HOUSE FINANCE COMMITTEE
January 27, 2022
1:38 p.m.

1:38:09 PM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 1:38 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Kelly Merrick, Co-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Bryce Edgmon
Representative DeLena Johnson
Representative Andy Josephson
Representative Bart LeBon
Representative Sara Rasmussen (via teleconference)
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

None

ALSO PRESENT

Brodie Anderson, Staff, Representative Neal Foster; Connor Bell, Fiscal Analyst, Legislative Finance Division.

PRESENT VIA TELECONFERENCE

Alexei Painter, Director, Legislative Finance Division

SUMMARY

HB 281 APPROP: OPERATING BUDGET/LOANS/FUNDS

HB 281 was HEARD and HELD in committee for further consideration.

HB 282 APPROP: MENTAL HEALTH BUDGET

HB 282 was HEARD and HELD in committee for further consideration.

PRESENTATION: LEGISLATIVE FINANCE DIVISION BASELINE and GOVERNOR'S 10-YEAR PLAN

1:38:29 PM

Co-Chair Foster reviewed the meeting agenda.

#hb281
#hb282
HOUSE BILL NO. 281

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

HOUSE BILL NO. 282

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

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Co-Chair Foster explained that the committee substitute (CS) represented the governor's proposed budget which removed the federal American Rescue Plan Act (ARPA) funding and replaced it with undesignated general funds (UGF). He detailed the reasoning for the change. It was important to strive to match recurring expenses with recurring revenue rather than with one-time revenue. He believed the action took a more conservative view of the budget to show the deficit, which would put pressure on the legislature to refrain from proposing additional expenses within the budget.

Co-Chair Merrick MOVED to ADOPT the proposed committee substitute for HB 281, Work Draft 32-GH2686\W (Marx, 1/27/22).

Co-Chair Foster OBJECTED for discussion.

BRODIE ANDERSON, STAFF, REPRESENTATIVE NEAL FOSTER, explained the CS, which he characterized as more of a process than a finished product. Alaska had received billions of dollars in federal aid through programs such as the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA), ARPA, and eventually would receive funds through the Infrastructure Investment and Jobs Act (IIJA). When the governor delivered his FY 23 budget, it was a finished product that reflected both his priorities and the designation of funds. Mr. Anderson thought that the legislature should take a similarly calculated approach. He suggested that the legislature examine and prioritize spending, then discuss the utilization of the available federal funds. In order to take the approach, the budget needed to be rolled back to a baseline starting point. The CS proposed the replacement of federal funds with UGF for spending. The changes included the following: an increase of $522.2 million spending of regular UGF, a decrease of $82 million of federal funds that would later become known as IIJA, a decrease of $21 million of CARES funding, a decrease of $560.7 million of CRRSAA funding, and a decrease of $44.4 million of Coronavirus State and Local Fiscal Recovery Funds (CSLFRF).

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Co-Chair Foster asked if Mr. Anderson was referring to a particular handout.

Mr. Anderson answered that he was referring to his opening statements but would be happy to move on to discuss document 1, "Changes from Gov to House Baselines CS" (copy on file).

Co-Chair Foster asked if there were more changes that Mr. Anderson wanted to convey in his opening statements. He assumed that the changes were outlined in document 1.

Mr. Anderson responded that the remainder of his opening statements were reflected in document 1.

Co-Chair Foster suggested that Mr. Anderson finish his opening statements.

Mr. Anderson continued that there was a decrease of $375 million of ARPA funding, which was spent in a similar manner as UGF. He noted the decrease explained why UGF funding in document 1 appeared to be so substantial. Also, a $7 million appropriation was removed for Alaska Seafood Marketing Institute (ASMI) in cooperation with the Office of Management and Budget (OMB). Finally, $5 million of UGF was added for the purpose of rate smoothing to match the previous year's budget structure. The net result of the changes was an increase in UGF of $146.8 million and a decrease of $148.8 million in combined federal funds, which reflected a $2 million cut from all funds.

Mr. Anderson suggested that he review document 1, which had been prepared by the Legislative Finance Division (LFD) and Co-Chair Foster's office.

Co-Chair Foster asked for a summary of the net result of the changes. He asked for verification that the budget would reflect a deficit of $300 million if ARPA funds were not utilized.

Mr. Anderson replied that LFD would be better suited to answer the question. He noted that LFD's fiscal summary indicated there would be a deficit of just over $350 million.

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Co-Chair Foster stated that the overall picture would show two numbers: $375 million as revenue replacement for ARPA and a little over $500 million to cover the other functions of ARPA funds. He relayed that the subtleties would be explained later in the meeting. He reiterated that ARPA funds had to be used, and he did not want to give the impression that ARPA funds were being replaced with UGF. The intent was to emphasize that ARPA was a one-time funding source and should not be factored into the budget as a reliable funding source. The funds should encourage the legislature to be fiscally conservative.

Mr. Anderson returned to document 1. He explained that the first column referred to the item numbers, the following six columns referred to the fund source codes, the next column referred to the net impact, and the final column showed the location of the item within the bill. The first item was revenue replacement which involved an increase of $375.4 million in UGF. The second item was ASMI, which experienced a $7 million decrease due to overextended spending. The next item was the Department of Correction's (DOC) DNA collection, which had previously been funded through CSLFRF and had been shifted back to UGF. The following item, the Department of Labor and Workforce Development's (DLWD) workforce training, was also moved from CSLFRF to UGF. Following that, the Department of Public Safety's (DPS) Victims of Crimes Act (VOCA) had also been moved from CSLFRF to UGF. He rolled the following three University of Alaska items together: $10 million for drones, $5 million for heavy oil, and $7.8 million for minerals switched from CSLFRF to UGF.

Mr. Anderson continued to address the next item, which reflected an addition of $5 million in UGF for rate smoothing to allow for rate changes and charges. The following two items were the Alaska Marine Highway System's (AMHS) funds for calendar year (CY) 22 and the actual AMHS increase. Both were currently funded through federal funds but would potentially qualify for IIJA funds designated for ferry systems. Both of the AMHS items had been switched to UGF. Finally, the Department of Transportation and Public Facilities (DOT) and other COVID-19 fund source items were moved to UGF, totaling $21.8 million in actual COVID relief and $560,000 in federal highway and CRRSAA funds. The handout concluded that there was an increase of $522.2 million in UGF that had been added to the budget to establish the true baseline. At a later date, the committee would have a conversation about the redistribution of CRRSAA and ARPA funds that had become available through switching items to UGF.

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Mr. Anderson reviewed the net result of the changes in the summary at the bottom of document 1. He noted that there was an increase of $146.8 million of UGF, a federal decrease of $148.8 million, and an actual reduction of $2 million in all funds in the governor's budget.

Co-Chair Foster emphasized that the governor had already made his decision as to how he would like to spend the federal ARPA and CSLFRF dollars. He suggested that the committee would also determine how it would like to spend the funds.

Vice-Chair Ortiz asked for more details on the rate smoothing process.

Mr. Anderson answered that OMB and the Department of Administration (DOA) worked with other departments to standardize rates and charges. Through the process, there could be fluctuations that were not been accounted for, and rate smoothing held both harmless and the process was worked through. Rate smoothing had been approved in 2021 and the process was continuing on in 2022.

Vice-Chair Ortiz stated his understanding that rate smoothing allowed for an amount of money to be set aside and made available to address any potential shortfalls.

Mr. Anderson responded in the affirmative.

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Representative Edgmon supported the process of switching out the federal funds and building the budget back up from the baseline. He understood that some of the funds would not been available to the state until federal guidelines were received.

Mr. Anderson answered that Mr. Alexei Painter from LFD would likely have a better explanation. He clarified that the second column on document 1 detailed the IIJA investment. He was not sure what the federal guidelines would be.

Representative Edgmon suggested that the state might not receive the federal funds and would need to account for the funds in another way.

Representative Carpenter commented that it was always exciting to see how the legislature rolled out the budget because it was never the same. He asked if there was a way to explain the fund codes at the top of the handout to make the conversation more accessible to the public.

Mr. Anderson answered that most of the time, the budget spending was referred to as general funds, federal funds, other, and designated general funds (DGF). At a more minute level, the four fund categories each fell into specific fund sources. For example, federal funds were provided by federal departments and would be designated a fund source code. He suggested that representatives from LFD could offer a more detailed explanation.

Co-Chair Foster asked if Mr. Anderson knew the breakdown within the columns on the handout.

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Mr. Anderson clarified that the first column with the fund source code 1004 relating to UGF was the main designated fund. He added that 1002 was the general federal fund code at the moment because an IIJA fund source code had not yet been established. He explained that the 1265 federal code related to CARES funding and 1270 represented federal funding through CRRSAA. He continued that 1269 and 1271 were applicable to ARPA and CSLFRF, and 1271 was revenue replacement specifically attached to authorization given by ARPA to replace lost revenue due to the pandemic.

Co-Chair Foster clarified that IIJA was the federal infrastructure funds that were forthcoming to the state. He understood that CRRSAA funds were mainly applicable to the transportation sector.

Mr. Anderson nodded in agreement.

Co-Chair Foster added that CSLFRF referred to discretionary money.

Representative Carpenter asked why more details were not yet known about IIJA. He wondered if it was because the federal agency had not yet given the information to the state or if the federal agency itself did not know the information.

Mr. Anderson answered that he was working with OMB to craft a presentation that would specifically explain IIJA and other COVID relief funds. He relayed that the IIJA bill had been passed and signed, but the federal agencies were still working through guidelines and regulations.

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Representative Josephson shared that he had been a student of the governor's vetoes and had authored an op-ed on the subject. He thought it was a great exercise in showcasing the difference between recurring need and recurring revenue. He was concerned about the three UA items: drones, heavy oil, and minerals. He expected that the items would be vetoed by the governor if they remained funded by UGF, based on past practices.

Co-Chair Foster thought that it was possible that the committee would fund the three items the same way the governor funded the items. He thought it required a mindset shift to refrain from adding any significant expenses to the budget if it appeared there was a small surplus.

Representative Thompson thanked Mr. Anderson for explaining some of the fund codes so that members of the public could understand. He thought it would be helpful to list the definitions of the codes in the documents themselves because it could be confusing considering the vast number of COVID related federal funds.

Mr. Anderson replied that he would work with LFD to accommodate the request.

Representative Wool referred to the revenue replacement line item in the far left column on document 1 and understood that it referred to leftover ARPA money. He thought that the $375 million UGF revenue replacement was specifically intended for the operating budget, and it was a misnomer to use UGF for revenue replacement. He thought the UGF total of $146 million in the summary at the bottom of the document made sense if the $375 million fund was not included.

Mr. Anderson agreed that the revenue replacement was part of ARPA and noted that in 2021, there had been a conversation about splitting the amount into $500 million for FY 22 and $500 million for FY 23. After the spending that occurred in FY 22, $504 million was left on the table. The governor's budget had exhausted the usage of the $504 million, which included $375 million in revenue replacement. By excluding the $375 million, there could be a full conversation on how much of the monies to use in revenue replacement.

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Representative Wool asked for clarification on whether the funds would expire if not used by a certain date.

Mr. Anderson believed the funds would be available through FY 24.

Representative Wool understood there was $5 million allocation for rate smoothing and a $7 million cut to ASMI. He asked for verification that ASMI would not receive the funding.

Mr. Anderson confirmed that the ASMI funding was intended to be a one-time item that was a residual holdover.

Representative Johnson asked if it was fair to say that the governor's hybrid budget followed the legislature's lead from the previous year.

Mr. Anderson agreed that the governor followed the same revenue replacement strategy that the legislature had proposed.

Representative Johnson was concerned that the numbers for the FY 22 management plan were not accurate unless the COVID money was removed.

Mr. Anderson deferred to LFD.

Co-Chair Foster referred to document 2 (copy on file) showing the FY 22 management plan. He asked if Representative Johnson was referring to column 1 of the handout which showed a deficit of $392 million.

Representative Johnson responded in the affirmative. She understood that any figures in column 1 would need COVID related funds to be removed to be accurate.

Co-Chair Foster believed the federal ARPA funds had already been backed out of the numbers.

Mr. Anderson clarified that document 2 was a comparison of all funds and document 3 (copy on file) was a comparison of UGF only. The only real change of all funds in document 2 was a $2 million decrement at the bottom of the first page and in the middle of the second page. He explained that document 3 showed the UGF comparison and showed an increase of $146.8 million. The reason for the increase was because the revenue replacement fund source code had been labeled as UGF. He suggested that Mr. Alexei Painter from LFD offer more detail.

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Co-Chair Foster corrected himself and thought he might have been confusing FY 22 and FY 23. He deferred to Mr. Painter.

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION (via teleconference), answered that because the changes were UGF to UGF, the year to year budgets were comparable because all of the revenue replacement was still UGF. The totals would not change; the only change would be the deficit number.

Representative Johnson asked for verification that the FY 22 and FY 23 management plans would compare directly. She asked if the plan would need to have the federal money backed out to be comparable.

Mr. Painter answered that the revenue replacement items would all show as UGF to avoid year to year distortions in the budget and would be comparable from year to year. He relayed that it was a deliberate strategy crafted by LFD and OMB. There was also a tracking code for OMB to report the revenue replacement use to the federal government and many multiyear items in the previous year's supplemental. The only ongoing item between FY 22 and FY 23 using COVID related funds was DOC's DNA collections piece. Other than that, the items were one-time uses year to year.

Representative Johnson thought she would need further clarification offline.

Representative Josephson stated that part of the revenue replacement from the previous year had to be defensible as replacement for lost local revenue. He asked if the circumstance was the same in the current year.

Mr. Anderson deferred to Mr. Painter.

Mr. Painter replied that the revenue replacement calculation executed by the Department of Revenue (DOR) had been performed in accordance with federal guidance. He elaborated that substantial lost revenue was demonstrated in FY 20 and FY 21. The monies could be implemented as revenue replacement during the qualifying period which was through the end of CY 24.

Representative Josephson asked for verification that it would not be necessary to prove up the lost revenue for each category. For example, oil prices were currently up but the prices had been down as a result of the original shock of the pandemic.

Mr. Painter responded in the affirmative. The state would be permitted to use the entire available amount of the COVID related relief funds for revenue replacement because there was significant lost revenue in 2020 and 2021. The revenue replacement funds were not required to be used in the same year in which the revenue was lost.

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Representative Thompson referenced the three UA items in document 1: drones, heavy oil, and minerals. He asked if the items would be better suited for the capital budget.

Mr. Painter replied that Representative Thompson had a great point. He agreed that the three items were more traditionally considered capital items. The fund source of CSLFRF was only available through December of 2024 and it was a multiyear item that would expire around that time. However, he agreed it should really be a capital budget item, especially if it became an item funded by UGF. He relayed that LFD would encourage moving the UA items to the capital budget.

Co-Chair Foster asked if Mr. Anderson had completed his presentation.

Mr. Anderson responded that he was finished.

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RECONVENED

Co-Chair Foster asked if Representative Rasmussen was online. It was unclear whether she still was online. He reminded members that there had been a motion to adopt the CS.

Co-Chair Foster WITHDREW his OBJECTION to the adoption of the CS.

Representative Carpenter OBJECTED in order to get a statement on the record. He thought that jumping from one budget method to another method from year to year was confusing. He would have to spend a good amount of time learning about the process and thought the change would require additional explanation to the public.

Co-Chair Foster thought Representative Carpenter had a good point. The budget process had always been an ongoing debate and change added another wrinkle to the process.

Vice-Chair Ortiz commented that the fluctuation was due to the changes in federal funds. He stated that until recently, the legislature had not had to deal with dramatic changes due to the pandemic. He thought that procedural changes were a result of the current circumstances. He did not believe the fluctuations would continue after the federal funds expired and there would be more predictability.

Co-Chair Foster agreed. He stated that his goal was to put downward pressure on spending, which he believed would be accomplished by the CS.

There being NO further OBJECTION, CSHB 218, Work Draft 32-GH2686\W (Marx, 1/27/22) was ADOPTED.

^PRESENTATION: LEGISLATIVE FINANCE DIVISION BASELINE and GOVERNOR'S 10-YEAR PLAN

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ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION (via teleconference), provided a PowerPoint presentation titled "Comparison of Governor's 10-Year Plan to LFD Baseline," dated January 27, 2022 (copy on file). He began on slide 2 and provided an outline of his presentation. He turned to slide 3 and offered a review of LFD's modeling baseline as follows:

- Legislative Finance’s fiscal model is designed to show policy makers the longer-term impact of fiscal policy decisions.
- The baseline assumptions are essentially that current budget levels are maintained, adjusted for inflation. Policy changes are then applied against that baseline.
- Our default is to assume that statutory formulas will be followed.

Mr. Painter turned to slide 4 and reviewed LFD's revenue assumptions as follows:

- LFD’s baseline revenue assumptions are the Department of Revenue’s Fall Revenue Forecast.
  - This assumes $71 oil in FY23, following futures market thereafter.
- DNR oil production forecast projects that Alaska North Slope production will increase from 500.2 thousand barrels per day in FY23 to 586.2 thousand barrels per day in FY31.
- For the Permanent Fund, we use Callan’s return assumption of 5.86% total return in FY22 and 6.20% thereafter.

Mr. Painter moved to slide 5 and reviewed LFD spending assumptions as follows:

- For agency operations, these scenarios assume the Governor’s FY23 budget grows with inflation (2.0%).
- For statewide items, the baseline assumes that all items are funded to their statutory levels beyond FY23.
  - This includes School Debt Reimbursement, the REAA Fund, Community Assistance, oil and gas tax credits.
- For the capital budget, we assume the Governor’s FY23 capital budget grows with inflation (2.0%)
- For supplementals we assume $50.0 million per year. This is based on the average amount of supplemental appropriations minus lapsing funds each year

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Mr. Painter highlighted the LFD modeling baseline on slide 6. He explained the modeling showed a deficit of $1.4 billion in FY 23, which would quickly go through the Constitutional Budget Reserve (CBR). The deficit would require additional draws from the Earnings Reserve Account (ERA) in order to reach budget levels based on the statutory dividend.

Mr. Painter moved to slide 7 and addressed the policy changes in the governor's 10-year plan as follows:

- PFD is 50% of POMV, including an FY22 supplemental;
- Agency operations are held flat in FY24, then grow at 1.5% for all items except Medicaid, which grows at 1.0%;
- Beginning in FY24, School Debt Reimbursement is funded at 50%, and the REAA Fund Cap is reduced to a flat $17.5 million;
- PERS and TRS health care contributions are not funded;
- The capital budget is held flat with no inflationary growth, but a General Obligation Bond issued in FY23 increases debt service by $22.8 million in FY24 and beyond;
- Supplementals and lapse are assumed to cancel out; and
- Governor uses $375.4 million of ARPA revenue replacement in FY23.

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Representative Josephson shared that he was the author of HB 55 in its original form, which was a defined benefits bill that informed future tiers that special health insurance would not be provided due to its costliness. He did not understand the governor's thought process because it seemed to indicate that retirees would not need additional health care funding for the next decade. He asked if he was understanding the fourth bullet on slide 7 correctly.

Mr. Painter answered that when unfunded liability was first opened up, there were two funds: a pension fund and a health care fund. The additional state contribution implemented in FY 14 was distributed to both funds based on the fund ratio at the time. Since then, AlaskaCare had held its costs significantly below the actuarial expectations from FY 14. There was an increase to the AlaskaCare rate in the current year for the first time in recent history through a number of cost saving measures. The actuarial analysis found that the health care contribution fund was funded at greater than a 100 percent ratio even if additional state contributions were not provided. Part of the reason for cautionary action by the Alaska Retirement Management Board (ARMB) was that the situation could change, and the board wanted to take it a year at a time. The system was fully funded and there was no need to continue funding the healthcare portion. He noted that the pension side was still underfunded, but the fourth bullet related specifically to the health care fund.

Representative Josephson relayed that he had confidence in Mr. Painter and did not doubt to his statement. However, he thought the choice to not fund health care was counterintuitive considering there had been so many conversations about the rising costs of health care.

Representative Carpenter stated that maybe the adequate funding of heath care was evidence that the arguments in the past were not accurate.

Mr. Painter advanced to slide 8 and provided a comparison of the LFD model to the governor's model as follows:

- Other than policy choices, there is only one substantive difference in assumptions:
  - LFD adopted an assumption from the Fiscal Plan Working Group that School Bond Debt Reimbursement will begin to add new debt after the current moratorium expires. This slightly increases the baseline for both School Debt and the REAA Fund.
- Other differences are due to rounding and presentation differences (for example, OMB includes fund transfers with statewide items, LFD separates them).
- We also have slightly different CBR starting balances – LFD will not update last year’s estimates until audited numbers are available, OMB has slightly higher estimates based on pre-audit actuals.

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Representative Carpenter suggested that it was important to keep in mind all the assumptions that came from the fiscal policy working group. He did not think it was the intention of the legislature to cherry pick from the working group's recommendations, but to instead look at the comprehensive plan.

Mr. Painter continued to slide 9, which showed a comparison of the governor’s 10-year plan to the LFD baseline. The main difference in FY 23 was the supplemental assumption. There was about a $200 billion difference in FY 24 due to the flat budget proposed by the governor that did not include inflationary growth. In the following years, the amount compounded and there was a slower growth rate. By FY 31, the policy changes proposed by the governor resulted in a budget that was about $400 billion less than LFD's baseline. He highlighted that in LFD's baseline, there was a drop in the budget between FY 25 and FY 26 due to oil and gas tax credits being paid off in FY 26 and resulted in a significant decrease in the budget.

Mr. Painter moved to slide 10 and discussed the difference in agency operations between the governor's 10-year plan and the LFD baseline. He noted that although the differences between the two seemed small, the amounts compounded quickly over time. For example, the $80 million difference in FY 24 became a $270 million difference by FY 31. It was surprisingly powerful over time.

Mr. Painter moved to slide 11 which compared the statewide items to the governor's 10-year plan and the LFD baseline. He pointed out that there was a slight difference in debt service reflected by the school debt amount and a significant difference in retirement due to the assumption that health care would not be funded. He summarized that the difference between the governor's 10-year plan and the LFD baseline in terms of statewide items was in the realm of $40 million to $70 million per year.

Mr. Painter advanced to slide 12 and discussed the LFD modeling baseline chart, which modeled the switch from the statutory dividend to the 50 percent of market value (POMV) draw. The proposed switch would result in a $400 million deficit in FY 23 if there were no other policy changes. The deficit would grow to about $484 million in FY 24 and would shrink down to $312 million in FY 31 and would be persistent if the governor's other policy changes were not also implemented. The dividend change alone was not enough to close the deficit in the model.

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Mr. Painter addressed the governor's 10-year plan in the LFD model on slide 13. He relayed that the numbers were close to what was shown by the governor's plan itself. There were significant deficits from FY 23 through FY 25, but the deficit began to shrink in FY 26. He relayed that LFD agreed with the governor's analysis that the deficit would be closed if all of the proposed policy changes were implemented.

Representative Josephson asked if Mr. Painter could reiterate what all of the policy changes were.

Mr. Painter responded that the changes were the items listed on slide 7. The most material components were the proposed year of no budget growth and the partial funding of numerous statewide items.

Representative Josephson stated that in a recent House Ways and Means Committee meeting, the Alaska State Hospital and Nursing Home Association (ASHNHA) shared that it did not agree that a one percent growth rate for Medicaid was sustainable. In the same meeting, school board organizations reported that the base student allocation (BSA) real spending was down significantly, and every department was experiencing massive turnover. He thought it was important to keep the information in mind.

Representative Edgmon stated he had the same concern as Representative Josephson. He thought the actual budget process was complex and the proposed policy changes were not inclusive of the complexities. He argued that there were other perspectives that should be considered. He understood the intent was to compare a 50/50 permanent fund dividend (PFD) with a full PFD, but he thought the real world would likely intervene in the plan and it would not play out as projected. There were many variables that had not been considered, and costs for things like Medicaid and education could increase dramatically.

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Representative Carpenter appreciated the first bullet point on slide 7 and argued that a 50 percent of POMV draw was outlined in statute. The real question was how the income should be determined. He thought that using a 50 percent of POMV draw and using 21 percent of net earnings were equally legitimate strategies according to the law.

Representative LeBon pointed out that 50 percent of POMV was not current law.

Representative Carpenter understood that the projections in the graph on slide 13 were following the projections for growth of the Permanent Fund and its earnings as well as the fall forecast for oil and gas revenue.

Mr. Painter responded in the affirmative.

Mr. Painter advanced to slide 14 and addressed whether the baseline should be higher:

- Several ongoing items in the Governor's budget are funded with short-term federal funds:
  - DOC's DNA Tracking program: $1.1 million CSLFRF (need to be replaced in FY24)
  – AMHS: ~$82.0 million in place of UGF from federal infrastructure bill (need to be replaced in FY27)
  – DOTPF: $22.4 million of FHWA and FAA funds (need to be replaced in FY24/25)
- In addition, the ARM Board decision not to fund retiree health care is backed out in LFD's baseline only for the statewide item. It would also have about a $15.9 million UGF impact on agency budgets.

Mr. Painter moved to slide 15 to discuss some additional items that should be considered, such as raising the baseline. The modeling showed what might happen when one-time federal funds were replaced with UGF. Altogether, the effected items would cause an increase of $39 million in the next couple of years and a $120 million increase in the long-term. If growth rate was accounted for, the difference between the governor's budget and the baseline would be increased. There was a minor difference in the first few years, but by FY 31 there was an over $500 million difference between the governor's budget and the LFD baseline. If the legislature felt the growth rate of inflation was insufficient, he suggested that members might support a policy change in the opposite direction of the governor's proposal.

Representative Josephson asked for verification that the assumption did not address any fiscal notes of legislation that had not yet passed, such as the Alaska Reads Act.

Mr. Painter responded that the governor's 10-year plan did not account for legislation that had not yet passed.

Representative Josephson acknowledged that although most bills did not pass, there were hundreds of bills. It was impossible to know which bills would pass in the current year, and it was even less possible to know which bills would pass in future years.

Mr. Painter responded in the affirmative and stated that it would be based on policy changes. He relayed that the governor had incorporated policy changes into his baseline in past years, but he had not in the current year. He encouraged the legislature to include any desired policy changes into its projections going forward.

Representative Josephson thought the suggestion was fair.

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Vice-Chair Ortiz asked about the origin of the $82 million Alaska Marine Highway System (AMHS) funding. He wondered what would happen to the funding once the federal money had been implemented.

Mr. Painter replied that the $82 million figure represented two other figures combined. In FY 22, the UGF amount that was distributed to AMHS only represented one year even though it actually funded one and a half years. The funding amount included 18-months' worth of other changes totaling $59.4 million. The governor was also proposing a service increase that would grow the budget by $22.6 million, which brought the number to $82 million. The $82 million figure represented the service level proposed in the governor's budget and not the current service level, which was slightly lower.

Vice-Chair Ortiz thought that AMHS had been funded at about $140 million in FY 15.

Mr. Painter did not know the numbers off hand.

Vice-Chair Ortiz emphasized that although it was a service increase as compared to recent years, the service was much lower than it had been in FY 15 and the years prior.

Mr. Painter turned to slide 16 and noted that the committee had heard a presentation from Callan Associates earlier in the week. He recalled that Callan had done some probabilistic modeling of the Permanent Fund for the Alaska Permanent Fund Corporation (APFC). He explained that DOR used to run similar modeling, and he wanted LFD to have a similar tool. The next portion of the presentation would offer a few scenarios to demonstrate the capabilities of the modeling.

CONNOR BELL, FISCAL ANALYST, LEGISLATIVE FINANCE DIVISION, spoke to slide 16. He explained that Callan had a more elaborate model than LFD, but LFD's model was more comprehensive. He paraphrased the slide as follows:

- LFD developed a probabilistic model to enhance our modeling capability. Unlike the Callan model, it is a complete fiscal model with the budget and revenue as well as the Permanent Fund.
  - Results for Permanent Fund scenarios are similar to what Callan's model produces.
- Runs 2,000 scenarios with varying assumptions for Permanent Fund earnings, oil prices, and oil production.
- Assumes LFD baseline budget, with only PFD amount changing by scenario.
- APFC 6.2% average return with 13.2% annualized standard deviation.
- Average oil price equals DOR's fall forecast. Applies standard deviation equal to 34% of a given year's average price.
- LFD can run additional scenarios as requested by legislators and staff.

Mr. Bell added that LFD's modeling held inflation constant. The LFD model differed in some ways from Callan, such as assuming that there would be no inflation proofing until FY 25. He explained that LFD would be happy to run any scenarios under the models and provide the results to legislators.

3:02:29 PM

Mr. Bell advanced to slide 17 and discussed a chart showing a stress test for a statutory PFD. The vertical black bar ranged from the tenth percentile to the ninetieth percentile of the expected outcomes. He highlighted that the difference between a $20 oil price and $30 oil price did not reflect a similar difference in overall revenue, while the difference between an $80 oil price and $90 oil price had a significant impact on revenue. Under the statutory PFD, the median deficit was about $1 billion to $1.5 billion per year. However, deficits of $2.5 billion or surpluses up to $5 billion were also possible. The likelihood of the deficit being above $2.5 billion in FY 23 was about 10 percent.

Representative Carpenter clarified that the statutory PFD referred to 21 percent of net earnings and 50 percent of the determination of the dollar figure of the dividend.

Mr. Bell answered in the affirmative.

Mr. Bell moved to slide 18 and explained that the chart on the slide was the same as the one on slide 17, but with a PFD equal to 50 percent of POMV. The chart represented the governor's budget proposal. The median deficit was around $300 million to $500 million, and surpluses ranged from $4 billion to $6 billion.

Mr. Bell advanced to slide 19, which was similar to the previous two charts but with a $1,100 per person PFD. The chart showed a $500 million to $1 billion surplus and up to $700 million in deficits. There were a huge range of outcomes, many of which were particularly dependent upon the price of oil and production. There could be substantial payouts or small payouts of the dividend.

Mr. Bell reviewed slide 20 and discussed the probability of an ERA shortfall by PFD scenario. Between FY 23 and FY 25, an ERA shortfall would not be possible in any modeled scenario. Currently, there was a healthy balance of unrealized gains in ERA that would be realized in the next few years and increase ERA. The possibility of shortfalls increased in FY 26, and by FY 31 there was almost a 30 percent chance of overdraw under the statutory PFD scenario, a 23 percent chance under the 50/50 PFD scenario, and an 18 percent chance under the $1,100 per person scenario.

3:08:09 PM

Representative Josephson asked Mr. Bell if an ERA shortfall meant depletion of ERA in full.

Mr. Bell responded in the affirmative. He clarified that a shortfall would mean the ERA balance was zero and all of the money in the Permanent Fund was in the principal.

Representative Carpenter noted that gross domestic product (GDP) might be a measure of the health of an economy. He asked what sort of growth was assumed under the listed scenarios.

Mr. Bell responded that GDP was not accounted for in the specific modeling. The most significant factor was oil prices.

Representative Carpenter commented that most Alaskans did not work in the oil industry. He asked what would happen if there was a two percent increase in GDP in the next decade that reflected an increase in state spending.

Mr. Bell responded that LFD would be happy to provide an analysis that assumed that budgets grew at a higher rate than anticipated.

Representative Carpenter thought the analysis was key to the legislature's discussions. He did not think there was enough discussion on how to grow the economy. He thought there should be discussions particularly on strategies to grow the private sector.

3:12:03 PM

Representative Rasmussen was curious how LFD derived the 18 percent or 30 percent surety that the ERA would be depleted by FY 26 or FY 31. She thought there were many variables that could not be easily predicted.

Mr. Bell answered LFD was modeling a range of oil prices and PFD returns, and even the ranges used were somewhat subjective. He relayed that LFD did not intend to report that the surety percentages were precise, but simply that the percentages were based on the ranges of different variables.

Representative Rasmussen attempted to respond, but her response was inaudible.

Co-Chair Foster noted that Representative Rasmussen's response was inaudible due to cell phone service.

Representative Edgmon understood that the modeling was subjective. He asked if the current year was the first year during which LFD had used the modeling.

Mr. Bell responded in the affirmative.

Representative Edgmon looked forward to the modeling being developed more in the future and was excited about modeling additional probabilities.

Representative Carpenter asked for clarification of the 50/50 POMV column on slide 20. He asked if it reflected the governor's plan.

Mr. Bell answered that it did not include all of the governor's proposed policy changes or a supplemental PFD. It strictly modeled paying out a PFD equal to 50 percent of the POMV draw.

Representative Carpenter believed the governor's plan rolled the ERA into the corpus of the fund, in which case there would be no ERA shortfall because there would be no ERA. He asked if it meant there would not be a payment from the Permanent Fund and wanted to see the scenario modeled.

Mr. Bell believed Callan's modeling showed the information. Under the governor's plan, the principal and ERA would be combined and there would be no possibility of overdraws. The modeling done by LFD specifically showed how the budget modeling would play in-to overdraws.

Representative Carpenter wondered if there would be a payment from the Permanent Fund under a plan where there was no ERA. He thought the modeling for the scenario should be examined.

3:18:54 PM

Mr. Bell answered that LFD could run modeling showing the information. In the modeling on slide 20, ERA served as a last chance reserve to fill deficits and the Permanent Fund would be one entity, and due to the size of the fund the likelihood of overdrawing was negligible. He was certain there would still be a PFD payout in a scenario where the principal and ERA were combined.

Representative Carpenter understood that an ERA shortfall meant an ERA depletion in full. He wanted to know the probability of a shortfall in the scenario.

Mr. Bell responded that in a scenario where ERA was combined into the principal, the POMV draw would not necessarily change but it would simply be paid out of the fund itself. There would be a constitutional barrier that prevented drawing any amount in excess of the POMV draw.

Representative Carpenter stated that the concept was otherwise known as a spending limit.

Mr. Painter added that in the model, the failure point was the point at which ERA was fully depleted. If the POMV draw was constitutionalized, the failure point would change to the point at which CBR was depleted. He emphasized that ERA draws were often used to fill budget deficits, and therefore the likelihood that there would be a lack of funds to fill deficits would increase because ERA draws would no longer be possible.

3:21:52 PM

Representative Josephson asked if slide 20 assumed LFD's two percent inflation and did not incorporate fiscal notes.

Mr. Bell responded in the affirmative. The slide assumed a two percent annual increase in agency operations.

Representative Josephson indicated that a world with no fiscal notes would eliminate a lot of bills. He asked for verification that the FY 31 projections would only increase if fiscal notes were incorporated.

Mr. Bell responded that the projections would increase if the fiscal notes were revenue negative and led to more expenditures.

HB 281 was HEARD and HELD in committee for further consideration.

HB 282 was HEARD and HELD in committee for further consideration.

Co-Chair Foster reviewed the schedule for the following day. He shared that Co-Chair Merrick would hold a hearing on February 2, 2022 to hear for HB 54, HB 90, and HB 111. The bills had amendment deadlines in the past, but there would be new amendment deadlines because it was a new year.

Vice-Chair Ortiz asked for clarification on the date of the meeting.

Co-Chair Foster repeated the information.

#
ADJOURNMENT

3:25:01 PM

The meeting was adjourned at 3:24 p.m.