growth and the potential the gap would increase.

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Commissioner Hoffbeck flipped to slide 9: "The New Sustainable Alaska Plan." The slide showed the various pieces of the new sustainable Alaska plan. The Alaska Permanent Fund Protection Act was a \$3.3 billion draw and existing taxes and fees and earnings on savings brought the number to \$4.285 billion. The numbers were forecasted out to FY 19, as it would take three years to get the plan in balance. The slide showed spending reductions in FY 17 through FY 19 in the amount of \$240 million (\$140 million in FY 17 and \$50 million the following two years). Another reduction of \$400 million was connected to the oil and gas tax credit reform. He noted about \$40 million in priority investments was placed back in. The net in spending reductions was \$600 million, \$500 million of which were in FY 17. He anticipated about \$457 million in new revenues. He concluded that the \$1 billion shortfall was covered with \$600 million in the form of reductions and about \$400 million in the form of new revenues.

Representative Pruitt thanked the commissioner for answering his question. He asked if the capital budget would be limited to \$50 million or if there would be additional capital spending. He asked if there was a commitment from the administration to continue reducing spending, He also wondered if the legislature would have hit the administration's goal in a single year.

Commissioner Hoffbeck suggested that where cuts were made would dictate his response to the representative's question. However, the governor had made it very clear that the plan was in pencil; if the legislature believed the proper balance included additional cuts and less revenues he was amenable to that. He relayed that the governor intended to work with the legislature to find the necessary balance; he was only using the plan as a template and left the door open to modify it. The only thing unacceptable to the governor was no plan at all. The administration expected greater reductions than what was proposed.

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Co-Chair Thompson referred to slide 8 and the PF corpus. The way the plan was set up 50 percent of mineral royalties and 100 percent of production taxes would go into the PF. He noted that the remaining 50 percent of the royalties would go towards the dividend. He mentioned the potential gas line in 10 years and suggested that 50 percent of gas royalties and 100 percent of gas production taxes could be added to the PF. There would be a much larger royalty and potentially a much larger dividend. He stated that possibly the dividend could grow to \$3,000 or \$4,000. He asked if he was correct.

Commissioner Hoffbeck responded affirmatively. The dividend would follow the economic health of the state.

Representative Edgmon reiterated his earlier question about why the plan needed to be formed in one year. He wondered how the legislature would sell the plan to the Alaska voters in such a short amount of time. He asserted that not only did the state have a fiscal problem, it also had a political problem. The plan had come about sometime in late October or early November of the prior year when it was presented to the legislature. He was trying to rationalize how he was going to explain to a group of people in Dillingham that the state was going to cut their dividend

in half, consolidate all of the state's savings accounts, and continue to make major reductions to K-12 education funding and several other programs. He suggested that whatever plan was adopted would be a cooperative effort between the legislature and the governor. It was already the end of January. He appreciated the work that had gone into the model and thought it had promise. He also liked the way the governor was trying to take a judicious approach to reducing the budget. However, he wondered if there was any other reason for hurrying the model out in the current year. He mentioned looking at the M/V Susitna in Ketchikan five years earlier. He recalled it had looked pretty good on dry dock. He wondered, though, how it was going to work in the water and the rigors of ice conditions. He emphasized the importance of needing to be able to explain the model to the voters in Alaska in order for the legislature to decide to go forward with the plan.

Commissioner Hoffbeck said he would bring in some matrixes that showed what the sustainable draw would look like if the legislature waited one year to take action. The impacts of waiting could be seen in the information he would provide.

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Representative Edgmon suggested that the inference was that the administration would be working with the general public between the present day and the end of session to help them understand why it was that the state had to take action and why it would be beneficial for the long-term sustainability of the state.

Commissioner Hoffbeck responded, "Absolutely, we will talk to anybody, anywhere, anytime about it."

Co-Chair Neuman remarked that the administration had been going around the state frequently. He added that he had been putting the presentations on Facebook and was trying to get them to the public as much as possible. He assumed Representative Edgmon was doing the same with his constituents.

Representative Edgmon responded that he did not understand the model well enough yet to sufficiently explain it to his constituents.

Co-Chair Neuman stated that it would take a while to better understand it, as it was a very complicated plan with several pieces. The goal for the current meeting was to provide a 50,000-foot view.

Commissioner Hoffbeck returned to slide 9 and reported there were separate bills for each of the components. The components included the Permanent Fund Protection Act, the spending reductions in the budget bills, and the new revenue components in the form of a series of tax bills introduced by the governor - mining, fishing, tourism [motor fuel], alcohol and tobacco, oil and gas, and individual income tax legislation.

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Vice-Chair Saddler referenced that new revenues were acceptable if the burden was shared equitably on slide 4; however, a sales tax was not included on slide 9. He asked why a sales tax was not put forward.

Commissioner Hoffbeck replied that the administration thought it was an "either/or" scenario - it believed proposing both would have been too much. The administration concluded that an income tax was more appropriate than a sales tax because of the federal deductibility of the tax, the ease of implementation and auditing, and feedback from communities. Many communities were already using sales tax as a major source of funding; they were concerned they would have to pull back if a state sales tax was added onto a municipality sales tax.

Representative Gara referred to slide 4 regarding equitability. He opined that equitability would really be the topic of discussion in the current year. He spoke to a study from Institute of Social and Economic Research (ISER) that showed if the dividend was reduced to the level the administration was suggesting, 50 percent of Alaskans (some of the least wealthy Alaskans in the state) would have their income reduced by about 20 percent. On the other hand the proposed income tax would be about 1 percent of the income of the wealthiest Alaskans. He added that most corporations in the state did not pay corporate tax. He suggested requiring corporations that earned over \$250,000 per year to pay a tax. He also alluded to the fact that the state had an oil tax policy in which every field after 2002, at oil prices below \$60 or \$70 per barrel, paid a

zero percent production tax. He asked how he would tell a constituent in Fairview or Mountain View or in some of the poorer parts of the state that they would be paying a tax equaling 20 percent of their income.

Commissioner Hoffbeck responded that first there was a balance by having both the PFD and an income tax. The state was aware that a smaller PFD would impact lower income families more. He conveyed that by tying the income tax to the federal tax liability so that it embedded all of the credits and exemptions within the federal tax structure the lower 40 percent or 50 percent of individuals would not be paying a state income tax or a very small one. The income tax would disproportionately affect higher earners. Conversely, the dividend would disproportionately affect lower earners. He concluded that by having the structure of the PFD and an income tax it created some balance although he realized it was not perfect. He continued that the issue with the corporate income tax payers was not with the C corporations but with the S corporations and partnerships. The personal income tax would become the mechanism to capture those. The income would flow through to the underlying partners. By having a personal income tax the state would be able to capture revenues from those corporations.

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Representative Gara suggested that the corporate tax for the other corporations would become 1 percent or 2 percent because of the income tax amount. He continued that the corporate tax for C corporations was 9.4 percent. He relayed that the administration's plan would have the other corporations paying about a sixth of the rate. He suggested measuring the rate against the 20 percent of income of Alaskans not in the top 50 percent of wage earners. He asked the commissioner if he thought it was equitable.

Commissioner Hoffbeck suggested that by tying the income tax to the federal income tax structure it removed a portion of the debate. The simplest way to get an income tax into play was to charge a percentage of the federal tax rate. If the state wanted to change to a structure of its own it could put one into place in the future. He added that within the oil and gas tax credit reform there was a provision that did not allow the new oil to drop below the

floor. In the hardening of the floor the minimum tax for new oil would be the floor rather than zero.

Representative Pruitt mentioned that all of the new revenue proposals except for an income tax already had an infrastructure in place. He wondered what the costs would be to build and maintain the infrastructure for an income tax.

Commissioner Hoffbeck responded that the upkeep would be about 3 percent of taxes collected. He would have to get back to the committee with the costs for implementation.

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Vice-Chair Saddler asked if the department had macroeconomic information as to how the revenue generated from the reduction in the PFD would compare to the amount of revenue generated by the proposed income tax which the commissioner had indicated was about equal. He wanted to see additional breakout numbers.

Commissioner Hoffbeck suggested that with an assumed dividend of about \$1,000 in the current year and \$2,000 in the previous year the amount would be \$700 million. The income tax would be \$200 million in revenues.

Commissioner Hoffbeck discussed the chart on slide 10: "The New Sustainable Alaska Plan: Per-Capita Broad-Based State Tax Revenues, by State 2014." He pondered what Alaska would look like if all of the levers within the fiscal plan were pulled. Currently Alaska had the lowest individual tax burden in the country at about \$500 per person. He noted that the slide he was presenting was an ISER slide. If all levers were pulled the tax would increase to about \$1,000 per person. The national average was \$2,300 per person. Alaska would remain either the first or second lowest taxed state in terms of an individual broad-based tax burden in the nation. He contended that the state was not creating a situation in which Alaska's tax level was so onerous that people would simply leave the state. There was no other state where they would pay less. He understood that when the tax burden went from zero to something it would feel like a significant amount. He wanted to put into perspective how Alaska taxes would rate in comparison with other states.

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Vice-Chair Saddler commented that because taxes were paid on the commonly owned oil wealth, the per capita tax paid either by or on behalf of Alaskans would likely be different from the chart.

Representative Wilson asked if property taxes were included in the amount of taxes listed on the chart. Commissioner Hoffbeck responded in the negative. The property taxes were local taxes and therefore not on the slide.

Representative Wilson speculated that the chart would look much different if the comparison between states included both taxes and cost of living expenses. Alaska would not appear at the bottom. She disagreed with the commissioner about his comment that adding a tax would not be onerous. She wanted to be careful about adding another tax. She asked if any studies had been done on the impacts of each of the proposals to the economy. She asked if there was any documentation showing why the administration chose the proposals it had. She needed to be able to take that information back to her district because she did not see a reduction in government included in the plan. She wondered if the information would be provided to the committee in order to better understand the administration's direction.

Commissioner Hoffbeck responded that the administration had contracted with ISER and Gunner Knapp was doing the study about the impacts of the various components of the fiscal plan. He thought the study would be completed by early to mid-February. He thought it would be available by the time the topic of revenue was brought up in committee. The administration thought that it was better to have the study completed externally to give it additional credibility. The Office of Management and Budget and DOR stood back and allowed ISER to do the study without input from either agency.

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Representative Wilson wondered if the study would include a recommendation for a sustainably sized government without making changes to the Permanent Fund or imposing additional taxes.

Commissioner Hoffbeck thought the report would answer her question - it would include the impact of various cuts and the impact of various taxes. He was certain that Mr. Knapp would not be recommending the right balance, but he would be providing the information necessary to compare the relative impacts between cuts and taxes. Ultimately, there were two pieces; math and politics. He thought it would be more difficult to answer the question about what Alaskans wanted.

Representative Wilson did not know what entity DOR was using or its background. She wondered if it had done any studies for other states doing something similar. She asked about the chosen entity's expertise. She thought there might be an economic group that had more nationwide experience.

Commissioner Hoffbeck replied that one of the advantages of ISER was that it had done similar types of analysis over the years; it would have the ability to recheck some of its previous assumptions. He noted that the agency had the best knowledge of Alaska as well.

Representative Wilson remarked that Alaska was not the first state to experience a budgetary crisis. She agreed that Alaska was unique in many instances but did not feel this was one of those instances. She stressed that if there were better experts available, the state should be using them to tell the legislature what had been done right or wrong. She believed the department thought the state had a revenue problem, but she disagreed. She thought the state had a spending problem. She thought ISER's experience was too specific to Alaska and she wanted to ensure the legislature was making the right decisions for its constituents.

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Commissioner Hoffbeck scrolled to slide 11: "The New Sustainable Alaska Plan." He conveyed that if every part of the fiscal plan went into effect it would leave Alaska with the lowest or second lowest taxes in the nation; Alaskans would still receive a dividend; the state would still be growing its savings over time; the state would continue to provide the majority of government services that people enjoyed; the state would still have money available for investing in the future through oil and gas tax credits at

a lower level; and, the state had an Alaska Industrial Development and Export Authority (AIDEA) loan fund to help support oil and gas development in Alaska. He opined that it was not the worst place the state could land.

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Representative Guttenberg agreed with Representative Wilson about a couple of things. He mentioned that the disparity between the cost of fuel (cost per gallon) and the price of oil was problematic. If the state simply wanted to increase the ability of the economy to function more efficiently the administration would find an answer to the problem. He was unsure if the proper statutes were in place to enable the administration to do so. The price of oil had dropped by about 80 percent. The price of motor fuel and gasoline was nowhere near that. In rural Alaska it was much worse. He relayed that it affected the economy every time the state filled up a vehicle or a piece of equipment such as a grader to plow the roads. He wanted to comment on the analysis presented in the flow chart and the CBR where a super majority would not be needed. He did not believe all funds should be easily accessible to everyone. He thought there should be an account in existence that was not easily accessible regardless of politics. He did not want the administration's plan to fail because it had focused on eliminating a CBR vote which he thought was clearly in conflict with the constitution. He hoped Commissioner Hoffbeck had a backup plan. He was concerned with spending significant time on a plan that may not be supported by Alaska's constitution.

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Ms. Pitney explained an LFD graph on slide 12: "FY 17 Budget Overview: Total Agency Operating Budgets, Statewide Items and Capital Budget Compared to Revenue (UGF Only-- \$billions)." She transitioned from the governor's numbers to the legislature's numbers. She reported that in most cases OMB and LFD agreed on the numbers. There were potential differences in how the numbers were categorized or what they were compared to. However, OMB and LFD agreed on the individual numbers, the directional changes, and the order of magnitude of the changes. She suggested that rather than focusing on whether the number was 5 percent or 4.3 percent she would be using LFD documents to explain where OMB had slightly different interpretations and the

reasoning behind them. She reemphasized that OMB and LFD agreed on 99 percent of the interpretations, 100 percent of the individual numbers, and there were only a few places where they disagreed on the comparisons. She pointed to the spending change overtime. The Legislative Finance Division reported a 30 percent reduction over time. She reported people saying that the administration had not reduced government. She countered that it had reduced government significantly. She reported nearly \$400 million had been reduced from the operating budget from FY 15 to FY 16. She mentioned that in FY 16 to FY 17 there were \$150 million in reductions and \$40 million in priority investments. She explained that the priority investments were very important.

Ms. Pitney furthered that \$38 million of the \$40 million represented operating funds to support the gas line development project. The Office of Management and Budget and LFD fundamentally disagreed on the comparison of the governor's budget in FY 17 to FY 16. In FY 17, for the first time, \$700 million in dividend checks was placed into the total for general funds. In the governor's version OMB showed that the earnings reserve cost was similar to prior years. If dividend check payouts in FY 16 were added, \$1.3 billion would be added on top of \$5.4 billion, which was clearly a reduction. She was trying to compare apples-to-apples. She continued that the reality was that there was \$5.5 billion in spending in FY 17.

Ms. Pitney discussed the four major components of the sustainable plan: 1) the amount and the method of using the earnings reserves; 2) the amount of the PFDs and the method in which to accommodate them; 3) the amount of spending reductions; and 4) the amount of new revenues to generate. She contended that the largest component was the use of the earnings reserves. She continued that all four components interplayed and had a balance. She pointed out that one of the main priorities during the current legislative session was to enact oil and gas tax credit reform. If reform legislation passed it would require an estimated \$1 billion to be transferred from savings into the oil and gas tax credit fund to pay all earned credits to date. She continued that \$200 million would be placed in a loan fund to continue the program. She concluded that the \$5.5 billion would become \$6.7 billion with reform. She explained that the oil and gas tax credit transition fund would allow for the state to get to a steady position of

paying about \$100 million in annual oil and gas tax credits instead of \$600 million or \$700 million currently.

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Co-Chair Neuman asked what ramifications would occur if the legislature did not implement the governor's change from the tax credits to a small loan program. He relayed that many of the tax credits sunset in January 2016. He wondered about the cost to the state. He noted that the governor had vetoed \$200 million in tax credits from the budget in the previous year. He asked how many tax credits had been applied for to date, the cost to the state, and the time in which they would need to be paid.

Commissioner Hoffbeck responded that in terms of applications almost the entire \$500 million had been paid out to date. Most of what would come in now would not be due until FY 17. He estimated that there would be about \$700 million in credits in the current year. He reported that only a few of the credits expired in FY 16 including the exploration tax credit. They were only a small fraction of the total tax credits being paid. The largest credit was the net operating loss (NOL) credit which would remain in the program due to the discussions the administration had with companies that felt that NOLs were critical in moving forward. The administration had put other provisions in the tax credit reform bill that would limit the amount of credits that could be cashed in and by whom. The idea was to limit the outflow of state funds while still allowing for the NOL credit to exist. The smaller credits were expiring.

Co-Chair Neuman remarked that he wanted the information on record.

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Representative Gara suggested that when discussing tax credits the governor was primarily focused on tax credits for new oil for companies that did not make a profit. He relayed that companies that made a profit received a different type of tax credit: a deduction. He relayed the prices at which companies were paying the profits tax under SB 21 [oil and gas legislation passed in 2013]. At oil prices of \$70 to \$80 per barrel, the oil companies paid a tax of about 70 percent and at \$100 per barrel the tax was

about 20 percent. The percentage would not increase to 35 percent until oil reached about \$160 per barrel. No matter what percentage companies paid, they were getting a 35 percent deduction for all of their capital and operating costs; the deduction was essentially a tax credit. He wondered why the administration did not look at changing the deduction. He asserted that the state was trying to save money on tax credits. He wondered why the administration was only targeting small companies, rather than asking the larger companies to help solve the state's budget deficit.

Commissioner Hoffbeck explained that the administration left the NOL credit of 35 percent intact, essentially leaving a balance in place where the smaller companies received a 35 percent credit while developing their fields.

Representative Gara commented that legislature was trying to decide what the state could and could not afford. He reported that when he paid his income his deduction rate matched roughly his income tax rate. He continued that in most income tax systems the deduction was about the same as the income tax. He thought the state had a very generous provision that was costing it a significant amount. He suggested that Exxon, Conoco, and BP were paying a 20 percent tax and receiving a 35 percent deduction for capital costs. He wanted to understand how the situation was sustainable when the state was trying to balance the budget.

Commissioner Hoffbeck thought it was a larger discussion than the governor wanted to tackle in the current session. The governor made a conscious decision to ask everyone to participate, but he did not want to put an excessive burden on any one particular sector or industry. He had made a mindful choice that the underlying oil and gas tax credit reform would not be part of the discussion, only the credits.

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Co-Chair Neuman communicated that the committee would be addressing the issue when the subject of tax credit came up at a later time.

Representative Gara remarked that from his perspective, everyone was not contributing.

Co-Chair Thompson understood that production taxes and tax credits were being discussed. However, he wanted to make the point that oil companies paid a 25 percent royalty up front. Commissioner Hoffbeck corrected that it was 12.5 percent.

Co-Chair Thompson continued that in addition the companies paid corporate taxes to the state. He hoped to be able to look at the taxes more in depth at another time.

Representative Gattis asked if the \$5.5 billion included the PFDs, whereas, previous years did not. She concluded that the legislature was not comparing apples-to-apples. Ms. Pitney affirmed that she was correct.

Representative Gattis asked where the tax credits that the governor had vetoed in the previous year fit into the budget. Ms. Pitney pointed to the chart and explained that the \$5.4 billion in FY 16 included \$500 million in tax credits, which was reflected in the middle yellow bar (on slide 12); the amount was \$73 million in FY 17.

Commissioner Hoffbeck added that the \$200 million would be in the transition fund.

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Ms. Pitney reviewed graph on slide 13: "Real Per Capita Unrestricted General Fund Revenue/ Budget History (2014 dollars Per Person)." She pointed to the size of the FY 17 budget. She drew attention to the dark blue portion of the vertical bars representing agency operations. She noted the cost of agency operations was among the lowest in the previous 30 years. The governor's plan included additional operating reductions in FY 18 and FY 19. There were reductions of \$140 million in the current year, \$50 million in the following year, and an additional \$50 million after that. She noted inflation increases were planned thereafter. She explained that statewide obligations were depicted in light blue and included retirement and pensions. In FY 17, unlike previous years, there was \$700 million in PFDs. The debt service and pension obligations were past debts as well as credits. She reported the capital budget being very constrained in the current year as opposed to growing in high revenue years. There was a limit to how much the capital budget could be reduced in

the down years. Although the capital budget showed an increase in the current year, it essentially funded the same priorities and projects proposed in FY 16 including a transportation match and deferred maintenance. She reported that the state had the opportunity of reappropriations in the FY 16 budget. The state used them in the previous year and they did not exist. Part of the difference between a \$118 million capital budget in the previous year and \$195 million had nothing to do with the projects included. Instead, it had to do with a lack of reappropriations in the current year to cover costs.

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Co-Chair Thompson relayed he would talk to Ms. Pitney later about the capital budget. He was handling the capital budget and had noticed some items that he thought belonged in the operating budget. Ms. Pitney concurred. There were a couple of items in the capital budget that LFD believed should be in the operating budget.

Ms. Pitney advanced to slide 14: "State of Alaska Fiscal Summary - FY16 and FY17 (Part 1) (\$millions)." She noted that the summary had been used by Mr. Teal the previous day. She pointed to line 23 titled "Debt Service" and noted a debt service increase in the governor's FY 17 budget from \$206 million to \$436 million. The number reflected a proposal put forth by the administration for financing the state's existing and projected retirement payments for the following 25 to 30 years.

Ms. Pitney scrolled to slide 15: "Pension Payments." She explained that Mr. Teal had stated that it would be \$58 million more in the current year to finance the retirement system rather than paying the actuarially required contribution. She noted that the green bar was without financing and represented the status quo. The yellow bar depicted a scenario where the state financed the obligation. She relayed that the administration had asked its debt manager to look at a structure that left the state's required payment as flat as possible understanding the state was headed into a very flat revenue environment. The idea was to reduce the increase structuring such that the state was paying the same amount as it was paying in FY 16. Overtime the yellow bar became less steep than the green bar, but the savings between the two (based on the actuarial findings) was \$1.7 billion. If the state did not

realize the return it anticipated the cumulative savings could drop to \$1 billion in savings. However, the \$100 million increase would be avoided in 10 years because there would not be a revenue structure to follow. The rationale behind the pension obligation bonds was to flatten it and to take advantage of the savings.

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Representative Wilson asked about the payment into the pension fund because of the possibility of bonding, aside from going from \$500 million in tax credits to \$73 million in tax credits.

Ms. Pitney responded in the affirmative. She pointed to line 28 on slide 14. The state went from \$262 million to \$48 million in direct payments. There was an offsetting increase in the debt service column. Between the debt service increase and the \$48 million the total equaled the level from the prior year.

Representative Wilson thought the \$262 million would not stay constant because the state had more debt. She wondered if she was correct.

Ms. Pitney answered, "Correct." She added that with financing the increase would be more gradual and there would be savings in the long-term. She relayed that six years out there would be a savings of \$60 million and in ten years the savings would be around \$100 million.

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Co-Chair Neuman added that he thought there was about \$8 billion available in the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) and a debt of about \$10 billion, making it 80 percent funded. He had heard from some of the state financial advisors that Alaska had one of the best, most stable retirement systems in the nation. He spoke of the state taking the available money, investing it into Wall Street, paying the PERS/TRS debt, and using the remaining profits to fund state government. He wondered if that was what was being discussed.

Commissioner Hoffbeck replied in the negative. He explained that with the particular plan the state would borrow money,

deposit it into the PERS/TRS fund, and allow it to grow. The state would pay the debt service from GF, essentially substituting the state's obligation to the retirement fund for an obligation to debt service. The state was not adding a new obligation. The state was not placing the money in the fund where the fund was responsible for paying back the debt. If the market did not respond the fund would go backwards. The administration had indicated that no matter what happened the fund would be better off if it contained an extra \$1 billion or \$2 billion. The state would simply be switching one obligation for another. The state would achieve savings over time which would benefit the UGF spending. He added that there was no pulling money back out of the pension fund.

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Representative Gara indicated it was very difficult to understand. He wondered how far out the state was in balancing its retirement debt if the current course was maintained. He wondered if it was 20 years or 30 years or another number.

Ms. Pitney answered that based on the schedule she had looked at, the number exceeded 25 years.

Representative Gara disputed that if the timeframe was 25 years, by extending the payments the state would pay a lesser amount each year. However, the state had been paying approximately \$262 million per year for 25 years. He reasoned the state could not merely pay \$50 million or \$60 million for 25 years and reach the same point. He suggested that the state could not just finance and reduce the amount that it paid. He did not understand how the state would go from \$262 million per year for the following 25 years to financing at \$60 million per year. He wondered how long the state would have to pay the debt.

Ms. Pitney reported that the administration had set its first combined debt service and direct payment at \$262 million. She detailed the amount would grow slowly, which was reflected in the yellow bar on slide 15; by 2030 the number would be about \$400 million. She added that the green would be at \$500 million; if the state stayed on its current system the green bar would be what the state would pay every year to meet its obligation. However, if the state financed the obligation the state would pay what was

reflected by the yellow bar. The difference was the savings [that would occur] by financing at present for what was a scheduled obligation for the next 30 years.

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Representative Gara asked if the state would still be paying of \$200 million per year. Ms. Pitney responded affirmatively, adding that it did not increase as quickly and there was a strong potential for savings.

Representative Gara clarified that the scenario bet on beating the market. Commissioner Hoffbeck responded that there had been some work done several years back on the potential of not beating the market over a 20-year period. He was still trying to pull the numbers together. He reported the chance of making less than the state's cost of debt was within the range of 5 percent and even if it did make less the difference would be de minimis. He concluded there was a much greater upside than downside.

Co-Chair Neuman referred back to slide 4. He stated that he understood the governor wanted to increase revenue sharing to distribute \$60 million per year to municipalities. He wondered where he could find the related appropriations. He was aware of \$35 million being in the supplemental. He wondered where the money would come from (another \$80 million) in FY 17.

Ms. Pitney indicated that \$35 million was circled in red in the supplemental appropriations section on slide 14. She reported that the \$35 million in the supplemental appropriation assured a \$50 million payout for FY 17. The intent would be to add \$60 million in as an amendment or as a supplemental in the following year. The administration did not anticipate paying out \$60 million immediately. Instead, it anticipated a contribution of \$60 million each year that would bring community revenue sharing back to the \$60 million over time. She suggested that it could really be 4.86 percent rather than 4.8 percent.

Co-Chair Neuman interjected that the figures would be in the supplemental budget. Ms. Pitney answered that the supplemental brought the payout amount to \$50 million.

Co-Chair Neuman asked about in FY 17. Ms. Pitney responded that in FY 17 it would be offered as an amendment or as

part of the supplemental budget. The intent was to bring community revenue sharing to \$60 million over time rather than by the following year.

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Co-Chair Neuman clarified that the administration would be asking for the appropriation through the supplemental budget. He thought normally it would be an operating expenditure so the legislature knew what was coming. Ms. Pitney would suggest putting it in beforehand as an amendment.

Co-Chair Neuman commented that there were planned expenditures and he did not feel a supplemental appropriation should be used.

Ms. Pitney remarked that the administration had addressed the \$700 million in dividends and how that differed from a comparison standpoint. Her final point pertaining to Mr. Teal's fiscal summary was shown at the bottom of slide 14. She detailed that under the governor's plan there was a deficit of approximately \$400 million. She anticipated the deficit in the following year's budget to be down to about \$25 million. The remaining balance would be reduced in the FY 19 budget. The two components necessary to close the gap were continued reductions and time for some of the revenue plans to take effect. Currently under the governor's plan there would be an additional draw from savings of \$400 million beyond the CBR draw into the Permanent Fund Protection Act. She concluded her presentation by stating that without the plan the state's deficit was \$3.5 billion.

Co-Chair Neuman addressed the schedule for the following week. He recessed the meeting to Monday, January 25 at 1:30 p.m.

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