

SENATE FINANCE COMMITTEE
January 21, 2016
9:04 a.m.

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CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 9:04 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

David Teal, Director, Legislative Finance Division; Senator Gary Stevens.

SUMMARY

^PRESENTATION: OVERVIEW FY17 OPERATING BUDGET

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, discussed the PowerPoint presentation, "Presentation: Overview FY17 Operating Budget." He felt that the appropriate beginning should be to examine the past, present, and future budgets.

Mr. Teal highlighted slide 2, "Unrestricted General Fund Revenue/ Budget History (\$ millions). He explained that the green background to the slide represented the state revenue. He stated that the chart showed that more revenue equaled more spending. He noted that there was a budget of

approximately \$2 billion for almost 20 years, and then, in 2008, the budget spiked to almost \$8 billion.

Mr. Teal discussed slide 3, "Total Agency Operating Budgets, Statewide Items and Capital Budget Compared to Revenue (UGF Only--\$billions)." He noted that revenue significantly declined in 2014.

Vice-Chair Micciche looked at slide 2, and queried the significant fund transfers between 2005 and 2011, and the decline below the bottom after 2011. Mr. Teal responded that the red bars represented deficits, if they were below zero, and surpluses if above the spending line. He noted that there were many years with surpluses, usually at a time of high revenue. He shared that there were a number of years with a deficit when revenue did not keep pace with population and inflation. He stated that the deficits were generally less than half of a billion dollars. He noted 1998, when the deficit was larger than \$1 billion. He stressed that, currently, the state saw consistent deficits. He noted that the most recent two years were each a nearly \$3.5 billion deficit. He furthered that the projected deficit for the upcoming fiscal year was \$3.5 billion. He stressed that the state was using reserves at a rapid rate. He remarked that the state had substantial reserves, but the reserves were depleting at significantly. He remarked that there was only approximately three years' worth of reserves, if the spending pace was maintained.

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Co-Chair MacKinnon thought that there were not enough reserves to cover three years. She asked for further explanation, with the difference between fiscal and calendar years. Mr. Teal replied that there was approximately two years remaining in the CBR, because there was roughly \$7 billion in the CBR. He stated that spending one-half of the CBR in FY 17, the money would be gone in FY 18. He stated that, at that point, the remaining reserves was in the earning reserve account, which was currently used to pay the permanent fund dividend (PFD) and inflation proofing. He stated that using the earnings reserve to balance the budget, eliminated the inflation proofing and PFDs. The earnings reserve accounts were currently at \$8 billion, which would get the state through FY 20.

Co-Chair MacKinnon noted that the S and P report pointed to the Department of Revenue (DOR), which did not appropriately reflect the volatility of the downward trend in the oil industry. She wondered if Mr. Teal was familiar with that excerpt. Mr. Teal replied in the affirmative, and furthered that the revenue forecast was accurate. He stated that there should be a consideration regarding the revenue forecast, at roughly \$2 billion was based on a \$56 per barrel assumption and rising thereafter.

Co-Chair MacKinnon noted that between the spring and fall forecasts, Alaska lost a minimum of an additional \$700,000 million. She wondered if the \$700,000 million differential was taken into account in Mr. Teal's presentation. She queried the price per barrel that assumed the state only had three years of reserves. Mr. Teal replied that the summary was based on the official revenue forecast of \$56 per barrel. He noted that the adjustment for current prices, which were below \$30 per barrel, the picture looked substantially different. He noted that S and P looked at the oil forecast, and had questioned the numbers in the forecast. He stated that S and P felt that the projections of deficits were too low.

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Senator Bishop looked at slide 2. He noted that there was a 600,000 to 2 million barrel per day production from 1981 to 2001. He stressed that the state would not see that kind of production again. Mr. Teal remarked that, at its peak, oil was moving through Trans-Alaska Pipeline System (TAPS) at 2 million barrels per day. Currently, TAPS was moving 500,000 barrels per day. He stated that the much of the graph was based on production of oil, not price of oil. He stressed that the price had been declining for years, and asserted that the price would stabilize with additional oil field production. He stressed that, without additional oil fields, production would continue to decline. The forecasts that included oil development, did not return production to the 2 million barrel per day.

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Mr. Teal continued to discuss slide 3. He noted that, in FY 13 there was \$7.8 billion in revenue, and \$6.9 billion in spending. He remarked that there were limited changes in statewide spending due to debt service and retirement

services. He remarked that paying less debt service required cash infusion. He stated that there was no available cash infusion, so the debt service must maintain continued payments over time. He looked at FY 17, and felt that the issue was related to "doing the right thing." He remarked that, if oil was lower than the projection, there would be an even greater deficit. He felt that there were differing opinions as to whether the deficit was related to low revenue or high spending.

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Mr. Teal addressed slide 4, "Real Per Capita Unrestricted General Fund Revenue/ Budget History (2014 dollars Per Person)." He stated that the chart was the same as chart one, but was adjusted to population and inflation. He stated that the chart showed that the deficit could be related to revenue. He felt that taxes would not fully cover the deficit. He concluded that merely reducing spending and adding taxes would not fully relieve the deficit. He felt that the discussion was important, because Alaskans understood that revenue was low, but remembered that oil had been at a low price in the past, and there was a positive result. Therefore, many felt that the spending increase was the reason for the deficit.

Co-Chair MacKinnon wondered if the double dividend was in FY 13. Mr. Teal replied in the negative.

Vice-Chair Micciche looked at slide 4, and felt that the scale was incorrect. Mr. Teal replied that the slide was adjusted for both population and inflation. He explained further with slide 2, and noted the number differences. He explained that adjusting for both population and inflation would impact the spending.

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Senator Bishop felt that many Alaskans were paying attention to the state budget. He looked at the statewide operations on slide 4, and remarked that it was related to debt service and retirement. He looked at FY 13, and remarked that the bar had decreased since that time. He wondered if the cash infusion in FY 13 helped to decrease the debt. Mr. Teal replied that the liability had continued to increase and the payments increased. He agreed that the cash infusion helped to alleviate the debt service. Without

the cash infusion, the debt would have been nearly \$1 billion in the current year. He stressed that it greatly helped the deficit.

Mr. Teal continued to discuss slide 4. He remarked that some people felt that spending, per person, had continued to increase.

Mr. Teal highlighted slide 5, "AGENCY OPERATIONS 2014 Inflation Adjusted \$." He stressed that the budget had been reduced. He noted that most of the agencies were operating within the FY 08 category.

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Co-Chair MacKinnon wondered why the comparison was for management plans, rather than actual spending. Mr. Teal replied that management plans and actual spending were often very similar. He felt that the most recent spending reports were not fully accurate. He stated that there were many times when the actual spending was incorporated in the comparison reports. He felt that the graph would not be much different with actual spending comparison.

Mr. Teal explained that the public felt that the budget continued to increase. He noted that this was the first year with an operating budget reduction. He felt that there had not been enough time for the public to fully understand the pain of the state's budget impact.

Senator Bishop disagreed with Mr. Teal's last comment. He stressed that his constituents had felt the budget impact.

Co-Chair Kelly noted that the Revenue Sources Book reflected the forecast at \$56 per barrel. Mr. Teal agreed.

Co-Chair Kelly wondered if there was an estimate for \$30 per barrel. Mr. Teal replied there was not an estimate, but further explained with slide 7, "FY17 Unrestricted General Fund Revenue -Fiscal Sensitivity":

This graph excludes the Governor's proposed legislation and is intended to provide a picture of the "status quo" for FY17.

Co-Chair Kelly felt that the sensitivity chart was not easy to understand.

Co-Chair MacKinnon noted that the revenue had fallen off the cliff in the revenue sensitivity chart. Mr. Teal stated that the chart was designed to show what would occur, should oil not be at the DOR forecast level. He stated that the chart showed what the price would need to be to balance the budget.

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Vice-Chair Micciche surmised that there was a 4 percent floor at \$80 and below; and a 35 minus the applicable per barrel credit at \$80 and above. Mr. Teal agreed, except the change in the schedule had an adjusted floor year to year. He stated that the state operated on net profits, so the floor could change from year to year.

Mr. Teal discussed slide 6, "State of Alaska Fiscal Summary--FY16 and FY17 (Part 1)." He looked at lines 1 through 10, which added a number of new lines in FY 17. He felt that the new fiscal plan should be presented, before the other revenue sources were incorporated.

Co-Chair MacKinnon felt that the chart was "leaky", and she explained a plumbing analogy. She felt that the new FY 17 budget had too many components. She wondered if it was better to examine the current revenue structure, before incorporated new sources. Mr. Teal replied that the Legislative Finance Division (LFD) incorporated the governor's proposal.

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Co-Chair MacKinnon wondered if a governor should inconstantly incorporate and exclude certain aspects of the budget. Mr. Teal recalled that the governor had previously incorporated Medicaid expansion, and Co-Chair MacKinnon had the same reaction. He furthered that the governor proposed a budget, based on his desires. He stated that the governor was required to submit a balanced budget, so the governor should, therefore, incorporate revenue sources to maintain a balanced budget. He stressed that the revenue must be understood, before the budget could be discussed.

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Co-Chair Kelly explained that the committee would focus on the current revenue sources, before discussing additional revenue. He stressed that there would be discussion about additional revenue sources.

Senator Hoffman wondered if the three year projected reserves reflected the governor's proposal. Mr. Teal replied that the projections only referred to "business as usual." He stated that the expenditures for FY 17 in slide 6, were only related to the governor's proposal.

Senator Olson requested an evaluation of the strengths and weaknesses of the governor's plan. Mr. Teal understood that the question related to whether the governor's plan would work. He felt that the discussion about the revenue plan must be in depth. He would offer his opinion, once the other issues were addressed.

Senator Olson felt that the issues were surrounded by politics. He noted that the governor was not up for reelection, so he wanted to be sure that the plan was sound.

Mr. Teal continued to discuss slide 6. He encouraged the committee to only look at the unrestricted general funds (UGF) in FY 16 and FY 17. He stated that appropriations were split between agency operations, statewide operations, and capital appropriations. He highlighted each line of the appropriations.

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Mr. Teal addressed slide 8, "Agency Operating Budgets Percentage Change from FY16 Mgt Plan to FY17 Gov (UGF Only)." He shared that there were a few departments that had higher requests from FY 17. He remarked that the Alaska Liquefied Natural Gas (AKLNG) had major increases in Department of Revenue (DOR). He explained that the Department of Military and Veterans Affairs (DMVA) request was to expand the rural presence of the state defense force. All other agencies had decreases in their budget. He explained that the chart showed the axis's percent, so the percentage reduction had varied between 25 percent in Department of Commerce, Community and Economic Development (DCCED) through other increases. He noted that the requests for AKLNG and DNR were requests for general funds. He noted that AGDC had been receiving and allocating money to

agencies. He stated that AGDC was intended as the coordinating agency. He noted that the displayed numbers were not reimbursable service agreements from AGDC, but were requests for general funds, and may or may not be coordinated through AGDC.

Mr. Teal highlighted slide 9, "Agency Operating Budgets Change from FY16 Mgt Plan to FY17 Gov." He noted that Department of Health and Social Services (DHSS) budget had a dramatic decrease.

Senator Hoffman felt that Alaskans were concerned with education funding. He noted that the governor had committed to the previous budget level. He wondered how the \$90 million education reduction was determined. Mr. Teal replied that that the education spending was decreased, so the budget had been reduced. He stated that the governor had proposed the use of the rural trust fund to fund K-12 education.

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Senator Hoffman wondered if the \$17 million was sustainable. Mr. Teal replied that it was not sustainable. He stated that usage of the trust would only allow approximately \$15 million. He explained that the governor had a bill that changed the trust.

Mr. Teal continued to discuss slide 6. He noted that Medicaid was down approximately \$32 million. The savings due to Medicaid expansion were taken in the FY 16 budget. The \$32 million was attributable to reforms. He stated that DHSS had not specified the reforms, so it was hoped that there would not be a supplemental request. He explained that the net was the operating budget on line 13 at approximately \$100 million. He noted that debt service had changed from \$206 million in 2016 to \$436 million in 2017, which was an increase of \$230 million. He looked at line 28, which showed retirement costs.

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Mr. Teal displayed slide 11, "FY17 Governor's Request Agency Operating Budget, Statewide Items and Capital Budget (Formula and Non-Formula) (UGF Only--\$ millions)." He explained that state assistant programs would stay at \$99 million, with no change. He explained that issuing pension

obligation bonds would eliminate state assistance, because the contribution rate would drop to 22 percent or lower. He stressed that it cost money to issue the bonds, but the debt service would go to \$129 million. This adjustment would cause \$136 million in costs. The issuance of bonds would cost the state \$37 million more in FY 17. He stated that the rate would not decrease as much with TRS, but there would still be state assistance. He stated that the cost of issuing TRS bonds would be an additional FY 17 cost of \$22 million, resulting in a \$60 million cost increase in FY 17 with the issuance of pension obligation bonds. He stated that state would come out ahead at the end of 20 years with the issuance of the pension obligation bonds.

Senator Dunleavy wondered what would occur at a price per oil decrease from \$100 to \$20, and asked about the ability to fund the debt service in a deflationary period. He also looked at the permanent fund scenario with the assumption that the fund would develop a continual set number. He felt that the numbers were often extremely inaccurate.

Senator Dunleavy wondered if the projection was based on inflation. Mr. Teal replied in the affirmative.

Senator Dunleavy noted that the revenue was deflating rapidly, with no guarantee of the permanent fund earnings because of no market guarantees over 5 years. He understood that the fund was diversified, and there was an averaging concept. He restated that a downturn in the market would result in a reversal of the revenue fund earnings. Mr. Teal agreed.

Senator Dunleavy surmised that the state only had control over spending. Mr. Teal agreed.

Senator Hoffman deferred to Co-Chair MacKinnon.

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Co-Chair MacKinnon noted that S and P reports had reflected that there was a continued negative outlook at a cost of \$1 million per \$1 billion of borrowing assets. She stated that the reports showed that conversations in the Alaska Bond Bank had created the downgrade. She did not support moving into pension obligation bonds in the current time. She stressed that the market was focused on the committee, and therefore the change in structure provided instability. She

asked about the debt service related to the credit rating. She noted that the state's credit rating had recently decreased. Mr. Teal explained that the credit raters looked at Alaska as a "low debt state." He remarked that Alaska had recently taken more debt. He stated that the models were not often accurate, because they were merely projections. He stressed that there was a substantial risk in issuing bonds. He used an analogy of mortgaging a home versus putting money in the stock market. He felt that investing in bonds should only occur with a high level of confidence. He explained that issuing bonds would cost an additional nearly \$60 million.

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Senator Dunleavy felt that issuing bonds only avoided the eventual payment on the debt, however there was a possibility that the bonds may not have a great return on investment. He did not feel that many households would run on the displayed scenario. He queried Mr. Teal's comments on the models. Mr. Teal felt that models were helpful, but should only be treated as projections, not predictions. The models were run, with changes in the inputs.

Co-Chair Kelly recalled that Mr. Teal said, "Models are nice, but I don't believe them."

Senator Dunleavy noted that there was a precedence in the country using pension obligation bonds, and many cities had suffered using the concept.

Co-Chair Kelly did not support pension obligation bonds in any scenario.

Senator Hoffman wondered if other states had recently used pension obligation bonds. Mr. Teal replied that there were some states that had used the bonds. He stated that most states had local government with different systems.

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Senator Hoffman asked what the states used the newfound revenue toward. Mr. Teal replied that the money would be only be used in the retirement trust funds to earn money and pay benefits.

Senator Olson wondered how the numbers would vary as related to Alaska's decreased credit rating. Mr. Teal replied that the credit downgrade would only affect the state's issued bonds. He stated that there was not a consideration about loss of money, after the bonds were issued. He explained that LFD had published a paper about the subject.

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Mr. Teal addressed slide 12, "Unrestricted General Fund Revenue/ Budget History (millions)." He noted that line 25 showed oil and gas production tax credits. He stated that the credits went from \$500 million in 2016 to \$73 million in 2017. He recalled that the legislature appropriated \$700 million for tax credits, and the governor had vetoed \$200 million. He stated that there was an anticipation of \$625 million in tax credits in 2017. He noted that the addition of the \$200 million from FY 16 totaled the tax credits to \$825 million tax liability for 2017. He stated that the governor's appropriation was for \$73 million, which was the statutory minimum.

Co-Chair MacKinnon surmised that there was still debt, but the money would be used from a different source. Mr. Teal explained that the money was still owed, but its payment was not reflected in the budget. He explained that the governor intended to take \$1.2 billion from the CBR, deposit it in the oil credit, which made it invisible on the fiscal summary. He explained that the credits could be paid with GF, and draw from the CBR to pay the deficit to make the transactions more transparent. He shared that the credits had incurred debt, so the committee must determine the best way to deal with that debt.

Vice-Chair Micciche had a general understanding of the priorities of credit rating organizations. He wondered if LFD could provide a source of action to stop the downgrade. Mr. Teal replied that LFD could not make that determination. He stated that the credit rating organizations would be the most happy with a very small portion of debt.

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Mr. Teal looked at line 27 of slide 12. He noted that FY 16 did not have a number in that portion. He stressed that the reserve account was not considered UGF.

Senator Hoffman queried the benefit by switching funding sources. Mr. Teal replied that there was a disconnect between the fiscal health of the state and dividend payments. He explained that most people felt that the dividends were their share of the permanent fund. He felt that the dividend should be seen as a reflection of the fiscal health of the state. He liked that the dividends were considered an expenditure. He felt that the earnings reserve account should be categorized as UGF.

Mr. Teal looked at line 32 of slide 12. He noted the \$35 million supplemental appropriation for revenue sharing. He explained that the program took one-third of the earning balance, and distributed it to the communities. He stated that the governor wanted to return revenue sharing to \$60 million, therefore there was a required appropriation of \$80 million in FY 17. He stated that there was no money in the governor's budget that was appropriated for revenue sharing.

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Senator Hoffman stressed that the communities that depend on revenue sharing should be very concerned due to additional cuts to the budget. He stated that there would be more pressure on the legislature in the upcoming year. He felt that the revenue sharing program must be reevaluated, because of the services to the smaller communities in the state.

Mr. Teal explained that the revenue sharing program was developed to provide communities with a predictable cash flow, while also reflecting the state's current budget situation. He felt that appropriating money in the supplemental budget defeated the purpose of the financial expectation.

Mr. Teal continued to discuss slide 12. He stressed that there was no additional money for AKLNG in FY 17, other than the direct money in the departments. He looked at line 41, which was the total authorization. He noted that the total authorization went from \$5.4 billion to \$5.5 billion. He noted the increase in the budget of \$65 million of UGF.

Co-Chair Kelly queried the line number. Mr. Teal replied with line 41. He noted the increase of \$65 million.

Co-Chair MacKinnon wondered if Mr. Teal meant million or billion. Mr. Teal replied that he meant to say billion.

[10:34:37 AM](#)

Mr. Teal highlighted slide 42, which showed a \$3.8 billion deficit in 2016 and shifted to line 44. He stated that line 44 showed maintaining the status quo. He shared that the best guess at adjusting the governor's revenue resulted in a deficit of \$3.5 billion. He stated that the current revenue was expected to cover less than 30 percent of the state's expenditures. He stated that the forecast of increased revenue in FY 17, the revenue would cover approximately one-third of the expenditures. He noted that the revenue forecast could be very inaccurate, so there may be no improvement. He looked at line 41, which showed that the governor's plan had the deficit at under \$500 million.

Senator Olson surmised that the governor's plan would result in a \$400 million which would go to zero in the future, and doing nothing would continue with the deficit. Mr. Teal agreed.

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Senator Olson asked for further explanation. Mr. Teal explained that the governor's plan would bring the state to zero deficit within his model. He furthered that there were other factors such as oil revenue, interest, and other factors that would affect the outcome.

Senator Olson wondered if Mr. Teal was optimistic about the proposed model. Mr. Teal replied that he was optimistic, but furthered that there were many separate models that were essentially the same thing.

Senator Dunleavy surmised that it was a revenue-based model. Mr. Teal replied that model relied on earnings from the Permanent Fund.

Senator Dunleavy asserted that the model shifted the burden of revenue to instruments related to the people of Alaska

such as taxes and the dividend. Mr. Teal agreed, and explained that, conceptually, the money came from the elimination of inflation proofing and reducing dividends.

Senator Dunleavy stated that it was a revenue model. Mr. Teal agreed.

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Mr. Teal looked at the capital budget appropriations in slide 12. He stated that the capital budget had increased from \$118 million to \$195 million, which was a \$75 million increase.

Mr. Teal highlighted slide 13, "FY 17 Governor's Request Agency Operating Budget, Statewide Items and Capital Budget":

Revenue is estimated to be \$1.8 billion in FY 17, which is equal to the sum of appropriations for these purposes.

Mr. Teal explained the graph.

Vice-Chair Micciche felt that the only way the state could have saved money was to decrease the budget at an earlier time. Mr. Teal agreed, and explained that there would have been a larger reserve balance, had the statewide cuts occurred earlier.

10:48:08 AM

Senator Dunleavy felt that the state could have saved money by paying off the debts.

Mr. Teal looked at slide 14, "Unrestricted General Fund Revenue and Budget History." He stated that the state was "stuck." He stated that the Permanent Fund Act had been revised since the analysis, so the governor's appropriation bills needed to be revised to match the Act. He hoped that the governor's plan was portrayed as the governor intended. He stressed that business as usual would result in a gloomy picture.

Co-Chair Kelly stressed that the \$2 billion was more line \$1.7 billion. Mr. Teal agreed.

Co-Chair Kelly felt that there were many pitfalls in the governor's plan. He felt that there should be continued cuts, which would be much less complicated.

Vice-Chair Micciche noted that there was less current spending. He stressed that there would be some very difficult decisions.

Co-Chair Kelly felt that the press had done a poor job up to the current point. He stressed that the legislature had reduced the size of state budget. He remarked that the press should focus on the good things that had resulted in state savings.

#

ADJOURNMENT

10:54:00 AM

The meeting was adjourned at 10:53 a.m.