

SENATE FINANCE COMMITTEE  
January 23, 2015  
9:09 a.m.

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CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:09 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Pete Kelly, Co-Chair  
Senator Peter Micciche, Vice-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget

SUMMARY

PRESENTATION: OVERVIEW FY16 OPERATING AND CAPITAL BUDGETS

PRESENTATION: FALL 2014 FORECAST

[Note: The presentation was postponed until January 26, 2015. See January 26, 2015 minutes for detail.]

^PRESENTATION: OVERVIEW FY16 OPERATING AND CAPITAL BUDGETS

[9:10:50 AM](#)

PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET (OMB), presented "FY2016 Budget Overview" (copy on file). She noted that considering the gubernatorial transition and the precipitous drop in the price of oil, the state was facing a different budget situation. She clarified that

Governor Walker submitted former Governor Parnell's work in progress (WIP) budget to satisfy the December 15th deadline, and the overview represented the governor's endorsed budget which would come through as amendments. She added that putting Alaska and Alaskans first was paramount, and asserted that in the current tough budget climate OMB was prioritizing economic stability. She referred to slide 3, "Budget Priorities," and highlighted OMB priorities including education, resource development (a priority to get to additional revenues in the future), affordable energy, and supporting Alaskan families.

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Ms. Pitney referenced slide 4, "Budget Guidance: Limit Spending," and related that OMB asked departments to view the budget situation as a multi-year issue while first looking at current spending. She noted that every commissioner had considered how to constrain spending as much as possible, and that OMB also asked what departments could do if their budget was reduced by five to eight percent in addition to what the WIP budget had predicted. She explained that within this scenario, OMB asked departments to focus on administrative structures in order to maximize continued service delivery. Additionally, OMB asked the departments to consider where they could partner, and whether they could privatize. The departments contemplated those scenarios and then OMB analyzed their responses.

Ms. Pitney went on to relate that OMB had also asked the departments to forecast the outcome of a 25 percent reduction over a four-year period. She related that OMB had asked departments to consider which programs were required by law, which were not; and to focus on the latter. She noted that over the current and subsequent legislative sessions OMB had looked at recent statutes, their associated costs, and whether any of them could be considered for savings. She summarized the concept of short-term constrained spending combined with structurally moving to reduce spending in the future. She added that OMB wanted to keep Alaskans involved and keep the process as open as possible.

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Ms. Pitney discussed slide 5, "FY 2016 Budget by All Fund Sources," and noted that the endorsed budget was \$13 billion, remarkably almost the same amount as the prior year. She noted that the consistency in amounts was a good sign and helped to stabilize the economy. The slide identified the following fund sources: Federal Funds, 28 percent (\$3.7 billion); Permanent Fund, 18 percent (\$2.3 billion); Unrestricted General Fund, 25 percent (\$3.3 billion - reserves); Unrestricted General Fund, 17 percent (\$2.2 billion - FY 16); and Designated General Fund, 7 percent (\$875 million). She added that the state's dependence on the reserves was significant, and that at \$3.3 billion, they were down from the projected \$3.5 billion. She noted the Unrestricted General Funds had decreased.

Ms. Pitney reviewed slide 6, "FY2016 Budget by All Fund Sources," to demonstrate how federal funds and the Permanent Fund are expended, and how the state attracts federal funds. She related that funding categories for federal funds included the Department of Transportation and Public Facilities (\$1.1 billion); Medicaid (\$1.4 billion); and all other Federal Funds to include the University of Alaska (University), K-12 education, and the Department of Environmental Conservation. She explained that of the \$2.3 billion in the Permanent Fund, \$1.4 billion went out to citizens as a dividend and almost \$1 billion went to inflation proofing.

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Senator Dunleavy queried as to whether the committee would have access to the 5 and 8 percent reduction reports from the departments. Ms. Pitney replied that the committee would have access to the departments' recommendations, and that the reduction reports were considered internal working documents for deliberative purposes only. Senator Dunleavy asked if they would see the raw data from the departmental recommendations. Ms. Pitney further explained the scenarios of developing recommendations based on budgetary targets provided by the governor. She clarified that if commissioners were asked to consider budget cuts or growth, they would provide contingency figures for each. Senator Dunleavy contended that the subcommittee process would shortly begin and they would soon begin considering those details. Ms. Pitney maintained that OMB had committed to the commissioners that the documents would be for

deliberative purposes, and it wanted to protect that agreement.

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Ms. Pitney referred to slide 7, "FY 2016 Budget by Category All Funds," which illustrated the distribution by fund source based on the entire budget. She listed the categories as follows: Agency Nonformula, \$4.3 billion (includes Legislature & Judiciary [Alaska Court System]); Capital Budget, \$1.4 billion; Permanent Fund, \$2.3 billion; Statewide Appropriations, \$1.3 billion; Other Formula (primarily health), \$2.5 billion; and K-12 Formula, \$1.3 billion.

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Ms. Pitney discussed slide 8, "FY2016 Budget by Category All Funds." The pie chart included categories that were state funded (shown in solid colors) and categories that were externally funded by the investment of state funds (shown in patterned colors). She went on to list categories of Unrestricted General Funds as follows: almost 40 percent in Formula funds; almost 40 percent in Agency Nonformula budgets; 20 percent in Statewide Appropriations; and 3 percent in the current year's capital budget. She noted that the current capital budget was quite small.

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Co-Chair MacKinnon asked if there would be anything in the slides that would quantify one-time funding reductions versus funding that would last over a period of multiple budgets. She noted that the current oil price forecast for the subsequent two years projected approximately \$50 to \$60 per barrel. She commented that with a current budget built on the assumption of oil priced at \$100 per barrel, the committee was looking for long-term savings. She continued that making cuts sooner to items extending over the budget period would help Alaskans better to "recalibrate." She noted that she was trying to determine how much one-time funding was proposed by the governor to eliminate as far as the transfer of general fund to federal dollars. She noted that it appeared as if Medicaid and the switch of the \$450 million was why overall state spending appeared whole. She noted that she could quantify the reductions within the capital budget but not within the operating budget.

Ms. Pitney responded that there was no slide to reference the amount of one-time funding cuts. She continued that the reductions in the agency operating budgets were expected as base reductions rather than a one-time reduction that would be funded at a later date.

Co-Chair Kelly pointed out that the committee would need the reductions quantified; specifically if education was included, as it was identified by the governor as one-time funding in the amount of \$91 million.

Ms. Pitney responded that the funds were not reflected in the budget. She explained that because the education funding was appropriated entirely in 2015, it would be reflected as a \$52 million dollar reduction in the 2015 supplemental budget, and was not reflected in the numbers displayed in the presentation. She added that \$40 million of the aforementioned \$91 million was used in 2015, and only reduced the 2016 and 2017 one-time funding. She concluded that what was reflected were base reductions.

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Co-Chair MacKinnon clarified her request for a dollar amount and associated percentage of the budget cuts to agency operating budgets or otherwise. Ms. Pitney specified that there was a summary sheet included in the printed materials provided to the committee; it quantified the amounts in question and she would review it at the end of the presentation.

Co-Chair MacKinnon noted that both Ms. Pitney and Governor Walker (in his State of the Budget speech the previous evening) mentioned privatization. She asserted that privatization could alternately save or cost money, and wondered how OMB would strategize and evaluate costs when considering privatization in reference to management fees, specifically those that were an expense to the Permanent Fund. She added that those are huge numbers to the people of Alaska, and stated that she did not need the numbers on that day. Ms. Pitney acknowledged her request.

Senator Dunleavy followed up and asked if there was any department, division, or function that the governor would not consider for privatization. Ms. Pitney responded that

there was nothing off the table, and furthered that the current fiscal situation demanded that the state look differently at the way it did business. She noted that they would be looking at short and long-term savings as criteria.

Senator Dunleavy inquired if the governor would seriously consider a state function for privatization if it was demonstrated that the function could be done more cost effectively without impacting quality. Ms. Pitney responded in the affirmative.

Co-Chair Kelly noted that the committee should not ask over-arching policy questions that would undoubtedly be further discussed by the governor's cabinet. He asserted that he did not want to put Ms. Pitney in a difficult position and that the committee primarily needed the numbers at that time.

Ms. Pitney referred to slide 11, "FY2016 UGF Spend: \$5.55 Billion," which reflected a bit about the financial trend. She drew attention to the significant difference in General Fund spending from FY 13 to FY 16 as well as the highlighted \$3 billion payment to the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS) in FY 15. She noted that the payment resulted in a lower annual payment into the PERS and TRS accounts, and would be a positive force in stabilizing the cost of PERS and TRS in the future. She stated that the PERS and TRS portion of the WIP budget would be a pension obligation bond, and rather than having a \$5 million debt service there would be a \$260 million payment.

Ms. Pitney moved to slide 12, "UGF/CBR/SBR spending by category FY2013-FY2016," and noted that the non-formula and formula agency budgets were the most stable. She pointed out that the capital, retirement systems, tax credits, and other statewide budgets were more volatile; adding that they were "fairly stable," although growing.

Ms. Pitney referred to slide 13, "All Agencies contributing," which illustrated the percentage of reductions for agency non-formula funds. She commented that Judiciary had almost no change from the previous year. She pointed out that the governor's budget was reduced by 30 percent, due to 2016 not being an election year, whereas 2015 was higher than normal because of the election year.

She referred to an 11 percent reduction mentioned by the governor and attributed it to a reduction in his executive office. She explained that the Department of Labor and Workforce Development and the Department of Commerce, Community and Economic Development were the two areas that had grown the quickest in the previous few years.

Ms. Pitney continued to explain slide 13, and noted criteria that was used included how much entities had increased over the past; how much they had been reduced in recent years; as well as what would be a priority need for service in the future. She pointed out reductions in the Department of Natural Resources, Department of Public Safety, and Department of Health and Social Services, and highlighted a \$16 million reduction to the University budget the previous year. She commented that the University was sizing into the previous reduction while they were taking the additional reduction in the current budget proposal. She went on to state that this particular budget eliminated the fuel trigger mechanism. She noted that in the case of current oil prices it made sense.

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Senator Hoffman wondered if the committee could get a departmental breakdown of what the reductions entailed. Ms. Pitney responded that OMB would be prepared to provide that information. She noted that the departments were given reduction targets to consider one week previously, and would be working through the reduction scenarios. She added that because the departments had completed 5 and 8 percent reduction scenarios, they had already made some progress. She noted that as the reductions became specific they would come across as amendments.

Ms. Pitney went over slide 14, "FY2016 Capital Budget" and explained that it was a high level summary. She reminded the committee that the capital budget was stripped down in order to meet the December 15th deadline.

Ms. Pitney related that a few projects were added back for a total of \$150 million. She added that the total also included appropriations for two projects: the Mt. Spurr Geothermal project (the primary offset for the energy and weatherization programs); and \$22 million of the \$25 million for the aerospace project. She explained that the maintenance was scaled down significantly from prior years;

although the total still included some for Department of Administration, University, Department of Transportation and Public Facilities, and a small amount for a year of construction for the University of Alaska Fairbanks engineering building.

Ms. Pitney referred to the "Arctic Policy" component of slide 14 and opined that arctic policy was an important opportunity for Alaska. She stated that starting in 2015, the United States was serving its two-year chairmanship of the Arctic Council. Alaska was the only arctic state, she continued, and the state had only two years to ensure that its arctic agenda was at the top of the United States agenda during the chairmanship. She mentioned that the budget component added to what the Commission on Arctic Policy should do, and surmised that Alaska's Arctic Policy Advisor Craig Fleener had likely worked on policy prioritization.

Vice-Chair Micciche wondered if the presentation was available electronically. Ms. Pitney responded in the affirmative.

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Ms. Pitney presented slides 15 to 20, noting that the slides represented three revenue scenarios with graphs depicting the price of oil returning to \$100, \$85, and \$50 respectively. She pointed out that state spending for 2016 was reflected significantly higher; this included the \$3.3 million gap she referred to in an earlier slide. She related that under the \$100 oil price scenario, the state budget reserves would last until FY 22 and the reserves came down significantly each year. She noted that even optimistically, the gas line could start in 2023, so there could be a very small bridge if oil prices go to the forecast. She stated that under the \$85 oil price scenario the budget reserves would last until FY 18.

Senator Hoffman asked what the assumed agency reduction scenario was under the revenue forecasts being presented. Ms. Pitney responded that the projection was built on the FY 16 flat budget, but the committee would see a 25 percent budget reduction in agency operating budgets. She noted that with that reduction, the projected \$1.9 billion reserve for FY 18 (illustrated in slide 18) would move to about \$2.2 billion. Senator Hoffman requested similar

reserves projections with the reductions up to 25 percent as forecasted by the governor. Ms. Pitney acknowledged the request.

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Ms. Pitney referred to slide 20, "Reserves Projection at \$50 oil," and explained that under the scenario the state's reserves would total \$2 billion at the end of FY 17, which would not be sufficient to get the state through FY 18 without additional revenue.

Co-Chair MacKinnon asked if Ms. Pitney would clarify when FY 18 would occur in a calendar year. Ms. Pitney stated that FY 18 would begin in July of 2017. Co-Chair MacKinnon noted that the date was less than 1,000 days away.

Vice-Chair Micciche noted that he appreciated the projections being presented in the slides, and the fact that OMB would be focused on a more realistic range of oil prices. He added that he would like to see a final projection with oil at the \$40 range for realistic consideration, and that it would be a very different outlook than the current projection based on \$50. He stressed the importance of considering what the state would be faced with in case of such low prices. Ms. Pitney opined that it was very possible oil would be priced at \$40 a barrel and stay there. She commented that an important question was 'what should Alaska's budget be?' She pointed out that Alaska was the only state that managed its budget on the price and production of oil.

Ms. Pitney referred to slide 21, "What's in an Alaska budget?" which outlined some supported items in the budget, including:

- 128,100 K-12 students
- 507 schools in 53 school districts
- 33,000 University students
- 150,000 - Medicaid beneficiaries
- 23 public health clinics
- 2,360 children in foster care
- 456 Pioneer Home residents in 6 facilities
- Grants to more than 900 nonprofits
- 5,600 miles of roads and highways
- 805 bridges

- 2,427 state buildings and facilities
- 254 state airports and 2 international airports
- 35 ferry terminals and 11 ferries
- 25 state harbors
- 12,400 offenders in custody or supervised
- 13 correctional institutions
- 43,300 retirees from public service
- 40,000+ full-time state, university and K-12 employees
- 640,500 Alaskans receiving a PFD
- 3.3 million acres in 123 state park units
- Manage ownership of 160 million acres of State land
- 132,032 Court cases annually
- Response to 2,028 spills of 285,000 gals. of oil and hazardous materials

Ms. Pitney pointed out that Alaska had the largest airport system in the world, as well as the largest marine highway system. She remarked that the important question was not what the state could afford with oil at \$40 a barrel, but rather what was the right size for Alaska's government. She noted that OMB took two approaches to analyzing the question - elucidated in slides 22 through 23.

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Ms. Pitney cited slide 22, "Average Total State Expenditures," and acknowledged the slide's complexity. She described the points on the graph as depicting spending for each state based on population. She pointed out that the line represented the per-population average, and that Alaska was above the line, indicating greater spending per capita. She concluded that if Alaska was on the line (not taking into account cost/salary/heat differentials) the trajectory would predict that the state's budget would be \$5.3 billion. She added that the current submitted budget was \$5.5 billion. She furthered that if the "big four" states (California, Florida, Texas, and New York) were removed from the equation, the state expenditure average would predict a \$4.8 billion budget for Alaska. She summarized that the two predictions represented boundaries of a sort; they illustrated what other states spend for their state government.

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Senator Dunleavy made note of the 150,000 Medicaid beneficiaries on slide 21, and wondered how many more Alaskans would receive benefits under Medicaid expansion. Ms. Pitney responded that some reports showed 40,000 while other predictions showed as little as 16,000. Co-Chair Kelly remarked that based on new information, he considered the range of new beneficiaries to have been 16,000 or below.

Ms. Pitney referred to slide 23, "Inflation and Population Adjustment Approach," which illustrated a projection graph based on FY 98 agency operations and adjusted by inflation and population. She noted that when Co-Chair Kelly was a member of the Senate in 1998, there had been 15 years of flat budgets in the State of Alaska, resulting in what he described as a "pent up demand." She characterized it as a "low point" and commented that it was a very lean budget. She presented scenarios under which the 1998 budget was adjusted for inflation (\$3.2 billion), and then for inflation plus population growth (\$4 billion), to view what that would yield for the current time as compared to the governor's proposed budget (\$4.2 billion). She described the approach as another boundary that could be considered when looking at state spending. She reiterated that the totals were still significantly more than what \$40 or \$50 a barrel oil would predict.

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Senator Bishop made a reference to the aforementioned "pent up demand" that was the result of several years of lean budgets. He referred to the deferred maintenance of 2,400 state buildings, and inquired as to whether they should be made a part of the current budget. He opined that deferred maintenance was a bad practice. Ms. Pitney noted that the graph they were viewing was only a representation of the operating budget and the deferred maintenance was not reflected.

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Co-Chair Kelly asked for clarification on the combined capital and operating budget totals in FY 98. Ms. Pitney explained that the capital budget was small (a maximum of \$100 million) through the 1990s and it was difficult to

discern on the graph. She added that the \$2.2 billion total at the time included the capital budget.

Ms. Pitney explained slide 24, "UGF Revenue Scenarios and FY16 Spend by category" and noted that it was for demonstrating perspective. She pointed out that agency operations for nonformula funding would eclipse revenue brought in at \$40 a barrel. She additionally pointed out the graph bars for FY 16 agency operations, FY 16 Unrestricted General Fund endorsed budget, as well as a bar to denote if the state was 25 percent below the FY 15 funding level for agency operating budgets. She commented that the capital budget was very small, and the tax credit and retirement payments were not discretionary. She surmised that even at \$100 a barrel oil, spending did not quite match the 25 percent reduced rate.

Vice-Chair Micciche pondered that it would be challenging to get state spending on par with smaller-population states. He referred to slide 22, and noted that Alaska was an outlier on the graph. He alleged that it would be illustrative for the Alaskan people to see colored data points to illustrate which states on the graph had income, sales, or state taxes. He added that achieving the state's budgetary goals would be difficult unless it became aggressive and Alaskans identified what services they demanded as opposed to what they had become accustomed to. Ms. Pitney stated that she could add the requested colors on the graph.

Ms. Pitney referred back to slide 24, and reiterated that based on current oil production priced at \$100 a barrel and considering a budget reduced by 25 percent, still left a gap in funding. She remarked that the gap was small with revenues based on \$100 a barrel, and the state could get to 2022 and then rely on gas revenues. She qualified that below the \$100 per barrel price, the state would need to do some "bridging" to make up for the deficit of funds. She added that there was a summary of the agency budgets and budget targets as well as a capital project summary attached to the presentation (copy on file).

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Co-Chair MacKinnon wondered if there had been any re-appropriations for mega-projects (such as Mt. Spurr and aerospace) and invested federal funds. Ms. Pitney replied

that there were no other appropriations for mega-projects, pending the evaluation.

Co-Chair Kelly noted that one of the problems in the Legislature was that during session the members were forced into the role of manager rather than board of directors; this did not work well with the current budget scenario that included serious reductions. He applauded the governor for what he had done so far with the budget, and remarked that more reductions would be necessary. He continued that he had confidence in Ms. Pitney, expressed appreciation for the governor's budget, and stressed that it was the administration's responsibility to manage the budget. He added that the graphs presented did not solve the fiscal problem, and urged continued budget increases.

Senator Olson wondered when the governor would be releasing his new endorsed budget.

Ms. Pitney responded that from a technical standpoint, the budget before the members was the level of budget they would see, and that the transaction detail would come in shortly after the first of the current month.

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RECESSED UNTIL 9:00 A.M. JANUARY 26, 2015