

HOUSE FINANCE COMMITTEE  
INTERIM  
January 8, 2021  
11:01 a.m.

11:01:32 AM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 11:01 a.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair  
Representative Jennifer Johnston, Co-Chair (via teleconference)  
Representative Ben Carpenter (via teleconference)  
Representative Dan Ortiz, Vice-Chair (via teleconference)  
Representative Andy Josephson (via teleconference)  
VACANT  
Representative Bart LeBon (via teleconference)  
Representative Kelly Merrick (via teleconference)  
Representative Colleen Sullivan-Leonard(via teleconference)  
Representative Cathy Tilton (via teleconference)  
Representative Adam Wool (via teleconference)

MEMBERS ABSENT

None

ALSO PRESENT

Representative Delena Johnson; Representative-Elect James Kaufman.

PRESENT VIA TELECONFERENCE

Larry Persily, Former Department of Revenue Commissioner; Alexei Painter, Director, Legislative Finance Division; Representative Harriett Drummond; Representative Matt Claman; Speaker Bryce Edgmon; Representative Sharon Jackson.

SUMMARY

PRESENTATION: GOVERNOR'S BUDGET ASSESSMENT BY LARRY PERSILY

OVERVIEW: FY22 GOVERNOR'S BUDGET BY THE LEGISLATIVE FINANCE DIVISION

Co-Chair Foster reviewed the meeting agenda.

^PRESENTATION: GOVERNOR'S BUDGET ASSESSMENT BY LARRY PERSILY

11:04:57 AM

LARRY PERSILY, FORMER DEPARTMENT OF REVENUE COMMISSIONER (via teleconference), introduced himself. He provided a PowerPoint presentation titled "Time and Money," dated January 6, 2021 (copy on file). He would be providing some context around the governor's proposed budget for FY 22. As he reviewed the budget, he concluded legislators would be faced with two questions around time and money. The first question was whether the state would have enough time to wait for enough money to come in to ensure a sustainable balanced fiscal plan. The second question was whether the state had enough money until additional monies became available. His presentation was designed to explain, in realistic terms, where Alaska stood. He suspected it would be a tough year for legislators.

Co-Chair Foster noted Co-Chair Jennifer Johnston, House Speaker Bryce Edgmon, and Representative Matt Claman had joined the meeting via teleconference.

Mr. Persily turned to slide 2: "Time is short for Alaska, as is money." He indicated that the balance of the Permanent Fund (PF) earnings reserve account (ERA) as of November 30, 2020 was \$9.45 billion. The funds were described as uncommitted and available in the ERA. He asserted that of the \$9.45 billion about \$7.1 Billion were realized gains (actually in the bank). The other \$2.3 billion were unrealized gains (profits on the books as of November 30, 2020). The unrealized gains would turn into realized gains when the investments were sold. The uncommitted \$9.45 billion balance in the ERA accounted for the percent of market value (POMV) draw for the current fiscal year [FY 21] and the anticipated 5 percent POMV draw for FY 22 in the amount of \$3.069 billion.

Mr. Persily continued that in the FY 22 budget the governor was proposing a \$1.2 billion draw from the ERA in the spring of 2021 to pay an additional dividend to Alaskans of about \$1,900. He was also proposing a \$2 billion draw in FY 22 to pay a full \$3,000 dividend in the fall of 2021 which would require legislative approval. In summary, the governor was looking for an additional \$3.2 billion in the calendar year spread over a couple of fiscal years to payout an additional \$5000 in dividends. The governor had been talking with Alaskans about how the PF had gained more than \$10 billion from April 1, 2020 through November 30, 2020. However, there was more to the story. He elaborated that \$7 billion was lost in the first three months of 2020. The Permanent Fund's net balance was up by the end of 2020 but not by \$10 billion. The numbers provided on the balance sheet were as of the date of the balance sheet and could be different on the following day.

[11:11:17 AM](#)

Co-Chair Foster recognized Representative Sharon Jackson on the line.

Mr. Persily turned to slide 3 and considered whether the savings would last. He indicated the governor was proposing POMV 5 percent draws for FY 21 and FY 22 and two additional draws for spring and fall dividends which totaled more than \$9 million or 13 percent of the total balance of the PF on November 30, 2020. He noted that the principle of the fund could not be spent.

Mr. Persily continued that over the years the board of trustees of the Alaska Permanent Fund Corporation (APFC) had consistently talked about maintaining a solid balance in the ERA because the funds were being used to pay for public services and dividends. The board recommended that, if the legislature were to continue taking a POMV draw of 5 percent, the amount remaining in the ERA should be about 4 times the amount of the draw or \$12 billion to guard against any future losses. He provided context by referring to the economic meltdown in FY 09 in which the PF lost about \$6 billion. He thought there was reason to be concerned about the potential of overdrawing the fund, experiencing a poor investment return period, and leaving the state without much of a cushion. Alaska had been using fund earnings through the POMV since FY 19. Prior to that for more than half of the 30 years since it was created,

the constitutional budget reserve (CBR) had been used to assist in balancing spending.

Mr. Persily indicated that the deficit was not new. The balance of the CBR would be about \$600 million at the end of the fiscal year and would not be a fund source the state could count on. The state would be relying on the ERA and the PF.

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Co-Chair Foster recognized Representative Tilton on the line.

Mr. Persily moved to slide 4 titled "Longer-term solutions." He noted that the state had run through the CBR and had not paid the full statutory Permanent Fund Dividend (PFD) since 2015 because of a lack of funding. Previous legislatures and governors had looked at the available funds and the needs of the state to arrive at an affordable PFD amount. If the PFD was calculated based on the formula from 1982, it would be greater than \$3000. The governor had proposed a special election in the spring on an advisory question to Alaskans regarding a 50/50 split for dividends and government services. He thought there was a risk of the public rejecting the 50/50 split. He speculated that if the legislature did not have to debate the dividend annually, sessions would be shorter.

Mr. Persily also reported that the governor was proposing three constitutional amendments. By law they could only appear on a general election ballot, the next of which was set for November 2022. The first proposal would turn the PF into a true endowment, something the trustees had previously recommended. There would no longer be a line between the principle and the earnings of the fund. The whole kitty would be treated as an endowment with a maximum withdraw amount (5 percent in current statute). The fund was expected to earn 6.75 percent in the long-term. The fund would continue to grow after drawing the 5 percent. In some years, the earnings might be less than 6.75 percent, while in other years, they might be greater.

Mr. Persily relayed that the governor was proposing a constitutional amendment that would set a spending limit and another that would instate a prohibition on any new

taxes without the vote of the public - potentially posing calendar challenges.

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Mr. Persily turned to slide 5 titled: "Matching spending with revenues." The governor was proposing \$450 million or more in budget cuts in FY 22 through FY 24. The governor's 10-year budget plan counted on other revenue sources of \$1.2 billion in FY 23 and about \$1 billion each year thereafter. He suggested new revenue sources would need to be addressed soon in preparation for the FY 23 budget. He remarked that any new broad-based tax would take significant time to implement, and the revenue numbers were speculative. He thought it ironic that after Alaskans had voted not to change oil taxes in November 2020, the most immediate way for the state to generate revenue would be to raise oil taxes. He was not advocating for the idea, but noted the state had boxed itself in.

Mr. Persily advanced to slide 6: "Repair and rebuild Alaska economy." He reviewed the items that had negatively impacted Alaska's economy including COVID-19, low fishing prices, low oil prices, and the outmigration of residents. The governor was proposing a state-wide general obligation bond package (\$300 million - \$350 million) which would have to be voted on by the public. The bonds would be used for shovel-ready projects. The governor did not provide any specifics but mentioned roads to resources, renewable energy projects, ports, harbors, and runways. The vote would occur in the spring in order for Alaskans to get to work on the projects. He was unsure if the people of Alaska would be willing to take on any additional debt.

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Mr. Persily moved to a calendar on slide 7: "Is this a realistic calendar?". He suggested that the legislature would have to determine whether the state would have a special election in the spring to decide the bond issue and to determine whether to exceed the 5 percent POMV draw to pay for public services or dividends. He suggested that any dividend payment would require the legislature to spend beyond the 5 percent draw. In the following year, the legislature would be building the FY 23 budget with a hole to fill of \$1.2 billion. He stressed that if new revenues

were desired for FY 23 it would be necessary to implement something in FY 21.

Mr. Persily turned to slide 8 titled "Support for constitutional amendment." The Permanent Fund Board of Trustees had adopted resolutions three times in support of a constitutionally protected endowment that would eliminate the distinction between the principal and earnings of the fund. The principal and the ERA were being managed the same. However, the accessibility of each account was different. The Board had not weighed in on the dividend formula. He wondered whether the dividend should be placed in the constitution if the constitution was amended to make the PF a true endowment fund. He reiterated that if the legislature limited its draw to 5 percent per year, the APFC was confident \$80 billion would reside in the fund by the end of FY 30 based on its forecast.

Mr. Persily advanced to slide 9 titled "Permanent Fund grows." He stated that APFC projected \$80 billion at the end of FY 30 assuming that the fund earned 6.75 percent and the annual draw was maintained at 5 percent. He suggested that if the legislature paid out a \$5,000 dividend in FY 21, in FY 30 there would be less of a POMV draw in the future.

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Mr. Persily turned to the last slide titled: "Almost forgot - what about oil." Mr. Persily opined that Alaska was no longer an oil state in terms of revenue. The state received its revenues from the federal government and investment earnings of the Permanent Fund. He reported the projected oil revenues for FY 22 were \$800 million versus the POMV draw of over \$3 billion. All other revenues generated from taxes and fees for unrestricted general funds (UGF) would be less than \$400 million. The Fall 2020 Revenue Sources Book projected oil at \$48 per barrel in FY 22. The Alaska North Slope crude closed earlier in the week a few dollars higher. He stated that if North Slope oil averaged \$60 per barrel in FY 22, the state would earn about \$270 million in additional revenue for the general fund (GF). He noted that the budget gap would likely be closed for FY 22, but it would not include a PFD payout.

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Co-Chair Foster thanked Mr. Persily for the high-level look at the primary issues facing the state.

Co-Chair Johnston referenced a contract Mr. Persily had been a party to with the Alaska Municipal League (AML) regarding sales tax and internet sales. She asked if he had done any modeling of a statewide sales tax. She wondered if he had any revenue figures.

Mr. Persily answered that he had a contract with AML in the previous year to help with setting up the organization's online sales tax administration and collection program. He had not done any modeling for AML regarding a statewide tax. However, he had done modeling for the Department of Revenue (DOR) over the previous 20 years. He had also done some modeling when he worked for the Municipality of Anchorage and as a legislative aide. He addressed a state sales tax. He indicated that every percentage point had the potential to generate between \$100 million to \$200 million in revenue. The question came down to exemptions and caps.

Mr. Persily continued that the Kenai Peninsula Borough had a 3 percent tax with a cap of \$500. A person could purchase a \$50,000 truck but only pay a sales tax of \$500. In North Dakota if a person were to purchase a \$50,000 truck, they would pay sales tax on the full \$50,000. Having a cap made a huge difference in collections as well as what was taxed. He brought up the notion of the end user paying the tax for goods. A person buying a book at Barnes and Noble would pay a sales tax. He wondered if an oil company buying oil pipe should pay a sales tax. Currently, municipalities considered the oil companies activities as manufacturing and did not collect sales tax on materials. He suggested that in order to spread out the oil tax base it was necessary to pull back on exemptions and have a lower tax rate with a broader base.

Co-Chair Johnston mentioned a value-added tax which was low and broad. She had been looking at the 10-year fiscal plan, 2023, other revenues, and the 50/50 split. She was concerned with the ERA. She recalled a low dividend in 2008 due to a market drop. She thought the legislature would be taking the majority of the ERA and noted that the look-back was only for 5 years at 5 percent. She wondered what would happen and asked Mr. Persily to comment.

Mr. Persily replied that there was always the risk of the market declining resulting in declined earnings of the PF. He stressed that the market had been up and down during the current week. He listed various unknowns that could impact the market including the incoming administration and COVID-19.

[11:35:15 AM](#)

Co-Chair Johnston asked for verification that it would require a vote of the people to use funds from the principal of the Permanent Fund.

Mr. Persily replied affirmatively. He elaborated that currently in the constitution there was a principle that could not be used, and the earnings from the fund went into the GF just like motor fuel taxes. He relayed that eliminating the line between the principle and the earnings of the fund and putting a constitutional direction around the entire fund as an endowment would require a vote of the people. It would take a two-thirds vote in both the House and the Senate and a vote in the next general election scheduled in November 2022.

Co-Chair Johnston was concerned with the value of the U.S. dollar. It was her understanding that 35 percent of the money in existence had been printed since March. She noted the uncertainty of the value of the dollar in the coming year or two.

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Representative LeBon thanked the presenter. He asked if Mr. Persily had an opinion on the revenue level that could be raised through a state income tax. He indicated that a typical model would be a percentage of the federal income tax. He asked what percentage would be needed to raise a meaningful amount of money for the state given how many Alaskans paid a federal income tax.

Mr. Persily replied that a percentage of federal taxes paid would be the easiest and simplest state income tax structure. However, the state would be at the mercy of the federal government's tax policies rather than setting its own. A recent statistic showed that 40 percent of American households did not pay an income tax even though some paid

withholding and Social Security. He viewed an Alaska state income tax as a financial, economic, and political problem.

Mr. Persily elaborated that over the course of working for the legislature, he had heard from legislators that they did not like the idea of a state income tax because only a portion of people would pay any tax at all. He suggested the issue could be dealt with by incorporating a minimum tax. He was uncertain how much of an income tax Alaskans could afford. He thought generating \$1.2 billion in income taxes would be a heavy lift with economic consequences. He suggested collecting \$300 million to \$500 million in either an income tax or a sales tax in conjunction with other revenue sources. He believed the state would have to overdraw the ERA at greater than 5 percent to balance the books in the coming year. He would try to find the percentage rate needed for an income tax based on federal income taxes paid by Alaskans.

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Representative Wool commented on the previous question related to an income tax. He suggested using a line of the federal income tax form such as the adjusted gross income line. A percentage could be applied to the adjusted gross income rather than the federal income tax paid. If the state were to overdraw the ERA by \$3 billion in the coming year, by FY 30 the 5 percent draw would be reduced by \$200 million and would decrease every year between now and then. He asked what the cumulative reduction in the draw would be in the same period.

Mr. Persily replied that he had not done any calculations. In the early years there would be a smaller hit to the annual draw and a greater hit in the out years. He reminded members that the POMV draw was based on a 5-year average. There would be a reduced balance in the first year, but it would grow over time.

Representative Wool thanked Mr. Persily for the clarification. He reiterated that over time the reduction would increase, especially if it was spread over 5 years.

Vice-Chair Ortiz thanked Mr. Persily for his presentation. He referred to slide 5. His understanding was that the governor was proposing an annual reduction in the budget of 10 percent (approximately \$450 million per year) for FY 22,

FY 23, and FY 24. He suggested that such reductions would likely come out of the budgets for education and health and social services, as several cuts had already been applied to other departments. He asked if his assumption was accurate.

Mr. Persily clarified that the proposed reductions to the state budget totaled \$450 million by FY 24 - about 10 percent of the current GF budget. He responded to Representative Ortiz's question about areas of the budget that would likely be affected. The largest areas of spending in the budget were K-12 education, Medicaid, and PFDs. He opined that it would be difficult to come up with \$450 million in cuts over three years that did not affect the big-ticket items.

Co-Chair Foster thanked Mr. Persily for his presentation.

^OVERVIEW: FY22 GOVERNOR'S BUDGET BY THE LEGISLATIVE FINANCE DIVISION

[11:47:15 AM](#)

Co-Chair Foster noted Mr. Painter would be doing a more detailed analysis of the governor's budget at a later date. The current day's presentation would provide a high-level perspective. Legislators would have the opportunity to ask questions allowing the Legislative Finance Division (LFD) time to respond at a future hearing.

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION (via teleconference), provided a PowerPoint presentation titled "Preliminary Overview of the Governor's FY22 Budget," dated January 6, 2021 (copy on file). He was happy to take questions following the items in the outline:

- Alaska's Structural Budget Deficit
- LFD's FY22 Budget Baselines
- Governor's FY22 Proposal and FY21 Supplementals
- Governor's 10-Year Plan

Mr. Painter began on slide 3 titled "Note of Caution." He qualified that the numbers in the presentation were drafts and might change prior to session. He reported that LFD would publish its overview of the governor's budget on the first day of session with a detailed analysis. It was his understanding that some of the items in the governor's

budget might shift, as he had sent out clarifying questions prior to the holidays. He anticipated responses to the questions within the week.

Mr. Painter moved to slide 4 titled "Alaska's Structural Budget Deficit." He reported that FY 21 marked the ninth straight year of budget deficits for the State of Alaska. The budget deficit began in FY 13 when the price of oil reached \$100 per barrel. Therefore, the budget deficit was not just a function of oil prices, even though the state was currently in a significantly low period of oil revenue.

Mr. Painter continued that the projection in FY 22 was anticipated to be lower than in FY 21. It was projected to be the lowest amount of oil revenue the state had brought in since FY 78 in nominal terms (not adjusted for inflation). If adjusted for inflation, the amount would be the least amount of petroleum revenue the state had received since the pipeline's construction began in FY 75. He opined that the state was at a historical point, as oil would no longer be the foundation of the budget because of the decline in revenue. The state had reduced its budget substantially over the prior decade. The state's largest budget totaled \$7.8 billion UGF in FY 13. By FY 21 the budget had been reduced to \$4.5 billion UGF, a 43 percent decrease. However, 9 straight years of deficits had taken a toll on state reserves. The reserve balances dropped from over \$16 billion in FY 13 to about \$900 million in FY 21.

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Mr. Painter moved to slide 5 titled "Alaska's Structural Budget Deficit (Cont.)" The slide showed UGF revenue excluding anything from the Permanent Fund. Only traditional revenue was reflected over the previous decade. The state's revenue peaked in FY 12. Petroleum was nearly \$9 billion declining thereafter. It declined in FY 16 and FY 17 and started increasing again in FY 18 and FY 19. Revenue dropped again with the COVID-19 pandemic starting in FY 20. He noted that the state had deficits in FY 18 and FY 19 based on petroleum revenue that was over twice what was expected in the current year. He suggested that even a recovery in oil prices would not bring the state to a structurally balanced budget.

Mr. Painter moved to a chart on slide 6 showing the UGF budget from FY 12 to FY 22. He reemphasized that the budget

had decreased. The state's peak budget was in FY 13 at over \$8 billion UGF. The state saw its largest capital budget in the same year reaching \$2 billion UGF. The state's largest operating budget was in FY 14. The capital budget was reduced at the time due to the budget deficit. However, statewide items and agency operations were still significantly high. He reported that FY 15 was the high year for agency operations but noted a reduction to statewide items due to refinancing the retirement system. The state began budget reductions to the operating budget in agency operations in FY 16 and FY 17. Since then, agency operations had remained flat with upward pressure in FY 19 and FY 20 which was reversed in FY 21 and FY 22.

Mr. Painter advanced to slide 7 with a chart combining both pictures of the UGF budget and revenue for FY 12 through FY 22. He relayed that the bars showed the budgets for the years and the area in the background represented revenue. The last time the state had a balanced budget was in FY 12. The state had a significant amount of surplus at the time and transferred money to the state's savings accounts. The deficits began in FY 13. He highlighted that as revenue declined, the deficits peaked in FY 15. Adopting the POMV draw, beginning in FY 19, had substantially reduced the state's budget deficits. They had been over \$2 billion per year beforehand. In FY 19 the deficit dropped to \$300 million, but the state was paying less than the statutory dividend. The governor's budget in the current year paid the statutory dividend bringing the state back to a deficit of about \$2 billion.

Mr. Painter moved to the graph on slide 8 showing the state's budget reserve balances for the CBR and the statutory budget reserve (SBR) from FY 12 to FY 22. The years of deficits had taken their toll on the balances. He elaborated that from a peak of \$16 billion the state had spent down the SBR completely and the CBR would have a balance of about \$900 million at the end of FY 21. The governor's budget would not draw much from the CBR leaving a balance of about \$900 million at the end of FY 22.

Mr. Painter reported that in October 2020, he had stated that the CBR balance would likely be larger than the \$600 million he had projected at the end of session. He had increased the projection to \$900 million which was a rough figure. He had not yet received the Comprehensive Annual Financial Report (CAFR) of the state which was currently

being audited by the Legislative Audit Division. The auditor might make adjustments and provide a different understanding of the reserve balances. The current estimate was agreed on by LFD and the Office of Management and Budget (OMB). He reiterated that the number remained preliminary.

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Mr. Painter advanced to slide 9: Alaska's Structural Budget Deficit (con't)." He noted an error on the slide where it stated "Overall UGF Reduction." He explained that the reduction was made to the FY 21 authorized budget. The management plan included some carry forward funding. The overall UGF reduction to agency operations should be \$515 million or 11 percent, not \$625 million or 13.8 percent. The slide showed that while the state reduced the budget substantially since the peak of agency operations spending in FY 15, the reductions had not been felt equally across state agencies. The state's public protection agencies including the Department of Corrections (DOC), the Department of Public Safety (DPS), the Department of Law, and the Judiciary had seen increased budgets of 6 percent above where they were in FY 15. Generally, the trend was downward for other agencies.

Mr. Painter reported that the Department of Education and Early Childhood Development (DEED) had been slightly reduced. Most of the education funding went out to school districts and the K-12 formula and had been reduced by about 2 percent. The reduction was mostly due to one-time money outside the formula that districts received in FY 15 and had not received in FY 21. Education had been relatively flat over the period. The Department of Health and Social Services (DHSS) had been down 6 percent. However, he thought the true reduction to DHSS was understated. He explained that in FY 21 the state had \$90 million of one-time money for COVID-19 relief. The true reduction to the department was larger, but a straight-line comparison showed a 6 percent decrease. The twelve other agencies were down by \$441 million or by more than one-third. He surmised that while the large formula-driven agencies had seen relatively small reductions to their budgets, the other agencies had seen much larger GF reductions.

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Mr. Painter turned to slide 10 titled "LFD's Budget Baselines." His division had developed budget baselines as a point of comparison for the governor's budget. He explained that, rather than viewing the governor's budget in isolation, LFD wanted to have baselines to understand the governor's budget more clearly. The division used two different baselines: current policy and current law. He elaborated that the difference between the two baselines was that in current policy there was an assumption that statutes overfunded or underfunded in FY 21 would continue into FY 22. The current law baseline assumed that regardless of how the items were treated in FY 21, the legislature would return to the statute in FY 22.

Mr. Painter continued that for agency operations, both of the baselines used an adjusted base which removed one-time items from agency budgets and added in automatic changes such as salary adjustments. A slightly modified version of the FY 22 adjusted base was used to incorporate changes to the K-12 formula due to projected student count changes. He did not think it was fair to blame or credit the governor for a change in projection outside of his control which was why LFD incorporated it into its baseline. He relayed that the largest difference was the PFD. The current policy assumed that the state would pay a dividend costing \$680 million which equated to about \$1,000 per person. The current law assumption was that the state would pay a statutory dividend which was slightly over \$2 billion - a payout of approximately \$3,000 per person.

Mr. Painter advanced to slide 11 showing a table of statewide items detail. He conveyed that the slide compared the statewide items between the two baselines. The difference in debt service was due to the municipal project debt that the governor vetoed in FY 21 equaling about \$2.4 million. In FY 21, the governor vetoed all funding for school bond debt reimbursement. The current policy assumption would leave the number at zero. The current law assumption would result in an appropriation of \$54.2 million in UGF along with funding from other sources. The amount for state retirement was the same, as the appropriation was fully funded in FY 21. The Regional Educational Attendance Area (REAA) fund, which provided funding for school construction and major maintenance in rural schools, was vetoed in FY 21. The governor vetoed community assistance funding in FY 21. If the current

policy assumption was applied, the UGF appropriation would be zero. In current law, he would assume that the UGF portion (in order to do the statutory \$30 million deposit) would be \$17.6 million and would also be funded from the Power Cost Equalization (PCE) Fund. The legislature did not fund the oil and gas tax credits in FY 21 even though the statutory formula called for \$60 million in FY 22. The current law assumption included \$60 million. Altogether, there was about \$170 million of differences between the two assumptions for statewide items.

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Mr. Painter moved to slide 12 showing a table of FY 22 current policy and current law scenarios and a full-picture comparison. The agency operations total was \$3.9 billion in both scenarios. The Legislative Finance Division assumed that a baseline capital budget was about \$150 million based on the numbers from the previous 6 years. It was not enough to fully address the state's maintenance needs. Under the current policy scenario, the state would be looking at a budget deficit of about \$900 million in FY 22. Under the current law scenario, the deficit would be approximately \$2.4 billion mainly due to the difference in the PFD.

Mr. Painter compared the governor's budget to the baselines on slide 13. The governor's agency operations were \$77.4 million below LFD's baseline. He would detail the reductions in an upcoming slide. Statewide items were about \$30 million higher than the current policy and \$139 million below the current law, as the governor was not fully funding several items. The governor's capital budget was \$58.3 million - significantly below currently policy and current law due to the use of one-time Alaska Housing Finance Corporation (AHFC) bonding for statewide matching funds. The statewide match was about \$101 million. If the match was counted as UGF, the governor's capital budget would be about \$160 million - slightly higher than the baseline. The governor's budget included the statutory dividend. Altogether, the governor's budget deficit was about \$1.2 billion before fund transfers landing between current policy and current law baselines. Overall, compared to the current law scenario, the governor's budget was down by about \$300 million reflecting some reductions. He would provide additional detail of the reductions further into the presentation.

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Mr. Painter turned to slide 14 and continued to address the governor's FY 21/22 budget. He pointed to some of the budget highlights including a supplemental PFD payment for FY 21 (\$1.2 billion from the ERA). The budget took two ERA draws in FY 22: the regular POMV draw plus another \$2 billion for the dividend which LFD thought of as a deficit draw beyond the statutory amount. The governor's budget submission also included a fast-track supplemental budget, many items of which were not funded in the capital budget. During the previous session, the legislature did not pass a stand-alone capital budget. Rather it placed portions of the typical capital budget into the operating budget. He noted, however, there were substantial omissions. The intention had been to return to session. Many of the same items were found in the fast-track supplemental budget. Altogether, the FY 22 budget had a small deficit from the CBR after the ERA draw. He suggested that even with the additional \$2 billion there was an additional \$38 million deficit from the CBR.

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Mr. Painter moved to slide 15 and continued to review the governor's budget. Reductions to agency operations totaled \$77.4 million. The largest reduction was to Medicaid in the amount of \$35 million. However, the governor included backstop language that reappropriated projected lapsing Medicaid funds, about \$35 million, from FY 21 into the FY 22 budget. Resultingly, Medicaid would be funded at the same level as it was in the current fiscal year. The projected lapse was due to the higher FMAP, the reimbursement rate from the federal government in the CARES Act. Therefore, there was really not a reduction to Medicaid. He thought the numbers reflected the governor's ambition for FY 23. He continued that despite the numbers looking like a reduction, it was not a reduction in service. It was simply a reduction in the funding level. He noted that looking at the 10-year plan, the governor called for further agency operations reductions in FY 23 and FY 24. The governor was already setting Medicaid at the level he hoped to achieve in FY 23 and would most likely not be suggesting further reductions in FY 23.

Mr. Painter continued that the next largest reduction was to the University of Alaska. The budget reflected a

\$20 million reduction which was part of the governor's compact agreement with the University. The agreement reflected a reduction of \$70 million to the University's budget over 3 years. The Department of Transportation and Facilities Maintenance (DOT) was down by \$17.2 million; \$14.1 million due to one-time fund changes to utilize federal CARES Act money and \$3.6 million to the Alaska Marine Highway System (AMHS). The reductions to DOT brought the budget down to match the governor's original FY 21 proposal (slightly lower than his post-veto amount). The fund change of \$14.1 million would not be sustainable and would likely have to be reversed in FY 23. Therefore, while it made the budget appear smaller in the current year, the amount would need to be reinstated in the following year.

Mr. Painter reported another major reduction in the budget to the Public Assistance Administration in the amount of \$3.4 million UGF and a reduction in more than 101 positions. The change was due to substantial technology changes resulting from the pandemic and related workflow changes. The division would be reducing about one-quarter of its workforce. He also reported that the K-12 formula was fully funded in the governor's budget. The Legislative Finance Division had factored in changes to the baseline. He reported a projected student count reduction in the following year below the count used to set the FY 21 budget. The student count projection was sensitive to changes in how schools would operate - there were massive differences because of the pandemic. Districts had been all over the map in their projections for FY 22. It was difficult to know whether the projected reduction to the student count would materialize because of not knowing how the pandemic would proceed over the following year. All other agency changes netted a reduction of \$1.7 million. He also noted there were small increases in DOC and other places and smaller reductions in many of the agencies. The result was a relatively flat budget.

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Mr. Painter advanced to slide 16 and continued to review the governor's proposed budget. Statewide Items in the governor's budget totaled \$464.1 million. The governor proposed only funding School Debt Reimbursement and the Regional Education Attendance Area (REAA) Fund Capitalization at 50 percent of the statutory level - areas he had vetoed in FY 20. In FY 21 the governor vetoed 100

percent of the two items. The governor proposed funding Community Assistance solely with PCE funds which were designated general funds (DGF), and he did not add any of the allowable UGF. The fund was paid out based on one-third of the fund balance. If the legislature accepted the governor's budget, \$19.5 million would be paid to communities in FY 23. The amount was almost the exact amount needed to pay the community base payments. The base payments went out first. Any additional funding was disbursed in per-capita payments according to population. He continued that the \$19.5 million only covered the community base payments. Therefore, large urban centers would experience the largest impact not receiving any funding.

Mr. Painter reported that in the budget the governor proposed fully funding oil and gas tax credits at the \$60 million statutory level. However, the credits were funded with Alaska Industrial Development and Export Authority (AIDEA) receipts, "other" fund code, rather than UGF. He indicated that LFD considered such a change to be a trick to reduce the budget. If the legislature felt that AIDEA was over-capitalized there was a number of things that could be done to reduce the amount in AIDEA's funds such as increasing the dividend it paid the state. He suggested that having AIDEA pay directly for statewide items that had nothing to do with AIDEA's functions made the budget look smaller but was not consistent with transparent budgeting. If the legislature felt that AIDEA had an extra \$60 million, the transparent action would be to transfer \$60 million from AIDEA's reserves into the CBR and fund the tax credits with UGF. He concluded that while the governor's number was \$464 million, another \$60 million would need to be added to truly reflect the size of the budget.

Mr. Painter conveyed that the governor also had a Public Employees' Retirement System (PERS) bill. The associated dollars were not included in the totals but were in the fiscal summary. There was an estimated savings associated with the bill of \$43.3 million UGF. The bill involved eliminating the statutory cap a state employer paid. However, it would not impact non-state entities. Only the State of Alaska would be impacted. The amount would be paid with other fund sources, particularly federal funds, to pay the full costs. The estimate was \$43 million, and more analysis would need to be done by the executive branch to determine how much of the non-UGF fund sources would be

realizable. Once the bill reached the legislature, fiscal notes would be necessary to truly understand it.

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Mr. Painter advanced to slide 17 and continued to review the governor's proposed budget. The capital budget totaled \$58.5 million UGF but was bolstered by an AHFC bond package in the amount of \$101.6 million. The true total of the capital budget would be closer to \$160 million taking advantage of the low interest rate environment to propose bonding. The bonding would be paid for out of a reduction to the future AHFC dividend, a UGF revenue source. He relayed that AHFC would pay the debt service and lower its dividend to the state. Essentially, the payments would show up as reduced UGF revenue.

Mr. Painter reported that the governor also planned a general obligation (GO) bond proposal. However, no legislation had been submitted to-date, and a list of projects had not been submitted. There was no shortage of projects that could be listed. He indicated that the list of school construction and major maintenance projects combined to over \$400 million. The division was waiting on details that might be provided once the legislative session began. He reiterated that the fast-track supplemental included some unfunded FY 21 capital projects; other projects were moved to the FY 22 budget; a few other projects had been funded through the Revised Program Legislative (RPL) process in FY 21; and some projects were funded through other means. The division would provide a full analysis in its overview of the governor's budget.

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Mr. Painter turned to a table on slide 18 showing a short fiscal summary of the governor's budget (UGF only). The slide showed the factors he had reviewed. He highlighted that in FY 21 the governor's budget would have a deficit of \$2.1 billion. The legislature had already authorized CBR draws to pay for some of the deficit. The governor proposed to pay for the rest by paying for the supplemental PFD directly out of the ERA beyond the statutory POMV draw level. In FY 22 there would be a slightly smaller deficit but close to \$2.1 billion. The governor proposed to pay for most of the deficit with a draw from the ERA that would go

directly to the dividend fund. The remainder would be paid with CBR monies. He paused for questions.

Co-Chair Foster referred to slide 18. He clarified that for FY 22 the governor's budget included a full PFD totaling about \$2 billion. He also clarified that for FY 21, the supplemental appropriations included a supplemental PFD of \$1.2 billion and other supplemental items. He asked if he was correct.

Mr. Painter responded, "Mr. Chairman, that's correct." He noted that the other supplementals equaled \$39.8 million, the largest of which was part of contingency language to reappropriate money into the disaster relief fund. The governor was appropriating \$30 million into the disaster fund and the rest was for capital projects.

Co-Chair Johnston asked if LFD would be able to model what the PF would need to earn to have the funds available in FY 23 for the governor's budget - for the structured draw. She wondered whether there would be enough funds in the ERA to balance the budget if the legislature were to pass the governor's budget and the governor's supplemental, or whether the account would earn enough to balance the budget. Mr. Painter could follow-up with some modeling.

Co-Chair Johnston thanked Mr. Painter for pointing out the one-time only budget reductions. She was interested in the unfunded liability of the state's pension funds and how to pay it. She appreciated the governor's idea regarding savings. She mentioned the Department of Health and Social Services positions and wondered how many of them were paid with both federal and state dollars. She thought federal dollars would be used to pay for positions related to the unfunded liability. She queried about a reduction in the budget.

Mr. Painter replied that it would be a shift of fund sources. There would be no reduction in the budget in all funds. He explained that when the additional costs of retirement were paid, they were paid entirely with UGF dollars. In the agencies there were matching federal funds available. Some of the spending could be shifted to federal fund sources. He would expect that the fiscal notes would reflect a \$95 million reduction to the statewide item of retirement payments. There would also be a \$95 million increase in agency funding. However, not all of the

\$95 million in agency funding would be UGF. He explained that \$43 million was the amount of reduced UGF because of the switch to other funds sources that OMB estimated related to the 50/50 positions within DHSS. There was the potential for significant UGF reductions simply by shifting the payment of certain positions to the federal government.

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Co-Chair Johnston surmised that the amount of the budget would remain the same. The federal funds would be used for operations and for paying off the state pension fund liability. Mr. Painter agreed. The total budget level would remain the same. However, there would be an increase in federal funds being used to pay for the liability costs.

Co-Chair Foster acknowledged Representative-Elect James Kaufman in the audience. He thanked him for joining the meeting.

Vice-Chair Ortiz returned to slide 9. The slide showed where the different reductions had been made to the different agencies. He drew attention to the top of the slide. Under "all other agencies" there was a 35.6 percent reduction in funding for all agencies outside of DHSS, DEED, and DPS. He wondered if it was within the purview of LFD to conduct assessments related to the impact of reductions on the effectiveness of agencies to carry out their constitutional requirements. Conversely, he wondered whether assessments had been conducted regarding the impacts of funding increases of agencies and their ability to do their required work.

Mr. Painter replied that there are a series of missions and measures reported as part of the governor's budget submission that were required by statute. The success of each component within the budget, relative to the applied metrics, were reported. A person could study and compare the performance metrics prior to the reductions and following the reductions. The legislature had not given the metrics resource much attention in recent years. The missions and measures process was designed to provide the information. He indicated that the information could be found on OMB's website where detailed budget books were available. He reported that LFD had not perform any additional analysis.

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Representative Wool referred to slide 12 of the presentation showing current policy and current law scenarios. He deduced that the pre-transfer deficit would be \$886 million. If the PFD was zero, the deficit would be \$200 million. He asked if he was correct. Mr. Painter answered that with the other current policy assumptions he would be correct. He suggested that without funding any other statewide items the deficit would be about \$200 million.

Representative Wool asked about the reduction of 101 positions in the Public Assistance Division and a budget reduction of \$3.4 million. He averaged the cost savings per position of \$34,000. He thought there had to be greater reductions than \$34,000 per position. He wondered if other areas had experienced a similar reduction in positions due to the pandemic and people working remotely.

Mr. Painter clarified that the \$3.4 million was the UGF reduction. There was also a reduction in federal funding. The reduction was about twice the amount in all funds. He indicated that the Public Assistance Division experienced the largest reduction of positions clarifying that the change was essentially a shift in service delivery. There were some smaller efforts towards reductions. He noted closing some of the Division of Motor Vehicle (DMV) offices which would result in a reduction of positions and in a smaller savings. The Department of Revenue within the Child Support Division experienced the second largest reduction of positions. The reduction was due to a re-platforming project. Most of the decreases applied to contractual services rather than positions.

Representative Wool summarized that the Public Assistance Division and the Division of Child Support had received the largest reductions. He pointed to the short fiscal summary on the bottom of slide 18. He asked for clarification about the balance of the CBR. Mr. Painter answered that LFD projected that \$900 million would be left in the CBR at the end of FY 21 following the deficit draw. The amount had already been calculated out because of the way the legislature funded the budget. The legislature had approved one-quarter of the budget coming directly out of the CBR. The amount was drawn at the beginning of the year and was factored into LFD's projections.

Representative Wool confirmed that the balance included the withdraw of \$896 million. Mr. Painter responded, "Yes, that's correct."

12:29:07 PM

Representative LeBon referred to slide 16. He wanted to discuss AIDEA receipts being used to fund oil and gas tax credits. He opined that it was not possible for AIDEA to be overcapitalized, as it was the state's bank. He suggested it would be helpful to define what it meant for AIDEA to be overcapitalized. He continued that AIDEA's capital level helped them to originate investments on behalf of the state and to secure low interest rates on their bond raising activities. He disagreed that AIDEA was overcapitalized. He asked if it was a practical strategy to draw \$60 million from AIDEA in FY 22 to fund the oil and gas tax credits. He was unsure if the governor's plan was a one-year or multi-year plan.

Mr. Painter did not know the governor's plan in subsequent years. Based on the governor's 10-year plan there did not appear to be an increase in FY 23 that would suggest that the the administration planned to pay for tax credits with UGF. Two years prior, the legislature had discussed whether AIDEA was capitalized at the proper level when the governor had proposed to directly draw AIDEAs funds. It was the legislature's policy call as to how much funding AIDEA should have.

Mr. Painter suggested that if the legislature thought AIDEA had more reserves than needed, it could increase the dividend statute to match AHFC's dividend statute. The Alaska Housing Finance Corporation had to pay about 75 percent of its earnings of net revenue as its dividend. Alaska Industrial Development and Export Authority's dividend statute called for a dividend payout of between 25 percent to 50 percent of earnings. He noted that the most recent credit rating for AIDEA specifically cited the legislative appropriations from AIDEA receipts from 2 years prior with a note of caution for AIDEA's credit. There was a general concern that AIDEA funds would be used by the state to meet its expenses which could result in a reduced credit rating.

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Representative LeBon appreciate the input.

Mr. Painter moved to slide 19 to discuss the governor's 10-year plan. It called for ERA draws beyond the statutory level in FY 21 and FY 22. However, his plan called for a balanced budget beginning in FY 23. He achieved his plan through three main mechanisms. The first mechanism was to change the statutory dividend formula from 50 percent of statutory net income to 50 percent of the POMV draw. It would be a reduction of approximately \$400 million per year and was contingent on a vote of the public. The second mechanism was to reduce agency operations by about \$100 million each in FY 23 and FY 24. In out years he planned for 1.5 percent growth, which was consistent with the constitutional spending limit proposed by the governor. The largest deficit filling item in the governor's 10-year plan was \$900 million to \$1.2 billion in new revenue starting in FY 23. The governor did not specify where the revenue would come from. The largest year of revenue was in FY 23 and the amount moved around as needed to ensure there were no budget deficits each year.

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Mr. Painter moved to final slide, slide 20. The overdraws from the ERA increased future deficits by reducing the amount of money in the PF. The Legislative Finance Division's rule of thumb was to have a 5 percent POMV. Therefore, \$3.2 billion of draws meant that 5 percent was a permanent increase in the deficit. He suggested that 5 percent of \$3.2 billion was \$160 million. Future deficits would be \$160 million larger in real terms or inflation-adjusted terms. The legislature needed to weigh its desire for stimulus spending in the current year. Because the economy was struggling, the governor wanted to inject capital into the economy through higher dividends and a bonding proposal. Both would come at a long-term cost in the form of reductions to future revenues which could lead to future taxes and reduced services.

Mr. Painter also noted that the new revenue in FY 23 proposed in the governor's budget would need to be authorized in the current year because of the time it would take to implement tax measures. It was possible to incorporate revenue measures quickly, particularly with a sales tax. He noted several municipalities that had sales

taxes in place and reiterated the possibility of having a sales tax in place in a timely fashion. He suggested the legislature would need to take up the issue in the current session. He pointed out that in the following year the legislature would still be faced with a large deficit even with turning a corner with the pandemic and infusing cash into the economy. There would be no other measure to resolve the deficit than to take another unplanned draw from the ERA. He thought the ERA could be drained rapidly similar to how the CBR and SBR were depleted. Each year the legislature delayed resolving the long-term deficit, the deeper the deficit hole would become. Every year the legislature drew more from the ERA than the statute called for would result in higher taxes or reduced services in the future.

Mr. Painter continued that if the legislature pulled from designated funds such as the PCE fund, additional funding would have to be identified or the program would cease placing increased pressure on the budget. He presented an analogy. The governor's stimulus plan was akin to getting dessert (stimulus monies) but only if a person also ate their vegetables (budget cuts and new revenue) - the governor's plan relied on both. The legislature could make completely different policy decisions such as calling for lower dividends, less revenues and deeper cuts, and other actions. However, the bottom line was that every year the legislature delayed closing the structural deficit would make it more difficult and more costly to do so in the future. He concluded his presentation.

Co-Chair Foster asked about the FY 22 budget and wondered what the price of oil would need to be to balance the budget. Mr. Painter could provide an answer at a later time.

Mr. Painter looked forward to working with the legislature in the coming session.

Co-Chair Foster thanked the presenters.

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ADJOURNMENT

[12:40:26 PM](#)

The meeting was adjourned at 12:40 p.m.