

**ALASKA STATE LEGISLATURE
HOUSE JUDICIARY STANDING COMMITTEE**

October 19, 2001

11:11 a.m.

MEMBERS PRESENT

Representative Norman Rokeberg, Chair
Representative Scott Ogan, Vice Chair (via teleconference)
Representative John Coghill
Representative Kevin Meyer
Representative Ethan Berkowitz

MEMBERS ABSENT

Representative Jeannette James
Representative Albert Kookesh

OTHER LEGISLATORS PRESENT

Representative John Davies

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 15

Proposing amendments to the Constitution of the State of Alaska relating to inflation-proofing the permanent fund.

- HEARD AND HELD

CS FOR SENATE JOINT RESOLUTION NO. 23(FIN) am

Proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit.

- HEARD AND HELD

CS FOR SENATE JOINT RESOLUTION NO. 24(RLS)

Proposing amendments to the Constitution of the State of Alaska relating to the budget reserve fund.

- HEARD AND HELD

PREVIOUS ACTION

BILL: HJR 15

SHORT TITLE: CONST. AM: PERMANENT FUND

SPONSOR(S): RLS BY REQUEST OF LEG BUDGET & AUDIT

Jrn-Date	Jrn-Page		Action
02/14/01	0316	(H)	READ THE FIRST TIME - REFERRALS
02/14/01	0316	(H)	JUD, FIN
02/14/01	0316	(H)	REFERRED TO JUDICIARY
10/19/01		(H)	JUD AT 11:00 AM Anch LIO Conf Rm

BILL: SJR 23

SHORT TITLE:CONST AM: APPROPRIATION/SPENDING LIMIT

SPONSOR(S): SENATOR(S) DONLEY

Jrn-Date	Jrn-Page		Action
04/09/01	1013	(S)	READ THE FIRST TIME - REFERRALS
04/09/01	1013	(S)	FIN
04/11/01	1080	(S)	COSPONSOR(S): AUSTERMAN
04/17/01		(S)	FIN AT 9:00 AM SENATE FINANCE 532
04/17/01		(S)	Heard & Held
04/17/01		(S)	MINUTE(FIN)
05/03/01	1462	(S)	FIN RPT CS 4DP 2DNP 3NR SAME TITLE
05/03/01	1462	(S)	DP: DONLEY, GREEN, LEMAN, WARD;
05/03/01	1462	(S)	NR: KELLY, AUSTERMAN, WILKEN;
05/03/01	1462	(S)	DNP: HOFFMAN, OLSON
05/03/01	1462	(S)	FN1: (GOV)
05/03/01	1465	(S)	RULES TO CALENDAR 1OR 5/3/01
05/03/01	1471	(S)	READ THE SECOND TIME
05/03/01	1471	(S)	FIN CS ADOPTED UNAN CONSENT
05/03/01	1471	(S)	COSPONSOR(S): LEMAN, KELLY
05/03/01	1471	(S)	ADVANCED TO 3RD READING FAILED Y14 N6
05/03/01	1472	(S)	ADVANCED TO THIRD READING 5/4 CALENDAR
05/03/01		(S)	FIN AT 9:00 AM SENATE FINANCE 532
05/03/01		(S)	Moved CS(FIN) Out of Committee
05/03/01		(S)	RLS AT 1:45 PM FAHRENKAMP 203
05/03/01		(S)	MINUTE(FIN)
05/03/01		(S)	MINUTE(RLS)
05/04/01	1502	(S)	READ THE THIRD TIME CSSJR 23(FIN)
05/04/01	1502	(S)	RETURN TO SECOND FOR AM 1

			UNAN CONSENT
05/04/01	1502	(S)	AM NO 1 ADOPTED UNAN CONSENT
05/04/01	1503	(S)	AUTOMATICALLY IN THIRD READING
05/04/01	1503	(S)	PASSED Y14 N6
05/04/01	1503	(S)	ELLIS NOTICE OF RECONSIDERATION
05/05/01	1526	(S)	RECON TAKEN UP - IN THIRD READING
05/05/01	1526	(S)	PASSED ON RECONSIDERATION Y14 N6
05/05/01	1559	(S)	TRANSMITTED TO (H)
05/05/01	1559	(S)	VERSION: CSSJR 23(FIN) AM
05/05/01	1571	(H)	READ THE FIRST TIME - REFERRALS
05/05/01	1571	(H)	JUD, FIN
05/05/01	1571	(H)	REFERRED TO JUDICIARY
10/19/01		(H)	JUD AT 11:00 AM Anch LIO Conf Rm

BILL: SJR 24

SHORT TITLE:AMEND CONSTITUTIONAL BUDGET RESERVE FUND

SPONSOR(S): FINANCE

Jrn-Date	Jrn-Page		Action
04/09/01	1013	(S)	READ THE FIRST TIME - REFERRALS
04/09/01	1013	(S)	FIN
04/17/01		(S)	FIN AT 9:00 AM SENATE FINANCE 532
04/17/01		(S)	Heard & Held
04/17/01		(S)	MINUTE(FIN)
04/23/01	1215	(S)	FIN RPT 6DP 3NR
04/23/01	1215	(S)	DP: DONLEY, KELLY, GREEN, WILKEN,
04/23/01	1215	(S)	LEMAN, WARD;
04/23/01	1215	(S)	NR: AUSTERMAN, HOFFMAN, OLSON
04/23/01	1216	(S)	FN1: (GOV)
04/23/01		(S)	FIN AT 9:00 AM SENATE FINANCE 532
04/23/01		(S)	Moved Out of Committee
04/23/01		(S)	MINUTE(FIN)
04/30/01		(S)	RLS AT 11:50 AM FAHRENKAMP 203
04/30/01		(S)	<Bill Postponed to 5/1/01> -- Time Change --
04/30/01		(S)	RLS AT 4:45 PM FAHRENKAMP 203

04/30/01		(S)	-- Meeting Canceled --
05/01/01	1401	(S)	RULES TO CAL W/CS 10R 5/1 SAME TITLE
05/01/01	1401	(S)	FN1: (GOV)
05/01/01	1412	(S)	READ THE SECOND TIME
05/01/01	1412	(S)	RLS CS ADOPTED UNAN CONSENT
05/01/01	1413	(S)	ADVANCED TO 3RD READING FAILED Y14 N6
05/01/01	1413	(S)	ADVANCED TO THIRD READING 5/2 CALENDAR
05/01/01		(S)	RLS AT 12:15 PM FAHRENKAMP 203
05/01/01		(S)	-- Time Change --
05/01/01		(S)	MINUTE(RLS)
05/02/01	1443	(S)	READ THE THIRD TIME CSSJR 24(RLS)
05/02/01	1444	(S)	HELD IN THIRD READING TO 5/3 CALENDAR
05/03/01	1472	(S)	HELD IN THIRD READING TO 5/4 CALENDAR
05/04/01	1503	(S)	BEFORE THE SENATE IN THIRD READING
05/04/01	1503	(S)	PASSED Y14 N6
05/04/01	1504	(S)	ELLIS NOTICE OF RECONSIDERATION
05/05/01	1527	(S)	RECON TAKEN UP - IN THIRD READING
05/05/01	1527	(S)	PASSED ON RECONSIDERATION Y14 N6
05/05/01	1559	(S)	TRANSMITTED TO (H)
05/05/01	1559	(S)	VERSION: CSSJR 24(RLS)
05/05/01	1571	(H)	READ THE FIRST TIME - REFERRALS
05/05/01	1571	(H)	JUD, FIN
05/05/01	1571	(H)	REFERRED TO JUDICIARY
10/19/01		(H)	JUD AT 11:00 AM Anch LIO Conf Rm

WITNESS REGISTER

CLARK GRUENING, Member

Board of Trustees of the Alaska Permanent Fund Corporation
217 Second Street, Suite 204
Juneau, Alaska 99801

POSITION STATEMENT: Testified in support of HJR 15 and
responded to questions.

ROBERT STORER, Executive Director
Alaska Permanent Fund Corporation
Department of Revenue
PO Box 25500
Juneau, Alaska 99802-5500

POSITION STATEMENT: Responded to questions regarding HJR 15.

MARY GRISWOLD
PO Box 1417
Homer, Alaska 99603

POSITION STATEMENT: Testified in support of HJR 15.

JIM KELLY, Research & Liaison Officer
Alaska Permanent Fund Corporation
Department of Revenue
PO Box 25500
Juneau, Alaska 99802-5500

POSITION STATEMENT: Responded to questions regarding HJR 15.

SCOTT GOLDSMITH, Economist
University of Alaska - Anchorage
6035 Bluebell
Anchorage, Alaska 99516

POSITION STATEMENT: Testified in support of HJR 15 and testified on SJR 23.

SENATOR DAVE DONLEY
Alaska State Legislature
Capitol Building, Room 506
Juneau, Alaska 99801

POSITION STATEMENT: Testified as the sponsor of SJR 23, and on behalf of the Senate Finance Committee, sponsor of SJR 24.

DAVID TEAL, Director/Legislative Fiscal Analyst
Legislative Finance Division
Alaska State Legislature
PO Box 113200
Juneau, Alaska 99811-3200

POSITION STATEMENT: Answered questions on SJR 23 and SJR 24.

ACTION NARRATIVE

TAPE 01-82, SIDE A
Number 0001

CHAIR NORMAN ROKEBERG called the House Judiciary Standing Committee meeting to order at 11:11 a.m. Representatives

Rokeberg, Ogan (via teleconference), Coghill, Meyer, and Berkowitz were present at the call to order.

HJR 15 - CONST. AM: PERMANENT FUND

[Contains brief reference to SJR 13, the companion bill to HJR 15.]

Number 0020

CHAIR ROKEBERG announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 15, Proposing amendments to the Constitution of the State of Alaska relating to inflation-proofing the permanent fund.

Number 0036

CLARK GRUENING, Member, Board of Trustees of the Alaska Permanent Fund Corporation ("the board"), said that the board enthusiastically supports HJR 15. He noted that it was upon the recommendations of the board that the Legislative Budget and Audit Committee requested that the House Rules Standing Committee and the Senate Rules Standing Committee sponsor HJR 15 and SJR 13, respectively. He relayed that for the first 21 years of the permanent fund's existence, the fund has been governed by a six-member board of trustees whose single highest priority policy has been to protect the fund against inflation. The very first board testified before the legislature that the greatest threat to permanence of the fund is inflation. In response, the legislature adopted statutory inflation-proofing in 1982. In more recent years, he said, the board has examined various large endowments and public funds that use a formula approach to determine the method and size of payouts.

MR. GRUENING explained that this approach is generally referred to as the "percentage of market value payout," or POMV payout. The purpose of this endowment-type formula is to protect the long-term viability of a fund and provide consistent distributions to the beneficiary's of that fund. He went on to say that after considerable review and discussion, the board recommends the constitutional change that is proposed in HJR 15. The language of HJR 15 provides a spending limit on what can currently be appropriated. The existing constitutional language, which established the permanent fund, only prohibits the appropriation of principal; in other words, he added, anything that is not principal is considered income, which can be spent. He explained that principal does not vary or move up

and down with the market; instead, principal is a notional number that simply equals the sum of the constitutionally mandated 25 percent deposit of mineral proceeds, and the voluntary deposits that the legislature may choose to make.

MR. GRUENING acknowledged that two-thirds of the \$21 billion deposited to the principal of the fund has been made voluntarily by the legislature as either inflation-proofing or as extra deposits to the principal; only one-third of the \$21 billion came from the mandated deposit of 25 percent of mineral proceeds. Over the past year, he noted, "we" have lost three former trustees who had a great deal to do with the formation and success of the permanent fund: Elmer Rassmussen, Hugh Malone, and Oral Freeman. He added that they were concerned with the future of the fund and were totally committed to inflation-proofing it, recounting that Elmer Rassmussen used to say, "Inflation is a thief in the night," which is as true today as it was in 1982.

MR. GRUENING went on to say that things have changed since 1982. For instance, the earnings reserve is now a much greater proportion of the total fund. Also, the fiscal position of the state is dramatically [different]. Mr. Gruening informed the committee that if all the deposits to the fund from 1977-1992 were averaged, the earnings reserve averaged approximately 8 percent of the fund. Even today, with the recent payout and the travails of the market, the earnings reserve still makes up about 14 percent of the fund. Unlike the current statutory provision, for which the legislature has faithfully appropriated money, the proposal before the committee provides for inflation-proofing of the entire fund. Moreover, the proposal is a formula that will maximize distributions over the long term, which is significant due to the state's current fiscal situation. "The Alaska permanent fund has, and will continue to be in the future, the largest single revenue source ... as compared to any other Alaska resource," Mr. Gruening emphasized. The Alaska permanent fund will be larger than oil in the future, and larger than tourism, fishing, and anything anticipated from a natural gas pipeline. Mr. Gruening explained that the board's proposal for inflation-proofing doesn't require any statutory change, including the dividend statute. Therefore, the 5 percent payout of market value assures complete and protected inflation-proofing while providing maximum sustainable payout over the long term, regardless of future decisions made by the legislature or the voters.

MR. GRUENING concluded by saying that if Alaska is going to have a fund that is truly permanent, steps to ensure that have to be taken. Therefore, there has to be investment for future generations as well as current generations, which requires commitment to the principles of long-term investment. The long term is more than a business or political cycle. At a minimum, the long term should include the time in which "our children, grandchildren, and their children grow into adulthood." Mr. Gruening said, "The critical flip-side of a sound long-term investment strategy is a sound and sustainable distribution payout plan; a plan that will sustain and maximize benefits to each generation of Alaska." The form in which these benefits flow will be a subject of debate in the years to come. However, the fund can't do it all. Mr. Gruening remarked:

What, I think we ..., as Alaskans, want to avoid at all costs is defaulting to a position where the constitutional budget reserve is today. Within the next 4-5 years, the CBR, without some change, is destined for extinction. As the investment horizon of the CBR shortens, it has been and will continue to be necessary to keep the assets of the CBR in very short-term and less profitable investments. As the day of the CBR's demise grows near, the trustees and staff of your permanent fund will also have to seriously consider a shorter investment horizon for a significant proportion of the fund, unless there is something that changes. Whether we liken an Alaskan permanent fund to a whole resource industry, like the Alaska fisheries, or to some kind of perpetual endowment, one thing is clear: the Alaska permanent fund imports more money into the state year after year than any other revenues or natural resources. Legislative passage and voter approval of this amendment would protect the ability of the fund to be managed for the long term and to continue to pour money into the Alaska economy. One final thought: Your legislature, that is the Twenty-Second Legislature, has an opportunity to accomplish something, I think, as significant and as beneficial as the Ninth Legislature did 25 years ago with the original constitutional amendment. The trustees believe that this proposal for complete and protected inflation-proofing makes ultimate good sense for Alaska's permanent fund for Alaska's future.

Number 0170

REPRESENTATIVE BERKOWITZ remarked that it seemed that most of the [proposed] changes could be done statutorily. If that isn't the case, are there any collateral benefits, such as providing Wall Street greater assurance with regard to the security of the permanent fund, that would enhance the state's bond ratings.

MR. GRUENING answered that a statutory payout rule would be no different, in terms of its impact on inflation-proofing, than the current statute, which has been [saving] the fund because the money was there. Much of the money that was part of the principal was extra that wasn't required. However, he emphasized that any appropriation [that the legislature makes] overrides the statute. "Unless it's in the constitution, it's not constitutional to protect it," he pointed out. When the voters hear and understand this, the public seems to accept that the fund can be used for other things than its current use.

Number 0193

ROBERT STORER, Executive Director, Alaska Permanent Fund Corporation, Department of Revenue, responded with an unequivocal yes to Representative Berkowitz's question regarding bond ratings. He pointed out that part of recognizing one's risk tolerance is one's discipline to stay the course. The past three years of fall meetings with the rating agencies has illustrated that rating agencies like to see a disciplined spending approach and such an approach enhances the way in which the rating agencies view the State of Alaska's finances, and therefore the state's credit rating.

Number 0204

REPRESENTATIVE MEYER commented on the challenge of educating the voters on the issue and, therefore, he asked if that is a concern. Furthermore, the permanent fund is a sensitive issue. Representative Meyer asked whether any thought had been given to such concerns when reviewing whether to proceed with a constitutional proposal versus Representative Berkowitz's proposal.

MR. GRUENING related his belief that the public would feel a greater degree of confidence with [the constitutional proposal]. Clearly, this will be the [public's] most important policy initiative. He highlighted his belief that this is really going to be up to the legislature, especially since there's only one more session before its possible passage. The idea of this

matter being in the constitution has seemed to provide the public with some comfort. He noted that he discovered this in the presentations [with which he had taken been part].

MR. STORER agreed. Mr. Storer noted that the challenge, during these presentations, is to distill this idea into understandable terms. From his speeches, he has gathered that the public finds comfort in seeing a disciplined approach to the permanent fund.

Number 0235

REPRESENTATIVE COGHILL returned to the issue of the [state's] bond rating. He asked if the combination of the legislature's actions with regard to the statute and its authority, and the management of the fund, has lessened [the state's] bond rating.

MR. STORER replied no. He acknowledged that the legislature has appropriated money into the principal fund, inflation-proofing as well as additional sums. The rating agencies have been comforted by that action. He clarified his perspective that as the state's finances are debated more, the more disciplined approach will provide continued solace for the bond rating agencies.

REPRESENTATIVE COGHILL expressed concern with the notion that since the fund, under this proposal, would be managed under a constitutional protection, it would provide a better bond rating than if in statute with public debate. He said that such a situation would call in to question the credibility of the public debate in the legislature.

MR. STORER clarified that the legislature's actions to date have assisted in the state's high bond rating. Therefore, from his perspective, the statute could settle the issue if [the statute] was memorialized in the constitution, which is, to some degree, a higher order of discipline. The rating agencies would find solace in that. However, that isn't to say that the rating agencies would view some use of the permanent fund as [inadequate].

Number 0277

CHAIR ROKEBERG turned to Mr. Gruening's statement that this amendment [HJR 15] wouldn't require any statutory changes. He found that statement troubling because, in his opinion, the current statute is broken and needs to be fixed. Chair Rokeberg also expressed concern with how the inflation-proofing design

fits into the entire model in terms of the statute, specifically related to the sweep effect and down market situations.

MR. GRUENING clarified, "What is meant by that is that you can adopt a constitutional spending limit or inflation-proofing provision and still administer the dividend statute in the same way." Mr. Gruening noted that "we" have indicated that having a payout of the dividend based on market value is probably less volatile. Although that would be advisable, it isn't necessary for passage of [HJR 15]. However, the statute could, undoubtedly, be improved upon and that will be up to the legislature to decide how to do so.

CHAIR ROKEBERG recalled earlier comments that CBR investments must be for the short-term horizon because of the contraction of the length and need for the funding. Chair Rokeberg said that he understood that the perceived need for funding, market conditions, and the amount available has an impact on the length and quality of the investment instrument that [is chosen]. However, he also understood testimony to indicate that as time passes without any changes, the same type of policy changes that relate to the permanent fund itself will have to occur. He said:

I suspect that that's because ... if we kept the status quo, the earnings reserve is in the situation where it could be appropriated by the legislature; therefore, as a matter of policy, the corporation would have to shorten the length of commitment on the part of the investment vehicle in the security you might buy to make sure that those funds were available for appropriation on a near-term basis as we get nearer falling of the cliff and go broke.

MR. GRUENING agreed with Chair Rokeberg's understanding.

Number 0332

MR. STORER posed the question: Why 5 percent? He noted that the staff and the board have spent much time reviewing that and have determined that 5 percent of a five-year moving average is on the high end of achievable. He explained that over the long-term, the current asset allocation of the fund would earn about 8.25 percent. Analysis suggests that inflation will be about 3.25 percent. Therefore, "we know that we can afford to payout up to 5 percent of the fund and retain the balance of the earnings to ensure that the fund is inflation-proofed for the

future," he explained. However, Mr. Storer acknowledged that markets change and thus there has been review of history, which has found that asset allocation similar to the fund and statute have also amounted to about a 5 percent payout. This review is over about a 75-year course. Mr. Storer reiterated that there is review of risk, which is measured by volatility of the market. He expressed the need to define an asset allocation, within a risk tolerance, that achieves the goals while also having the discipline to stay the course. Without that discipline, one won't achieve his/her goals.

MR. STORER informed the committee that there are two components of this fund. What makes the fund unique is its principal protection via the constitution. However, when reviewing any fund, one would review the fund's cash flow. The fund has been in a situation whereby it has been in a negative cash flow for a decade. Although such a situation is fine and part of the analysis, one must recognize that and include it in the risk return profile. He explained that he mentioned this because most endowment funds that use this model have a 4.5-5 [percent] payout rule, although some payout more. In response to Chair Rokeberg, Mr. Storer said that the inflation-proofing appropriation isn't part of cash flow in his calculation. He explained that "we" are paying out \$1.1 billion on the dividend while receiving about \$400 million.

CHAIR ROKEBERG related his understanding that although it's an appropriation to the corpus, the inflation-proofing appropriation isn't considered part of the cash flow.

MR. STORER clarified, "I do not consider it a negative cash flow because it's retained in the fund."

CHAIR ROKEBERG asked if it's a positive cash flow because it moves from the earnings reserve into the corpus.

MR. STORER said he would say no, although he remarked that it is a good point. "If that's the case, we're at about a push right now," he said. He specified that most would define it as money that is leaving the fund rather than entering the fund. He explained, "My point is that if you look at a Harvard or an MIT, they can afford to take a greater risk profile and the reason being is they can withstand the near-term volatility of a riskier profile ... because they are continuing to get new funds so they can meet their payoff discipline. And if their wrong in the near term, they know that they'll have a positive cash flow, which allows them ... to take ... an asset allocation that would

have a higher expected return, significantly higher than ours as an example." He explained that he noted this because if the CBR dissipates and there are greater withdrawals on the permanent fund, ironically, the fund would have to be managed more conservatively. Therefore, the 5 percent discipline provides more effective management.

Number 0429

CHAIR ROKEBERG asked if the unrealized gains are now considered part of the principal.

MR. STORER replied no, the principal would be new oil revenue and contributions to the fund by the legislature, as well as inflation that the legislature appropriates into the fund. Unrealized gains and losses aren't part of the principal. However, the accounting records have changed. Mr. Storer explained that the dividend is calculated by realized income, which is the dividend's interest plus the actual realized gains of a buy and sell of a security. However, "GAP" accounting says that one must book the gains and losses every day. "It's not a question of principal, it's how you mark to market the fund on a daily basis," he explained.

CHAIR ROKEBERG inquired as to the position of the corporation. He asked, "Which set of books do you use?"

MR. STORER answered that the "GAP" is followed for accounting purposes as well as the annual report, which says that gains and losses are recognized.

CHAIR ROKEBERG interjected that he disagrees with that ["GAP" accounting].

MR. STORER continued by informing the committee that [the corporation] does recognize realized income to compute the dividend. Therefore, "you see it both ways."

Number 0496

MARY GRISWOLD testified via teleconference in support of HJR 15 because it provides a better money management framework. She said that POMV reduces the pressure to manage the permanent fund for return over value. "Managing for value is generally considered a better fiscal approach. A 5 percent payout is generally recognized by large endowments as the highest sustainable payout, beyond which the real value of the fund

would diminish over time." She highlighted a secondary benefit of HJR 15 as providing a reasonable money stream for government if the legislature chooses to use it. Currently, the money in the earnings reserve account is available for legislative appropriation for purposes other than dividends. Although the legislature has never spent it, she felt that there would be more pressure in the future for the legislature to use this money. Therefore, HJR 15 will limit the amount the legislature can use to a predictable and modest amount.

MS. GRISWOLD noted that it is important to recognize that dividends are as much as they are because the legislature made special appropriations from the earnings reserve account to the principal and did not spend the earnings available. However, any use of permanent fund earnings for purposes other than dividends will decrease the value of the dividend because whatever is spent won't be available to earn more money. Still, dividends could be reduced by much more under the current payout system versus POMV. The status quo dividend formula could be preserved with a 5 POMV, an 80 percent allocation for dividends, and a 20 percent allocation for government. However, one must realize that a 20 percent transfer from the fund will reduce the fund's future income-producing potential. Ms. Griswold said that she believes it is time to allocate some permanent fund earnings to government and she saw a 5 POMV as the best way to do so. More importantly, Ms. Griswold saw the 5 POMV as a better money management tool that will keep the permanent fund permanent for future generations.

MS. GRISWOLD, in response to Chair Rokeberg, agreed that her understanding was that there would have to be an 80:20 allocation in order to maintain the permanent fund dividend at its current level.

Number 0546

ARLISS STURGULEWSKI, former Senator, Alaska State Legislature, remarked that she is really proud of the Board of Trustees and its management of the fund. She felt that there has been extraordinarily good management of the fund, and that has placed the state in its current position. Furthermore, the legislature has been [helpful as well]. Ms. Sturgulewski announced that she is in strong support of this proposed constitutional amendment. Ms. Sturgulewski commented that Hugh Malone and Elmer Rasmussen, as well as people from around the country who dealt with large foundations really developed the idea of inflation-proofing. She informed the committee that last year, 32 percent of the

amount of the dividend came from inflation-proofing. There was also a substantial portion of the dividend that came from the dollars that the legislature put into the fund. Ms. Sturgulewski related her feeling that the permanent fund would be the target if the fiscal gap isn't answered, which she felt would be a mistake. Ms. Sturgulewski noted that she serves on the University of Alaska foundation, the Board of Sheldon Jackson, and the local board of the YMCA, all of which use similar principles [to that of inflation-proofing the permanent fund].

TAPE 01-82, SIDE B

MS. STURGULEWSKI highlighted the fact that [even with HJR 15] the legislature would maintain its authority. The resolution merely protects a pot of money that will afford the legislature the ability to appropriate money from this pot in times of pressure. She hoped the committee would move ahead with this.

Number 0009

CHAIR ROKEBERG remarked that one of the problems with HJR 15 is that it requires the legislature to place a de facto cap or stipulate an allocation.

MS. STURGULEWSKI [agreed] that HJR 15 doesn't solve the fiscal planning, although it provides a tool: money. The legislature still has to make the decision.

CHAIR ROKEBERG surmised then that [the constitutional amendment] would have to proceed one step further in order to impact any of the long-range fiscal gaps.

MS. STURGULEWSKI agreed.

CHAIR ROKEBERG expressed concern with the adoption of this amendment without the ability of the legislature to deviate from the 5 percent constitutional rate, in the event of an emergency. He said that flexibility would probably give this amendment a boost.

MS. STURGULEWSKI echoed earlier statements that it would be up to the legislature to make the determination. Furthermore, the earned income account would still be available.

CHAIR ROKEBERG interjected that with the adoption of [HJR 15] the earned income account would go away.

MR. GRUENING remarked that the only thing that would be limiting would be the concept of principal. He posed a situation in which [HJR 15] was in place and there was a large emergency, which would result in the reordering of priorities.

MS. STURGULEWSKI said that everyone should understand that currently "we" have the components of the constitutional appropriation and there is the amount that the legislature has placed in the corpus. Furthermore, there are the earnings.

Number 0044

CHAIR ROKEBERG restated his question that deals with the circuit breaker concept. He saw this amendment as allowing [the legislature access to] only the 5 POMV funds. Therefore, he was concerned that the legislature has no provision to allow for an emergency allocation.

MR. GRUENING said, "Without amending the constitution." Mr. Gruening pointed out that such an argument was made against establishing the permanent fund in the first place. Senator Radar said to the Senate that it shouldn't tell future legislatures that it can't spend it all.

CHAIR ROKEBERG commented that such was taken care of with the creation of the statutory earnings reserve, although he wasn't sure that was fully understood at the time the fund was created.

MR. STORER pointed out that there is 5 percent, \$1.2-\$1.3 billion, available per year under this program. However, it would mean spending the dividend. In response to Chair Rokeberg, Mr. Storer said that this year it was just short of \$1.1 billion. Therefore, the legislature would have about \$1.25 billion to address an emergency. He noted that usually an emergency of the magnitude [that would be addressed by the \$1.25 billion] would take years to address.

CHAIR ROKEBERG questioned whether \$9 [a barrel for] oil would be considered an emergency.

MR. GRUENING facetiously pointed out that a three-quarter vote could be taken.

CHAIR ROKEBERG expressed concern with the potential \$800-\$900 million annual gap and the availability of [only] about \$200 million [to address that gap].

MS. STURGULEWSKI commented that such difficulties illustrate why the permanent fund is a target. She asked whether [the legislature] wants to have [the 5 POMV of the permanent fund] as one of its tools on an ongoing basis [as proposed under HJR 15].

Number 0089

REPRESENTATIVE COGHILL turned to the mechanics, the timing, that would take place if HJR 15 were to pass and be adopted by the voters. He inquired as to the timing in relation to overlapping the statute with regard to the earnings reserve account and the determination of advisory averaging while moving into a market base.

MR. STORER answered that he believes there is a 60 or 90 day lag. However, the computation would use the prior five years and thus one would immediately know how much is available.

Number 0100

JIM KELLY, Research & Liaison Officer, Alaska Permanent Fund Corporation, Department of Revenue, clarified that it would be less than 90 days; it would be some time prior to February 2003. At that time, the projections show a 5 percent payout being around \$1.3 [billion]. He pointed out that in terms of emergencies, the legislature has a solution in the form of the CBR, which has \$3 billion and that is as much as is in the earnings reserve account. Mr. Kelly remarked that if one wants to think about a long-term solution to a problem, one wants to keep a constitutional budget reserve. However, the permanent fund should be looked at as a growing source of income. Mr. Kelly reviewed the forecast over time in regard to the growth of the [earnings reserve account] and emphasized that the legislature wants to ensure that it has this resource. Without [the earnings reserve account], there is not only no resource, there is no solution to the problem.

Number 0125

REPRESENTATIVE COGHILL referred to lines 9-11 of HJR 15 and asked if that was taken care of in [subsection] (b). He asked whether that language [on lines 9-11] was necessary.

MR. KELLY explained that when the constitution was created 20 years ago, all the income from the permanent fund was to be deposited into the general fund, unless otherwise provided by

law. Therefore, the permanent fund was the principal only. In 1980, with the passage of the Alaska Permanent Fund Corporation Act, the law was changed to provide that income stayed in the permanent fund in an earnings reserve account. Therefore, it was clear in statute that the income was included as part of the permanent fund. This constitutional change clarifies the matter further by placing [the aforementioned language] in the constitution and thus the income of the earnings reserve account is part of the permanent fund. Therefore, the 5 percent of the income is paid plus the principal.

MS. STURGULEWSKI clarified, "On top of that."

Number 0157

CHAIR ROKEBERG requested that Mr. Storer or Mr. Kelly comment on his belief that the statute is broken as it relates to the Mother of all Models (MOMA) and thus [the state] finds itself in a negative market situation. He recalled that particular run of the model was based on the 1970s. He also requested comments regarding what would happen in relation to the statute with a Nikkei market that was 10-year down or flat-lined.

MR. STORER said that without using the MOMA but rather a simpler model he [researched] the type of market impacts that would have an adversarial effect on the permanent fund. He found, in reviewing the size of the fund now back to 1971, there was a lag. In about 1977 he found that the dividend ceased to exist and it was difficult to fund inflation-proofing for about a year, after which it went back up. That was the most negative scenario he could find. He mentioned that he actually [reviewed] the Depression era, where he found no impact.

CHAIR ROKEBERG recalled testimony from the corporation at a Senate Finance Committee hearing that if the large amount of monies in the earnings reserve hadn't been available, the dividend wouldn't have been paid. He mentioned a timeframe [during which the market] was on the downside.

MR. STORER agreed that the earnings reserve does allow a cushion in really negative environments such as is the case currently.

CHAIR ROKEBERG surmised then that if all the money people had wanted to take from the earnings reserve to place in the corpus had been done, there may not have been the money to pay the dividend, even in the near term.

MR. STORER agreed. He noted that in the late 1980s some money did go into the principal, which replenished the earnings reserve very quickly. Although that cushion [the earnings reserve] is down, it still constitutes about 15 percent of the fund. Mr. Storer indicated agreement with Chair Rokeberg's statement that in the 1980s almost everything was inflation-proofed.

CHAIR ROKEBERG expressed concern with the allocation issue and reiterated his concern with the circuit breaker issue. He related his belief that if [HJR 15] is adopted, then there should be a statutory scheme in place that goes along with it so that voters understand what will happen. He explained that the threat of an untoward allocation on the PFD could be used by opponents of the amendment. For instance, there [could be] a 50:50 split between the GF and the PFD that would lower the PFD to the point that this amendment [HJR 15] would be defeated. On other hand, having a residual of \$100-\$200 million for the GF seems to "lock up" the permanent fund for perpetuity and would also lead to the defeat of [HJR 15]. Therefore, Chair Rokeberg felt that the statute has to be changed along with the amendment, and also there needs to be some sort of circuit breaker even if that is the three-quarter vote.

Number 0242

SCOTT GOLDSMITH, Economist, University of Alaska - Anchorage, spoke in support of this amendment, HJR 15. He felt that [HJR 15] would achieve three very important objectives. First there is always the potential, under the current structure, that there may be conflicting management objectives. On the one hand, there is the objective of maximizing long-term real rate of return on the fund. On the other hand, there is the short-term objective of meeting any dividend payment target, which would be eliminated with a 5 percent annual automatic draw from the fund. Furthermore, Mr. Goldsmith felt that the 5 [POMV] would free management to look to the long-term and maximize the real rate of return of the fund. Second the current annual flow of income off the fund is somewhat unstable. Although the 5 [POMV] wouldn't completely eliminate that instability, the fluctuations from year to year would be significantly reduced, he thought. Such would be useful in regard to long-term fiscal planning. Finally, this amendment would solidify the inflation-proofing of the principal so that there would be no chance of having years without inflation-proofing.

Number 0276

REPRESENTATIVE DAVIES explained that the inflation-proofing [the 5 POMV] is built in to the calculation, assuming the long-term rate of return and the long-term inflation rate. Therefore, he questioned how "good" those numbers are.

MR. GOLDSMITH noted that he isn't an expert in how other funds have performed. However, in speaking with others that are more knowledgeable, he understood that 5 percent is a reasonable target that can be achieved over the long-term. He said he wouldn't recommend going higher than 5 percent.

CHAIR ROKEBERG pointed out that [the 5 percent] is the payout and isn't necessarily the real rate of return, which is based on the level of inflation.

MR. GOLDSMITH clarified that he has the understanding that a 5 percent rate of return isn't unreasonable over the long term. In response to Chair Rokeberg, Mr. Goldsmith remarked that a 6 percent rate of return would be "stretching it a little bit."

MR. GOLDSMITH, in response to Chair Rokeberg's concern regarding a circuit breaker for emergencies, noted that the legislature would probably have other sources available in an emergency. He felt that turning to the permanent fund should be the last resort. He echoed earlier testimony that the CBR or temporary taxes could be options.

CHAIR ROKEBERG announced that the public hearing on HJR 15 would be recessed until some time in January.

[HJR 15 was held over.]

CHAIR ROKEBERG called for a recess at 1:06 p.m. He called the meeting back to order at 1:45 p.m.

SJR 23 - CONST AM: APPROPRIATION/SPENDING LIMIT

Number 0326

CHAIR ROKEBERG announced that the next order of business would be CS FOR SENATE JOINT RESOLUTION NO. 23(FIN) am, Proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit.

Number 0331

SENATOR DAVE DONLEY, Alaska State Legislature, testified as the sponsor of SJR 23. Senator Donley informed the committee that when the Senate passed SJR 23 he promised to work with Legislative Legal Services and the Legislative Finance Division on defining the concept of a constitutional spending limit. The aforementioned group has been working on that and developed the proposed committee substitute (CS) that is before the committee today.

Number 0361

REPRESENTATIVE MEYER moved to adopt proposed HCS CSSJR 23, version 22-LS0734\P, Cook, 9/4/01, as the working document before the committee. There being no objection, Version P was before the committee.

SENATOR DONLEY turned to his slide presentation that is included in the committee packet. He remarked, "Most Alaskans agree that development of a long-range fiscal plan is one of the greatest challenges facing our state." He felt that it is surprising to look at where [the state] is today versus where it was with the constitutional budget reserve (CBR). He pointed to a chart that illustrated that the CBR didn't follow the projection that it would be exhausted in 2000. Legislative Finance reviewed why the result was drastically different than what was projected several years ago. There were four major reasons for the difference. The second largest reason was lower general fund (GF) spending while the largest reason for the difference was that there were more settlements coming into the CBR.

CHAIR ROKEBERG clarified that the CBR is higher because of \$711.9 million in spending cuts, \$1.3 billion in greater settlements, as well as greater than projected earnings and oil revenue.

REPRESENTATIVE DAVIES explained that the \$711.9 million is partly because of budget cuts and partly because the budget didn't grow by that much. He pointed out that there was an assumption that the budget would grow by a certain percent and since it didn't, there was a difference.

SENATOR DONLEY agreed.

CHAIR ROKEBERG asked, "It's not the actual savings from the elimination of the monies, then?"

SENATOR DONLEY answered that it's the elimination from projected budget growth. He explained that the original graph illustrates where the state would be with the CBR based on the projections in 1995. The next graph explains why the CBR didn't move/expire as projected in 1995.

SENATOR DONLEY said, "The Senate Majority believes that before considering major new taxes on Alaskans, first we need to make sure that ... state government is running as well as possible." He pointed out that in the U.S. constitutions are the basis for government. Therefore, the first step should be to review the state constitution and determine whether it is functioning properly. He felt that there are two parts, which deal with fiscal policy, of Alaska's constitution that aren't functioning properly. Those are the existing constitutional appropriation limit and the existing constitutional budget reserve provision. The resolution before the committee addresses the existing constitutional appropriation limit.

SENATOR DONLEY stated that the current constitutional appropriation limit provision isn't working, the language is misleading and unclear, and the limit has grown too large. He explained that the limit was set in 1982 with an escalator based on population and inflation that has driven it to an unrealistically high amount of over \$6 billion. However, the definition of what is included in the constitutional appropriation limit would lead to spending of about \$3 billion. He reminded the committee that the discussion revolves around spending, as defined by the constitutional provision.

SENATOR DONLEY turned to the overwhelming rejection of the last fiscal plan proposal in September 1999. He interpreted that rejection as the public not wanting to give the government a blank check; the public wanted some assurance that additional revenues wouldn't merely fuel more spending. Therefore, having reasonable limits on government spending would seem to be acceptable to the majority of Alaskans and thus is the proposal embodied in SJR 23.

SENATOR DONLEY moved on to the next slide that has a graph illustrating the current spending limit versus recent appropriations. The graph illustrates that [the state] is spending about half what [the limit] allows. Senator Donley reiterated that the constitutional appropriation limit isn't working and has never worked. Furthermore, the language in the provision leads one to believe that one-third of the spending has to be towards capital projects, but an attorney general's

opinion has stated otherwise. Again, an average citizen would be confused and thus the language should be simplified. The interpretation has been that the one-third spending towards capital projects would only occur if the \$6 billion spending occurs, which won't happen. "To correct this, the proposed committee substitute proposes to base any allowable increases on previous year's budgets and to limit those increases to only 2 percent," he explained. The [CS] also clarifies what is and is not included in the appropriation limit.

SENATOR DONLEY continued with the slide that includes a graph illustrating the effect of Version P. He noted that there is a safety valve in that in years when there is the need to spend more money, a super majority concurrence allows an additional 2 percent to be appropriated. He clarified that the [additional 2 percent appropriation via a super majority concurrence] ensures that it is based on what is being spent in the current year. Therefore, there wouldn't be a growth rate that is higher than the out years. He specified that it is always based on the amount of the prior two years, which he saw as a big improvement to the 1982 amendment. This amendment will base the appropriation limit on the two previous years' budgets and thus there is a greater relationship between the two.

SENATOR DONLEY announced that these artificial limits on spending aren't his first choice. He preferred that the legislature and the executive branch come together and limit spending, which is very difficult. He felt that an artificial restraint would be the best option right now. This artificial restraint provides the public with a constitutional mandate that any money, in addition to the 2 or 4 percent, would go towards reducing the fiscal gap.

Number 0553

REPRESENTATIVE OGAN inquired as to whether Senator Donley was concerned that this would send a signal to legislators that it is acceptable to increase the budget by 2 percent every year, and 4 percent if the votes are obtained.

SENATOR DONLEY acknowledged that there may be a tendency to think that way. However, this [proposal] is vastly superior to the current malfunctioning [limit]. This proposal is a realistic limit because going over 2 percent could only occur with a super majority vote and going over 4 percent would require some other provisions. Furthermore, Version P requires that this automatically return to the voters in four years in

order to assess whether it's working or not and whether there is the desire to take it out of the constitution. After the first four years, the opportunity to remove this from the constitution would automatically occur every six years.

Number 0583

REPRESENTATIVE OGAN posed a situation in which there is an emergency need for increased spending that exceeds the 4 percent. He asked if there is any circuit breaker to deal with that possibility.

SENATOR DONLEY pointed out that there are ten exceptions, including appropriations to the permanent fund, dividend program, disasters, the railroad, general obligation (GO) [bonds], and revenue bonds. He emphasized that if there was ever a real problem that didn't meet other definitions, such as a disaster or war, then the capital budget could be placed on a GO bond and placed before the voters. There could be a contingent budget based on voter approval. Under the existing budget, there is over \$100 million of emergency leeway and the general operating dollars would be replaced with the GF for the capital budget.

Number 0628

REPRESENTATIVE DAVIES pointed out that a contingent budget couldn't be passed because that would be tantamount to the people appropriating.

SENATOR DONLEY indicated agreement with Representative Davies, but noted that [the legislature] could be prepared to deal with it if the people didn't approve it.

TAPE 01-83, SIDE A

SENATOR DONLEY noted the option of bonding for some expenses that are currently dealt with through GF. Senator Donley continued with the exceptions. Money that is appropriated from the federal government is excluded from the [constitutional appropriation] limit as are obligations on bonds, certificates of participation, reappropriations, transfers between state agencies, and appropriations under the super majority provision. Senator Donley felt that [HCS SJR 23] is a vastly superior definition in regard to what is included and not included in the calculation of the appropriation limit versus the 1982 version.

Number 0010

REPRESENTATIVE COGHILL inquired as to how [HCS SJR 23] addresses capital.

SENATOR DONLEY explained that non-federal capital expenditures are included in this appropriation limit while federal money isn't included.

REPRESENTATIVE COGHILL referred to the one-third portion for capital spending that is currently in the constitution.

SENATOR DONLEY interjected that it's deleted.

REPRESENTATIVE BERKOWITZ asked if this resolution would eliminate the three-quarters (indisc.) line item.

SENATOR DONLEY replied no.

Number 0025

DAVID TEAL, Director/Legislative Fiscal Analyst, Legislative Finance Division, Alaska State Legislature, referred to [Article IX] Section 16 of the Alaska Constitution, and explained that the limit can be exceeded for permanent fund bills and appropriation bills for capital projects if approved by the governor. The entire discussion regarding a portion being used for capital budget spending [is deleted] while [the current constitutional language] refers to bills passed by the governor or an override of a capital bill.

REPRESENTATIVE BERKOWITZ inquired as to the section in the constitution where the three-quarter override of an [appropriation] veto is located.

SENATOR DONLEY answered that the three-quarter override language is located in the primary part of the constitution under Executive Powers.

MR. TEAL quoted from Article IX, Section 16 of the Alaska Constitution as follows: "The legislature may exceed this limit in bills for appropriations to the Alaska permanent fund and in bills for appropriations for capital projects, whether of bond proceeds or otherwise" [This resolution] says that bills that appropriate money to the permanent fund or appropriate money for any capital projects that are passed by the governor or overridden by the legislature are outside the limit.

SENATOR DONLEY interjected that the three-quarters override requirement for a budget item is contained in the original constitution.

MR. TEAL noted that all appropriation bills have a three-quarter super majority override while a two-third override is required for nonappropriation bills. Mr. Teal clarified, "What it really says is that if you exceed the limit, you can go to the voters and ask them if it's OK to exceed the limit."

Number 0077

REPRESENTATIVE BERKOWITZ posed a hypothetical situation in which there was a federal mandate, a large population increase, or a large increase in inflation. In such a situation, how would this spending cap operate?

SENATOR DONLEY answered that the ordinary growth would be limited to 2 percent, while any federal funding for the situation would be outside of the limit. Furthermore, with a super majority, the [appropriation] could be increased to 4 percent in additional spending. If inflation or population growth was over 4 percent, then the actual per capita spending would be forced to decrease.

REPRESENTATIVE BERKOWITZ posed a situation in which there was 10 percent inflation and a large population increase while the federal government says that funding must be changed pursuant to federal standards. He asked if the state would have to "eat that difference."

SENATOR DONLEY answered that the next step would be to review GO bonding, a portion of the capital, in order to free up additional GF for operating, which would require a vote of the people. He emphasized that for most states, when there isn't enough money for their operating budget, they don't have a large capital budget. The second step would be the automatic review by the voters after four years, and then again in six years. If this [appropriation limit] wasn't functioning properly, then it could be taken out of the constitution. The ability to vote to take the provision out of the constitution is something the 1982 provision doesn't have.

REPRESENTATIVE BERKOWITZ inquired as to why 4 percent was chosen.

SENATOR DONLEY explained that the original proposal was one-half of population and inflation growth. However, the past seemed to support 2 percent as a reasonable amount of growth. He further explained that he was trying to tie it to a close previous year rather than a fixed point in time. However, a reasonable amount of increase is open for debate.

REPRESENTATIVE BERKOWITZ related his understanding then that the 4 percent relates to historic inflation and historic population growth.

SENATOR DONLEY answered, "Somewhat." However, Senator Donley noted that one of the intents of this resolution is to work towards lower per capita spending. "So, while it allows real spending increases by only allowing a 2 percent increase, in years where you may even have a bigger inflation and so you need to go to 4 [percent], you're still working towards reducing our overall per capita spending," he clarified.

Number 0094

CHAIR ROKEBERG pointed out that if there is high inflation, a 4-6 percent increase, then there may actually be a diminishment of spending in real terms. Therefore, it is possible to move into a negative growth situation that may or may not be good.

CHAIR ROKEBERG inquired as to where the state stands in regard to the [actual appropriated] GF.

MR. TEAL answered that [the actual] GF [appropriated] is \$2.4 billion.

CHAIR ROKEBERG noted that there is about a \$770 million distinction in definition between what is called GF now and what the definition is [in this resolution].

SENATOR DONLEY noted that there is an existing definition in the constitution for the existing appropriation. Therefore, Version P revises that existing definition.

MR. TEAL added that what happens over time is a shifting of expenditures from the general fund to the other fund's column. He explained that [Version P] looks at all state expenditures rather than looking at straight GF appropriations, which is what the constitution did. With this new approach, one must also review what is excluded. For example, [the language in the constitution for the appropriation limit] excluded permanent

fund dividends, but it didn't exclude permanent fund inflation-proofing or special appropriations to the permanent fund both of which are excluded in Version P. Furthermore, bond proceeds were already excluded from the limit, but with Version P debt service on bonds is also excluded. The Alaska Railroad Corporation is excluded because it is off-budget and there is no desire to include them even if the corporation became part of the budget at some time.

MR. TEAL agreed with Chair Rokeberg's earlier remark that there is about \$700 million of other state spending that is subject to the limit, not just GF.

MR. TEAL, in response to Representative Davies, confirmed that the other state spending does include the Alaska Housing Finance Corporation (AHFC) and the Alaska Industrial Development and Export Authority (AIDEA). Mr. Teal indicated agreement that AHFC and AIDEA are included because they are subject to the Executive Budget Act. He explained that the operating expenses of AIDEA and AHFC are appropriated.

Number 0150

REPRESENTATIVE MEYER remarked that this proposal reminds him a lot of the tax cap the Municipality of Anchorage (MOA) has. He recalled that the MOA's tax cap is based on increases in the CPI and a five-year average of the population. He asked if an approach like that of the MOA would be better than specifying 2 percent.

SENATOR DONLEY said that such models had been reviewed and he was open to such a proposal. However, he noted that he was pleased with his resolution because of its simplicity, and because of its ultimate result of reducing capital expenditures if inflation and population increases continue. One of the biggest faults with the 1982 amendment was that whatever the population and inflation, the growth was allowed.

MR. TEAL remarked that simplification is really the answer. He recalled that the discussion over the resolution moved to the question of how much money is involved. That discussion [resulted] in the determination that this limit allows budget growth of \$64 million with a simple majority vote and \$128 million with a two-thirds majority. Therefore, if one is attempting to limit expenditures, what number would one choose. Rather than try to figure out inflation and population growth, a number was chosen. Two percent is about half of the long term

... However, Mr. Teal mentioned that if one is interested in making this [appropriation limit] last forever, without any modifications, then the actual growth rates should be included because it would better keep pace.

Number 0198

REPRESENTATIVE MEYER inquired as to why the amendment [embodied in SJR 23] would go before the voters every six years.

SENATOR DONLEY reiterated that the 1982 amendment has never worked. He wished that there had been an automatic opportunity to get rid of [the 1982 amendment] because it's difficult to reach the consensus necessary in the legislature to place it on the ballot. The amendment goes before the voters in order to ensure that the issue is reviewed in a meaningful way. This automatic placement before the voters forces honest review of the amendment by the legislature. Although Senator Donley acknowledged the argument that too many items on the ballot [make the voter complacent], he felt that the largest problem facing [the state] is the fiscal gap. The number one way to solve the fiscal gap is to ensure the public, through the constitutional guarantee, that [the legislature] won't go crazy if additional revenue is found.

Number 0226

REPRESENTATIVE BERKOWITZ inquired as to the appropriation limits that were in place prior to 1982.

SENATOR DONLEY replied none, save the constitutional provision to balance expenditures to revenue.

CHAIR ROKEBERG pointed out that there could be deficit spending.

REPRESENTATIVE BERKOWITZ remarked on the simplicity of that approach and thus he suggested going back to that provision.

MR. TEAL pointed out that in 1982 people expected \$100 per barrel of oil and revenues that exceeded expenditures. Therefore, the purpose of the limit was to try to force [the legislature] to not spend some of that excess revenue. Although the \$100 per barrel of oil never came, [the legislature] managed to get through the budget process. Therefore, some would argue that an [appropriation] limit isn't necessary because public opinion and limited revenue are the appropriation limit. However, that is a political argument.

REPRESENTATIVE BERKOWITZ highlighted the other limit that is in place, an election. Elections take place every two years, and therefore if people are unhappy with the appropriations that legislators make, then the public can vote the legislator in or out. Representative Berkowitz expressed concern that the fundamental purpose of this appropriation limit is to reduce per capita spending, which he didn't believe to be the primary obligation of a legislator. The primary obligation of a legislator is to fulfill the constitutional mandates for education, public safety, and transportation. Although that obligation is different, it does overlap [with per capita spending].

Number 0268

SENATOR DONLEY commented that he believes it's a political question. Senator Donley said, "My first choice is ... that we would have the discipline to prioritize our budget, to live within our means, and still fulfill those constitutional directives and mandates. Unfortunately, government in a democracy is driven just the opposite direction." Our system of government doesn't lend itself well to dealing with deficits because there is always this great demand for additional spending without additional taxation. [Alaska] is almost to the point of crisis and it's time to start doing something about it. This proposal is a positive step forward. Furthermore, all that is really being done here is allowing the people to vote as to whether they think the current constitutional appropriation limit should be revised to this proposal.

REPRESENTATIVE BERKOWITZ stated his belief that allowing people to vote is always a good plan.

MR. TEAL pointed out that the appropriations or expenditures of most states are limited by revenue. However, Alaska has the CBR, which is essential to the state as a shock absorber or budget stabilizer because oil prices and revenue fluctuate a lot. The difficulty is that there are projections that the CBR will not exist in five years because of the fiscal gap. Without the CBR, the state would be in real trouble.

Number 0307

REPRESENTATIVE BERKOWITZ inquired as to how this amendment would impact the CBR evaporation.

MR. TEAL answered by pointing out that there is some feeling that the revenue side of the problem can't be addressed until the blank check is taken away. Therefore, this proposal restricts expenditures, although he didn't have an exact amount of the restriction. This proposal has the probability of being more effective than the existing limit. The fact that the limit exists may help the legislature address the revenue side as well.

REPRESENTATIVE BERKOWITZ said that in looking at a spending restriction, there is still a revenue gap. Therefore, he felt that the public should have a complete picture, and be told how the revenue gap is simultaneously filled. That is, the entire package.

SENATOR DONLEY responded that such an approach is problematic because the public doesn't know what will and will not pass. Furthermore, a package of these proposals can't be created. Therefore, an [incremental approach] must be taken, which begins by fixing the foundation.

Number 0337

CHAIR ROKEBERG inquired as to what would happen to the base if there was an extraordinary natural disaster that necessitated a \$300 million spending appropriation.

SENATOR DONLEY clarified that things that are outside the base don't count towards the next year's base, which he felt was an improvement [over the 1982 amendment].

CHAIR ROKEBERG remarked that, in a certain sense, artificial caps create artificial problems. However, he acknowledged that the exceptions included in this resolution seem to offer some flexibility.

SENATOR DONLEY pointed out that the super majority vote for a 4 percent increase, the public review, and the bonding option are safety valves for a limited amount of time.

Number 0380

REPRESENTATIVE DAVIES remarked that originally he understood this [2 percent] to be based on the previous two years and averaged; however, [now he understood] it to be based on the two years preceding. Therefore, "it's just looking back two years."

SENATOR DONLEY interjected, "Because we don't have the numbers for the prior year to be able to prepare the budget for the next year. So, we had to go back two years to base it on."

REPRESENTATIVE DAVIES surmised that if there was a situation in which the budget was reduced and "you went out a couple of years," then there might be a large step function that got limited. He offered one solution: a funding average over a few years. If there was a year in which [the budget would really be reduced], then there wouldn't be such an impact in the next two years.

CHAIR ROKEBERG noted the possibility of making it open-ended [with the super majority vote to break the 6 percent] rather than having the 2 percent. However, he questioned what would happen in regard to budget discipline. The public would be left to determine whether the super majority vote was valid.

REPRESENTATIVE BERKOWITZ remarked, "I'm sure when the time is right, our friends in the Republican minority won't ... withhold their votes for anything."

Number 0417

SENATOR DONLEY suggested that the chance of reducing the amount of money that falls under this appropriation by more than 2 percent in one year would be fairly slim. If a 2 percent cut was achieved, it would automatically be made up.

CHAIR ROKEBERG mentioned the possibility of underfunding the growth effect. If there was extraordinarily fast growth, then [the budget] may not be keeping up with public services appropriately. Therefore, he questioned how that would be addressed when there are static numbers. Chair Rokeberg noted that such could be the reason for a public policy that makes the assumption that overspending is occurring currently, and therefore the spending cap would need to be limited in order to deal with it underneath it.

SENATOR DONLEY answered that if forced, some prioritizing decisions could be made to shift funds to education, public safety, and transportation in order to ensure those areas are addressed.

Number 0461

SCOTT GOLDSMITH, Economist, University of Alaska - Anchorage, related an observation from the public's perspective in regard to whether a 2 percent growth limit would convince the public that the legislature was "taking the cure." Mr. Goldsmith pointed out that an average of the growth rate on the chart [included in the committee packet] would probably average 2 percent. Therefore, one could argue that this proposal merely puts in place what is already being done and thus [the problem isn't really being addressed]. Furthermore, the argument could continue in the vein of the public - the general public who doesn't understand real dollars versus nominal dollars - wanting "real cuts." However, Mr. Goldsmith felt that [Senator Donley] is on the correct path in saying that the public needs to understand that working to reduce the budget has to happen first. Mr. Goldsmith asked, "What's to stop the legislature, on the first day of the session, from just all pledging that this year the budget is going to be no bigger than it was last year?"

MR. GOLDSMITH informed the committee that he had done an analysis of the earlier version of SJR 23, and therefore it's not directly relevant to Version P. However, a number of the changes encompassed in Version P responded to some of his thoughts on the earlier version of SJR 23.

Number 0518

CHAIR ROKEBERG commented that by going to a 4 percent solution, then there is a static number. However, the prior version did include population growth and inflation. Chair Rokeberg expressed concern that if there is a stipulated amount of 4 percent or even 6 percent, it would have a potential negative impact on economic growth in this state. He noted the need to keep in mind the impact of the state government on the gross state product and how much economic activity state government generates. To him, even the status quo is not a very satisfying prospect, as a matter of economic policy.

MR. GOLDSMITH said that it seems that [the state] faces a trade-off. On one hand, everyone recognizes that there is a severe fiscal problem and there have been no solutions. However, if holding the line on spending can be a first step to providing a solution, then serious thought should be given to that. At the same time, one should recognize that when one ties [the state's] hands and limits the growth to a fixed percent per year, there will potentially be some consequences that may be adverse in the future. He felt that the most obvious potential adverse consequence is the one that [Chair Rokeberg] suggested.

MR. GOLDSMITH pointed out that the amendment begins by going into effect for four years. In his opinion, the growth rate of the population and inflation over the next four years would be 1 percent a year and 2-3 percent, respectively. He felt that those projections would be consistent with [2] percent growth in the state budget, which would mean that the budget would get a little smaller in real per capita terms. However, that is also a continuation of the trend line that the state has been on for the last few years. On the other hand, the Alaska economy is very difficult to predict. If there is one year when population growth is higher [than his aforementioned projection], then it isn't so bad, as long as it falls again. However, if there is a longer period, 5-10 years of sustained rapid growth of the population or inflation, then there would likely be faster growth of the economy. The most obvious situation that would trigger such a scenario would be a gas line or the opening of the Artic National Wildlife Refuge (ANWR). Such was the case in the 1970s when the annual growth in population was 3 percent and the annual rate of inflation was 7.6 percent. He noted that those figures were taken from the Anchorage CPI and thus are lower than the U.S. CPI. If there was another decade like the 1970s, then a 2 percent limit would result in a reduction in real per capita spending of 8 percent every year for ten years.

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MR. GOLDSMITH continued by saying that one must recognize the difficulty in predicting these rates of growth, and a stipulated percent ties the state's hands in terms of flexibility and how one can respond to situations. Furthermore, there are some things that lay outside the GF budget, but are tied into economic growth such as the operation of the airport, and the non-GF portion of the university budget. He posed a situation in which there is an influx of students. Such a situation would be great for the state, but he surmised that their tuition would be included in the cap and would place a squeeze on the GF.

Number 0013

MR. TEAL responded, "That is one of the weaknesses here." However, there are ways to maneuver around having too much decline and limited flexibility in responding to high inflation. For instance, a third provision could be added that the cap would be 6 percent [to an] unlimited [percent] with a 75 percent vote.

CHAIR ROKEBERG said he liked that idea.

MR. TEAL returned to the earlier example in which university enrollment increases, let's say that enrollment doubles in the next five years. In such a situation, the university's tuition receipts would double, and tuition receipts aren't exempt from spending limits. Therefore, something will suffer if the 2 percent is used on funds that one doesn't really want to consider, however there is no way to write them out. He guessed university funding could be exempted. Mr. Teal clarified that the more exemptions there are, the less the limit accomplishes. Although one can argue that any agency or program, such as the university, that generates its own revenue shouldn't be subject to the limit, "we can't figure a way out of it."

Number 0038

REPRESENTATIVE COGHILL inquired as to the lag time when determining population and inflation growth.

MR. GOLDSMITH remarked that inflation [growth] would be easier to pin down. As mentioned earlier, Anchorage has a CPI, which comes out in May of the next year. Therefore, there would be a five-year delay. However, the U.S. CPI is calculated monthly. In regard to Alaska's population growth, he suggested asking the Department of Labor & Workforce Development.

REPRESENTATIVE COGHILL related his view that if the [appropriation] limit is tied to per capita, then it could grow with the per capita while limiting spending. Perhaps an artificial cap may place undue pressure on areas where such isn't desired. However, [there could be a] combination of inflation and population growth with a year-and-a-half average. He felt that such a formula could be sold [to the public] more easily.

MR. GOLDSMITH recalled a problem with the Anchorage cap due to the lag, in that the additional amount in expenditures is based on the population change and inflation from the last year. However, what one would want to do is spend to the population and inflation change that is expected for the upcoming year. If the population went down last year but is expected to increase [this year], the spending [still] has to be based on what happened in the prior year. Such a "squeeze" occurred in the late 1980s.

SENATOR DONLEY said he would agree with that if he felt that government was operating at maximum efficiency. However, he felt that there is greater flexibility in the numbers rather than following exactly what population and inflation does.

MR. TEAL noted that although the moving average does stabilize things, it causes "you" to respond slower.

CHAIR ROKEBERG interjected that a U.S. city average, which is published on a monthly basis, would have to be adopted.

MR. TEAL stated that having the "latest, greatest data doesn't do any good. He pointed out that the Office of Management & Budget (OMB) and the agencies are preparing the 2003 budget, and thus they need to know what the 2003 numbers are now. Furthermore, the expenditures for 2002 can't even be dealt with because the 2002 expenditures are unknown and thus the expenditures are based on 2001, which is why there would be a two-year lag. Therefore, the population and inflation [data] may as well be behind a year as well. In his opinion, "it's just not that critical."

Number 0092

REPRESENTATIVE DAVIES mentioned the tendency to mix appropriations and expenditures. He pointed out that the resolution refers to the appropriation, not the expenditure, for the two years preceding. Therefore, he questioned why there needs to be a two year lag if it's based on the appropriation, which is a known.

MR. TEAL pointed out that the supplemental [appropriations] aren't complete. He reiterated that the appropriations for 2002 would be unknown.

REPRESENTATIVE DAVIES interjected that such could be known.

SENATOR DONLEY remarked that people could be enticed to short fund the budget if the desire was to not encourage fiscal discipline. He predicted that such a situation would result in a larger supplemental [budget].

REPRESENTATIVE DAVIES said that the supplemental [budget] in a given year would have to be included.

MR. TEAL, in regard to Representative Davies' suggestion, said that FY02 supplemental [appropriations] could be counted as FY03 spending.

CHAIR ROKEBERG asked if anyone else wanted to testify on SJR 23. There being no one, the public hearing on SJR 23 was recessed.

CHAIR ROKEBERG remarked that he was [less] skeptical now, after recognizing that [SJR 23] may be a symbolic political act that is necessary for the state's long-range fiscal plan.

REPRESENTATIVE DAVIES estimated that the portion of the population that this proposal would appeal to represents about one-third of the population. In his experience, those people want 40 percent cuts on an annual basis, real Draconian cuts. Therefore, he questioned whether [this proposal] would satisfy those people to which it attempts to speak. He asked if this [proposal] will really address the problem, so that the legislature can move on to solving the real problem of the fiscal gap.

SENATOR DONLEY responded that he would like to put forth his best effort to make [this proposal] a realistic restraint without being Draconian, if for no other reason than eliminating what is currently in the constitution.

CHAIR ROKEBERG recessed the hearing on SJR 23.

[SJR 23 was held over.]

SJR 24 - AMEND CONSTITUTIONAL BUDGET RESERVE FUND

Number 0151

CHAIR ROKEBERG announced that the last order of business would be CS FOR SENATE JOINT RESOLUTION NO. 24(RLS), Proposing amendments to the Constitution of the State of Alaska relating to the budget reserve fund.

Number 0153

SENATOR DAVE DONLEY, Alaska State Legislature, testified on behalf of the Senate Finance Committee, sponsor of SJR 24. This resolution would amend the current constitutional budget reserve (CBR) amendment. Although the CBR is functioning well as a fiscal shock absorber, it isn't functioning well in regard to helping control spending and enforcing fiscal discipline. Under

the current situation, small groups of legislators can force increased spending by withholding CBR votes. If one were to count all the proposed floor amendments that were made, rejected, and eventually included in the budget in order to obtain the three-quarters vote, it would sum \$150 million this year. Senator Donley agreed to provide the delineation of the \$150 million.

SENATOR DONLEY informed the committee that the packet should include the language that the voters saw when the CBR was adopted in 1990. The lieutenant governor's description of the CBR said that the fund could be used when money available for appropriation in the year is less than the year before, but only if the shortfall is made up. However, the legislative affairs' summary specified that appropriations may be made from the CBR only if the money available for the fiscal year is less than the amount appropriated for the prior year. The proponents' statement says that the CBR is an effective first step to controlling state spending and that is partly due to the ability to use CBR funds when revenues are less than the amount appropriated in the previous year, in which case the amount appropriated from the CBR couldn't exceed the shortfall. Even the opponents' explanation said that a simple majority of the legislature could borrow funds from the CBR to make up any shortfalls in revenues up to the amount appropriated in the previous year. Everyone agreed that money [from the CBR] could be accessed with a simple majority vote in order to make up for the shortfall, up to the amount that was appropriated in the previous year.

SENATOR DONLEY said that didn't happen, however. Once the amendment was adopted, the legislature adopted the statutory explanation of the language, which the court subsequently overruled as being in conflict with the court's meaning of "being available for appropriation". Whether the court was correct or not, that wasn't what the people voted on. Therefore, this resolution is an attempt to restore what was meant by Ballot Measure No. 1 with regard to accessing the CBR. Thus, SJR 24 proposes to correct the problem identified in the court case and clarify that in a year in which revenues are less than the previous year, the legislature may access the CBR by a simple majority vote for funding up to the previous year's appropriation. This resolution also deletes the so-called "sweep provision," which requires a three-quarters vote to repay the money taken from the CBR in the previous year.

Number 0217

REPRESENTATIVE DAVIES noted that [SJR 24] has been characterized as fixing a budget, a "blackmail" situation. Although that argument can be made, the other side is that in other areas of the budget the Majority short funds the budget, relying on the Minority to force limits that the Majority wants, but for which they don't want to take credit or blame.

CHAIR ROKEBERG said that there is some truth to that statement.

REPRESENTATIVE BERKOWITZ commented that he noticed that Senator Donley's budget report to the public took credit for funding that "we" [the Minority] insisted on as part of the CBR vote. He cited the funding for education and the troopers as examples.

Number 0248

MR. TEAL, in response to Chair Rokeberg, explained that typically each year the appropriation's bill contains what is called "the reverse sweep" section. That section is included because the constitution specifies that if there are any outstanding borrowings from the CBR, then every June 30th all the subaccounts of the general fund (GF) are swept into the CBR in order to repay it. He estimated that there is about \$3 billion in debt.

SENATOR DONLEY pointed out that it is a year-to-year forgiveness, and therefore there is no outstanding debt that has to be handled by a three-quarters vote on the \$3 billion. He clarified that the debt is only for the debt of the prior year.

MR. TEAL estimated that approximately \$100 million a year from the GF subaccounts is swept into the CBR. The language in the appropriation's bill says that the money taken from the GF subaccounts is replaced by withdrawing from the CBR. Therefore, that is a withdrawal from the CBR and would require a three-quarter vote. In essence, [the language] says that in order to make the [GF] subaccounts whole, a three-quarter vote is required. That is part of SJR 24 because if the super majority vote is trying to be avoided in order to just have a budget that is the same as last year, then the \$100 million sweep super majority requirement must be eliminated.

CHAIR ROKEBERG related his understanding, then, that this resolution maintains the CBR while modifying how it functions.

SENATOR DONLEY explained that the resolution modifies how the CBR is accessed and eliminates the sweep provision. The original intent of the amendment is restored, in that a three-quarter vote is only required for those funds that are over and above what was appropriated for the previous year. Therefore, a three-quarter vote would be required if the desire is to increase spending and obtain the [increase] from the CBR. Only a simple majority vote is required to access money that is equal to what was appropriated in the previous year.

Number 0292

REPRESENTATIVE DAVIES asked if that would have any cash flow implications.

MR. TEAL noted that the opinion on that differs. Currently, the Department of Revenue doesn't believe the cash flow issue to be a large problem. In fact, borrowing \$50-\$100 million isn't really an appropriation from the CBR because it is being repaid before the end of the year. In other words, in FY01 the CBR draw wasn't necessary at all because \$300-\$400 million was taken from the CBR, but repaid before the end of the year. In response to Chair Rokeberg, Mr. Teal said that no interest is paid on the draw.

CHAIR ROKEBERG expressed his concern with the lack of interest payments.

MR. TEAL turned to FY01, when the legislature did take money from the CBR. Of course, the interest earnings that the GF recovered stays in the GF, and thus the year ends and there is a GF surplus of \$80 million. The sweep provision says that the \$80 million goes into the CBR, which happened. However, the reverse sweep only applies to the subaccounts of the GF, not the GF itself. Therefore, the interest was returned.

CHAIR ROKEBERG characterized [a draw from the CBR] as a single appropriation rather than an installment.

SENATOR DONLEY explained that if this resolution was placed on the ballot and approved by the voters, the situation would change such that the legislature could access the CBR with a simple majority for an amount up to the prior year's expenditures. However, there is much pressure to do more than that. Senator Donley felt that the three-quarters vote is appropriate since that was the original intent.

Number 0352

REPRESENTATIVE BERKOWITZ pointed out that [Article IX] Section 17 says, "(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature." He understood that language to refer to any appropriation.

MR. TEAL informed the committee that there are two sections that refer to removing money. One section requires a three-quarters vote for any purpose. The other section requires a simple majority vote, as long as the withdrawal is no more than was spent in the prior year.

REPRESENTATIVE BERKOWITZ said that under law that is in conflict, the default is to the [language] that is more restrictive.

SENATOR DONLEY disagreed and explained that the default is to try to read the [sections in conflict] jointly in an attempt to make sense.

MR. TEAL clarified that the three-quarters vote [is required] when the prior year's budget has been exceeded.

Number 0373

SENATOR DONLEY posed the possibility that the court is correct. Even if that were the case, the court's ruling isn't what the voters thought they were voting for nor was it the intent of the sponsors or the opponents. Therefore, he felt that the voters should have the opportunity to restore what they thought they were voting for. Senator Donley went on to point out that the court case centered around the language "available for appropriation". As a lawyer, he felt that the court had a defensible conclusion. However, it doesn't make it the best public policy or what the public thought it was getting.

CHAIR ROKEBERG recalled that there have been resolutions to repeal the entire section regarding the CBR. He inquired as to why Senator Donley chose to take the tact he did versus repealing the entire section.

SENATOR DONLEY answered with his belief that the CBR is working well and was a wise step as a fiscal shock absorber. Therefore, he felt that the well-functioning parts should be kept.

CHAIR ROKEBERG asked whether Legislative Legal Services had provided an opinion that [Article IX, Section 17] subsection (c) doesn't need to be modified to be crystal clear in regard to the intent.

SENATOR DONLEY informed the committee that the version adopted by the Senate Rules Committee accomplishes that goal.

CHAIR ROKEBERG asked whether anyone else wished to testify. [There being no one, the hearing on SJR 24 was recessed.]

[SJR 24 was held over.]

ADJOURNMENT

Number 0412

There being no further business before the committee, the House Judiciary Standing Committee meeting was adjourned at 3:23 p.m.