

SENATE FINANCE COMMITTEE  
October 5, 2015  
10:06 a.m.

[Note: Meeting held at the Fairbanks Legislative Information Office]

[10:06:43 AM](#)

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 10:06 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, Office of the Governor.

PRESENT VIA TELECONFERENCE

Sheldon Fisher, Commissioner, Department of Administration; Valerie Davidson, Commissioner, Department of Health and Social Services; Margaret Brodie, Director, Division of Health Care Services, Department of Health and Social Services; Representative David Guttenberg.

SUMMARY

PRESENTATION: UPDATE ON FY16 OPERATING BUDGET

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Co-Chair Kelly relayed that the intent of the meeting was to touch base with the administration regarding the FY 16 operating budget. He mentioned a list of various people available online. He referred to a letter [Dated: September 22, 2015 from the Senate Finance Committee] to Ms. Pitney containing a series of questions. He asked her to present the answers to each of the questions in her presentation.

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^ PRESENTATION: UPDATE ON FY16 OPERATING BUDGET

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Senator Kelly referred to the first question which mentioned the "burn rate" on the state's savings accounts and asked for a specific date by which the accounts would be depleted.

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, responded that the "burn rate" depended on the price of oil and on spending. At the current oil prices (roughly \$50 per barrel) and applying anticipated reductions to the operating budget the state would run out of savings by early September 2018. She added that if the price were to go up to \$65 per barrel the savings would last until December 2018 or January 2019. She commented that if the price was lower than \$65 per barrel, running out of savings would be eminent. The state was spending approximately \$9 million per day from the Constitutional Budget Reserve (CBR), 60 percent of the state's current spending level. The state would draw \$3.2 billion from the CBR for the year if the price of oil was \$50 per barrel.

Co-Chair Kelly noted that reporter Matt Buxton had walked into the committee room and was the only one covering the meeting. He recapped the topic for Mr. Buxton about the "burn rate" on state savings. He thought people would be interested in the topic. He reiterated that by September 2018 at the current burn rate with a \$50 per barrel price for oil the state would run out of savings. If the price of oil were to increase to \$65 per barrel the savings would run out by December 2018. The state would not gain much

even with a significant jump in oil price. He asked if the current burn rate from the CBR was \$9 million per day.

Ms. Pitney interjected that the burn rate was precisely \$8.76 million at \$50 per barrel, and the state would run out of savings by September 2018. The state would be able to close out FY 18 but would not be able to start FY 19.

Senator Dunleavy asked Ms. Pitney if she was referring to savings accounts. He wanted to clarify that she was just talking about the CBR. Ms. Pitney responded in the affirmative.

Senator Dunleavy asked if there were any other accounts that were being contemplated. Ms. Pitney responded that currently there were not. She affirmed that there were other accounts that could be drawn down. However, they were statutorily designated for other purposes. At present the administration had not considered using them.

Senator Dunleavy asked if the Alaska Performance Scholarship (APS) funds, and the Power Cost Equalization (PCE) funds were being considered for use to slow the burn rate of the state's CBR. Ms. Pitney agreed and furthered that the funds in the accounts mentioned by Senator Dunleavy were to be used for the purpose they were intended. They could potentially be used to offset something but within the sane structure of the endowment that they were set up for.

Co-Chair Kelly asked if the funds could be used. Ms. Pitney indicated that they were legislatively assigned.

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Vice-Chair Micciche asked if Ms. Pitney could provide a product that captured all of the accounts with the corresponding statutory support. Certain funds that were previously put into place might have to change. He thought it would be helpful to the Senate's assessments.

Co-Chair Kelly conveyed that copies of the information Vice-Chair Micciche was asking for would be distributed by the end of the meeting.

Ms. Pitney informed the committee that questions 3 and 4 were related to question 1. She discussed the oil forecast,

summarizing that at \$50 per barrel, the state would manage through September 2018 if the CBR was used to fill the gap. If the price of oil was \$50 per barrel, the state would draw \$3.2 billion in 2016. If the price of oil decreased to \$40 per barrel the state would be drawing \$3.4 billion. At the end of session in the prior year the assumption was that the price of oil would be \$65 per barrel or a draw of about \$2.7 billion. The difference between \$65 oil price per barrel and \$50 price per barrel equaled a discrepancy of about \$500 million.

Vice-Chair Micciche asked if it was a significant price change. Ms. Pitney indicated that it was significant.

Co-Chair MacKinnon asked Ms. Pitney if she would be discussing any tools the administration had implemented in the first quarter to start reducing costs in state government or holding expenditures down. Ms. Pitney expressed a willingness to jump around or follow the questions.

Co-Chair MacKinnon indicated she could wait.

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Co-Chair Kelly addressed question 2, having to do with earnings reserve of the Permanent Fund (PF). He was aware of a series meetings she had around the state and wanted an update on the administration's plans for the earnings reserve. He asked if legislation would be introduced.

Ms. indicated that legislation had not been drafted at present.

Co-Chair Kelly asked if the administration would be introducing one itself or looking at some of the pieces that was part of other bills. He mentioned SB 114 sponsored by Senator McGuire and one in the House by Representative Hawker. He wondered if the administration would piggy-back on already introduced legislation.

Ms. Pitney said there was no definite plan as of yet as to whether the administration would rely on previously introduced legislation or to introduce new legislation. She relayed that they hoped to roll out a plan relatively soon. She referred to the numerous presentations conducted around the state with several more scheduled to discuss various

options. The starting point was looking at the Legislative Finance Division's model presented in the previous session. The administration was updating the model in order to start the revenue conversation in June of the current year. The components of reaching a sustainable budget would include using earnings reserves, imposing broad-based taxes, and reducing expenditures. The exact combination of the components remained unknown. She thought it was likely that there would be a piece of legislation dealing with the earnings reserve account and likely piggy-backing on the other bills as well.

Co-Chair MacKinnon pondered that the earnings reserve would be affected with the passage of either of Senator McGuire's or Representative Hawker's bills. She understood that there was a management tool of the actual PF versus the reserve account. She wondered if there were two different philosophies that the administration was thinking about.

Ms. Pitney described the two philosophies as complimentary. She explained that a person from Harvard that had done studies on how countries were using their sovereign wealth funds, the number of sovereign wealth funds, and best practices. One of three studies was centered on Saudi Arabia. Alaska had the constitutional protection of the corpus of the PF, a major strength. Russia, Venezuela, and Saudi Arabia had a sovereign wealth fund, but not the same protections. Alaska had a fully isolated and protected corpus of its PF, giving it lasting power for generations. She noted Alaska's heavy dependence on oil revenue, and correlated the spending ratios of Alaska and Saudi Arabia. She continued that when oil prices went up government spending went up. In comparing Alaska and Saudi Arabia for the past 30 years they almost matched exactly. She explained that the construct that was being discussed was to use the PF to take the upside wealth off of the table, placing it into the PF or the PF earnings reserve account, and removing the immediate volatility factor. She added that part of the construct also included using the earnings in moderation so that it was always sustainable. She reiterated that if the upside wealth was placed into the PF it could not be spent, increasing the base from which the earnings could be drawn. She summarized that the concept was to strengthen the earnings reserve and at the same time use it at a very moderate level.

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Co-Chair MacKinnon asked if the legislature would have access to the study from the Harvard professor. Ms. Pitney responded that she could send it to the finance committee in the current day.

Co-Chair MacKinnon asked if there was an analysis done concerning additional revenue if the account was managed as an endowment account. She asked if the model had been tested with different percentages. She was specifically interested in inflation proofing. Currently the state inflation proofed by the growth in its assets and by a specific number. Inflation proofing would happen overtime based on the growth of investments growing in the endowment approach. At present, the state saved a fixed amount.

Ms. Pitney recounted that in 2002 the PF Board suggested a 5 percent amount across a 5 year rolling average. She likened it to a college endowment, and noted that the administration had tested the scenario with a 1 year approach. She reported that using a 5 percent model with a relatively robust reserve depleted the earnings reserve at a faster rate than the administration was comfortable with. She conveyed that a 4.5 percent model kept the earnings reserve steady. The administration also tested drawing a set amount with an inflation increment. She suggested taking an amount equal to 4.5 percent, approximately \$2.4 billion along with a small inflation growth rate of 1.8 or 2.2 percent, the life of the earnings reserve account would be extended and the earnings would not be exhausted unless the state experiences several down years.

Senator Hoffman discussed inflation proofing, and recounted that when asked about prudent practices in investments and whether the state inflation-proofs the fund, Commissioner Hoffbeck of the Department of Revenue answered in the negative. Senator Hoffmann wondered if other countries such as Saudi Arabia and Norway, inflation-proofed their funds. Ms. Pitney responded that Alaska was the only state that inflation proofed in the way it did. She explained that with the endowment approach the state would be drawing less than what the overall asset was earning. The way Alaska did inflation-proofing was unusual.

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Co-Chair MacKinnon wondered if Ms. Pitney had charted or had documents that provide a specific number, \$2.4 billion at a 4.5 percent draw. She was looking at a 4 percent draw that would protect individual Alaskans Permanent Fund Dividends. She wondered if she was correct.

Ms. Pitney responded that under either scenario there were provisions that dividends would be available. It was the amount of the check that could potentially change based on 4 percent or 4.5 percent. She added that the 4.5 percent was the draw and then there was the share of what would be distributed to Alaskans.

Co-Chair MacKinnon asked if there was a chart documenting PF earnings made over time in order to examine the rate of returns. She recalled a 21 percent rate of return several years previously.

Ms. Pitney thought that the average rate of return over several years was about 9.7 percent. The PF Corporation had all of historical return data. The return for the current year was low. However, the previous year's return was much higher. She mentioned that she had seen in the paper that it went from \$8 billion down to \$2.5 billion. She commented that it was kind of scary that even on a low return year the state made more in PF earnings than in oil revenue. She reported that the state was looking at a 5-year moving average rolling good and bad years together.

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Co-Chair MacKinnon asked if there would be a spreadsheet on the different points affected in any conversion about the earnings reserve, the PF, or inflation proofing. She wondered if Ms. Pitney had statements that made it clear what knob was tied exactly with what return in terms of dollars to help address the state's revenue shortfall.

Co-Chair Kelly asked Co-Chair MacKinnon to restate her question.

Co-Chair MacKinnon clarified that Ms. Pitney suggested different components. The first was an endowment approach with a 5-year average and a 5 percent payout which equaled approximately \$2.4 billion in potential revenues. The components had associated dollar values. Specific to inflation proofing, she wondered what the dollar amount was

and how it was different or how the dollars were affected by 4 percent. She wanted to understand which knob was being turned on the dollars.

Ms. Pitney indicated that the information would be available once the plan was ready. She was not ready to discuss the individual pieces. She suggested that if Co-Chair MacKinnon was asking whether the amount of the current check that went out for \$2000 [Note: Ms. Pitney was referring to the Permanent Fund Dividend check amount for 2015] would have changed if the state had not inflation proofed the fund, the answer would be no. The inflation proofing amount of 900 million was placed as a separate action from the appropriation of the checks.

Co-Chair MacKinnon suggested that the state could calculate the inflation proofing figure based on a 5-year average. Her point was that there were different options.

Ms. Pitney added that if the state used an endowment model it would by nature inflation proof the fund without having to be a separate action.

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Co-Chair Kelly asked Ms. Pitney to update the committee as to where the administration was in regards to the labor contracts. The decision was made at the end of the previous special session to fund the contracts out of one-time monies. There were formal and informal conversations that the state would see a zero percent increase in the contracts coming up for negotiation. He asked whether the administration had identified how it would internally navigate the \$30 million dollar budget cut to the base to accommodate the contracts.

Ms. Pitney reiterated that the \$30 million in one-time coverage, and the corresponding \$30 million base reduction would result in a \$60 million base reduction in FY17 for the \$30 million cost. She stated that the \$30 million decrement had been proportionally spread across various agencies, and each agency had identified individual reductions beyond the \$300 million. She quoted that there had been a reduction of \$340 million, and additionally \$30 million in agency operations. In terms of a labor strategy, she reported that 86 percent of the state's workforce was in a union or was directly affected by contracts up for

negotiation. She relayed that the administration was not ready to disclose how it intended to navigate the union negotiations. She noted that the unions understood the state's fiscal predicament but had a responsibility to advocate for their employees.

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SHELDON FISHER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION (via teleconference), related that this was a critical time in terms of the magnitude of employees that were impacted, as well as the fiscal situation of the state. He presumed that both the state and the unions understood that the 2.5 percent cost of living adjustment (COLA) had been appropriate as a one-time increment, and that that would provide a framework for future discussions. He felt that it had been the intent of the legislature to "claw back" or reverse the salary increase. He said that the administration intended to claw back or find other terms that offered an equal amount of savings to the state in labor contracts. He stated that any guidance offered by the committee would be appreciated. He added that work had been done with the bargaining units to develop strategies and to explore options that would lead to a fair and equitable solution for all parties.

Co-Chair Kelly surmised that the administration was attempting to accommodate future increases by making reductions elsewhere in the budget.

Commissioner Fisher replied no. He relayed that it had been his understanding that the intent of the legislature was to claw back the 2.5 percent COLA increase that had been negotiated at the end of the fiscal year. He articulated that the department either needed to claw back the COLA, or find savings in other areas of the contracts that could be offered as a replacement for the COLA increases. He stated that it was not the intent of the administration to negotiate additional salary increases during the current bargaining period.

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Co-Chair Kelly related that he had distributed a letter authored by himself and Representative Mark Neuman (copy on file) that expressed the legislature's desires concerning how to proceed with future labor contracts in light of the

current fiscal situation. He stressed that a reduction in salaries had not been the intent; however, going forward, he encouraged the administration to seek a net-zero increase in union contracts. He asserted that reductions in other areas should not be made to accommodate pay increases; the reality was that government needed to be reined in at all levels. He hoped that a piece of legislation separate from the budget bill could be drafted that would allow for the approval, or disapproval, of increases. He awaited a bill based on the negotiations reflective of the compromise set out in the conference committee letter. He shared that, historically, union contracts were separate from the budget bill; he believed that keeping the contracts separate from budget legislation would be a cleaner modus operandi. He reiterated that the pay increases should not be honored at the cost of other vital services, and that the department should negotiate net-zero increases in future contracts.

Senator Dunleavy recalled discussions in which it was clear that the bargaining units understood the position of the state amid a fiscal crisis. He was impressed with the fact that they wanted to negotiate. He asked if Ms. Pitney could provide a document that listed reductions comprising the \$30 million across agencies. He thought it would be helpful to have that information as the budget subcommittees go to work. Ms. Pitney specified that the information would be included in the full FY 17 detail.

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Senator Dunleavy asked if a hiring freeze had been implemented by the Department of Administration (DOA). Ms. Pitney replied in the negative but all departments had been asked to scrutinizing positions. A hiring freeze for an agency that ran a 24/7 facility, such as the Department of Corrections, would be difficult to accommodate. In some cases refraining from filling certain vacancies helped to offset a portion of the \$30 million reductions.

Senator Dunleavy asked if there was a hard freeze on hiring. Ms. Pitney clarified that there was no hard freeze. She elucidated that every business unit had a different need; however, an assessment of need was being conducted for every agency position that became vacant.

Senator Dunleavy asked if there was a state travel freeze in effect. Ms. Pitney stated that there was an expectation that agencies would limit themselves to essential travel such as prisoner transport and travel for her to be at the current meeting. Departments were being asked to pay close attention to travel.

Senator Dunleavy asked if the question of hiring positions was left to the discretion of division directors. Ms. Pitney stated that within each agency there was a high stress test for each spend because of all of the recent reductions.

Senator Dunleavy spoke of trying to gain understanding as to the perspective of the administration. In the previous year the Senate had proposed steep reductions which were thought to be too deep. He had been asked by constituents whether there was a hiring freeze in place. He understood there would be exceptions within certain departments such as DOC.

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Co-Chair Kelly remembered that in 2000, he had sponsored legislation that advocated a blanket hiring freeze. Through his experience he learned that hiring freezes needed to be crafted such that exceptions for essential personnel were contained. He wondered if the administration had looked at departments developing a hiring freeze consistent with their operations.

Co-Chair Kelly relayed an announcement from Governor Bill Walker in response to the FY 16 budget about instituting a hiring freeze. He wondered if that had stayed in place.

Ms. Pitney responded that it came down to agency scrutiny. The administration's preference was to accommodate downsizing with the least destruction to individuals and services. Attrition and retirement were the state's very best tools. She suggested that when someone left a position the commissioner would be evaluating the vacancy in the context of service need, the current year's budget, and the following year's budget. For example it did not make sense to hire someone in the current year if the position was slated to be eliminated in the following year. The number of employees would be dropping. Recent statistics showed that the state had 600 fewer employees at the end of August

2015 than there were in December 2014. She discussed taking advantage of retirements and attrition. Employees either retired or were transferred to positions not subject to layoffs. The administration felt that such actions were less disruptive for employees, and protected morale and service levels.

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Co-Chair Kelly commented that Ms. Pitney had mostly discussed attrition rather than a hiring freeze. He supposed they were different.

Ms. Pitney clarified that attrition was not rehiring a person. Attrition helped in a hiring freeze because when a person left, retired, or moved to another job the position would not be refilled. The positions would not be rehired based on the three criteria mentioned previously. It also assisted the state in not having to do mass layoffs.

Co-Chair Kelly expressed that he was unsure of the correlation between a hiring freeze and the aforementioned "mass layoffs."

Ms. Pitney explained that agency commissioners had been directed to scrutinize every position that becomes vacant prior to filling them as the state would continue to make cost reductions.

Co-Chair Kelly concluded that mass layoffs were not necessarily related to a hiring freeze. Ms. Pitney did not mean to relate the two.

Vice-Chair Micciche surmised that every box on an organizational chart should be defensible. Departments running as efficiently as possible would likely have lean organizational charts. Realistically, the ultimate goal would be smaller departments in which every position was key. He asked if the departments were evaluating key positions. He wondered if all of the department commissioners had evaluated the necessity of every position within their department.

Ms. Pitney responded that each department was looking at cost savings and efficiencies. She reported that there were cross agency efficiencies in place. She could not confirm with confidence that every commissioner had reviewed each

of the boxes on their organizational chart. She thought the Senator's suggestion of being able to defend each position and to ensure maximum efficiency was a reasonable guidance measure.

Vice-Chair Micciche relayed that in the previous session the legislature had reacted by making budget cuts, some of which were clumsy. These cuts bought the administration time to come up with more prudent reductions, an attempt on behalf of the legislature to work with the administration. He opined that one of the most effective ways to reduce spending was to reduce head count, hence his suggestion about defending positions. He expressed his concern that after an additional year the administration was not putting downward pressure on the departments to defend every aspect of their operation. He believed that the commissioners would be the people to bring forth creative solutions to the budget deficit.

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Ms. Pitney specified that every commissioner had been directed to place downward pressure within their departments. How they applied the pressure would vary depending on the constraints each of them had. The commissioners had been instructed to find additional reductions. She did not believe the agencies would get anywhere close to the \$400 million reduction in agency operations taken in FY 15 to FY 16. She reported a 13.5 percent reduction for executive agency operations in the previous year. She believed that only in the 80's was that level of reduction taken. The next set of reductions would not be as deep. However, the reductions would be prudent and prioritized by different functions and services. Offset revenues would be applicable in some instances. The above listed items would be reflected in the budget put forward in the following year.

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Vice-Chair Micciche asked about methods the administration was using to determine what Alaskans believed were key constitutionally required services and what kind of messaging was going out to the public concerning certain programs that would be at risk for cuts.

Ms. Pitney commented that it depended on which Alaskan was being asked the question. The administration was using the constitution as a primary guideline as well as the state's priorities to ensure a prosperous future. She claimed that every program had its constituents or a large level of constituents. The hard choices would have to be made and there would be some people supporting them and some that would not. The administration was getting feedback from Alaskans through a survey. Alaskans saw most state services as important and provided some good ideas through the survey. She hoped that when the administration rolled out the budget detail additional feedback would come in from constituents.

Vice-Chair Micciche remarked that he was neither anti-union nor pro union; he was pro state employee. He mentioned the unallocated 2.5 percent reductions that were added back into the budget (\$30 million restored in the budget during special session). Although Ms. Pitney indicated that the cuts were proportional, he wondered if any consideration had been taken on a per covered state employee capita versus a per non-covered state employee capita. In other words, he wondered if the departments that had a greater number of covered employees pushed to find a greater portion of the unallocated increase versus departments that had a fewer number of covered employees.

Ms. Pitney replied that since the executive branch took all of the reductions, the units with a higher level of covered employees took a much greater share. The executive branch also took the offset (the unallocated reductions) for the \$3 million of increases for the legislature and the court system.

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Vice-Chair Micciche responded, "Perhaps not proportional."

Ms. Pitney replied, "A proportionally larger share, by far."

Senator Hoffman disagreed that the legislature would be able to achieve the level of cuts that were made the prior year. He reported that the state only had 24 months of reserves. The Alaska Constitution required the legislature to balance the budget. Given those facts the legislature made substantial cuts but the projected revenues from the

prior few months was down by \$400 million to \$500 million. Many of the cuts that were made were essentially offset with decreased revenues leaving the state with the same large deficit. In looking at a sheet passed out to members by James Armstrong, staff to Senator Pete Kelly, [may be referring to a State of Alaska Fiscal Summary FY 15 and FY 16 part 2] the state was spending \$2.2 billion. Many people have advised that the legislature needed to reduce the budget to a target level of \$4.5 billion which would require additional cuts of about \$700 million within 24 months. He reiterated that there was \$2.2 billion in unrestricted and designated general funds and \$3.1 billion. If the target was \$4.5 billion, the legislature would have to come up with cuts or revenues equal to \$1.4 billion within the following 24 months assuming that the state could cut \$400 million first. He suggested that within the following 24 months the state would have to come up with a combination of additional revenues and reductions of over \$2 billion. He thought the state needed to go beyond looking at an organizational chart and defending each position. He suggested the state should be looking at restructuring in light of the vast state deficits. He furthered that without restructuring the state would be forced to chop up complete departments due to the magnitude of the deficit. He believed the writing was on the wall and drastic measures needed to be taken within the following 24 months. He stated that what the Senate did in the prior session would look like a walk in the park in September 2018.

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Senator Dunleavy agreed with Senator Hoffmann. He referred to a governor's press release about instituting a hiring freeze across departments with certain exceptions. Ms. Pitney had eluded to the hiring freeze having soft boundaries. He wondered about the administration's philosophy. He wondered if the state spent too much or did not generate enough revenue. He suggested most of the members of the Senate thought the state spent too much, but recognized the state could not cut its way out of the current budget crisis. He asked if the governor shared the Senate's philosophy that the state had a spending problem, or was the governor's philosophy that the state had a revenue problem. If the Walker Administration's philosophy was that the state had a revenue problem then it made what Ms. Pitney was saying clear.

Senator Dunleavy thought it was best to be as close philosophically as possible to reach the goal. Ms. Pitney replied that the administration's philosophy was that reductions to agency operations needed to continue.

Senator Dunleavy asked to what degree. He relayed that in the previous year's reductions equaled 6 percent. The senate had come in at a much higher rate and was told the cuts were too deep. Overall the Senate had cut 10 percent overall. He asked about the target percentage. Ms. Pitney replied that it was 10 percent across the board, for agency operations and 13.5 percent for executive branch non-formula programs.

Senator Dunleavy asked for the goal for the coming year. Ms. Pitney replied that the administration would inform the legislature once the administration's plan was set. She indicated that it would be down.

Senator Dunleavy commented that it would make it difficult without a plan for the legislature to do its finance subcommittee work.

Ms. Pitney responded that the plan would be released soon and would reflect additional cuts to operating costs in FY 17 and FY 18. She agreed with Senator Hoffman that the state would have to discontinue some programs. There were some agency budgets, on an inflation adjusted basis, lower than they were 10 years previously because of the reductions taken in the past year. She opined that decisions had to be made about the critical pieces that would have to be preserved. She stated that agency operations made up a certain amount of the spending component. Other parts of spending included retirement, debt service, and tax credits. She reported that one decision on tax credits could counteract all of the spending reductions on the operating side. The state did not have a capital budget. If it were to decide to have even a modest capital budget it would offset any savings the state could achieve on the operating side. The administration would focus on operating cost reductions. She opined that there would likely be a difference between what the governor thought was a prudent approach and the Senate's approach. She added that the governor and the agencies were committed to finding cost reductions on the operating side. However, cost reductions alone would not

close the fiscal gap. She stressed that cost reductions and new revenues had to be implemented in parallel in order to prevent reaching the cliff. She furthered that it was very important to preserve the state's credit rating if the state was going to invest in a gasline. The alignment of the state's revenues and expenses in the budget would be the key factor in the evaluation of the state's credit rating.

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Senator Dunleavy believed the committee knew all of what Ms. Pitney had just stated. He thought it was important to revisit history. He spoke to deeper cuts for the reasons stated during the meeting. He discussed the price of oil. He wondered if the legislature would be told again that cuts were too deep. He did not believe the state could go far enough. He wanted to better understand the philosophy of the administration so that he could move forward accordingly.

Co-Chair Kelly asked Ms. Pitney if the FY 17 budget for the Department of Health and Social Services was going up or down. Ms. Pitney responded, "Down."

Co-Chair Kelly asked the same question about Department of Education and Early Development. Ms. Pitney answered, "Flat."

Co-Chair Kelly next asked about employee contracts. Ms. Pitney responded that the administration was trying to meet the net zero mark. She added that it was very difficult to do so in the current environment.

Co-Chair Kelly offered that Ms. Pitney's responses answered Senator Dunleavy's question about the administrations' philosophy. He noted that he was not crediting the departments for any federal dollars received.

Ms. Pitney indicated that much of the reduction had to do with what could be extracted from Medicaid reform. She added that as far as supplementals, the state had foster care and subsidized adoption formulas that would make up a large part of the operating supplementals.

Co-Chair Kelly asked how much was anticipated. Ms. Pitney reported about 10.

Co-Chair Kelly referred to the agency operations graph, what he called the slider graph. He thought it put the problem the state was dealing with into perspective. He suggested that as much as the administration might want to squeeze agency operations, there was not much to squeeze unless it looked at reductions within the Department of Health and Social Services and the Department of Education and Early Development. The problem with the state's payments was that it could not reduce its debt. He did not agree with what the governor did with credits. In his opinion it meant nothing to reduce the credits that would just come back in the form of a supplemental. They would have to be paid according to statute. There had been some increase in the oil fields regarding one set of the credits and in the other set had to do with keeping the lights on in Anchorage. His point was that if education was going to be flat then the administration was going to refuse the final year of increases that came under HB 278 [Legislation that was passed in 2014 regarding education]. He asked if the administration was taking the Senate's position.

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Ms. Pitney replied that the goal was to keep the spending level flat from year-to-year.

Co-Chair Kelly concluded that the legislature would have to disregard the increase. Ms. Pitney responded that the administration wanted to keep the education spending level flat but not the per-student level.

Co-Chair Kelly remarked that it was a good start.

Ms. Pitney noted that statute regarding tax credits allowed for 10 percent of the estimated production tax to be paid out in any given year. It had a limiting factor. She explained that the amount still had to be paid. However, by waiting until the state had a tax revenue to help offset expenses, the state's liquidity remained intact. It pushed the bill out farther when cash was available. It did not buy the state a savings, rather it bought time for cash flow to materialize.

Co-Chair MacKinnon addressed a question to Commissioner Fisher with Department of Administration. In light of wanting to preserve as many jobs as possible and to ensure

the sustainability of Alaska's economy, she wondered if the administration had taken any steps that the legislature should be aware of regarding negotiations to bring all parties to the table. She wondered if there was a working group in place with different representatives from labor unions, the administration, and the different departments to discuss the workforce and to see if there were conditions that could be changed to bring the legislature a zero personnel growth budget.

Commissioner Fisher replied that in addition to DOA doing substantial analytical work all of the commissioners had been engaged in a dialog around the state's workforce. Also there had been a series of meetings with the state's administrative service directors in terms of how to deal with improving the quality of the state's workforce and dealing with productivity and performance issues. He indicated discussions would occur about shared services and lean initiatives to improve the efficiency of Alaska's workforce. Many of the discussions did not require that the state bargain any additional flexibility of terms. There would be some implications which would be on the table as the state begins negotiating. The state had 5 bargaining units that DOA was either currently negotiating with or will be in the following several weeks.

[11:27:49 AM](#)

Co-Chair MacKinnon asked if the state would align holidays. She wondered if there were benefits to limiting the number of holidays in terms of consistency of operation throughout the state. Commissioner Fisher answered that it went beyond holidays. The department was looking at many of the terms in the labor contracts to simplify and minimize any inefficiencies. There was a general goal of trying to standardize across contracts.

Co-Chair MacKinnon asked if the commissioner had reviewed best practices related to accrued leave. She relayed that the committee had been given a presentation that showed and reflected a huge liability related to accrued leave. She wondered if he was looking at it in the contract negotiations. Commissioner Fisher replied in the affirmative; they would continue to discuss the issue.

Co-Chair MacKinnon asked if the unfunded liability was on the table as a negotiable item. She wondered if increased

contributions to the system or other ideas were being looked at.

Commissioner Fisher had not contemplated additional contributions by employees. He agreed that the unfunded liability was a significant issue and upon her prompting would look at it. There were other tools and factors addressed. The administration shared the concern about the unfunded liability.

Co-Chair MacKinnon asked about how the classification system and the personnel rules affected the commissioner's ability to act.

[11:31:12 AM](#)

Commissioner Fisher asked for specifics.

Co-Chair MacKinnon replied that the state had an overall pay scale salary that had classified positions that the administration boxed employees into particular areas. She wondered if DOA was looking at the pay scale and the classifications and whether they were affecting the growth in government.

Commissioner Fisher replied that the department was looking at pay scale. In the previous year in some of the hearings the department showed some of the growth in salary of employees over time that was impacted by the merit and pay increments. The Department of Administration was also examining general classification processes and how the state classified its employees. He had not anticipated a wholesale revision of the way the state classified employees but it was an ongoing discussion within the administration. He was open to being persuaded and was looking at the way salaries grew over time more deeply than the way classifications were structured.

Co-Chair MacKinnon asked specifically about the salary discussion. She expounded that part of the difficulty in the prior special session was addressing the 2.5 percent cost of living adjustment (COLA). The legislature had included merit raises and step increases in the budget, giving 2 out of 3 raises for employees that were working hard. Two years previously the legislature had seen a slide presentation from the prior administration that showed a nearly 34 percent cost increase on the personnel line for

several of the bargaining units because of the 3 layered approach to incentivize performance. She wanted the administration to look at the 3 different incentive models to provide an opportunity for employees to see growth but respect that the state could not support all of the 3 ideas. The Alaska Marine Highway System (AMHS) brought to mind personnel rules. The personnel rules had employees transferred or flown in to a particular location and the associated costs. She was looking for ways the legislature could help the administration implement some difficult things. She wanted to do them as cooperatively as possible at the bargaining table. Commissioner Fisher would be the person at the bargaining table.

[11:34:59 AM](#)

Commissioner Fisher replied that the department was looking at a number of rules that impacted the efficiency of the workforce. He reported that all of the AMHS bargaining units were not on the table currently, however the department was looking generally at work rules to ensure that the state was operating as efficiently as possible. He felt that standardizing the contracts would be an important tool. He shared her focus and concern.

Senator Bishop was fixated on Senator Hoffman's overview earlier in the meeting. He was of the same mindset. He mentioned that additional reductions would be seen in the Department of Labor and Workforce Development, one of three of his finance subcommittees. The department would likely consolidate within the department. He had looked at doing so when he had been the commissioner. Commissioner Drygas and the governor had been able to consolidate the Business Partnerships Division by rolling it into the Employment Security Division, a division that had really stepped up to the plate to carry on the tasks with fewer people and a \$600 thousand cost savings. He thought that it was an example of trying to save money in the budget going forward.

Vice-Chair Micciche indicated he was a big supporter of Commissioner Fisher, one of the few private sector folks in the administration. He thought that public sector operations were less headcount efficient than private sector operations. He mentioned that the administration had been willing to hire pricey consultants with various levels of expertise. When asking commissioners and directors to

evaluate efficiency there was inherently a level of parochialism and protectionism for departments. He asked if he had considered requesting the administration's support in hiring a public sector consultant to evaluate program efficiencies for things such as consolidation, the potential for privatization, general department efficiencies, and efficiencies specific to procurement. He asked if the commissioner would support the idea.

[11:39:58 AM](#)

Commissioner Fisher noted that the question related to Question 6. He discussed having looked to a shared services model. Shared services would be those areas where there was common functions that tended not to be mission-critical to any department, but that every department had. Earlier in the current year the administration had reached out to a person with a great track record in history who had performed similar consulting work for the State of Ohio. Prior to the end of the session he hoped to get him in front of the legislature to meet him and get a sense of his work. The basic structure of his work was to simplify and standardize all of the shared service type functions. For example, the state was looking at procurement, information technology, travel, collections, accounts payable, and accounts receivable, all enabled with Alaska's Integrated Resource Information System (IRIS) upgrade. He also mentioned having unified facilities management

Vice-Chair Micciche asked if 60 percent of the general day-to-day efficiencies were separated from the process. Commissioner Fisher agreed. He elaborated that the shared services would not include everything that was done by the state. For the functions that did not lend themselves well to a shared service model, DOA was examining the processes that the state followed and improve them. Cutting out steps and implementing tools or systems were things that could be done to lean the processes. The person the state would be working with had a lean background, essential to developing efficient shared services. He was philosophically completely aligned with the idea that the state had to be more effective and efficient in the use of its workforce. It would be important to examine the way the work was done, to remove unnecessary steps, and to simplify the process. He stated it would be present in the shared service model and core functions of the various departments.

[11:44:22 AM](#)

Co-Chair Kelly asked for the best guess on the supplemental figure. Ms. Pitney did not have a guess at present. She knew of a couple of numbers pertaining to the Office of Child Services, foster care, and the Division of Juvenile Justice. The division had always depended on \$1 million. When the Department of Health and Social Services had the ability to move within appropriations they found it. Currently, they no longer had that ability. She also mentioned that the pipeline funding (\$120 million) would also be a part of the supplemental request.

Co-Chair Kelly asked if there was a source for the pipeline funding. Ms. Pitney replied that it would come from the General Fund and would depend on the CBR. She thought that for FY 16 it was reasonable. For FY 17 and future years it would require thinking through the best source and how it was repaid was an appropriate discussion. She did not believe it would have to come from GF. She did not believe the state would get by without financing the project. The discussion would be how to fund the pipeline.

Senator Dunleavy asked for her answers to the questions in writing. Ms. Pitney responded that she would be able to distil some of them in writing.

Senator Dunleavy asked if new programs were being considered by the administration. He referred to a news broadcast of the governor. It sounded like a homeless program was being contemplated. Ms. Pitney answered that currently within the existing budget there was homeless program funding. Her expectation was that the state would look at what the state was currently spending and get the most out of it. It was possible that to do so the state would have to redefine the program. The administration was looking at obtaining the most value.

Senator Dunleavy asked if new programs would be using existing funds. Ms. Pitney answered that the administration would look at funding offsets in the same area, looking at ways the program could provide additional value for the same or less money.

[11:48:12 AM](#)

Senator Dunleavy asked if any UA contracts would be coming up in the current year. Co-Chair Kelly did not know.

Senator Dunleavy asked if the university would come directly to the legislature. Co-Chair Kelly replied that the contracts tended to expire in the off years from its larger contracts. He imagined it was very possible but did not know for sure. In general, the university only came before the legislature a few times.

Ms. Pitney replied that the union contracts were staggered.

Co-Chair Kelly asked Co-Chair MacKinnon to incorporate the answers to 9 and 10 in her question. The questions would be finished.

Co-Chair MacKinnon mentioned space management. She believed there was a significant portion of the Atwood Building sitting vacant currently. She asked testifiers to discuss the process that was used to evaluate space management and what the state was doing with the excess lease space it had.

Commissioner Fisher answered that the administration was constantly evaluating space. Two years prior DOA implemented some space standards freeing up a fair amount of space in the Atwood Building and in other buildings and leverage it in many respects. Currently the department was examining the options to use the space which included bringing in a couple of departments that could potentially cancel their commercial leases. Also, the department was in discussions with the legislature to hold the space open as an option for the legislature to occupy should it choose to leave the Anchorage Legislative Information Office (LIO). It was an active and ongoing discussion in trying to manage and maximize space.

Co-Chair MacKinnon asked if the commissioner would be bringing a recommendation forward and whether he felt like he had to hold the space open for the Alaska State Legislature. She thought the state had a signed rental agreement which it was not happy with. Her understanding was that it would take litigation for the legislature to get out of its lease.

Commissioner Fisher replied that he was not making a recommendation how the legislature should handle the LIO

space. There had been some interest which DOA was trying to accommodate and to balance it against other opportunities. He thought it was fair to say that the department was pursuing other alternatives in parallel and would be looking to see what the legislature decided to do. Should the legislature not be interested the department would act quickly to move other departments into the space. Knowing that the legislature was looking for space in the Atwood Building, the department was wanting to accommodate the need.

[11:52:33 AM](#)

Co-Chair MacKinnon wondered if the department was signing new commercial lease agreements. Commissioner Fisher was not aware of entering into any new lease agreements in the past 6 to 9 months. The department was consolidating and looking to get out of space or reduce costs.

Co-Chair MacKinnon asked how often the administration cabinet met. Ms. Pitney replied that members typically met quarterly. She added that various subcabinets met more frequently.

Co-Chair MacKinnon asked if fiscal policy was on the agenda for the meetings. Ms. Pitney answered that the administration discussed the fiscal policy at least twice a week with a strong contingency of cabinet members. She furthered that half of the cabinet met at least once per week.

Co-Chair MacKinnon asked Ms. Pitney to speak to the \$200 million veto. She wondered if it had facilitated conversation and if there had been any unexpected consequences to do with the tax credit conversation.

Ms. Pitney answered that it had created the conversation sought by the governor. One question that surfaced was whether the state was getting the return the state anticipated or a potential for the return from providing the credits. Discussions ensued about how much the state was spending on tax credits relative to income generated from them. The other talks were about how much the credits would improve the state's production tax picture in the future and about what control the state had in the level of tax credits going out the door. She believed there would be a bill presented in the following session related to tax

credit reform. She elaborated that the legislation would provide assurances that the investments would have a reasonable level of return, a limit relative to the overall production tax level, affordability, and the incentive for production in different areas in order to generate future returns for the state.

11:56:05 AM

Co-Chair MacKinnon referred to a newspaper article reporting that Miller Energy filed bankruptcy: their lending agency walked away from the company for a variety of reasons. One of the reasons cited in the article was that the state continued to owe the company \$17 million in tax credits and the uncertainty in the timing of the payment had placed the company into bankruptcy. There were several local businesses that had huge losses or potential losses based on what happened in bankruptcy court. She recalled a conversation with Ms. Pitney about the governor's intention to veto the bill. She asked Ms. Pitney for her comments.

Ms. Pitney answered that there were provisions to sell the tax credits to producers with a tax liability. There was a way for companies that had earned the credits to receive the money outside of the cash payment made by the state. She spoke of issues resulting from the reform effort. She emphasized that the state would honor all credits earned, it was the timing in which they were honored was in question. The statute provided for having 10 percent of the production tax set aside for production credits. The state was at about 5 times the level currently.

Co-Chair MacKinnon asked about prioritizing the payment of Alaska contractors that were owed from tax credits payments. She wondered if there would be a provision in the tax credit reform legislation being crafted by the administration that prioritized Alaska companies since it was the state's money that was going into a bankruptcy court finding.

Ms. Pitney would have to follow up with an answer to Co-Chair MacKinnon's question.

Co-Chair MacKinnon referred to pension obligation bonds. She asked for an update on the status of pension obligations and whether the administration was considering

bonds. She thought the original budget that was presented had a reference to pension obligation bonds in the previous year and that Governor Walker changed the reference eliminating it in order to have a chance to review the concept. The legislature provided the tool for pension obligation bonds. She wondered if there was serious consideration of pension obligation bonds and wondered what kind of analysis was being done with the market to understand the bandwidth available in the kind of market for upside. She also wondered about the impact of cash infusion into the current liability situation that the state was facing inside of the pension or the arm board.

Ms. Pitney answered that the administration was seriously considering pension obligation bonds with a significant level of due diligence and caution. It could be a step that had a nice upside but could also have a downside. The administration had some of its bond council providing information. Currently, the state was anticipating about a 5 percent rate. Over the previous 25 years the state had earned almost 8 percent. Past returns did not guarantee future returns. She relayed that there were several considerations. She reemphasized that the administration was serious about it but had not made the decision to include it in the governor's budget request. She requested that Commissioner Fisher add any information he thought was fitting.

[12:01:52 PM](#)

Commissioner Fisher replied that the Department of Revenue had taken the lead on the issue. He reiterated what Ms. Pitney had said regarding the state's serious approach on the issue. He remarked that it was a market timing strategy and that if it was the right thing to do the state would be in a position to do it.

Co-Chair MacKinnon followed up on the question. If the state was considering pension obligation bonds and, hypothetically speaking, had a \$12 billion pension liability and the state cash infused \$3 billion leaving a \$9 billion pension liability still on the books, she wondered what dollar amount for bonds the administration would be considering. She was trying to establish the magnitude of dollars for pension obligations the state was considering. She had heard from some investors that there was not a bubble in the market while other claimed that the

market would recalibrate downward in 12 to 24 months. Proportionally, she wanted to know what the administration was looking at.

Ms. Pitney responded that the limitation on the top end was \$5 billion. Whatever the administration decided would be in the form of tranches. The administration was modeling at the \$3 billion and \$5 billion level. She stressed that the administration would be doing a significant amount of due diligence prior to coming forward with a recommendation. It was an interesting concept and one of its nicest features was being able to preserve liquidity.

12:04:49 PM

Co-Chair MacKinnon asked whether the administration had offered any guidance on the travel issue to boards and commissions. She indicated she served on at least one board and was aware that the other legislators serving on the same board stressed being conscientious of travel. She reported that the legislature would be looking in the finance subcommittees at the use of travel funds, not necessarily taking them, but reviewing usage in a revenue shortfall. She wondered if the governor asked boards and commissions to meet via teleconference to mitigate travel costs or to reduce or limit travel. Ms. Pitney responded that there had been internal discussions about travel restrictions but no mandate had been issued.

Co-Chair MacKinnon requested that there be a set of guidelines for the boards and commissions. She acknowledged those groups that have tried to cut down on costs when possible using tools such as teleconferencing. She understood the need for certain boards to meet face-to-face. However, it would be helpful to have boards focusing on reducing travel costs. Ms. Pitney responded that she would commit to her request.

Co-Chair MacKinnon asked a question on behalf of Co-Chair Kelly about the impact of the recent adoption of the expansion of the Medicaid program. She asked whether the current Xerox system had been certified by the federal government and about increased costs related to the expansion. Ms. Pitney responded that the certification application would be submitted in December 2015 and expected Centers for Medicare and Medicaid Services (CMS) to be onsite the first quarter of calendar year 2016. She

continued to explain that the certification did not stop the reimbursement process but was a necessary step in streamlining certifications. She deferred to Commissioner Davidson to answer Co-Chair MacKinnon's other questions.

[12:08:46 PM](#)

VALERIE DAVIDSON, COMMISSIONER, DEPARTMENT OF HEALTH AND SOCIAL SERVICES (via teleconference), told of the department pursuing certification in December 2015. Once the state notified CMS of its intent to certify, generally they would come onsite 2 to 3 months following notification. Director Brodie had been in contact with CMS to request an expedited visit. The state expected them to be onsite within 2 months following the submission of the state's official certification request.

Commissioner Davidson responded to the question concerning payments to providers. A certification of the Medicaid Management Information Systems (MMIS) was a separate issue from the payments to providers. Similar to previous testimony, the department had been seeing over 95 percent of Medicaid payments being processed on time and accurately; a better percentage rate than the state's old Legacy System. The state was working with providers on the issue of back payments for some that received advanced payment. She reported the state being on track to have it cleared up by December.

[12:10:34 PM](#)

Co-Chair Kelly asked if the anticipated \$64 million was included. There was not a way to track the amount paid out and the reimbursement amount.

Commissioner Davidson responded that the state tracked the amount of advanced payments that were made as well as the payments received. She reported that all of the providers were on a repayment plan and she expected to be able to recoup the expenditures that were made. She deferred to Director Brodie who had the most up-to-date information regarding the payments.

MARGARET BRODIE, DIRECTOR, DIVISION OF HEALTH CARE SERVICES, DEPARTMENT OF HEALTH AND SOCIAL SERVICES (via teleconference), answered that there was not a direct correlation between the advances paid out by the state and

when the claims were paid. There was a specific amount of claims that the state manually adjudicated when the advances were originally paid. The adjudication process allowed the department to say how much the state owed a provider which determined the advance payment amount. In the meantime the department had corrected hundreds of defects and put in change requests which have enhanced the system dramatically. As the department fixed items the claims were reprocessed. The disconnection was a lack of tracking when the exact claims that had been partially paid were reprocessed. The department would be doing a settlement at the end of the process to ensure that all claims that the state issued an advance for were properly adjudicated through the system and paid out to the providers. Currently the department was stepping up its collection efforts on the advance payments. The department sent out letters to 42 providers each agreeing to a repayment schedule. The department would be mailing out letters to another set of providers in the current month. The last set of letters would be sent out in November 2015. In the previous week the department collected over \$1 million from the advances.

Co-Chair Kelly remarked that all of the questions had been addressed and invited committees to wrap up.

Senator Dunleavy was looking forward to getting some answers, as he wanted to avoid a repeat. He mentioned an issue in the Mat-Su with the school district. The district started a middle college concept several years previously of which the local college did not want to be a part. Therefore, kids were going through the Eagle River campus. The program was fantastic and the individuals at the Eagle River Campus had been very accommodating. He relayed that he would be talking with the committee about shifting the cost of travel via school bus from the school district to the university.

Co-Chair MacKinnon relayed that when she was the former chairman of the Legislative Budget and Audit Committee there had been some difficulty with DHSS complying with audit requests and providing information that was needed to support the singlewide state audit. She wondered if it was going better than it had been in the past under Commissioner Davidson's new leadership and asked about any continued challenges.

Commissioner Davidson responded that the department had been able to meet the majority of the requests for the audits. She relayed that there had been a couple of instances in which the department had to request an extension of 1 to 2 days. The department had been able to meet all of the requests for information for the audits.

12:15:52 PM

Ms. Pitney added that Legislative Budget and Audit, given the size and scope of the particular audit, requested to be relieved of the responsibility of performing the audit. The request included having the Department of Administration contract the audit, the funding of which would be provided through a capital budget item. She wondered if it was an administration or legislative audit and thought the matter deserved further consideration. She felt that the request was out of the ordinary.

Co-Chair MacKinnon believed the legislature moved it into Ms. Pitney's court because it was her team that had been non-responsive to requests for information necessary to complete the audit. The legislature was happy to have a conversation. However, because of the Medicaid issue with Xerox, Medicaid had been set aside from the audit. It had been challenging from the administration's perspective in trying to catch up. She was willing to work with the administration on reassessing. She wanted to make sure that the state's federal funding came through as anticipated and the audit was an important component. Ms. Pitney agreed that it was important and believed the participation was high.

Co-Chair MacKinnon spoke of her and Co-Chair Kelly discussing a first quarter review of the administration. One of their goals was to know where the administration stood to-date. After one quarter, while the state faced a \$3 billion to \$4 billion draw from the constitutional budget reserve (CBR), she wondered if the administration had met the budget reductions that had been anticipated. She wanted to know how the administration was tracking for the first quarter.

Ms. Pitney responded that she did not have an exact accounting with her. She relayed that in terms of the state's budgetary process and communications the administration was on track to accommodate over \$3 million

in reductions. The administration was also on track to recommend additional reductions for FY 17 for agency operations. It was also taking steps to glean savings within contract purchases, by imposing travel limits, and by not refilling certain vacancies. She added that the agencies would meet the budget with some formula driven and some choice driven supplementals. She spoke of a correctional facility in Nome that had a problem that needed fixing. She relayed that the Office of Budget and Management (OMB) was on track to produce the budget well in advance of the December 15th deadline and hoped to have a planned framework to the legislature sometime in mid-October (although she did not have a precise date). The administration wanted to give the legislature as much time as possible to evaluate the FY 17 proposal to facilitate efficiency in the 90 day session.

[12:21:13 PM](#)

Co-Chair MacKinnon asked when the legislature would see the items on the call for the special session. Ms. Pitney did not have the answer but would find out.

Co-Chair MacKinnon stated that it would be helpful in order to get prepared ahead of time.

Senator Olson asked about the administration's philosophy related to solving the state's fiscal circumstances. The state had been told by experts that making cuts alone would not completely solve its fiscal problems. Revenues would also be necessary. He asked about the administration's position on an educational head tax or instituting an entire state income tax. He wanted to know if it was leaning towards an individual income tax or a corporate tax similar to the reserves tax.

Ms. Pitney relayed that the administration's plan would include a mix of solutions. The fiscal gap was too drastic to solve with only one answer. All options would be considered with a phased approach in mind. The administration wanted to preserve the CBR and the state's credit rating, knowing the potential investment in the gas line. If the state could take significant steps through spending reductions and new revenue measures to address about half of the budget gap, then broader measures could be taken in the following years. She posed the question of how to have a balanced approach. She did not want to pull

any lever too hard making it impossible for a particular sector, community, or industry to work viably in the state. She wondered how to fix the fiscal gap for the long term and to stabilize the state government budget.

[12:25:42 PM](#)

Senator Olson was concerned that there was not a definitive plan. Ms. Pitney responded that there would be a plan released within the following ten days.

Senator Bishop suggested the key was to fix the problem long-term. He suggested focusing on a price per barrel amount which the state would build its budget around. He suggested that even if the price of oil recovered somewhat, the state should fix its current problem. He did not want to leave a mess for others to clean up later. The cuts that had been brought forward had to be dealt with by the departments. They had to take the budget amounts and dealt with them the best way possible. He mentioned various cuts to the Department of Transportation and Public Facilities (DOT). He wanted people at home to know the reality of the state's fiscal situation.

[12:28:21 PM](#)

Vice-Chair Micciche relayed that Ms. Pitney had made the statement that the savings from the agency non-formula funding was only a portion of the solution. He stated the state was still at the \$4.9 billion unrestricted general fund (UGF) spending level with a \$2.7 billion gap. He was concerned because the state was still spending \$2 billion for agency operations. He worried that it was not the priority of the managers of the various agencies to make additional cuts. He believed that every bit of potential savings counted in the current fiscal situation. He wondered if she was reflecting the administrations perspective that the cuts had been reached or that the managers needed to look under every rock for other substantial savings in agency operations.

Ms. Pitney indicated that she had 14 budget "heads-up" meetings to discuss budget cuts and potential options. The choices that were discussed would be tough choices and difficult to communicate. After adding up every reduction dollar the gap would still be large. The monumental task of finding every potential savings and the impact that it

would have on a particular service or function was large. The state had to incorporate all possible reductions but, in the end, they made up a small portion of the gap.

Vice-Chair Micciche asked what individual groups (the Senate, the House, or the administration) could do to collaborate better. All parties knew that additional cuts and efficiencies were needed.

Ms. Pitney commented that Vice-Chair Micciche posed an excellent question. She thought it came down to those things to preserve and making sure they were running efficiently. Not only did the state want to know that it was funding only those things the state chose to run, but also to know that they were running as efficiently as possible.

[12:33:18 PM](#)

Senator Hoffman understood the magnitude of the problem but opined that the state did not take every possible cut at the opportunity provided in the previous session. He mentioned that the reductions that were proposed in the senate were hard-fought. He suggested that because the next year was an election year members would not want to make the necessary cuts. Many legislators were not going to be willing to make the hard cuts. He was predicting that the needed cuts were not going to happen with politicians worrying about their careers. He did not feel that what was needed to be accomplished would happen until the following session. He added that the senate was gun shy after the administration stated that the senate went too far. His greatest concern was that because of politics the legislature would have to be on hold for one year in order to address it the year after with a new group of people due to election cycles.

[12:36:35 PM](#)

Co-Chair Kelly asked if OMB had started the feasibility studies necessary for any of the privatization of services.

Ms. Pitney conveyed that the Pioneer Home and the Alaska Psychiatric Institute (API) feasibility studies to be out in advance of session. She also reported working with the municipalities, the tribes, and across agencies to partner to minimize staff.

Co-Chair Kelly relayed that prior to privatizing a state agency with contracts a feasibility study had to be done first. He suggested that the requirement acted as a barrier to privatization efforts. He wondered about the percentage of cuts for agency operations.

Ms. Pitney responded that for formula and non-formula it was about 3 percent.

Co-Chair Kelly wrapped up by saying that a person had to paint their house to keep it from falling down. However, prior to painting things like furnaces had to be fixed. He indicated that when he heard terms like efficiency, streamlining, and collaborations among agencies it was "normal speak." He suggested that "normal speak" was common in years without budget problems. He opined that the legislature was at the cliff. He expressed his concerns about the administration making a sincere attempt to cut the budget but it would not be enough standing by itself. The administration would then rely on revenues to fix the remainder of the state's fiscal problems. He explained that the people of Alaska wanted to see cuts before new revenue measures were implemented. He had the sense that many people were more in favor of revenue measures than they had ever been. However, if the legislature ended up with very little cuts or 3 percent cuts the people of Alaska would say it was not enough.

[12:41:29 PM](#)

Co-Chair Kelly expressed his concerns about the previous cuts amounting to nearly \$800 million that were made including cuts to the capital budget and the fact that they had not been adequately communicated to the people of Alaska. He did not believe the public had seen services reduced to the point that people took notice. He believed there was more to cut. He pointed out that the magnitude of the cuts was not communicated properly and attributed it to poor reporting by the press at the end of session. He added that for the most part he believed the reporting done was agenda driven. Progress was made last session but the legislature did not receive its due credit and placed more pressure on the agencies. He encouraged Ms. Pitney to look at further agency reductions rather than adding additional revenues. He believed it was time to pull the fire alarm. He did not believe she would find support for new revenues

in the Senate or in the House. He added that people would likely support serious budget reductions. Once the cuts were made he thought she would find more support to discuss revenue measures towards the end of session because reductions that were made could be pointed out.

[12:45:08 PM](#)

Senator Hoffman remarked that if Ms. Pitney could get revenue measures through the House he was certain they would be given very serious consideration by the Senate.

Ms. Pitney suggested that the agencies would argue about the size of reductions and the priority of particular services. However, even with the largest imaginable reductions she believed that there would be a diminishment in the state's credit rating reduction without implementing new revenue measures. She closed by stating that revenue was a critical step in the current legislative session.

Co-Chair Kelly stated that the legislature would be going to some difficult places and needed the administration to have the courage to go with the legislature. At the end of session the branches needed to be working together to get things accomplished.

#  
ADJOURNMENT

[12:47:17 PM](#)

The meeting was adjourned at 12:47 p.m.