

SENATE FINANCE COMMITTEE
January 23, 2019
9:01 a.m.

9:01:25 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:01 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Peter Micciche
Senator Donny Olson
Senator Mike Shower
Senator Bill Wielechowski
Senator David Wilson

MEMBERS ABSENT

Senator Lyman Hoffman

ALSO PRESENT

Donna Arduin, Director, Office of Management and Budget;
David Teal, Director, Legislative Finance Division; Senator
Cathy Giessel; Senator Chris Birch; Senator Lora Reinbold;
Senator Mia Costello; Senator Shelley Hughes;
Representative Tammie Wilson; Representative Cathy Tilton;
Representative DeLena Johnson; Representative LeBon;
Representative Sarah Vance; Representative George Rauscher;
Representative Dan Ortiz; Representative Jonathan Kreiss-
Tomkins.

SUMMARY

OFFICE OF MANAGEMENT and BUDGET - BUDGET DEVELOPMENT
PROCESS

LEGISLATIVE FINANCE - FY20 FISCAL OVERVIEW

Co-Chair Stedman reviewed the agenda for the meeting. He noted that the upcoming budget would be available on the 13th of February. The focus of the meeting would be on the process of the development of the budget versus the number detail. He thought it was important for the public and the legislature to be provided with the thought process behind the budget. He invited the Office of Management and Budget director to the table and requested that she provide a brief background.

^OFFICE OF MANAGEMENT and BUDGET - BUDGET DEVELOPMENT PROCESS

9:04:40 AM

DONNA ARDUIN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, (OMB) introduced herself. She confirmed that she would be presenting the governor's budget for FY 20 on February 13, 2019. She relayed that she would be reviewing the processes employed by OMB to build the budget in her presentation, "State of Alaska Office of Management and Budget; Building the Budget: A Policy Driven Approach" (copy on file).

Ms. Arduin reported that OMB began on day 1 of the administration by eliminating budget silos, tearing them down.

Co-Chair Stedman interjected asking Ms. Arduin to provide some background information about herself. He thought it was important for the public to know the new director had some background in the subject matter she was about to present. Ms. Arduin conveyed that she had served with seven different governors in six states. She had been a budget director or deputy director for a substantial amount of time. She worked once in the legislature for the Speaker of the House of Florida.

Co-Chair Stedman queried her background outside of her experience as a budget director. Ms. Arduin relayed that prior to working as a budget director she worked in investment banking. Following her service, she started an economic consulting firm with Dr. Arthur Laffer, President Ronald Reagan's economist, and Steve [Stephan] Moore, a prominent economist in Washington D.C.

Co-Chair Stedman clarified that Ms. Arduin had been doing her job for a few decades. Ms. Arduin responded affirmatively.

[9:06:42 AM](#)

Ms. Arduin read slide 2, "Building the Budget: Eliminate Budget Silos":

- Bringing Administrative Services Directors into OMB
 - Collaborating with and across departments
 - Identifying redundancies
- Establishing Policy Teams across Departments
 - Boards and Commissions
 - Regulatory reform
 - Healthcare coordination
 - State asset inventory and divestiture

Ms. Arduin explained that on December 14, 2018, OMB issued the fiscal summary shown next to the governor's preliminary FY 20 budget on slide 3, "Building the Budget: Define the Problem." The Office of Management and Budget started by using the numbers from the Department of Revenue's (DOR) updated revenue summary book. The statutory earnings reserve calculation was added to DOR's numbers to reach an unrestricted general fund (UGF) revenue total of about \$3.2 billion. The Office of Management and Budget estimated about a \$1.6 billion UGF deficit using the previous administration's November 30th proposed spending plan - the starting place OMB used. She highlighted that OMB streamlined the fiscal summary by condensing the amount of line items. The information still existed and would be available to legislators who requested it. She argued that it would be much easier for the public to see the revenue line, the expenditure line, and either a debt or a surplus.

Ms. Arduin addressed slide 4, "Building the Budget: Where is the money going?" She highlighted that the legislature was accustomed to the blue line chart. However, she wanted to make sure OMB was capturing everything going out of the state's treasury. Therefore, OMB included designated general funds (DGF) in addition to UGF. All money was green and should be viewed and analyzed. She thought it was important to look at everything the state was spending money on regardless of the funding source.

Ms. Arduin looked at slide 5, "Building the Budget: Combine UGF and DGF":

- The Alaska Constitution does not allow for designated funds
- State spending is State spending - all programs should compete for available dollars
- Examples of designated funds:
 - Alcohol Tax
 - Vehicle Rental Tax
 - Motor Fuel Tax
 - Fees

Mr. Arduin argued that the programs that competed for DGF should be scrutinized because all money was green and belonged to Alaskans. She provided some examples of designated funds. The blue chart on the slide showed that as a percentage of the general fund budget, DGF had been increasing over the previous years.

Co-Chair Stedman commented that before moving to the following slide he highlighted the first line that indicated the constitution did not allow for designated funds. He thought the word that should be used was dedicated funds. Ms. Arduin agreed.

Senator Micciche noted the substantial percentage difference between FY 14 and FY 18. He queried about the 80 percent increase from 10 percent to 18 percent UGF. Ms. Arduin agreed to provide a breakdown of the point of the analysis to show that it was no longer a sliver of the budget. Instead, it continued to grow. She concluded that the portion of the budget that had been relatively unscrutinized was growing and should not be off the table.

Co-Chair Stedman noted that he had had some discussions with the OMB director about keeping the 2 general fund sources separate, but to analyze both and put them together later if desired by the legislature. He did not want the committee to concentrate on one without the other. He suggested there would be work over the interim regarding fund designations.

Senator Micciche felt that it was due largely to a function of the reduction in UGF. He wondered about the constant and would wait for a response from OMB.

[9:12:29 AM](#)

Ms. Arduin discussed slide 6, "Building the Budget: Colors of Money." She indicated there were many different colors of money coming into the state. However, OMB considered all money green. The slide illustrated that although there were receipts and revenues coming in from several sources, they all went to the same place and should all be scrutinized.

Ms. Arduin highlighted slide 7, "Building the Budget: Guiding Principles":

- Revenues = Expenditures
- Maintain reserves
- Department missions should drive Department programs
- Statute and regulation reform to reduce or eliminate programs
- Policy driven proposals
- Doing less with less

Ms. Arduin indicated OMB was building the budget on a set of guiding principles. She noted the governor talking about revenues and expenditures remaining equal. In other words, expenditures should not exceed statutorily available revenues. Another of the guiding principles was to maintain reserves. She read the remaining guiding principles listed on the slide.

Co-Chair von Imhof appreciated the list of guiding principles. She pointed to policy driven proposals and department missions driving department programs. She wondered how data fit into driving proposals, programs, and resource allocation. Ms. Arduin appreciated the question and would be addressing it in one of the upcoming slides. She confirmed that data was a requirement for policy driven proposals.

Senator Bishop noted that the director had mentioned doing less with less within departments. He queried Ms. Arduin about how the principle was weighted within each department. He was sensitive to the issue of Alaska workforce development and training. He mentioned the governor's support of Alaska hire. He asked if she intended

to shut down workforce development, a critical mission of the state, because revenues were down.

Ms. Arduin replied that the detailed proposals would be available on February 13, but she noted that the discussion of a policy driven approach was what OMB used with the agencies. She did not give the agencies an across-the-board cut number. Rather, she asked agencies to apply a policy driven approach. She would review the approach OMB used with each of the agencies to determine which programs were priorities, core services, aligning core services, and eliminating duplications. She would be taking the committee through OMB's approach as she presented the slides.

Senator Wielechowski reported having asked questions of people from the administration who deferred to Ms. Arduin. He wondered if the cuts were coming from the commissioners and the administration, or whether she was proposing them.

Ms. Arduin felt that the commissioners had been consistently describing OMB's process which was to bring the administrative service directors to OMB and allowing the budget to be constructed within OMB. The budget process was not strictly left for the agencies to build. The office of Management and Budget had been working with the agencies to review and identify the core programs, prioritize the core programs, and to ensure programs fit within departments' core missions and business processes. In the final analysis, OMB was compiling the budget with the help of the agencies. Department budgets were not constructed, as in past years, solely by the agencies.

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Senator Wielechowski expressed concern, because the State of Alaska had commissioners who were selected by the governor and approved by the legislature, whereas, Ms. Arduin was not approved by the legislature and had only been in Alaska for a month or 6 weeks. He was aware that she would be leaving Alaska in the following few months after the legislature was finished. He was troubled by the amount of power and budget-creating ability was being placed in her hands. He queried whether commissioners had the ability to argue that decisions being made would hurt their departments, or whether Ms. Arduin had the final say.

Ms. Arduin replied that she worked for the governor's office, and all decisions were vetted through the governor and through the commissioners. She stated that commissioners had a say, as they were driving their core programs and services. She emphasized that OMB had been working very well with them.

Senator Olson asked about Ms. Arduin's receptivity to supplemental budgets in the following cycle. Ms. Arduin responded that OMB would be submitting a supplemental budget for FY 19. However, it was not her intention to build a budget that would require a supplemental for FY 20.

Co-Chair Stedman stated that a supplemental budget was historically provided to address the previous year's unforeseen events such as forest fires and earthquakes. He remarked that there was a hope to have a budget that did not require a future supplemental. He reported encouraging OMB to include statutory language that would allow the implementation of reductions in their budget submission. He wanted to ensure that the legislature did not remove funds in the budget that were statutorily required for the governor to implement. He also asked the OMB director to provide a list of statutorily structural changes that would be needed to implement the budget. He hoped the information would be delivered on February 13, 2019 along with the budget.

Senator Micciche was glad Ms. Arduin had previous experience in other states. He anticipated issues around Health and Social Services such as the federal Medicaid requirements and the Supplemental Nutrition Assistance Program (SNAP) requirements. He queried about Ms. Arduin's experience in delivering reductions and about tensions between federal requirements and making reductions. Ms. Arduin responded that many states had been able to work with the federal government to receive waivers, particularly Medicaid waivers, to implement programs that were more efficient and tailored to a specific state. She would pursue waivers for Alaska.

Senator Micciche mentioned the maintenance of effort being a challenge for programs such as SNAP. He asked if she had experienced successes with other public assistance programs. Co-Chair Stedman asked Senator Micciche to define SNAP for the public. Senator Micciche responded, "Food stamps, if you will, for the public."

Ms. Arduin relayed that every state had different challenges. She thought maintenance of effort was likely more challenging in Alaska than in other states. It was also one of the items on her discussion list for the commissioner and the administration's talks with the federal government. She believed OMB would be seeking waivers that included maintenance of effort in certain cases.

[9:24:16 AM](#)

Ms. Arduin read the list on slide 8, "Building the Budget: A policy-driven approach":

- Consistent policies
- Core services alignment
- Program Prioritization
- Research: Metrics, Outcomes, Best Practices

Ms. Arduin addressed slide 9, "Building the Budget: Consistent Policies":

- Reducing Dependence
- Business Process Realignment
- Unleashing entrepreneurialism
- Program Reform
- Maximizing return on assets
- Outsourcing
- Reducing regulatory burden
- Eliminate duplication
- Non-essential programs
- User pay

Ms. Arduin reviewed a list of examples of consistent policies the administration was employing across state government. She read the list.

Ms. Arduin discussed slide 10, "Building the Budget: Core Services Alignment." she reported asking all the agencies to start with a core services alignment. She pointed to the illustration on the slide for the Department of Environmental Conservation. She emphasized the importance for any business or state agency to analyze what they are doing and why, and to determine their most important priorities. The Department of Environmental Conservation's core services in priority were to protect human health,

then to protect the environment. There were other things the department did that did not fall within its core services. She thought it was a good place to begin the analysis.

Senator Wielechowski looked at slide 9 and queried the examination of outsourcing and nonessential programs. He also wondered what areas the director envisioned more user pay. Ms. Arduin replied that the administration's proposals and specifics would be available on February 13, 2019. There were opportunities across state government for all the items listed including outsourcing. The slide described the administration's belief that there should be consistent policies throughout state government. She cited user pay as an example. She posed the policy question about user revenues matching expenditures because Alaska was not allowed to have dedicated funds. Some agencies were asking whether, for a low priority program, the state should be working with user groups to determine if they would rather pay for the services as opposed to seeing them drop from the state.

[9:27:50 AM](#)

Co-Chair von Imhof referred to the third item on slide 9, unleashing entrepreneurialism. She wondered, within the current labor laws and state contracts with unions, whether the state could offer things such as merit pay, seniority, job-sharing, the ability to work from home, and other innovation rewards. The private sector engaged in many her examples. She wondered if the state could offer the same things within the confines of state government and union contracts.

Ms. Arduin indicated OMB was exploring some of the things Co-Chair von Imhof mentioned. There were many facets to entrepreneurialism. She argued that the state should not be competing with the private sector and believed state government should encourage private enterprise. She agreed that the businesses that stay within state government should be able to reward those employees and departments who were achieving their outcomes. She could provide labor rule information to the committee.

Co-Chair Stedman looked forward to the release of the information and supporting documents on February 13, 2019.

Senator Wilson had concerns about user fees and user groups. He wondered if there was a process in place to properly identify the user fees if the state was going to have user groups pay for services. He wondered how the services would be maintained without being able to have designated funds in the budget.

Ms. Arduin replied that the details of the budget would be out February 13, 2019. She furthered that the issue was how the state would treat the related policies. It was a question the administration was asking the legislature. She asked, as a policy, whether the state would continue or have user fees pay for services. She wondered if, because the state did not have designated funds, the policy would be not to require user fees to be consistent with expenditures. She was asking a policy question.

Senator Micciche clarified that he was an avid supporter of government not competing with the private sector. He favored privatization and outsourcing when possible. He had researched other states that had taken large swaths of government and privatized them. Often, within a year or two the government would pull those services back in when they could not be offered at a lower price. He asked the director if she had a team assembled that would adequately analyze whether privatization of services would be at a lower cost to the state. Ms. Arduin responded affirmatively that there would be a team assembled to conduct the necessary analysis.

[9:32:12 AM](#)

Ms. Arduin highlighted slide 11, "Building the Budget: Program Prioritization." She referred to the core services of DEC. Protecting human health was a priority over protecting the environment. It did not mean that protecting the environment was not a priority. However, in lining the priorities, human health came first. She explained that the department was asked to prioritize all its programs. She reemphasized that the highest priority programs were those that protected human health. It did not mean that all programs protecting human health were priority programs. She pointed to the right-hand side of the list noting that some of the programs were not a priority because they were inefficient. The Office of Management and Budget went through the exercise of prioritizing programs with all the

agencies to begin to build a budget that focused on the core programs that were most efficient.

Senator Wilson asked if the ranking data for all the departments would be available on February 13, 2019. Ms. Arduin indicated that OMB would have the outcome of the prioritization - the governor's proposed budget.

Co-Chair Stedman added that the subcommittees would be able to ask for the information when doing the subcommittee work. He noted previous struggles getting the agencies to prioritize. Much of the time the agencies prioritized all the programs as number 1.

Senator Wilson mentioned that in his tenure he had been trying to have the departments develop a priority list. He appreciated the current administration doing so recognizing the process of ranking programs was difficult. He wanted some of the related details and could speak with the director offline.

Senator Bishop clarified that Ms. Arduin was not lessening the fact that protecting the environment was equally important. Ms. Arduin replied that protecting the environment was important. However, if the programs had to be prioritized, protecting human health was DEC's highest priority. It did not mean that the department did not have a priority of protecting the environment. She indicated that what was not shown were things the department did that did not fall into either category. The low priority programs were identified as potential programs for elimination. Senator Bishop commented that he believed protecting human health and the environment were one and the same.

[9:35:49 AM](#)

Ms. Arduin displayed slide 12, "Building the Budget: Metrics, Outcomes, Best Practices." She spoke of the metric analysis on the slide. She started at a high level but took a deep dive into all the state programs. For example, the total per capital state spending in Alaska was represented by the yellow bar and was higher than most other states. She continued that on a per capita basis Alaska out spent other states. She continued that OMB started comparing across facilities and regions. From there, OMB looked at outcomes and best practices from other states and around

the world. She relayed that the metrics, outcomes, and best practice analyses would be used to finalize the administration's budget proposal.

Co-Chair Stedman suggested looking at the Kaiser Family Foundation analysis in more detail if it was the will of the committee. However, he believed Alaska was structured much differently than other states in that it was the only state that owned its subsurface held in commons. Also, the state did not have counties with county sheriffs and courthouses. He thought the analysis would have to be broken down for an accurate comparison. He noted that Alaska had massive geographical coverage with a very sparse population and an underdeveloped infrastructure. He thought it was difficult to compare Alaska to the original 13 colonies with no federal land but basically owned by the federal government.

Senator Wielechowski asked if the chart calculation for Alaska included appropriations for the Permanent Fund Dividend (PFD). Ms. Arduin suggested that since the chart referenced per capita state spending it likely did not include the appropriation. However, she would find out. She noted that the chart looked generally the same for every program that OMB looked at comparing Alaska to other states. Alaska, in general, outspent other states in most programs. Co-Chair Stedman requested more detail from OMB regarding the Kaiser Analysis. Senator Bishop concurred with Co-Chair Stedman.

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Ms. Arduin moved to slide 13, "Building the Budget: Streamlining the Fiscal Summary." She reported that OMB was streamlining the fiscal summary. She noted on the December 14th summary several lines were collapsed leaving revenues and appropriations and whether the state was in a deficit or surplus circumstance. In addition, in the governor's February 13th release, OMB would also be collapsing UGF with DGF resulting in one general fund category. She suggested that when the general funds were combined into one category there would be about \$4.2 billion in total general fund revenues rather than \$3.2 billion in UGF revenues available for spending. She also reported that in the coming budget, there would not be a deficit for FY 20.

Co-Chair Stedman encouraged OMB to keep all the general fund classifications in their fiscal summary. The Office of Management and Budget could comingle them in an easy statement like the one on the slide. However, he noted that it was nice to have the more detailed statement with footnotes to be able to compare OMB's fiscal analysis with that of the Legislative Finance Division (LFD). Going forward he would work with OMB on potential classifications between the two categories over the interim. The current timeframe did not allow for them to be clearly defined during session. He stressed that the finance committee had no intention of comingling the two fund groups. He thought the distinction should remain. The committee might target one general fund group for a full analysis, then the other - bifurcating the two and reassembling them later. Otherwise, he believed the complexity would reach a level that would make it difficult for legislators to understand what was occurring in the budget process. He would work with OMB on how they presented data to the committee. He also pointed out that in most private enterprises forecast revenues were placed on top and expenditures on the bottom. However, governments typically presented the information in the opposite order: Expenditures were on top and revenues were on the bottom.

Senator Micciche noted that earlier in the slide deck there was a focus on user fees. He cited an example with the University of Alaska. He asked for clarification regarding the delineation of user fee funds. Ms. Arduin replied that the point of highlighting the DGF expenditures as general fund expenditures along with everything else was so the public could see the expenditures more clearly. The budget would show everything that was coming in, everything Alaska was paying, and everything government was spending on the people's behalf.

Senator Wielechowski asked Ms. Arduin if she was looking into Alaska tax credits or deductions. Ms. Arduin replied that it was the administration's policy for expenditures to match statutory revenues which would be reflected in the budget being released on February 13th. The administration was not proposing to change any statutory revenues.

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Co-Chair Stedman referred to the previous question about combining the two general fund categories. Joining the

categories would provide a sense of the overall government spend. He relayed that for numerous years the administration had talked about DGF going down and operating budgets going down. In reality, they were both going up. He noted that most of the sound bites from the press reflected expenditures dropping. However, they were going up. He suggested that combining the categories would provide a clearer overall picture. He reemphasized the committee would be looking at the categories separately, then combined. He wanted to be able to fix the problem before the state ran out of cash.

9:46:08 AM

Senator Shower asked Ms. Arduin to review her philosophy about an UGF approach and why it was a flawed approach. Ms. Arduin echoed what the chairman iterated about being more transparent. She thought some games had been played in terms of moving funds back and forth to misrepresent the size of state spending in Alaska. In addition to being transparent, the administration believed that all revenues coming into the state treasury should be available for review and that some programs should not be treated differently than others. They should have their spending scrutinized from year-to-year to determine how money was being spent. She thought that all spending should be accounted for, rather than only UGF.

Senator Shower asked Ms. Arduin to elaborate on her experience. He wanted to assure the public that her approach had been successful in other states. Ms. Arduin clarified that she had never been asked whether she was planning to stay in Alaska, nor stated that she was not planning on staying in the state. She reported that other states had had tremendous success in working through budgets with the processes she was applying. In her experience, to attain a sustainable, predictable, and affordable budget, a policy driven approach was required. Programs were reviewed for efficiencies and prioritized. She emphasized that continuous review was necessary for success.

Co-Chair von Imhof returned to slide 5. She thought it was okay to combine UGF and DGF in reporting. She agreed that if UGF spending decreased it could be propped up with DGF. She drew attention to the examples of designated funds on the slide which included taxes and fees. The state might

have to increase user fees, or the University might have to increase tuition if it received less general fund dollars. She argued that, although it was fine to report UGF and DGF combined, it was important to be able to look at the numbers separately. She wanted the information to be available to the Senate Finance Committee when requested.

Co-Chair Stedman remarked that the legislature and the governor's administration were equal branches of government. The governor and OMB did not have dictatorial control over how the information would be handled. The legislature would be working with the Legislative Finance Division (LFD) and OMB to make sure there was a transparent result. He did not mind the OMB director combining the numbers in her presentations from time-to-time. However, the legislature could not manage the resources of the state without separating the numbers. He remarked that both columns should be watched. He commented that the press only looked at one column or the other. He continued that without providing a whole picture, the public would be left with a distorted picture.

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Co-Chair Stedman invited Mr. Teal to come to the table and to provide the committee some background information.

^LEGISLATIVE FINANCE - FY20 FISCAL OVERVIEW

[9:54:49 AM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, discussed his background. The primary role of the Legislative Finance Division was to assist the entire legislature in crafting a budget.

Co-Chair Stedman asked Mr. Teal the length of his tenure at LFD.

Mr. Teal responded approximately 20 years.

Mr. Teal discussed the presentation, "Overview of the Fiscal Summary and Alaska's Fiscal Situation" (copy on

file). He explained that the statutory deadline for the governor to submit a budget was December 15th of each year. For a sitting governor that was usually not a problem. However, an incoming governor, particularly one from a different party, had 2 weeks from the time of taking office to the deadline to prepare a budget. No one expected a new governor to submit a budget reflecting his policies and priorities in such a short amount of time. He continued that usually a place holder budget was submitted by the deadline and an amended budget followed. Currently, members had a place holder budget in front of them. He suggested that analyzing a place holder budget was possibly a waste of time. The chairman requested he discuss some alternative topics, specifically the fiscal summary with an emphasis on the find source classification. Secondly, he was asked to discuss the state's fiscal situation.

Mr. Teal looked at slide 2, "State of Alaska Fiscal Summary - FY 19 and FY 20 (Part 1)." He indicated that the fiscal summary was the budget on one page. It was the highest level of report LFD produced. The summary had a significant amount of numbers and information.

Mr. Teal turned to slide 3, "Short Fiscal Summary FY19 - FY20 UGF Only." He reported that LFD used a shorter version of the fiscal summary. Frequently the short fiscal summary was produced daily near the end of session because it gave the chairman a status check based on any suggested changes to the budget.

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Mr. Teal switched back to slide 2. He relayed that the longer version was produced twice per year - once when the governor submitted a budget and once the legislature finished its deliberations. It was also produced after the governor vetoed things. It was a reference document.

Mr. Teal continued that the most common question he received was why there were so many lines and columns. He responded that the summary provided detail including sub-allocations among the three main categories of expenditures. He reviewed the categories which included agency operations, statewide items, and the capital budget. Statewide items consisted of things that did not have to do with day-to-day government operations. They were expenditures that were difficult to avoid. He expressed

that there was a tremendous loss of information in a summary.

Mr. Teal spoke to the number of columns which accounted for FY 19 and FY 20. He highlighted the columns for FY 20. He noted the earlier discussion about consolidating UGF and DGF into a single column of general funds. He recalled that the OMB director thought it was more transparent to combine all general funds, as they were all green. He disagreed and presented an example for clarification. He suggested that if he was given a \$10 bill to purchase a bag of chips at the lounge, he would come back with a bag of chips. However, if he went down to the lounge with a \$10 Monopoly bill, he was not sure he would come back with a bag of chips. He equated DGF to Monopoly money - it was authorized to be spent. However, the authorization was worthless unless the receipts were collected to spend. He asserted that authorized money was not real money but could become real money. In other words, all appropriations, or authorizations, were not green.

Mr. Teal continued with his example. If he were to collect \$15 dollars, he would only be able to spend \$10, the authorized amount. He conveyed that UGF could be spent any time for any purpose. Whereas, designated funds could not be spent unless they were converted to receipts, such as university tuition, snow mobile trail receipts, and ticket sales for the Alaska Marine Highway System (AMHS). He furthered that DGF was money that, if collected, could be spent. The reason a separate category, DGF, was needed was to prevent games. He suggested that combining DGF and UGF into a single category had the opposite effect. He returned to Senator Micciche's example of university tuition. The University might have \$30 million DGF in surplus tuition authorization on its books. If the Senate Finance Committee were to cut \$30 million out of the budget, it would be cutting \$30 million in hollow authorization - uncollectable receipts. In other words, the committee would not be preventing the University from spending money, and it would not change the deficit. However, it would appear as if the committee reduced the budget by \$30 million. If the reports were combined it would reflect a \$30 million reduction. He explained that it would be very different if the legislature cut \$30 million in UGF.

Mr. Teal suggested that the subcommittees should be looking at the impact of any reduction. For example, it would be

helpful to look at whether a reduction would result in increased tuitions or the loss of grant monies without matching state funds. He indicated that the subcommittee should be asking questions to help their analysis of reductions. He believed a combined fund source made it more difficult to analyze. He favored simplifying things if it helped legislators make decisions but believed they would have an easier time making decisions if they understood the fund sources.

[10:08:47 AM](#)

Mr. Teal expounded that over-simplifying fund sources lead to unintended consequences. As an example, he cited the Pioneer Homes. There was a waiting list for rooms in the Pioneer Homes at the same time there were vacancies. The cause had to do with not understanding the difference between DGF and UGF.

Mr. Teal continued to address slide 2. The concept of spending being limited to the lessor of the authorization or what could be collected applied to the other state funds. International airport funds, the permanent fund operating budget, and retirement funds, for example, could not be used for anything other than the purpose for which they were dedicated. He discussed federal funds, which often had requirements attached and were only to be used for specific purposes. The legislature had very little discretion in spending federal funds. Other state funds were often dedicated monies.

[10:11:55 AM](#)

Mr. Teal reiterated that discretion was necessary with DGF - unlike UGF that could be spent anytime, for any purpose, for any amount. If the state could not spend more than it received in federal, other, or designated funds, it could not have a deficit in those fund categories. A deficit was only possible within UGF.

Mr. Teal asserted that the summary helped him to keep the numbers straight. He suggested that it was important for legislators to understand how the funds were used and for what purpose. Decisions would be easier and better during the subcommittee process. The long summary was produced in the overview LFD produced each year. He remarked that the summary was thin in the current year because there were no

narratives included for each agency. They could not be produced because the budget was not out. An introduction was included which discussed the state's fiscal situation.

Mr. Teal moved to slide 3: "Short Fiscal Summary FY 19 - FY 20 UGF Only". He indicated that the short summary was a good reference document. It could be used if the focus was to balance the budget. He highlighted that the short fiscal summary was only UGF, as it was the only fund category that could have a deficit. The slide conveyed that in FY 20 there was a deficit of \$1.6 billion. The deficit reflected two sides, expenditures and revenue. He recommended legislators asking whether the deficit problem had to do with revenues or expenditures and about how to tell the difference. He pointed out the traditional revenue, such as oil, was down by about \$400 million from FY 19 to FY 20. He explained that the reason for the revenue change was due to an expected change in oil price from \$68 per barrel in FY 19 to \$64 per barrel in FY 20. He thought it was safe to assume that future years would look like FY 20 in terms of traditional revenues. He wondered if expenditures were the root of the problem.

[10:16:00 AM](#)

Mr. Teal moved to the chart on slide 4, "Real Per Capita Unrestricted General Fund Revenue/Budget History." Adjustments had to be made when looking at an extended period. The chart went back to FY 76. He mentioned starting with the State of Alaska in 1978 making \$25,000 per year. Currently, he would not want to live on that amount. His point was that numbers had to be adjusted for inflation and a growing population. He reported that the state provided services to more than twice the number of people as in the 1970s.

Mr. Teal reported having shown the graph on slide 4 to a group of university students. They were surprised that expenditures had not increased as they expected. They concluded that the state was not spending any more presently than historically. He referenced a chart the OMB director had shown of the expenditures per capita in Alaska and in other states. He looked at his chart as a more valuable way of looking at expenditures.

Mr. Teal continued that expenditures had fallen in recent years, particularly in capital and statewide spending. If

the legislature was looking to fix the deficit, the capital budget (represented by the yellow bars) could not be cut much more than it had been. The [light] blue bars represented statewide expenses such as debt service which could not be reduced. The operating budget was often the focus of cuts and was represented by the dark blue bars.

Mr. Teal reported that the class could see the state's expenditures had fallen in recent years and that they were historically low. However, revenue per capita had fallen even faster below historic lows. The class concluded that the state did not have an expenditure problem but a revenue problem. They asked why the legislature was not doing something about revenue. His response to the students was that the legislature had responded. He noted he was finished with the slide and was open to questions.

Senator Wielechowski asked if the Permanent Fund Dividend (PFD) and inflation proofing included in the chart on slide 4. Mr. Teal responded that inflation was included but the PFDs were not. He explained that it was difficult to include because the fund source had changed over time and people's view of the PFD as a government expenditure was different currently than in the past.

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Senator Olson respected Mr. Teal's opinions based on his experience. He wondered if the students had any ideas about solving the state's fiscal crisis, especially around revenues. Mr. Teal replied that they did, but he would wait to respond. He was reluctant to talk about their conclusions which border on political statements.

Senator Olson had been looking at slide 2 and slide 3. He remarked that in studying the categories, the numbers were off by about \$1 billion. He noted other discrepancies and asked for clarification. Mr. Teal remarked that the PFD would not be in the fiscal summary, as it was neither a revenue or an expenditure [according to the administration]. The Legislative Finance Division showed the PFD as a revenue and an expenditure. It increased revenue by \$1.9 billion and increased expenditures by \$1.9 billion resulting in the same deficit of \$1.6 billion.

Co-Chair Stedman invited Mr. Teal to continue to slide 5.

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Mr. Teal returned to slide 3. He did not have anything to say about the expenditure line, as the legislature did not have a budget worth discussing yet. However, on the revenue side the dividends were listed. They were also listed on the expenditure side. The dividends plus the share for government totaled \$2.9 billion, about \$200 million more than the previous year. He noted the state was down about \$200 million in revenue after considering the percent of market value (POMV). He answered the question as to how the state went from a surplus of \$300 million to a surplus of \$1.6 billion. He highlighted the \$300 million deficit in FY 19 and added \$200 million in expenditures along with another \$200 million in revenue losses. The amount totaled \$700 million. He commented that \$700 million was much different than \$1.6 billion. He explained that for dividends, the state spent \$1 billion last year, and \$1.9 billion was proposed for the current year resulting in a reduction of \$900 million in revenue. He added \$900 million to \$700 million totaling \$1.6 billion.

Mr. Teal provided an explanation of the POMV. He elaborated that Senate Bill (SB) 26 [Legislation passed in 2018] set up the Permanent Fund endowment type of fund. However, it was not strictly an endowment fund because only the earnings from the earnings reserve account (ERA) could be spent. The principle of the Permanent Fund could not be touched. In a regular endowment, the principle could be used if needed and paid back over time. He suggested that there was no difference in the two models if the ERA contained money. However, a payout could not be made if the ERA ran out of money. The state's current model reflected a separation of principle from earnings. The legislature chose a sustainable payout rate of 5.25 percent in the first year and dropping to 5 percent after that. He suggested that without a POMV payment of \$2.9 billion, the state deficit would be higher by an additional \$1 billion. He detailed that out of the \$2.9 billion, \$1.9 billion went to PFDs with a net gain of \$1 billion into the general fund. He elaborated that SB 26 read that once the PFD payment was calculated the government received what was left. He concluded that without the POMV, the state deficit would be \$1 billion higher, and the state would be at a \$2.6 billion deficit, comparable to the previous several years. There was not a real change to the state's

circumstances other than using revenue from the Permanent Fund to reduce dividends.

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Senator Shower asked whether the numbers reflected inflation proofing and repayment back into the Constitutional Budget Reserve (CBR). Mr. Teal responded that inflation proofing was considered an intra fund transfer going from one account in the Permanent Fund to another account in the Permanent Fund. The Legislative Finance Division considered the transfer off budget. In other words, it was not considered an expense and was not treated as revenue. He responded to Senator Shower's question about repayment into the CBR. The numbers did not reflect a repayment of the CBR. He explained that the constitution required a repayment at the end of each year. The repayment occurred if there was any excess left in the general fund or subaccount in the form of a sweep into the CBR. He relayed that when the state had a deficit there was no money to be swept in the general fund. There were subaccounts in the general fund. Typically, the legislature followed the constitution and the money was swept. There was a provision in one of the appropriation bills that stated that the sweep was reversed placing money back into several sub funds in the general fund. He concluded that no money was going to the CBR and inflation proofing was not counted.

Co-Chair Stedman directed Mr. Teal to continue.

[10:30:13 AM](#)

Mr. Teal continued to discuss slide 3. He specified that given the sequence of events where dividends were paid out and the rest was kept for government expenditures, it was easy to recognize the importance of the split between dividends and the general fund. The split was critical to the state's fiscal situation. Every dollar paid as dividends was a dollar that did not wind up in the general fund as revenue. A dollar missing from general fund revenue was a dollar added to the deficit. He remarked that to be fair, the opposite was true: every dollar spent on government services was a dollar that could not be spent on dividends. He summarized that the competition between dividends and government services created a huge fiscal problem for legislators. The state would have a surplus of

\$300 million if dividends were not paid out at all. If \$1.9 million was paid out in dividends, there would be a deficit of \$1.6 billion for FY 20.

Mr. Teal continued that there were several people including some legislators that do not think much of having a deficit. The state has had deficits year-after-year with no apparent ill effects. He posed the question as to why everyone was suddenly so concerned about deficits. He suggested that the fiscal impacts of deficits had been hidden by the legislature's ability to draw money from the CBR. The Constitutional Budget Reserve started out with about \$15 billion. The effect of year-after-year deficits had drained the fund down to about \$2 billion. He feared that people did not understand that deficits were a significant problem, because the state no longer had reserves. Budgets would have to balance because they could no longer be filled with savings.

Mr. Teal queried about being out of reserves. The Constitutional Budget Reserve account had an approximate balance of \$2 billion. The amount was just enough to cover PFDs but not enough to fill a deficit if the state did not have a POMV payout. Legislators could opt to use the CBR to fill the deficit one more year. However, the Constitutional Budget Reserve would no longer be a shock absorber. Revenue could fall by several hundred million dollars with a drop in oil prices. In such circumstances, most states would have to call a special session to address such a change in revenue. They would have to revisit the subcommittee process looking for areas to make cuts. Alaska's CBR allowed the legislature to fill the deficit without reconvening. He thought the account was a necessary shock absorber given the volatility of state revenues.

Mr. Teal continued that the revenue stream had become significantly less volatile with a POMV payout. He noted that more money was available with a POMV payout than the traditional structured payout as seen on slide 3. The state received more money from the POMV payout of \$2.9 billion than it received from oil revenues [in FY 20]. The percent of market value payout was determined in advance and was a known number providing more confidence in a revenue stream.

Mr. Teal suggested that the ERA could also be viewed as a source of reserves. Both chairs were on record that they did not intend to have the ERA go the way of the CBR

account being used in a period of 5 years - going from \$15 billion down to \$2 billion.

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Mr. Teal continued that his interpretation of the remarks of the co-chairs was that the ERA would not be available to fill deficits. He explained that drawing more than the sustainable amount was the equivalent of eating a seed corn. The fewer kernels available to plant, the lower the harvest would be. Taking money beyond the planned draw would reduce the seed corn or principle. He continued that with a lower market value of the Permanent Fund, the lower the earnings would be. Lower earnings would lead to lower dividend payments, a lower balance, and a lower payout from the POMV. As the payouts declined, without lowering expenditures, the deficits would increase. Larger deficits would lead to unplanned draws in the following year to fill the deficits. He thought the legislature would end up in a death spiral.

Mr. Teal explained that although it seemed like it would take a long time to use the ERA, it did not. The model by LFD showed that the ERA would be empty by FY 28. The danger of having an empty ERA would result in no dividends and no payout for services. He furthered that without a payout additional cuts would have to be made in the amount of approximately \$2 billion. He reiterated that without reserves only the 2 standard deficit filling tools would be available - raising revenues or cutting expenditures. Taxes were not currently an option. Therefore, cutting \$1.6 billion in expenditures from the budget appeared to be the next course.

[10:39:32 AM](#)

Mr. Teal discussed slide 5, "Balancing the FY 20 Budget by Reducing Expenditure Items (Small to Large)." The slide provided some perspective on the size of a \$1.6 billion reduction. He pointed to the blue bars on the graph which represented Governor Walker's budget containing a \$1.6 billion deficit. If the legislature were to fill the deficit by eliminating all general funds in the smallest expenditure items including PFDs, statewide items, agency items, and capital items, UGF would be eliminated in all the agencies. He reported that when the university students looked at the chart, they were surprised to find out that

the state spent 37 percent of its revenues for PFDs. The payout of dividends was the largest expenditure the state had and far outweighed what the state spent on education. The students commented that the legislature thought dividends were more important than education. He continued to discuss the student's comments about dividend payouts compared to education and other state services.

Mr. Teal reported being curious about the governor's budget proposal in terms of dividends, services, and revenues. He reiterated that the legislature would have to make policy decisions and LFD could provide information, including his model, that could be used to help with the process. The Legislative Finance Division was available to help with the normal analysis subcommittee work as the legislature moved through the budget process. He hoped the legislature would have a short and productive session.

Co-Chair Stedman thanked Mr. Teal for his presentation. The committee would invite LFD back after the governor's budget was released. He reviewed the agenda for the following day.

ADJOURNMENT

[10:45:12 AM](#)

The meeting was adjourned at 10:45 a.m.