

SENATE FINANCE COMMITTEE
February 2, 2016
10:23 a.m.

10:23:03 AM

CALL TO ORDER

Co-Chair Kelly called the Senate Finance Committee meeting to order at 10:23 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

Randall Hoffbeck, Commissioner, Department of Revenue; Pat Pitney, Director, Office of Management and Budget, Office of the Governor.

SUMMARY

SB 138 BUDGET: CAPITAL

SB 138 was HEARD and HELD in committee for further consideration.

SB 139 APPROP: OPERATING BUDGET/LOANS/FUNDS

SB 139 was HEARD and HELD in committee for further consideration.

SB 140 APPROP: MENTAL HEALTH BUDGET

SB 140 was HEARD and HELD in committee for further consideration.

PRESENTATION: NEW SUSTAINABLE ALASKA PLAN

#sb138

#sb139

#sb140

SENATE BILL NO. 138

"An Act making appropriations, including capital appropriations, reappropriations, and other appropriations; making appropriations to capitalize funds; and providing for an effective date."

SENATE BILL NO. 139

"An Act making appropriations for the operating and loan program expenses of state government and for certain programs, capitalizing funds, making reappropriations, making supplemental appropriations, and making appropriations under art. IX, sec. 17(c), Constitution of the State of Alaska, from the constitutional budget reserve fund; and providing for an effective date."

SENATE BILL NO. 140

"An Act making appropriations for the operating and capital expenses of the state's integrated comprehensive mental health program; and providing for an effective date."

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^PRESENTATION: NEW SUSTAINABLE ALASKA PLAN

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, discussed the PowerPoint, "New Sustainable Alaska Plan: Pulling Together to Build Our Future" (copy on file). He stated that there were short-term, mid-term, and long-term issues that must be addressed.

Commissioner Hoffbeck highlighted slide 2, "Fiscal Challenge":

Unrestricted General Funds Gap

\$3.8 billion (30 percent)

Unrestricted General Funds

\$1.6 billion (13 percent)

Designated General Funds and Other State Funds

\$1.5 billion (12 percent)

Permanent Fund Inflation Proofing and Dividends

\$2.3 billion (18 percent)

Federal Funds

\$3.4 billion (27 percent)

Commissioner Hoffbeck looked at slide 3, "Fiscal Challenge." He stressed that the mid-term challenge was due to the significant draw from savings. He remarked that the withdrawal from the constitutional budget reserve (CBR) would not bring relief to the long-term crisis. He stressed that, without a change to the fiscal system, the CBR would be greatly depleted after two years. He stated that there would be small tax increases and earnings from the permanent fund that would cover the issue.

Commissioner Hoffbeck discussed slide 4, "Fiscal Challenge." He stressed that there was only one funding source: petroleum, which was the main source of revenue for the state. He stated that state budget was very much based on the oil price volatility. He stressed that there should be more long-term stability in government spending.

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Commissioner Hoffbeck highlighted slide 5, "Message Received":

Take action now, not later:

- Government must be cut further
- Protect essential services

Use of Permanent Fund earnings is acceptable if:

- Protect the Permanent Fund Corpus
- Preserve a Dividend Program

New Revenues are acceptable if:

- They are not supporting a "bloated" government
- The burden is shared equitably

Commissioner Hoffbeck shared that the list on the slide was developed based on recommendations from citizens of the state.

Senator Dunleavy wondered if the administration's reductions were aligned with the recommendations of the people of the state. Commissioner Hoffbeck replied that the reductions were directly aligned with the desire to protect the essential services. He furthered that the public expected more than a \$100 million reduction.

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Co-Chair MacKinnon noted that the governor's budget was an increase from the previous year. She asked how the governor expected the legislature to justify an increased budget. She shared that her district wanted a "right sized government." Commissioner Hoffbeck responded that the administration wanted to protect as many services as possible, which resulted in using as many revenue sources as possible. He stressed that the goal was only to reduce GF expenditures.

Co-Chair MacKinnon shared that she had recently read an article that highlighted the use of nonrecurring money in the short-term budget, which would result in long-term spending issues. She queried the administration's perspective on the difference between the words "equitable" and "fair." She felt that her district wanted an equitable solution, rather than a fair solution. Commissioner Hoffbeck replied that there was a benefit to cyclical spending in difficult economic times. He felt that there was an advantage to one-time spending. He had not considered the nuance of the difference between the words "equitable" and "fair." He stated that industry had desired an "equitable" solution.

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Senator Dunleavy shared a story about some districts using or not using the federal "bailout" money, but then desired more money related to inflation.

Vice-Chair Micciche looked at slide 3, and felt that the real revenue picture would look different in the forecast. Commissioner Hoffbeck shared that the numbers were based on the Department of Revenue (DOR) Revenue Forecast.

Vice-Chair Micciche felt that there should not be a focus on filling the budget gap, because that would probably be filled by the energy revenue. He stressed that there were not enough Alaskans or alternate resources to fill the budget gap. He shared that his district showed support for the use of the earnings reserves, but demanded additional efficiencies. He pointed out that Alaskans should not be intimidated into believing that there should be an "all or nothing solution." Commissioner Hoffbeck understood that the chart was the "worst case scenario." He wanted to attempt to find an overall solution.

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Vice-Chair Micciche wondered if the administration would consider a change in the plan, with the possibility of an increase in oil price. Commissioner Hoffbeck replied that there could be a modification in the plan.

Co-Chair Kelly commented that the committee had dealt with many revenue issues. He remarked that using federal funds was a common solution, but he did not want to use federal funds. He stressed that he wanted to reduce the size of government.

Commissioner Hoffbeck addressed slide 6, "The New Sustainable Alaska Plan":

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

Commissioner Hoffbeck discussed slide 7, "Alaska Permanent Fund Protection Act":

A fiscal framework for using our wealth to:

Help resolve this year's fiscal challenge

Sustainably fund government operations into the future

Provide the maximum benefit to the broader economy

Main components of the framework:

Royalties and production taxes into the Permanent Fund

Endowment draw

Royalty dividend

Periodic review

Commissioner Hoffbeck addressed slide 8, "Alaska Permanent Fund Protection Act." He shared that 30 percent of the royalties flowed through the corpus. The earnings reserve must be built to four times the annual draw. After that draw, 100 percent of the royalties would flow to the corpus.

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AT EASE

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Commissioner Hoffbeck continued to discuss slide 8. He explained that the funds would flow to the corpus, when there was four times the draw. He stated that there were two outflows from the earnings reserve: a \$3.3 billion annual appropriation to the general fund; and an appropriation to the PFD that would equal 50 percent of the prior year's royalty revenues. He stated that the combination of the \$3.3 billion and the other revenues to the general fund would provide the totality of the amount

of revenue available for government spending under the current program.

Commissioner Hoffbeck discussed slide 9, "The New Sustainable Alaska Plan":

Alaska Permanent Fund Protection Act (annual draw):
\$3,300
Revenue from existing taxes and fees: \$850
Earnings on Savings: \$135
TOTAL: \$4,285

Spending Reductions (estimated amounts)
FY17-FY19 Cuts: (\$240)
Reform OandG Tax Credits: (\$400)
FY17 Priority Investments: \$40
TOTAL: (\$ 600)

New Revenue Components (estimated amounts)
Mining: \$6
Fishing: \$18
Tourism: \$15
Motor Fuel: \$49
Alcohol: \$40
Tobacco: \$29
Oil and Gas: \$100
Individual Alaskans (Income Tax): \$200

TOTAL: \$457

Senator Bishop looked at slide 7 and slide 5. He wondered if the periodic review was intended to protect the permanent fund corpus. Commissioner Hoffbeck replied that the review was intended to ensure that there was enough reserves to allow for a draw.

Senator Bishop wondered if the permanent fund board would continue to function in the same manner. Commissioner Hoffbeck replied that the corpus would not change the fund. The mechanism from moving the corpus to the reserve would still align with statute. He explained that there would be a change to manage the draw, because of the dividend.

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Senator Hoffman asked if the protection act was intended to protect the dividend, and the number of the payout.

Commissioner Hoffbeck replied that the act was intended to protect the dividend, corpus, and earnings reserve. He stressed that the act would allow for a sustainable dividend in perpetuity.

Senator Hoffman wondered how the dividend would be protected under the plan. Commissioner Hoffbeck replied that the bill did not offer a constitutional amendment. He hoped that the plan would be a robust and stable way to finance government. He stressed that there was no intention to take away the PFD.

Senator Hoffman stressed that the dividend was not protected. Commissioner Hoffbeck agreed.

Vice-Chair Micciche remarked that the ISER study was fundamentally flawed, because approximately \$60 billion in revenue was not included. The lowest price assumption was \$70 in FY 17. He stressed that the study did not portray the current gap. He remarked that people were concerned about supporting the plan, when there was possibility for turnaround. He stated that there could be a level of revenue from the production tax, and he asserted that there could possibly be \$3 billion from that tax. He also stated that there could be an opportunity to adjust the revenue for tax relief, whether income tax, fuel tax, or sales tax. He also noted that there could be revenue from the corpus, which would increase the dividend at a certain level of return. He offered that there could possibly be a 12 to 15 percent level of return. He stressed that a system that promised a return to more normalcy, if revenues or corpus returns were larger than expected, people may be more susceptible to a new revenue plan. He stressed that an increase in production tax revenue would result in tax relief.

Co-Chair MacKinnon wondered if the proposal affected inflation proofing statutes. Commissioner Hoffbeck replied that with no payment for inflation proofing, the plan would change the statute. The modeling was done, so the value of the corpus of the fund would be the FY 16 value plus inflation. The modeling allowed for the fund to grow at the rate of inflation, but there was no specific inflation proofing deposit. The \$3.3 billion draw was calculated at a level that allowed the fund to grow with inflation.

Co-Chair MacKinnon wondered if the language for inflation proofing was removed from statute in the bill.

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, replied that the component would be repealed in the legislation.

Co-Chair Kelly felt that the assumptions were failing, and queried some suggestions.

Commissioner Hoffbeck highlighted slide 10, "The New Sustainable Alaska Plan." He stated that the slide showed the per capita broad based tax burden on the people of the state. He shared that the state currently had the lowest personal tax burden for broad based taxes. He stated that the slide was a reflection of the ISER study. He shared that the tax burden for the state was approximately \$500 per person, and the national average was approximately \$2300. He stated that, even with the personal income tax and other taxes, there would only be approximately \$1000 per person tax burden. He stressed that there would not be a situation where a person was taxed beyond their capabilities. He remarked that the state may begin to look like some of the other states.

Commissioner Hoffbeck displayed slide 11, "The New Sustainable Alaska Plan":

- Lowest taxes in the nation.
- Receive a dividend.
- Grow our savings.
- Continue to provide essential services.
- Invest in future

Co-Chair MacKinnon announced that the state owed the CBR the amount of the previous year's withdrawal. Commissioner Hoffbeck deferred to DOL. He stated that the earnings reserve could not be "sweepable" into the CBR.

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Co-Chair MacKinnon surmised that there was no plan to "recharge" the savings. Commissioner Hoffbeck replied that there was no additional money for the CBR.

Co-Chair MacKinnon would like to know about the pension payments. She stressed that the state owed a significant amount of money for the pension liability. She queried the administration's efforts in paying down the pension obligation. Commissioner Hoffbeck replied that the state could still borrow at a low rate; and the market was beginning to correct, therefore the risk may be lower. He stated that there was also an examination of whether the pension obligation would take more of the fixed draw. He stressed that there would be no additional debt with the use of pension obligation bonds. He felt that the obligation would be replaced with another obligation. He proposed that the obligation for the debt would stay in the general fund.

Co-Chair Kelly surmised that the plan comingled the GF with the earnings reserve. Commissioner Hoffbeck agreed.

Co-Chair Kelly stressed that approval of the plan should be done with caution.

Senator Dunleavy stressed that someone had to pay for the state government and state services. He remarked that the plan was meant to pay for state, not the pension group. Commissioner Hoffbeck agreed, and stated that the bonds would pay for the state.

Senator Dunleavy wondered if there was a model that showed an increase of the value of the dollar, and how it impacted the state of Alaska. Commissioner Hoffbeck replied that inflation put pressure on anyone with outstanding debt. He preferred a deeper discussion on that issue.

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Senator Bishop noted the recent \$3 billion deposit for the pension obligation. He stressed that the current obligation was \$225 million, and the fund was at 80 percent. He felt that many states in the country would be envious of Alaska's pension obligation percentage.

Commissioner Hoffbeck shared that the modeling at the \$3.3 billion projected that the earnings reserve would go to zero 30 percent of the time. He stressed that a move to zero at any time in its life was considered a failure.

Co-Chair Kelly asked for a restatement.

Commissioner Hoffbeck stated that the modeling showed that there would be an extended period of low oil prices and low draw on the earnings reserve 30 percent of the time. He stressed that the periodic review would allow for the opportunity to correct a possible systemic problem. He stressed that the draw could always be reduced, but a statutory change was required for an increased draw. He shared that the move to zero would be in the out years. He felt that the plan was fairly robust, in order to eliminate the possibility of failure.

Co-Chair Kelly asked if there had been analyses of the sustaining the corpus at current levels. Commissioner Hoffbeck replied in the affirmative.

Vice-Chair Micciche queried the reasoning behind an income tax versus sales tax. He looked at slide 10, and noted that New Hampshire and Delaware did not have a significant sales tax. He felt that there were polls conducted that preferred sales tax. Commissioner Hoffbeck agreed to that discussion.

Senator Dunleavy shared that there would be a lunch and learn that was related to health care costs.

SB 138 was HEARD and HELD in committee for further consideration.

SB 139 was HEARD and HELD in committee for further consideration.

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ADJOURNMENT

[11:27:01 AM](#)

The meeting was adjourned at 11:27 a.m.