

HOUSE FINANCE COMMITTEE
February 26, 2019
1:35 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:35 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Tammie Wilson, Co-Chair
Representative Jennifer Johnston, Vice-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Andy Josephson
Representative Gary Knopp
Representative Bart LeBon
Representative Kelly Merrick
Representative Colleen Sullivan-Leonard
Representative Cathy Tilton

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division;
Representative Steve Thompson; Representative Sharon Jackson.

SUMMARY

PRESENTATION: OVERVIEW OF THE GOVERNOR'S FY 20 BUDGET -
ROUND 2

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Co-Chair Foster reviewed the meeting agenda.

^PRESENTATION: OVERVIEW OF THE GOVERNOR'S FY 20 BUDGET -
ROUND 2

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, provided a PowerPoint presentation titled "Overview of The Governor's FY 20 Budget - Round 2," dated February 26, 2019 (copy on file). He noted that the governor had made it clear that the December 15 [2018] budget had been a place holder. The amended budget had been released recently by the governor. He could not tell the legislature what actions to take on the budget, but he could discuss whether something met the budgetary principles outlined by the governor. He noted there was a fine line when talking about proposals - he clarified that any criticism he would make was not ideological or personal, but reflected a discussion of the process.

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Mr. Teal turned to slide 2 and addressed the governor's five guiding budget principles:

1. expenditures cannot exceed existing revenue;
2. the budget is built on core functions that impact a
3. majority of Alaskans;
4. maintaining and protecting our reserves;
5. the budget does not take additional funds from Alaskans
6. through taxes or the PFD;
7. it must be sustainable, predictable and affordable.

Mr. Teal addressed the first item on slide 2 and confirmed that expenditures could not exceed revenues in the long-term. He moved to slide 3 showing real per capita revenues and expenditures by the state and he noted that the governor's policy for expenditures to equal revenues was a mathematical relationship with policy implications. He did not believe there was any question that expenditures exceeded revenues in recent years [shown on slide 3]. Even with the addition of percent of market value (POMV) in FY 19 (shown in black), revenue was still substantially below expenditures. With the reductions proposed by the governor, the budget was essentially balanced. In FY 19 and earlier, the prudent question was whether expenditures exceeded revenues because expenditures were too high or because revenues were historically low. He stated it was for the legislature to judge. The expenditures operating budget in

real per capita terms had been fairly steady, while revenue had sometimes been very high and in recent years it had fallen with oil prices.

Mr. Teal pointed out that the mathematical relationship was easy, while the policy implications were not. He noted that the Office of Management and Budget (OMB) director reasoned that expenditures were too high because they exceeded revenue. He pointed out that it could also be argued that revenue was too low. He reiterated it was for the legislature to judge. He believed the answer would only come when the legislature reviewed the budget and decided what it wanted to spend, where the funds would be spent, and how much would be spent and then compared the expenditures to existing revenue. At that point, the legislature could decide what to do to fix the deficit if there was one.

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Co-Chair Wilson turned to slide 3 and referred to FY 19 when the state had the POMV for the first time. She presented a scenario where the state had the same concept and lived within its means. She asked how much the legislature would have needed to reduce the budget to remain at that spot.

Mr. Teal answered that when the legislature had gone home the previous year, a deficit of about \$700 million had been expected. He detailed that because revenue had been higher than anticipated, the deficit was closer to \$300 million.

Co-Chair Wilson asked for verification that if the legislature would have used the forecasted revenue and a POMV, there would have been a surplus versus a deficit.

Mr. Teal replied in the affirmative. He explained that the same was true for the current year; if Permanent Fund Dividends (PFD) were not paid there would be a surplus of about \$300 million. He elaborated that the dividends cost about \$1.9 billion and the deficit was about \$1.6 billion.

Co-Chair Wilson noted that the legislature had paid a dividend the previous year. She did not believe it was about a zero dividend. She elaborated it was about how much government needed to be able to meet the requirement portion and having that discussion. She stated that in past

years the legislature had not had the discussion because the money had always come from a savings account.

Mr. Teal agreed. He elaborated that the argument could be made that if FY 20 dividends were paid at the FY 19 level, the state would have an additional \$900 million in the General Fund, which would have reduced the projected deficit to roughly \$700 million.

Co-Chair Foster acknowledged Representative Steve Thompson in the room.

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Vice-Chair Ortiz asked if the year-to-year government expenditures on slide 3 included the PFD.

Mr. Teal replied that the PFD was not included in the chart. He explained that in past years dividends had been put at the bottom of the fiscal summary and had been "off budget" in a sense. He believed LFD, OMB, and the finance committee chairs had at some point said that dividends were not a zero expense and should be shown as a state expenditure. He explained that historically LFD had not gone back to include dividends. There was some confusion because it would require showing the revenue as well. He elaborated that each of the bars on slide 3 would increase with the inclusion of the PFD and revenue would also increase by that same amount each year.

Mr. Teal continued that the chart showed about half the revenue in FY 19 from POMV compared to FY 20. In FY 19 there was roughly the same \$3 billion payout from the Earnings Reserve Account (ERA), but \$1 billion went to dividends and \$2 billion went to the General Fund. In FY 20 there was closer to \$2 billion going out, which left \$1 billion in net revenue to the General Fund. The chart showed the extra revenue, but not the portion going to dividends. He reiterated his earlier statement that dividends were not included in the chart.

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Vice-Chair Ortiz asked if the "20GovA" bar [to the right of the chart on slide 3] would increase by \$900 million if the PFD was included.

Mr. Teal replied that the FY 20 bar would increase by \$1.9 billion - the entire amount of the dividend. He added that expenditures would also increase by \$1.9 billion.

Representative Merrick asked how much each recipient would receive if there was an expenditure of \$1.9 million [billion] for PFDs.

Mr. Teal replied roughly \$3,000.

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Mr. Teal returned to slide 2 and addressed the second of the governor's five guiding principles pertaining to the budget: the budget is built on core functions that impact a majority of Alaskans. He highlighted that the Donna Arduin the director of OMB had stated that the budget had been built from the ground up. He believed many people interpreted that to be zero-based budgeting, which was not correct. He explained that if the method utilized had been zero-based budgeting, the legislature would have received an analysis on the impacts of the cuts. He elaborated that the analysis would have been required to develop the budget. He noted that Ms. Arduin had later clarified that the process was really core-based budgeting. He expounded that OMB had prioritized things but did not necessarily have a position paper or any type of vetting of their ideas.

Mr. Teal discussed that Senator Lisa Murkowski had spoken to the legislature in a joint session and had specified that core services include education, healthcare, and access to transportation. Senator Murkowski had noted that the governor's budget had major reductions in all three of those areas. Whatever the budgeting process was called, he believed it was apparent that many legislators shared his frustration with the lack of analysis, evaluation, and vetting of the governor's proposal. He thought the proposal seemed to be ideas without the defense one may expect. He did not see budgeting as merely a math problem. He pointed out that expenditures equal revenue was an equation, but it did not tell the legislature what needed to be done; the calculation merely conveyed that there was a problem if the two were not balanced. He believed making good policy decisions required good information, which he did not believe had been provided yet.

Vice-Chair Johnston believed the other part of the core-based budgeting received from Ms. Arduin was the core programs including public safety, management of natural resources, and preserving maintenance of the state's transportation infrastructure. She asked Mr. Teal if he intended to address how the core programs fit into core-based budgeting.

Mr. Teal replied that he could address the agency budgets, but he did not tie it back to core because LFD did not yet have the priorities from the administration. The administration had stated that the budget was developed by setting the priorities. He thought that the Department of Health and Social Services (DHSS) may have released its priorities to the Senate Finance Committee. He was uncertain the House subcommittee on education had met yet. He had not yet seen the priorities from the governor and assumed the legislature had not yet seen them. He also assumed the information would be provided to budget subcommittees at some point. He believed the subcommittees would discuss how to stack up core programs and spending.

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Vice-Chair Johnston highlighted that the administration had its guiding principles and the budget included core programs, which she believed was prudent to keep in mind.

Representative Josephson referenced slide 3 of the presentation. He asked for verification the chart included inflation and reflected relative values year-to-year.

Mr. Teal answered in the affirmative. He explained the information was adjusted for population growth and inflation.

Representative Josephson asked for confirmation that the data reflected the administration's proposal to spend less in the coming fiscal year than the legislature spent before first oil flowed out of the Trans-Alaska Pipeline System (TAPS) in August 1977. He noted the chart included FY 75.

Mr. Teal replied that per capita spending for FY 20 was lower than in FY 04 and the 1980s and put the state back on par with the late 1970s. Spending on a per capita basis was as low as it had ever been.

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Representative Josephson stated that the chart reflected that before production from TAPS - he imagined there had been a small amount of revenue for the Kenai Peninsula - that the budget included more in relative dollars for government based on a state income tax and other small sources of revenue relative to the population and inflation.

Mr. Teal agreed. He believed the state income tax had been in place through 1981 or the early 1980s. He explained that the chart began with 1975 because that was as far back as the system went reliably. Records prior to 1975 were paper budgets.

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Mr. Teal returned to slide 2 and addressed the third of the governor's five guiding principles pertaining to the budget: maintaining and protecting our reserves. He pointed out that the budget pulled \$436 million from the Statutory Budget Reserve (SBR) and Alaska Industrial Development and Export Authority (AIDEA) reserves. He elucidated that in FY 19 the budget used less than \$300 million in reserves. The proposed budget pulled more from reserves in FY 20 than in the previous year.

Representative LeBon asked about the use of AIDEA funds as a fund source in the budget. He wondered if the amount was too high or just right and whether it was sustainable.

Mr. Teal believed Representative LeBon had addressed the point well the previous week when he had expressed his concern from the perspective of a banker. He recalled that Representative LeBon had shared that he had made loans for economic development projects, often with the participation of AIDEA. He stated that even the reduction to AIDEA reserves would limit its ability to finance economic development projects. He reported it was a policy call. He pointed out the proposal was a one-time drain of reserves and would take over half of AIDEA's reserves, which could not be continued for very long.

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Co-Chair Foster summarized Mr. Teal's statement that the proposed budget would take about \$437 million from reserves. He surmised that almost a quarter of the \$1.6 billion the public believed the proposed budget would cut, was actually coming from savings.

Mr. Teal responded that he would address the point later in the presentation. He moved to the fourth of the governor's five guiding principles pertaining to the budget (slide 2): the budget does not take additional funds from Alaskans through taxes or the PFD. He highlighted that the proposed budget did not really rely on existing state revenue to balance the budget - it would push costs onto municipalities, removed tax revenue from municipalities, and past some to all of those costs onto citizens. He recommended that the legislature consider whether it believed the administration was satisfactorily following the outlined guiding principles.

Mr. Teal addressed the fifth of the governor's five guiding principles pertaining to the budget (slide 2): it must be sustainable, predictable and affordable. If expenditures were set to equal revenues annually (revenue fluctuated due to the reliance on oil), the equation would specify that expenditures would be cut when [oil] prices fell, and expenditures would increase when [oil] prices rose. He explained it was not a good way to operate government; government worked better with stable funding. For example, hiring teachers and other employees back would be difficult once they were laid off. He acknowledged the same would be true for private business. Government operated a bit differently and stability was significant to government services.

Mr. Teal recommended considering what would happen if oil prices fell to \$50. He questioned how the budget could ever be cut to match that price while trying to remain sustainable, predictable, and affordable. He pointed out that reserves would be used if spending was straightened out and stabilized. He thought it seemed that by setting out the principles the governor was taking two of the three traditional budget balancing tools off the table: 1) add revenue, and 2) pull money from reserves (slide 4). He thought many people believed the governor balanced the budget by cutting \$1.6 billion from state expenditures. He clarified that it was not the case. Especially after hearing about the cuts to Medicaid, the University, and the

Alaska Marine Highway System (AMHS), he believed people thought the cuts were much deeper than they were. He underscored that the cuts were nowhere near \$1.6 billion.

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Representative Sullivan-Leonard returned to point 4 on slide 2. She referenced Mr. Teal's testimony about the governor's statement that the budget did not take additional funds from Alaskans through taxes or the PFD. She clarified that the governor had stated he did not want an income or sales tax or the use of the PFD to fund government operations. She believed it was something that needed to be said as opposed to just stating that municipal government would have an increase in taxes. She stated that was not yet known. She thought they needed to stick to the state budget and not the municipal budget.

Mr. Teal noted the point but recalled statements made by members of the committee that perhaps the governor's budget put too much focus on the treasury as opposed to the state. He explained that if the treasury was looked at by itself, the economic and local government impacts were missed. He stated it was the legislature's job to consider the impacts to the state as a whole.

Representative Sullivan-Leonard did not dispute the point, but she clarified that point 4 on slide 3 communicated that the governor did not want to impose an income tax, sales tax, or the use of the PFD.

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Mr. Teal turned to slide 5 and addressed an abbreviated fiscal summary showing undesignated general fund (UGF) only. He noted it was perhaps all the committee needed at present. He explained that LFD did not disagree with any of the numbers in OMB's fiscal summary; LFD only disagreed with some of the way the budget was presented. Therefore, it was possible to eliminate all of the other funds and federal funds and focus on the UGF only because it was the only type of fund that could have a deficit. The simple comparison showed that revenue was \$200 million higher in FY 19 than the projection for FY 20. The difference was an oil price of \$68 in FY 19 compared to a projected price of \$64 for FY 20. He continued that appropriations were down \$73 million (from roughly \$5.772 billion in FY 19 to \$5.699

billion in FY 20). In FY 19 there was a projected deficit of \$262 million; the governor was proposing a deficit of \$428 million in FY 20 (before new revenue came in). The new revenue of \$448.8 million, comprised of \$420 million of petroleum property tax (currently local revenue that the governor would turn into state revenue) and \$20 million in shared taxes (currently shared with local governments that the governor would turn into state revenue). The new revenue resulted in a surplus.

Mr. Teal noted that in the overview publication he specified that the governor would find it difficult to cut money from agency operations and that he may find himself having to cut where the money was (i.e. Medicaid, K-12 education, PFDs, DHSS, and the University) or costs would end up shifting to local governments. He did not believe his statement went very far out on a limb. He turned to slide 6 that showed cuts the governor was proposing to state agencies (excluding Medicaid and K-12 - the large formula programs under DEED and DHSS). The table showed a \$2 billion expenditure. He highlighted the difficulty of cutting \$1.6 billion from a \$2 billion portion of the budget.

Co-Chair Wilson appreciated that Medicaid and K-12 was not included in the table; however, she wondered why the University was included if the goal was to look at whether government had gotten smaller. She explained that although the table showed a decrement, the state gave a grant to the University and she did not view it as agency operations (unlike the Department of Environmental Conservation or DHSS). She asked how to make the determination about exactly how much came out of agency operations that the state was responsible for versus those that went to municipalities (e.g. K-12 or grants through DHSS). She did not believe the cut to the University should be reflected in state government operations.

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Mr. Teal knew the University liked to consider itself as a fourth branch of government, but it was not. He clarified that the University was an executive branch agency. The University was named in the constitution, but for budgetary purposes it was still considered as an agency and state funding was used for operations (like any other agency). He

added that the legislature did not budget the University the same way it budgeted other agencies.

Co-Chair Wilson understood that the University [was part of state government]. She reasoned that Medicaid and K-12 were also part of government. She relayed the desire to be able to explain to constituents the reductions in areas directly impacting the public such as DPS, DHSS, and DEC (areas that had substantial regulation and impact). She noted that the table excluded the other two [Medicaid and K-12]. She was trying to ascertain whether there was a better way to specify what came out of the budget that would be for municipalities to cover and the everyday budget items. She reasoned that \$1.6 billion had been taken out of the budget, but it was from areas that citizens would not all consider to be state operations.

Mr. Teal replied there were many ways to break the budget apart to make it digestible. The table was simply a way of showing the day-to-day operations of state government, without the large formula programs. The University was not a formula program - funds went to operate the University in the same way state funds went to the Department of Natural Resources (DNR) to operate. He stated whether Co-Chair Wilson considered the services to be a function of government was up to her. He elaborated that LFD viewed the University as a function of government and he did not know how LFD would treat it differently; LFD would continue to include the University in reporting because it was part of the budget process. To LFD, the University was simply another agency; it had been included in the table because it was a nonformula as were most of the other agencies in the table. The large formula funds were Medicaid and K-12 and had been excluded from the table.

Representative Sullivan-Leonard asked why the Department of Commerce, Community and Economic Development (DCCED) showed a 297 percent increase (slide 6).

Mr. Teal replied that the increase was due to Power Cost Equalization (PCE) that had previously been funded by the designated PCE Fund. The governor planned to eliminate the designated PCE Fund and not the program; the funding source would be transferred to UGF. The amount was \$33 million, which accounted for the huge increase.

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Mr. Teal continued to review the FY 19 management plan to FY 20 governor's amended budget on slide 6 and reported the total cut was 13 percent or approximately \$260 million. He remarked that despite campaign statements made by the governor that he believed \$200 million could be cut from state agencies with no impact (part of that was due to efficiencies and the governor's belief that there were a couple thousand positions that were funded but unfilled), he believed it was a myth. He believed cutting \$200 million from the specific portion of the budget was a stretch. The governor had exceeded Mr. Teal's expectations in his ability to cut from the area, but he had not foreseen a 41 percent (\$134 million) cut to the University or the cuts to the Alaska Marine Highway System (AMHS) that would result in the end of the system as the residents of coastal communities knew it. He summarized that cuts of \$260 million were more than he expected but were far less than \$1.6 billion.

Representative Merrick asked for an explanation of the positive figures for DEED, Judiciary, the legislature (slide 6).

Mr. Teal replied that the agencies listed by Representative Merrick had received increases; they received additional grants in some cases. He highlighted that they had been expecting to see a large reduction to DEED; however, K-12 funding had been removed from the data shown on slide 6. The DEED figures on slide 6 only included funding for the department itself. There was an increase, but he could not specify exactly what had been increased. He knew some early education cuts had been made, so it seemed strange there was an increase. He believed the increase for DNR was related to the governor's addition of funding for fire suppression. He explained that fire suppression had been underfunded for years; the governor had decided to fund it at a more reasonable level, which was several million dollars higher than in the past.

Representative Merrick reminded Mr. Teal she had asked about Judiciary.

Mr. Teal explained that the increase to Judiciary was primarily due to an effort to end the Friday afternoon Judiciary office closures, which was part of the governor's criminal justice initiative. He remarked that because the

governor wanted to be tough on crime, he would expect there to be increases in the Department of Public Safety (DPS), Department of Law (DOL), the Department of Corrections (DOC), and the Court System; however, that was not the case. He highlighted the proposed \$30 million reduction to DOC as an example. He detailed it was a combination of replacing UGF with Permanent Fund criminal funds (the state garnished felons' PFDs and deposited them in the Crime Victims Compensation Fund to fund healthcare costs within DOC). He explained that a bigger dividend the previous year meant more dollars that were not paid to criminals and more money to DOC. He elaborated that it resulted in a reduction of general funds; most of the reduction was due to a decision to move prisoners out of state. Despite the fact the governor wanted to be tough on crime there was a \$30 million reduction to DOC.

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Mr. Teal continued to answer the question. He pointed to the DHSS line on slide 6 and reminded the committee the reduction did not include Medicaid. The increment included the Pioneer Homes, which may appear to be untouched because there was a loss of \$18 million UGF that was replaced with the authority to increase rates. The data only reflected the UGF, not the potential for rate increases. He returned to DOC and relayed that LFD believed the numbers may be erroneous; based on a quick analysis, LFD anticipated a supplemental of \$7 million or more. Similarly, a supplemental for DHSS may be required, but he did not know because LFD did not have the data (i.e. what assumptions had been used - the number of residents receiving what level of care, how much money they make, etcetera). He was uncertain the administration had such an analysis. He could not envision how the subcommittees could make decisions on the items without more information about who was served, the chances of recovering money through rate increases, the number of people living in homes that would be moved out of homes. He reiterated that LFD did not have a set of assumptions showing how the administration got its numbers.

Representative Merrick asked about the 1 percent increase to the legislature's budget on slide 6.

Mr. Teal stated that the increase was due primarily to two things. First, the Senate Finance Committee had added two members and funding their staff. Second, the House Finance

Committee was a larger share of the increase because it had curtailed its own funding substantially; it had left 18 positions with only 11 or 12 to be filled according to the money in the committee's budget. At the request of the Legislative Budget and Audit Committee chair (Senator Bert Stedman) they had included the money to fully fund the House Finance Committee. He pointed out that the subcommittee may determine the money was unnecessary. He would not be surprised if the subcommittee decided the money was not needed since the positions had not been filled.

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Representative LeBon asked what the cost would be for the governor's proposal to close a correctional facility and transfer prisoners out of state.

Mr. Teal replied he could not answer the questions yet. His assumption on moving prisoners out of state would mean the legislature would have received an explanation outlining the criteria used to select who would be transferred out of state, the costs of the psychological and health examinations, the transportation cost, and the institutions the individuals were currently in. He explained that if the 500 individuals came fairly evenly spread from institutions across the state, it was not a very efficient way to run a prison. He elaborated that under the scenario perhaps individuals in-state would be transferred around in order to close to of the buildings at the Wildwood Correctional Complex. He questioned what the cost would be to internally rearrange prisoners. He emphasized that LFD did not have any information on how the governor's office had come up with the numbers or how much would be saved by moving prisoners out of state. He stated it was a budget proposal and should be included in the budget - a fiscal note should not be needed. He believed the information should have already been provided to the legislature [by the administration] for its review.

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Representative LeBon asked if the \$29 million in savings to DOC [shown on slide 6] may not include the details highlighted by Mr. Teal.

Mr. Teal answered that the information was not known. He added that LFD estimated the administration's budget understated the DOC cost by at least \$7 million. Consequently, he would expect a supplemental request. He noted that LFD had not done what he would consider to be an acceptable analysis either.

Co-Chair Wilson asked for verification that DOC could issue an RFP and move prisoners out of state without the legislature's permission.

Mr. Teal agreed.

Co-Chair Wilson clarified the legislature did not know where the administration was in the process. She understood it would be nice for the legislature to understand whether a supplemental would be needed before the proposed decrement was made. However, she wanted the committee to understand that the decision was in the administration's purview and not necessarily in budgeting. Separately, she asked for verification that the decrements of 32 percent and 41 percent to the Department of Transportation and Public Facilities (DOT) and the University respectively represented general funds only and not a cut to the agencies' entire budget.

Mr. Teal agreed, the chart only included UGF. He detailed that the cut [to DOT] was almost all to the AMHS; it did not include the reduction in marine highway system funds because they were DGF program receipts.

Co-Chair Wilson noted the figures did not include the DOT capital budget either.

Mr. Teal responded affirmatively.

Co-Chair Wilson asked what the decrements would be to the entire University and DOT budgets.

Mr. Teal did not know, but the reports were on the LFD website.

Co-Chair Wilson stated that she found it interesting the table only included UGF funds. She pointed out there were other fund sources including DGF and federal funding. She noted the University received a substantial amount of DGF funds; both entities received federal funding as well. She

wanted to ensure everyone understood the entire fund source picture. For example, perhaps federal funding had increased.

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Mr. Teal used the \$134 million in cuts to the University an example. He explained that if a person looked at total funds or total general funds, the University was up by 1.4 percent. However, as the University president Jim Johnson had testified in the Senate Finance Committee, the \$134 million cut to UGF was real money. He elaborated that adding \$134 million in tuition receipts was fantasy money. He furthered that Mr. Johnson had no doubt that he could not come anywhere close to replace the UGF with tuition increases.

Co-Chair Wilson agreed, but wanted to look at the bigger picture. She used Pioneer Homes as an example where it appeared there was not really a reduction because it was receipts - she reasoned that the Pioneer Homes could likely not collect the money [from residents]. She elaborated that at that point most of a person's assets had been turned over to the Pioneer Home for care. She spoke to the importance of looking at the entire funding source picture including DGF and federal funds. She noted it appeared that DOT had been cut by 32 percent; however, there were many other funds that came from other fund sources. She stated that sometimes people did not realize how many different funds came in to make up the whole picture. She did not want to make it look worse than it was.

Mr. Teal answered that for AMHS the federal funds were not an issue; there were general funds and program receipts from ticket sales. He detailed that federal funds, like highways, helped with construction of ferries and terminals, but could not be used for operating. In that case it was not a big issue. For the University, to the extent the loss in general funds caused a loss in faculty and research grants, there was potentially a significant loss of federal funds that general funds attract. He did not have details on the amounts.

Co-Chair Wilson stated her point was that the situation was not as simple as one worksheet. She noted there were many moving parts. She added that DOT could use federal funds

for design. She remarked it would offset some operations but not all.

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Mr. Teal asked Co-Chair Foster if his memorandum on subcommittees had been disseminated to committee members.

Co-Chair Foster believed the memo would go out to members that afternoon.

Mr. Teal addressed that Co-Chair Wilson was highlighting a need to see some facts and justification from the agencies. The memo from Co-Chair Foster mentioned a request that had gone out asking agencies to provide an impact statement for each of the proposed changes. There was concern that if the subcommittee process started and agencies had to follow up on requests to learn how numbers had been derived, it would delay the process another week or two. Therefore, letters had gone out to agencies asking for impact statements in order for subcommittees to already have information on impacts of proposed cuts to programs.

Co-Chair Wilson thought it was important to be careful in subcommittees to keep in mind that all fiscal notes in the governor's crime bills and others were not included in the percentages, and yet subcommittees generally did not consider pending legislation.

Mr. Teal agreed. He detailed they did not know what the fiscal notes were and had not seen a number of the bills. He had first heard the governor would submit 30 or more bills that would affect the budget; that number had dropped to 25 because the bills had been consolidated. The number was down to 16 bills, but LFD had not seen them or any associated fiscal notes and analyses.

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Representative Josephson stated that his sense of Mr. Johnson's statement on behalf of the University was that the match the University received brought in about \$250 million to \$300 million in the research component, which was as much as \$4 to \$1 and without the grant much of that funding would disappear. He asked if the conclusion was reasonable - that the reduction could result in a ripple effect.

Mr. Teal replied that it was reasonable. He did not believe the legislature should trust what appeared to be reasonable. He wanted to see the analysis and the University's statements showing what it would lose. Specifically, how a cut in general funds would impact programs and what federal funds would be lost as a result. He did not believe the request was unreasonable.

Representative Josephson calculated that if the proposed cuts to the University came to fruition, the overall cut to agency operations would be about 11 percent. He thought the reduction would be in addition to cuts of around 24 percent since 2014. He combined the two figures for a cut of approximately 35 percent to University operations.

Mr. Teal was not certain Representative Josephson was referring to the University or the totals. He explained if the \$134 million for the University (on slide 6) was removed it would cut the total figure [of \$260 million for all agencies] in half and would result in a 6.5 percent reduction [in total agency operations for FY 20].

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Representative Josephson clarified he was removing the University altogether, not only the reduction. He thought the total cut to the University would be around 35 percent from FY 15 to FY 20.

Mr. Teal answered that the subject was best left to the budget subcommittee. He elaborated that subcommittees would receive detailed binders that would include a 10-year lookback and reports comparing FY 15 to FY 19 and FY 15 to FY 20. Subcommittees would review agencies' past cuts and additional cuts.

Representative Josephson referenced Mr. Teal's discussion about the need for the legislature to ask [the administration] for impacts. He wondered whether the Senate had made the requests.

Mr. Teal replied he did not think the House needed to worry about duplicating work. The House and Senate were going through the same process and were considering the same budget. The departments would respond with the same information for both bodies.

Representative Josephson asked if the Senate had asked the same impact questions.

Mr. Teal believed the Senate was in the same place the House was. He thought questions had been drafted but may not have been submitted [to departments or the administration] yet.

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Mr. Teal continued with slide 6 and addressed proposed \$87 million in cuts to DHSS. He reported that Adult Public Assistance was down \$15 million, Temporary Assistance was down \$2.5 [million], \$17 million for Tribal Assistance had been eliminated, and \$20 million for Senior Benefits had been eliminated. He remarked that the committee had not yet started its budget overviews and he doubted the full committee would get into the detail that the Senate had. He noted the Senate [Finance Committee] had held nearly two weeks of three-hour per day meetings on agency impacts. There was information available and he suggested watching the Senate overviews. He suggested moving on to other areas of the budget since of the \$1.6 billion in cuts, the agency operating portion was the \$260 million shown on slide 6. He speculated that slide 6 likely left members wondering what the means of balancing the budget was (if the means was not agency operations).

Mr. Teal turned to a table on slide 7, "Filling a \$1.6 Billion Deficit." The top portion of the table showed reductions in agency operations of \$650 million. He explained that the table split agency operations in a way that made sense to him. He agreed that the data could be looked at in a number of ways. The nonformula line showed reductions of \$249 million; the number was different from the \$259 million on slide 6 because there were some formula programs (included on slide 6) other than K-12 and Medicaid. The table showed a cut of \$302 million to DEED, which reflected only the cut to the K-12 formula state funded portion. He elaborated there were also local contributions. He underscored that if there was an implication that local governments could make up the cuts, it was not necessarily how things worked.

Mr. Teal explained that local funding had two pieces mandatory contributions and voluntary contributions.

Mandatory contributions were based on property tax rates and 2.65 mills went to schools. He explained that under voluntary contributions schools could contribute up to 23 percent of basic need (another way of saying 23 percent of what the state gave schools through the formula). He pointed out that a 25 percent reduction to the formula would also mean a 25 percent reduction in the voluntary contribution cap. For example, Juneau and Anchorage funded to the cap, meaning voluntary contributions in those districts would decrease by 25 percent; it was not possible to give above the cap. Whereas, in places like Mat-Su that did not fund to the cap, local contributions could remain the same. Funding also depended on some other things, like how much state money went to the communities. For instance, the governor had proposed a reduction to school debt reimbursement. He used Mat-Su as an example and explained that if school debt reimbursement was reduced, the borough would have less money from the state. He noted that there was no way to know what communities would do, but it was extremely unlikely that local contributions would increase.

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Mr. Teal continued to discuss reductions in agency operations on slide 7. He stated there were indirect impacts, which tended to shy away from when discussing the cuts. He recommended hearing from Institute of Social and Economic Research (ISER), Ed King from the Office of Management and Budget, and/or Neal Fried from the Department of Labor and Workforce Development about what effects the cuts may have on the economy.

Mr. Teal highlighted cuts of \$132 million to DHSS, but noted it was tricky because the category at the bottom of the table included a line item labeled "SBR for Medicaid" for a total of \$172 million. He explained that the issue was more complicated than just using reserves. The \$172 million would drain the SBR; the funds were available for Medicaid in FY 19 with a carry forward specifying that the funds could be used in FY 20 if they were not spent in FY 19. The department's supplemental request for FY 19 was \$15 million. He explained that the \$172 million was not needed in FY 19 and was essentially an FY 20 appropriation. He believed using reserves in FY 19 was a way to make the FY 20 budget look smaller than it was. He elucidated that the \$172 million cut appearing in FY 20 did not happen.

Mr. Teal reviewed a \$33 million line item for PCE the governor had proposed to fund with UGF instead of DGF. The total reductions to agency operations on slide 7 was \$650 million. He turned to the category of "cost shifts from state government" on slide 7. The first item was \$420 million in petroleum property tax. The shift would require legislation and would take money from various communities, primarily the North Slope, and would shift tax revenue from communities to state government. The second item was \$28 million in shared taxes that would be new money to the Treasury. Third, \$68 million in school debt reimbursement would take money from communities and shift it to state government. The same was true for the \$3 million in debt service. The section totaled \$520 million in costs shifted from local governments to state government.

Mr. Teal addressed the using reserves category on slide 7. The first line showed \$180 million in AIDEA funds to pay for oil and gas tax credits and capital. He did not really care what the reserves were called, but he emphasized that the cash reserves of a state corporation were reserves. He detailed that UGF built the capital to establish AIDEA; while the state may have the right to take the reserves back, they were simply another form of reserves. He did not want to focus on the legalities of taking the money back, or how it may impact credit ratings or economic development in the state.

Mr. Teal shared that his focus was on the transparency of the operation. He shared that LFD thought if money was going to be pulled from a state corporation or other reserve accounts, it should show. The more transparent method would be to show the proposed use of \$180 million in AIDEA funds in FY 20 and \$84 million for FY 19; that \$264 million would be deposited into the General Fund and would be spent as general funds. He explained that transparency would show where the money came from and count it as an expenditure. Under the current budget process, AIDEA receipts were not general funds and the money would be spent as invisible revenue and expenditures. He did not view the method as transparent.

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Mr. Teal pointed to \$107 million at the bottom of slide 7 under "eliminating December 15 increments." He explained that the administration had used the December 15 budget,

referred to by some as the Walker budget, which was \$107 million higher than the FY 19 budget. The legislature's starting point was the FY 19 budget. Less than half of the deficit was actually filled with budget reductions - the remainder was filled by shifts and reserves. He found the shifts and use of reserves to be unexpected given the five principles outlined by the administration. He questioned whether adhering to the principles mattered or transparency mattered. The legislature could ask for another bill from the governor - one that did not cross fiscal years, use reserves, shift costs to local governments, and one that did not include cuts the legislature found unacceptable. However, he had zero expectation another amended budget would be received.

Mr. Teal noted that when OMB had been asked about analysis for the budget proposal, the answer had frequently been that the budget was merely a proposal. A statement by Mike Barnhill [OMB Policy Director] to the Senate Finance Committee was that the legislature would have to find alternative reductions to balance the budget if it did not like the proposal by the governor. He stated the situation put the legislature in a box. He asked how the legislature was going to balance the budget if it did not like the governor's proposals. The list of tools available was unchanged - reserves could be used but it was not sustainable, new revenue (broad-based tax) may not get through the legislature and may not survive a governor's veto, further cuts to agency expenditures would be difficult, cuts could be made to statewide items, some changes could be made to retirement amortization but not by shifting costs onto municipalities, and there may be some room in tax credits but not enough to balance the budget. The remaining option was cutting the PFD, which had its tradeoffs. He elaborated that dividends competed with other government expenditures, which did not make the decision about reducing the PFD to eliminate the deficit any easier.

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Mr. Teal continued that for the governor and some legislators, a PFD of less than \$3,000 was not an option. He stated that options were very limited if that was the case. He pointed out that at the other end of the spectrum, some people would note there would be a surplus if dividends were not paid. He explained the situation left people to conclude there was not a fiscal problem, but a

political problem. He noted that however the problem was defined, there were tough decisions facing the legislature. He believed decisions required strong supporting justification. He hoped the legislature received the justification for the [administration's] proposals soon. He shared that his first reaction to the proposed budget was to question where the supporting documentation was and what the purpose of all of the proposals was. He asked if it was just a design to throw the legislature into chaos due to the vast number of proposals. He questioned if the administration's goal was to present the legislature with so many proposals that it would not have time to analyze them all and it would accept the governor's budget. He did not know. He continued that it could also be looked at as a clever way of forcing a public conversation that was necessary to move forward. He questioned whether people would look at the budget proposals and plead with the governor and legislature to reduce the PFD in order to avoid the proposed cuts. He did not know what the governor's intentions were or how people felt about it.

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Mr. Teal turned to slide 8 and noted that he did not know how much people knew about the state's fiscal situation and budget. He questioned whether people knew that dividends consumed 37 percent of the revenue and expenditures. He wondered if people knew that the FY 20 UGF budget was only \$123 million (2 percent) less than the FY 19 UGF budget. He thought people believed there were much bigger cuts than there were. He asked if people understood the reductions to agency operating budgets only addressed \$650 million of the \$1.6 billion deficit. He considered whether people knew the remainder of the deficit was filled by shifting costs to local government or draining reserves. He asked if people understood that reductions to agency operating budgets addressed only \$650 million of the \$1.6 billion deficit.

Mr. Teal wondered if people knew the impact of the proposed cuts to the operating budget was greater than the 350 positions shown in the OMB overview. He explained that the number did not include the AMHS positions because the shutdown would not occur until October. He elaborated the cuts to positions should include 600 AMHS jobs, 1,300 University jobs, and 3,000 school district employees (that would result if \$300 million was cut for schools). The total job loss would be 5,000 positions or more. He noted

that the job losses were not all state jobs - school district jobs were not state jobs, but they were state-supported and the reduction in positions would be due to the loss of state support. He was not pretending to know what the citizens or the legislature wanted - his point was he did not know what people knew.

Mr. Teal did not know how flexible the governor was going to be on the \$3,000 PFD. He noted the governor appeared to be pretty flexible on maintaining reserves and on the tax issue. He asked if the governor was also flexible on dividends. He noted that there were at least 16 bills coming from the governor - he wondered if a priority was known. He remarked that the bills' content was not yet known. He stated it was a big workload for the finance committees to consider and get through during regular session. He reported that LFD still had a weak understanding of the governor's plan and intent. He hoped the understanding improved in coming weeks.

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Vice-Chair Johnston thought her question may pertain more to the Alaska Retirement Management Board (ARMB) but noted it was still part of the budget discussion, especially when considering some of the job loss. She elaborated that the University and school districts would likely face some rather large termination studies. Additionally, there would be a decline in state employees. She considered how the situation would impact "our payment and how it affects actually the tail for the municipal governments at the end." She detailed that municipal governments would take the lion's share with the extra amortization. She had not seen the issue addressed anywhere.

Mr. Teal stated it was an excellent point. He stated it was another example of "what would the impact be?" There would be costs, which would appear as increased retirement rates (contribution and employer rates). He used Anchorage as an example and explained there would be fewer employees to pay contributions on, yet the unfunded liability of the retirement systems was a dollar amount that was required to be paid annually. He detailed that if the amount was spread over 12,000 employees versus 15,000 the rate would be higher. He explained that the Municipality of Anchorage's contribution rate was capped at 22 percent; if the rate increased, the state would absorb all costs for retirement

for all municipalities and school districts. Retirement cost rates would go up and the state would be responsible for the payments above 22 percent or 12.56 percent [to Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) respectively]. The only way to figure out the amount would be to determine positions lost and provide the information to the actuaries for projections. He concluded the cost would not be insignificant.

Representative LeBon addressed item 4 on slide 8: The remainder of the deficit is filled by shifting costs to local government or draining reserves. He pointed out that diverting property tax collected from TAPS going through Fairbanks to the state would be an annual event. He added that it would not be possible to continue using reserves from AIDEA or the SBR on an annual basis.

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Mr. Teal agreed. He thought the administration's proposal would take a substantial amount from AIDEA. He noted that AIDEA had additional funds, but it was a policy call that would affect future development. The SBR had a balance of \$172 million, which would be used in its entirety under the governor's proposal. The proposal represented another one-time fix.

Representative Tilton asked Mr. Teal to define what the reserves were.

Mr. Teal reviewed the state's reserve accounts. The Constitutional Budget Reserve (CBR) currently had about \$2 billion remaining and required a supermajority to access (the fund used to contain about \$15 billion); the CBR had been the source (up to \$3 billion per year) used by the legislature to balance the budget. He elaborated that the CBR was no longer an option to balance the budget - perhaps it could be used for one more year before being depleted. The SBR currently contained \$172 million and could be spent by a simple majority; the account was designed to be a shock absorber. He explained that the account provided the legislature with a funding source to balance the budget in the event oil prices were lower than projected, meaning the legislature did not have to reconvene to rewrite the budget.

Mr. Teal continued to review state reserves. Other reserves that were often not counted as reserves were those of state corporations including AIDEA and the Alaska Housing Finance Corporation (AHFC). Additionally, there were endowment reserves such as the PCE that had a balance of over \$1 billion. He noted that some people would argue that PCE was not a reserve fund. He elaborated that PCE was a deal that had been devised years earlier due to power inequity between rural and urban regions. He explained that urban areas of the state were provided with hydropower and subsidized gas production from Cook Inlet. He furthered there was no good subsidy option for rural regions; therefore, PCE had been implemented to subsidize their rates. He reasoned that someone could argue the fund generated more money than it needed. Additionally, someone could choose to ignore the previous deal and use the PCE funds for something else. The Higher Education Fund was another endowment fund with a balance of \$330 million intended for scholarships and grants. He detailed that those funds could be taken as well.

Mr. Teal explained the remaining reserves were in small pools of money. He highlighted the loan funds. In addition to the governor's proposal to eliminate the PCE Fund and the Higher Education Fund, he was proposing to close the loan programs (totaling about \$31 million) and transferring assets to the General Fund. If the governor's proposal went through it would deplete reserves other than the CBR, which required a supermajority [vote to access].

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Representative Josephson referenced the supermajority and the CBR. He asked for verification that the budget did not reverse sweep funds back into the accounts as had been done in recent years. He believed the budget captured the funds and restored the other accounts to the CBR, which would require the legislature to recast a supermajority vote.

Mr. Teal noted that the term reverse sweep was a term used by the legislature that applied to the CBR. He elaborated that the constitution required the legislature to pay the money back to the CBR when it was used as a fund source. The money was paid back via the "sweep." He detailed that on June 30 of every year, the balance of the General Fund and all sub-funds were swept into the CBR. The reverse sweep referred to traditional budget language specifying

that the money swept from subaccounts of the General Fund all went back where it came from. Subaccount funds included [but were not limited to] the Worker's Safety Fund and funds created with alcohol and cigarette taxes. He explained that if the sweep was not reversed, all of the money would go to the CBR and remain there. He expounded that a nightmare of accounting problems would occur if the reverse sweep did not take place.

Mr. Teal reported there had been one year since the creation of the CBR without a reverse sweep. The situation had caused "crazy" accounting problems because agencies did not have cash to do what they were supposed to do; agencies ended up booking things at different times and correcting books. He characterized the situation as an unnecessary mess. The reverse sweep had historically been a fairly noncontroversial supermajority vote; it did not cost any more money, but not doing it made agency accounting more difficult.

Mr. Teal highlighted that the CBR language was missing the reference to access to the CBR in case of a deficit. He noted that someone may argue that the language was not needed for the proposed budget because there was no deficit. He considered that there was a \$20 million surplus, but if oil prices fell by \$0.50 the state would be in a deficit. At that point the legislature would be faced with determining what to cut. He underscored the importance of some type of automatic deficit filler due to the volatility of the state's revenue. It was not possible to know whether a revenue forecast would be \$0.50 high or low or \$5.00 high or low. He recommended including language in the budget because the governor did not include any automatic deficit filler language.

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Representative Josephson thought it sounded like Mr. Teal was talking about two different things - the reverse sweep to the various accounts and the right for the executive branch to access some number above the amount in the CBR without the legislature being required to reconvene.

Mr. Teal replied in the affirmative. He explained the two pieces of access to the CBR. The language in recent years had been that anytime revenue was less than what was appropriated, the gap could be filled by drawing from

reserves. He questioned where the incentive was to reduce the budget from the perspective of a fiscal conservative. He elaborated under the scenario a person could reason that it did not matter how much revenue there was, and they could spend whatever they wanted and the difference would be made up from reserves without anyone really knowing. He stated it did not matter what the oil forecast was. He continued that the public, for years, has had a deficit. He wondered how anyone in the public would know the consequences of a deficit were when they never saw it; every year the deficit was filled with reserves, which the public did not see and did not know about. He stated it was a dangerous way to budget. In recent years the legislature had changed the method to some extent because the second part of access to the CBR had been drawing what was needed to fill the deficit with the understanding there may be supplemental needs for something like fire suppression or Medicaid and that draw was limited to \$100 million (or whatever amount the legislature set). There were a number of triggers and ways to handle the situation. He thought the legislature wanted to include some sort of automatic deficit fill, but with a cap.

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Mr. Teal concluded with a table on slide 9 that showed a comparison of the FY 19 budget with the governor's amended FY 20 budget request (UGF only). The total reduction was \$123 million or 2 percent. He pointed out that even though about \$1 billion of the deficit was filled with reserves or new revenue, there was still \$650 million in cuts. The slide showed where the proposed cuts fell. He referenced his statement from a fiscal overview that the governor would have a difficult time finding cuts in agencies. He noted that if the governor was going to make big cuts they would be achieved in K-12 and the dividend.

Mr. Teal explained that the majority of agencies did not have large cuts. He would expect to get bigger dollar amounts from the larger dollar programs, but he did not expect to see bigger percentage cuts as well. He pointed to a 25 percent cut to K-12 with a 90 percent increase in dividends. He highlighted other large cuts including 38 percent to Medicaid, 33 percent in statewide funds (primarily due to school debt reimbursement), 18 percent to DHSS (outside of Medicaid), 41 percent to the University. He emphasized there were much bigger hits in the bigger

programs. He noted it could be argued that the big money programs were the state's core programs if they were defined as programs impacting the majority of Alaskans.

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Co-Chair Foster returned to slide 7 and referenced Mr. Teal's point that many people were under the impression the budget had been cut by \$1.6 billion, but that was not necessarily true. He continued that the budget included cost shifting of state services, the use of \$350 million in reserves, and the elimination of some December 15 increments. He furthered the chart table showed that \$650 million was the major part of the \$1.6 billion cut. He turned to item 2 on slide 8: the proposed FY 20 UGF budget is \$123 million (2 percent) below the FY 19 budget. He asked for verification that the difference was due to spending more on PFDs.

Mr. Teal replied in the affirmative; the increased PFD resulted in a \$1.9 billion expenditure. He looked at slide 7 and elaborated that property taxes resulted in revenue, but school debt reimbursement was a reduced expenditure (paid by the state). He had included the items under the cost shift from state government category, but he noted that someone else may think the reduction in school debt reimbursement belonged in the reductions in agency operations section of the table. He moved back to item 2 on slide 8 and explained it did not pertain to the operating budget, but pertained to the capital budget, statewide items, fund transfers, and fund capitalizations (the entire budget).

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Co-Chair Foster stated that of the \$1.6 billion there were \$650 million in operation cuts, but when considering the entire budget, it was really only \$123 million less than the prior year.

Mr. Teal agreed. He stated that Co-Chair Foster was on track when he had asked "how can that possibly be?" He explained there were cuts, shifts, and other things. He elaborated the budget was only \$123 million less than the FY 19 budget that because it spent \$900 million more on the PFD.

Co-Chair Foster recognized Representative Sharon Jackson in the audience.

Vice-Chair Ortiz asked about school debt reimbursement. He imagined the financial impact of the cut varied greatly across the state's 54 school districts. He noted that some districts had more bond debt than others and were reimbursed more.

Mr. Teal replied in the affirmative. He reminded the committee that all Regional Educational Attendance Areas (REAA) had no school debt reimbursement because the state paid for their construction cost directly. The school debt varied greatly across all non-REAA districts. For example, Mat-Su had built more schools than Juneau due to population growth. He reported there was a sheet showing the impact of the change in school debt reimbursement by community.

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Vice-Chair Ortiz asked if it was reasonable to say that every \$1 a school district did not receive in school debt reimbursement meant schools had to look for ways to compensate for the 23 percent reduction to the Base Student Allocation (BSA) and overcome the lack of reimbursement for school bond debt.

Mr. Teal agreed but clarified that schools and school districts did not owe the debt. Municipalities had issued the debt to build the schools. If the state did not reimburse the schools' debt service costs, the district had less money available and may or may not reduce school funding because of that reduction.

Co-Chair Foster thanked Mr. Teal for his presentation. He reviewed the schedule for the following day.

ADJOURNMENT

[3:26:56 PM](#)

The meeting was adjourned at 3:26 p.m.