

HOUSE FINANCE COMMITTEE
March 18, 2022
9:05 a.m.

9:05:18 AM

CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 9:05 a.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 Sara Rasmussen (via teleconference)
Representative Steve Thompson
Representative Adam Wool

MEMBERS ABSENT

Representative Bart LeBon

ALSO PRESENT

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: SPRING FORECAST BY THE LEGISLATIVE FINANCE DIVISION

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."

[9:05:54 AM](#)

^PRESENTATION: SPRING FORECAST BY THE LEGISLATIVE FINANCE DIVISION

[9:05:57 AM](#)

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION, introduced the PowerPoint Presentation: "Spring Revenue Forecast Modeling Update." He began with slide 2 to review an outline of the presentation.

[9:06:53 AM](#)

Mr. Painter turned to slide 3 showing a simple fiscal summary. He explained that it represented the spring revenue forecast in addition to the committee substitute (CS) for the operating budget [HCS2]. It also used some placeholders from the governor's budget. There was \$1.2 billion of additional revenue in fiscal year (FY) 22 and \$4 billion in FY 23. The percent of market value (POMV) draw had not changed. Altogether, the state was looking at about \$7 billion of unrestricted general fund (UGF) revenue in FY

22 and about \$8.3 billion in FY 23. He reminded committee members of his past testimony about the automatic negatives to reduce the budget in the adjusted base. He explained that HCS2 was up by about 5.3 percent as compared to the adjusted base due to the additional negatives.

Mr. Painter gave more details on the elements that were included in each statewide item. He referred to line 9, which showed that the statewide items in FY 23 were \$670 million. This was an increase from the governor's request due to the tax credits increase of \$149 million as prescribed by the spring forecast. The additional \$2.4 million dedicated to repaying debt service for municipal projects also contributed to the increase, referred to as "528 projects." He spoke to line 10, which detailed the appropriations for public education and the forward-funding of kindergarten through twelfth grade (K12). He noted that the way it was written in the bill was an "amount certain" not an estimate. Prior to FY 14, the state would estimate education costs based on the current year and adjust accordingly. The number was not fully considered forward funding because there was an element of estimation. If there was a deficit in FY 23, the deposit to the public education fund would decrease to act as a buffer to a deficit. Under the CS, the \$1.2 billion dedicated to public education would drop to avoid a deficit. The way in which the budget would react to oil prices was also an important factor to consider.

Mr. Painter continued to line 11 on slide 3. The total operating budget was \$6.2 billion, but the forward funding of education was responsible for some inflation.

[9:11:27 AM](#)

Representative Josephson shared his understanding that forward funding accounted for \$1.2 billion and energy relief accounted for \$800 million, totaling \$2 billion. He calculated that subtracting the number from \$6.2 billion [the operating budget total] would result in \$4.8 billion. He asked whether this calculation was correct.

Mr. Painter responded that he was correct. This was a large increase as compared to the previous year's budget.

Representative Wool offered that the difference between the budgets for FY 22 and FY 23 was represented by the oil tax credits listed on line 9.

Mr. Painter responded that he was correct and that the major difference was the \$54 million oil tax credit payments in FY 22. It was a significant increase. He moved to line 12 which reflected the supplementals for the operating budget. He explained that much of the supplementals were replacing items that were short funded in the previous year. Other factors were the oil tax credits which added \$60 million, the addition of the school debt reimbursements, and the incorporation of nearly all of the governor's requested supplemental items. This effort aimed to achieve 100 percent funding for items that had been short funded in the prior year. He shared that he was using the governor's amended capital budget as a reference. He explained that upcoming slides of the presentation would use figures from the amended capital budget.

[9:13:59 AM](#)

Vice-Chair Ortiz referenced line 14 on the slide, which was current year appropriations under the capital budget. He indicated that the appropriations were \$158 million in FY 23. He noted that this did not include the \$91 million [supplemental appropriations from FY 22]. He answered his own question and stated that he understood the concept.

[9:14:19 AM](#)

Representative Josephson asked if the supplemental was not shown because it had been rolled into HCS2. He asked for clarification.

Mr. Painter responded that there was one capital supplemental in the bill. He thought if only one supplemental was shown it would be more accurate as the other numbers had not yet been considered. He also noted there was one FY 23 capital item in the bill. He discussed the permanent fund dividend (PFD) lines, starting on line 17, which reflected the roughly \$1,100 dividend that had been paid out in FY 22 and the roughly \$1,250 dividend as seen in HCS2 and HCS1. This indicated 25 percent of the POMV draw. He noted that line 19, which showed the pre-transfer deficit, looked at ongoing revenue and expenditures. It would be a surplus of about \$1.3 billion

in FY 22 and \$532 million in FY 23. He explained that these surplus amounts would occur on an ongoing basis. There were also some fund transfers in an attempt to move money into the general fund. Additionally, there was a proposed \$300 million revenue replacement in FY 23, among other fund transfers. The FY 21 sweep was not reversed from the constitutional budget reserve (CBR) but HCS2 would mandate it be transferred from the general fund. He added that line 22 reflected the replaced swept funds.

Representative Wool asked about the \$452 million fund transfer on line 22 and asked whether it included the higher education fund.

Mr. Painter responded in the affirmative and shared that the higher education fund represented nearly \$400 million of the \$450 million total.

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Mr. Painter moved to line 23 which showed the post transfer surplus and reflected the final amount of money left over. The surplus would go into the statutory budget reserve (SBR). The CBR would not be affected by the budget. The only changes to the balance related to investment earnings and new deposits. The POMV draw was coming out of the earnings reserve account (ERA) and involved inflation proofing.

[9:18:49 AM](#)

Representative Wool asked about the ERA balance. He wondered if it was pre or post POMV draw.

Mr. Painter responded that it was after the POMV draw.

Representative Josephson asked whether the inflation proofing in the bill was formulaic or a fixed amount.

Mr. Painter responded that it was based on the formula in statute for inflation proofing. He noted that it was a projection and it was likely that inflation would be much higher.

Representative Josephson asked if the duty to inflation proof was a "may" or "shall" provision.

Mr. Painter responded that it was a statute that was subject to appropriation. There had been some years where there was no effort to inflation proof and other years where there was.

9:20:19 AM

Mr. Painter moved to slide 4: "Comparison of Oil Price Forecasts." The orange line represented the Department of Revenue (DOR) spring revenue forecast. The blue line represented the DOR fall forecast, and the grey line represented Brent Future prices which had increased by \$9 since March 12, 2022. He indicated that the graph illustrated the volatility in the short-term. There was a difference of about \$30 per barrel in FY 23. However, the futures market was generally trending downwards. The downward trend was apparent in the fall forecast and was even more significant in the spring forecast. The futures market did not appear to expect that the current oil prices would last in the long term, however the short-term trends were volatile.

Co-Chair Foster recognized Representative Rasmussen had joined the meeting.

Vice-Chair Ortiz asked about the \$1.2 billion for the spring forecast. He wondered what the price of oil would need to be in order to reach the forecasted \$1.2 billion.

Mr. Painter responded about \$115 per barrel of oil.

Vice-Chair Ortiz asked how the projected oil barrel price compared to the necessary \$115 per barrel price.

Mr. Painter thought he could talk to the issue on the next slide. He stated that the price changed daily, and if he gave the presentation yesterday, he would have reported a different number than today.

Vice-Chair Ortiz agreed, but the problem was that the legislature had to build a budget on some number. He asked what the minimum safe assumption would be. He suggested it might be \$800 million or \$1.2 billion.

9:24:55 AM

Mr. Painter continued to slide 5: "FY23 Oil Price Sensitivity Chart" to respond to the question. He explained that he looked back about a decade to prepare for the presentation. His predecessor in the Legislative Finance Division (LFD) had emphasized that when budgeting for oil prices, one cannot use a specific number but instead use a sensitivity chart to find a comfortable range. The slide included the FY 23 sensitivity chart. The orange line represented the spring forecast and the blue represented the fall forecast. He noted that there was not a significant difference between the lines.

Mr. Painter suggested that the legislature should consider what price makes them feel comfortable. He recommended that the budget assume a \$95 per barrel price, which is the assumption in HCS2. With revenue replacement funds factored in, the budget actually balanced at \$91 per barrel. However, if revenue fell below projections, that would eliminate forward funding for education and balance the budget at \$75 per barrel. He explained that this was one way to account for volatility. There was a relatively low chance that oil prices would fall below \$75 per barrel, but there needed to be a comfortable base assumption. He thought it would be smart to build a budget in a way that ensured that the budget would function at different barrel price levels. This would mean that if the state had more revenue, then education could be forward funded. However, if the state had less revenue, education would not be forward funded. He suggested it was a policy call for the legislature. He did not have a specific answer as to what a minimum safe assumption should be; however it was difficult to imagine prices going below \$80 or \$90 in the short-term.

Co-Chair Foster mentioned Representative LeBon was listening to the meeting [Representative LeBon was not physically in the meeting or online].

[9:28:54 AM](#)

Representative Wool commented that if the legislature forward funded education in the FY 23 budget, education would only need to be funded one time the following year and therefore the subsequent budget would be reduced.

Mr. Painter responded that he would categorize it as a form of savings. He indicated that forward funding was reflected

as a fund transfer in the past. He agreed with Representative Wool's concept.

Representative Wool mentioned the futures market changing frequently. He understood it to represent a price in the future that was agreed upon. He asked whether there was a certain amount of the "tail wagging the dog" when it came to the futures market, and how far in the future oil would be available to purchase.

Mr. Painter explained that the futures market went out through FY 30. The futures market was most useful as a directional indicator that indicated the direction of the price of oil. He explained that most traders believed that oil would go down in the long-term.

Representative Wool commented that predicting prices ten years in the future was "anyone's guess."

[9:32:41 AM](#)

Representative Johnson asked which predictions seemed to be the most accurate.

Mr. Painter responded that traders did not anticipate the War in Ukraine, and therefore the fall predictions were not accurate. He categorized it as a black swan event. He added that no one saw it coming, just like COVID-19. It reset the market in a fundamental way. He would not necessarily say that the fall forecast was wrong and the spring forecast was right, but instead he acknowledged that the forecasts were based on a specific point in time and the expectations of that time. He urged caution when crafting the budget due to the volatility of the market and of world events.

Representative Johnson asked if there were particular areas that tended to trend closer to reality than others.

Mr. Painter explained that DOR did some analysis when it decided to switch to the futures market. He reported that DOR found that the futures market was most accurate but still had a large margin of error. The analyst forecasts were not updated on a daily basis while the futures were, and this contributed to the accuracy.

Representative Johnson responded that she understood.

[9:36:40 AM](#)

Representative Josephson commented that the governor had stated in a press conference that he would like to spend the increased revenue that was forecasted on the PFD. It struck him that if the current legislature moved conservatively, the beneficiary would be the following year's legislature. He asked if there was some truth to his comment.

Mr. Painter agreed that more funding left on the table would mean more options for future legislators. He stated that it was a policy choice on whether spending the money immediately or saving it for the future would be more beneficial.

Representative Josephson thought that the legislature had learned a lot since 2014. The legislature had spent a significant amount of the state's savings, but he suggested that it was necessary. He commented that there may be a need for savings in the future.

Mr. Painter agreed that it bought the legislature a few years of time. He assumed that if the legislature had only a few billion dollars in savings then it would have had to act more quickly. He was confident that the legislature would have acted fast enough to not crash the state's finances.

[9:39:28 AM](#)

Representative Edgmon underscored the point Representative Wool made about the importance of forward funding. Forward funding gave schools some sort of security and certainty. It would also take some pressure off of legislators in terms of crafting the budget in the following year. He thought that there was wisdom in saving the money and putting it somewhere where it could have multiple benefits.

Co-Chair Foster indicated that he might recess the meeting to the call of the chair if it ran much longer.

Mr. Painter continued on slide 5 and noted that they had covered the majority of the information on the slide.

[9:41:36 AM](#)

Mr. Painter moved to slide 6: "Oil Prices, FY22 to Date." He noted that the chart on the slide was created two days prior to the meeting. Oil prices became volatile due to the War in Ukraine, and the chart reflected this. The volatility coincided with the deadline for DOR to prepare the forecast. He recommended looking to the sensitivity chart for budget purposes rather than being tied to one number.

[9:43:01 AM](#)

Mr. Painter reviewed slide 7: "Takeaways on Spring Forecast":

Oil prices have skyrocketed in recent months, but the market does not appear to expect that this will last over the long term.

Oil has been extremely volatile recently. ANS prices rose by \$31.11 (33%) from 2/25 to 3/8 and dropped by \$26.76 (21%) from 3/8 to 3/15.

LFD advises the legislature to approach oil prices conservatively given the level of volatility combined with relatively small savings account balances to backstop any shortfall.

[9:43:37 AM](#)

Mr. Painter advanced to the graph on slide 8: "Comparison of Potential Agency Operations Paths." He explained that HCS2 increased UGF by 5.3 percent as compared to the FY23 adjusted base. The governor's amended budget would increase UGF by just over 2 percent. Some of the biggest differences were the way in which the Alaska Marine Highway System (AMHS) was funded and the addition of \$50 million dedicated to K12. One of the changes from the spring forecast was that the Callan inflation rate had gone from 1.5 percent to 2.4 percent. The governor's amended budget was up about \$15 million from the governor's original budget, and this was represented by the green line on the graph. The purple line represented HCS2 with the growth of inflation. If the growth rate of 5.3 percent was used by HCS2, the budget would almost double. He noted that the difference did not seem like a lot, but if it was compounded over a decade it would make a difference.

[9:45:51 AM](#)

Mr. Painter continued to slide 9: "Learning from the Past: Agency Operations Growth, FY04-13." He highlighted that agency operations nearly doubled from FY 04 to FY 14. When there has been oil revenue in the past, agency operations were growing by about 10 percent each year. He noted that agency operations would grow faster than inflation. He referred to the quote on the right side of the slide about expenditure growth during the FY 13 budget discussions. It was easier to alter spending in the capital budget than it was to alter agency operations spending. The state was not able to go back to what it had been before. He suggested that increasing the agency operations would make it harder to balance the budget in the future and increased the likelihood of needing new revenue. The long-term path could be controlled through agency operations spending.

[9:48:31 AM](#)

Mr. Painter moved to slide 10: "Governor's 10-Year Plan with Spring Forecast." In this model, agency operations were growing slower than inflation and had more than 50 percent of the POMV draw going to the dividend. The model showed surpluses each year. Although revenue was higher, it had not changed significantly from the fall forecast and the projected surpluses were not huge.

Mr. Painter turned to slide 11: "GovAmend Growing with Inflation (2.25 percent), Spring Forecast." He explained that even with the higher forecast, the projections on the slide had fundamentally not shifted very much. The big difference was that reserve balances were significantly higher. Reserve balances in the governor's budget were fairly low in the fall revenue forecast. In the model, the reserve balances were built back up due to surpluses. There were some small deficits, but they would not affect reserve balances.

Mr. Painter advanced to slide 12: "HCS2 Growing with Inflation (2.25 percent), Spring Forecast, 25 percent POMV to PFD FY24+." The slide suggested that there would be large surpluses every year. The dividend plan based on HCS2 growing with inflation would produce the large surpluses.

[9:50:59 AM](#)

Co-Chair Foster indicated the committee could also come back after floor session.

[9:51:24 AM](#)

Mr. Painter continued on slide 13: "HCS2 Growing with Inflation (2.25 percent), Spring Forecast, 50 percent POMV to PFD FY24+." The slide assumed the energy relief check or a larger PFD including the 50 percent POMV would continue. He noted that the surpluses were shown to spike on the slide due to oil tax credits ending in FY 24. Additionally, the forward funding of K12 and agency operations played a significant role. There would be significant deficits with a 50 percent POMV plan.

Mr. Painter moved to slide 14: "HCS2 Growing by 5.3 percent, Spring Forecast, 25 percent POMV to PFD FY24+." There would still be surpluses at the beginning in this model, but there would be deficits at the end mostly due to the leverage of the agency operations growth rate.

[9:53:15 AM](#)

Mr. Painter advanced to the last example on slide 15: "HCS2 Growing by 5.3 percent, Spring Forecast, 50 percent POMV to PFD FY24+." He suggested that there again would be surpluses in the first few years but would turn into large deficits starting in FY 26. The governor's proposal worked in his models in large part due to the expenditure growth rate. If the state grew at a faster rate, the picture would be very different.

Co-Chair Foster indicated he would recess the meeting and allow for questions after floor session.

[9:54:22 AM](#)

Representative Josephson suggested that some of the realized ERA balances seemed larger than normal. He wondered if it would lead to the temptation to overdraw the ERA.

Mr. Painter agreed that it could. In the example on slide 15, there was an overdraw to balance the budget. The high SBR balance could create a temptation to overdraw as well. He agreed that making high amounts of cash available could lead to a pressure to spend.

Co-Chair Foster reviewed the agenda for the afternoon meeting. He would recess the meeting in case members wanted to come back with questions.

[9:56:12 AM](#)

RECESSED TO THE CALL OF THE CHAIR
[Meeting never reconvened]

#

ADJOURNMENT

[9:56:12 AM](#)

The meeting was adjourned at 9:56 a.m.