

HOUSE FINANCE COMMITTEE  
March 16, 2004  
1:44 P.M.

TAPE HFC 04 - 56, Side A  
TAPE HFC 04 - 56, Side B  
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TAPE HFC 04 - 58, Side A

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:44 P.M.

MEMBERS PRESENT

Representative John Harris, Co-Chair  
Representative Bill Williams, Co-Chair  
Representative Kevin Meyer, Vice-Chair  
Representative Mike Chenault  
Representative Eric Croft  
Representative Hugh Fate  
Representative Richard Foster  
Representative Mike Hawker  
Representative Reggie Joule  
Representative Carl Moses  
Representative Bill Stoltze

MEMBERS ABSENT

None

ALSO PRESENT

Cheryl Frasca, Director, Division of Management & Budget, Office of the Governor; Bruce Tangeman, Fiscal Analyst, Legislative Finance Division; Robert D. Storer, Executive Director, Alaska Permanent Fund Corporation, Department of Revenue; Bob Bartholomew, Chief Operating Officer, Alaska Permanent Fund Corporation, Department of Revenue; Laura Achee, Research and Communications Liaison, Alaska Permanent Fund Corporation; Roger Cremo, Anchorage.

PRESENT VIA TELECONFERENCE

None

SUMMARY

HJR 9        Proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit.

HJR 9 was heard and HELD in Committee for further consideration.

HJR 26 Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from and inflation proofing the Alaska permanent fund by establishing a percent of market value spending limit.

HJR 26 was heard and HELD in Committee for further consideration.

#HJR26

HOUSE JOINT RESOLUTION NO. 26

Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from and inflation proofing the Alaska permanent fund by establishing a percent of market value spending limit.

ROBERT D. STORER, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, introduced Bob Bartholomew, Chief Operating Officer, and Laura Achee, Research and Communications Liaison. He stated that Ms. Achee would give a power point presentation (copy on file.) and that Mr. Bartholomew would discuss the changes to HJR 26 in the Judiciary Committee Substitute.

Mr. Storer explained that from the time the Permanent Fund was created it has been the prerogative of the Board of Trustees to discuss inflation proofing and how the earnings are used. The Board believes the purchasing power of the Fund should be maintained for future generations. He said that he Fund can be divided into principal and appreciation, and realized income or the earnings reserve.

Mr. Storer said that the Board feels a 5% spending limit is appropriate because it creates a discipline during the up markets. He pointed out on the slide, "Permanent Fund market value," that on June 30, 2000 the Fund was worth over \$26 billion with \$3 billion in income, while that amount diminished during the following three years in the bear market. He reminded the committee that the principal is comprised of three things: mineral contributions, inflation-proofing from legislative appropriations from the earnings reserve into the principal, and special legislative appropriations from the earnings reserve or the General Fund, in the early 1980s, into the principal. The principal is almost equally divided into thirds.

Referring to the above slide, Mr. Storer noted that having a cushion and the discipline to not over-spend allowed the Permanent Fund to distribute three years' worth of dividends to Alaskans and also to inflation-proof the Fund.

Mr. Storer explained that after June 30, 2002, during the last fiscal year the Fund turned negative due to depreciation of the assets, but a strong fourth quarter helped the Fund have a positive 3-1/2% rate of return.

Describing the asset allocation, Mr. Storer explained that the current dividend or distribution formula is based on realized income from dividends, interest, cash flow from real estate, and realized gains from the sale of securities, primarily stock. He stated that the formula made a lot of sense in the late 1970s and early 1980s when the Fund invested exclusively in fixed income securities or bonds because most of the return on bonds came from the cash flow or interest from the Fund. Over its history, the Legislature has given the Permanent Fund greater latitude to make investments. More than half of the Fund is now invested in securities that gain not because of income on an annual basis, but because of appreciation in the equity markets. He said that the Fund has matured, but the payout methodology has not kept pace with contemporary asset management.

Mr. Storer explained that the Percent of Market Value (POMV) concept was discussed in the early 1990s when Hugh Malone was a trustee and again during a Board of Trustees retreat four years ago. Inflation proofing now occurs after the dividend distribution. The Board believes that inflation proofing, which is in statute, should be memorialized in the constitution to ensure equal treatment of all generations. The Board recommends a limit to the amount of appropriation of the Fund of no more than the real income in excess of inflation. The Board looked back at historical allocations and the assets of the Fund, as well as forward, and the Board believes 5% is on the high end of what is possible. No more than 5% could be appropriated in any given year, and to smooth the payout the Board proposes using the five-year average as of June 30.

Mr. Storer stated that this is consistent with modern payout methodology, with 85% of university endowments using some form of percent of market value. Over the long term, the Board projects that the Fund will earn 8%, with inflation at about 3%. The important number is the 5% real rate of return, he said. The Board adopted an asset allocation last week showing a projected rate of return of 7.6%. The Board's consultant projects inflation at 2.6% over the next five years.

Co-Chair Harris asked if the inflation proofing at 3% includes the money automatically deposited from royalties every year. Mr. Storer replied, no, the contribution from royalties would increase the size of the Fund and would be inflation-proofed along with the existing balance. Co-Chair Harris asked if the average of 3% could be higher if the

rate of return was higher, with the inflation-proofing as much as 15%. Mr. Storer said that would be true in the near term, in a single year, but with market volatility the Board believes it is important to look at a longer time horizon. Co-Chair Harris asked if the deposit of 25% of oil royalties is on top of the 3% inflation, and Mr. Storer affirmed.

Mr. Storer noted that page 4, "Fund Performance," shows the Fund returns for the past 10 years. The slide encompasses a number of extreme periods, including when the stock market was well above historical perspective and a period of bear market when it was going down. The Fund earned a 5.3% real rate of return because inflation was 2.5% during that period.

The next slide presented showed a rolling 10-year real rate of return. Mr. Storer explained that the average of the 10 years earned a return in excess of 5%.

Representative Croft asked if the graph shows the rate from 1994 looking back to 1984, rather than in a given year. Mr. Storer replied that is correct, and agreed that there is volatility in any given year. During two years of the bear market, the Fund still earned in excess of 1% real rate of return and up to 2%, but over shorter time horizons the volatility of the bear market did not achieve the goal.

Mr. Storer discussed the next slide, "Realized income v. market value" which shows the change in income from one year to the next. In 1995, the realized income was 80% greater than in the prior year. The slide indicates that the current formula has significantly greater volatility on a year-to-year basis than the proposed payout method limiting the payout to no more than 5%.

Mr. Storer addressed the question, "Why do we need The POMV?" The POMV ensures the option of an annual payout and the evaluation of a payout of up to 5%. POMV makes the payout more stable from year to year. The payout methodology is consistent with the Fund's current investment strategy. Under its current methodology, a security such as G.E. must be sold in order to gain any benefit from owning the stock, but with POMV the security could be held to gain the benefits of its appreciation during the entire period. For the future, POMV prevents overspending in the good years. Mr. Storer discussed "behavioral finance," explaining that this discussion five years ago at the end of the bull market would have made 5% too conservative, and now the Board is being challenged to consider if 5% is too optimistic in reaction to a bear market. He stated that the POMV maintains the purchasing power of the entire Fund.

Mr. Storer addressed the slide posing four questions "What are Alaskans asking?" They have asked, "Will this change leave the principal unprotected?" Mr. Storer explained that this methodology doesn't need the term "principal" in the Constitution because it leaves the entire Fund protected. Decision-makers would have the option of dipping into the "old concept" of principal, but it would be a policy decision.

In reference to the next slide, "How will POMV affect my dividend?" Mr. Storer said that it depends. Under the existing formula, it probably doesn't affect the dividend but the Board believes that there is a strong argument to mirror the dividend formula in POMV. The market will affect the dividend most, and asset allocation. If some of the Permanent Fund is used for state government, it will earn less interest on a smaller Fund and that would affect the dividend either modestly or significantly.

Mr. Storer discussed, "Is POMV a raid on the Permanent Fund?" The Board would be considering Percent of Market Value if there weren't fiscal problems, and the Legislature would be discussing how to resolve the fiscal problems if there weren't the POMV. The Board of Trustees proposal is to memorialize inflation proofing in the Constitution.

"Why fix the Permanent Fund if it isn't broken?" Mr. Storer offered an editorial comment that it is broken. A fifteen-year bull market has masked some of the problems with the payout formula. Under the existing formula there is some probability of no payout at all if an extreme bear market hits, or hyperinflation.

Another question is "Has the Permanent Fund been double-inflation-proofing?" Mr. Storer explained that the Fund invests in equities that appreciate well in excess of inflation. The answer is the Fund is not double-inflation-proofing under current statutes. If stock is bought and the managers decide to sell it and take a profit, the profit is converted into realized income and distributed to the citizens of Alaska. As long as the appreciation of that asset can be converted into realized income, it can be available for distribution.

Co-Chair Harris asked whether the dividend under the present formula would be more or less than last year's dividend.

BOB BARTHOLOMEW, CHIEF OPERATING OFFICER, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, replied that the October 2003 dividend was about \$1100. For the next three years the dividend is projected to be smaller than that, given the five-year averaging and the continuing effect of the bear market. A median case market for three years would

put the dividend below last year's amount, and then it would start to climb again.

In response to a question by Co-Chair Harris, Mr. Bartholomew explained that if the market increased very dramatically, the dividend might catch up, but over a 5-year average it would not catch up immediately.

Mr. Storer commented that the Fund earned in excess of 20% over the past calendar year including realized income. He said that even with that significantly higher return, we would still be seeing a lower dividend in the next few years.

BOB BARTHOLOMEW, CHIEF OPERATING OFFICER, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, explained the changes in the latest version, CSHJR 26(Jud) reflecting the Board of Trustees proposal. Page 1, line 10 adds a reference to the new subparagraph (b) being added to the constitution. Mr. Bartholomew explained it inserts one line where a second paragraph will define the five percent spending limit.

Page 1, line 11 removes the words "the principal of which" from the Constitution. This change removes the distinction between the principal and the earnings reserve. The Fund becomes one pool of money versus two. Mr. Bartholomew explained that under current statutes, there is a second set of books accounting for the earnings reserve and the principal. Currently the earnings reserve doesn't have the protection and this proposes to combine and protect the entire Fund.

Page 1, lines 13 & 14 deletes the guidance for where income of the Fund should be deposited. The intent is for all income to remain in the Fund until appropriated by the Legislature. Mr. Bartholomew informed the committee that the 1976 Constitution stated that all income from the Permanent Fund would be deposited directly into the General Fund. For several years in the late 1970s and early 1980s, all Permanent Fund earnings went directly into the General Fund on an annual basis and were spent on general state government.

Mr. Bartholomew continued, in 1982 the Legislature provided that the Permanent Fund income would go into the Earnings Reserve, which would be an account in the Permanent Fund. For the past 22 years the earnings have stayed in the Permanent Fund until appropriated by the Legislature. The effect of this change is not by statute but in the Constitution that all earnings would stay in the Permanent Fund until appropriated, subject to the spending limit.

Page 2, lines 2-4 adds a new subparagraph (b) that establishes an annual payout limit of 5% of the total market value of the Fund. The market value will be based on a five-year average. This is to protect the Fund from inflation and preserve the real value over the long term. Additionally, this provision allows the Legislature and the state administration to know one year in advance the amount available for appropriation. Mr. Bartholomew explained that the annual 5% spending limit based on the total value of the Fund would be computed on a five-year average to cover any big spikes up or down.

Page 2, lines 7 - 10 adds a transitional provision that clarifies that the balance in the Fund's earnings reserve remains in the Permanent Fund. Some have argued that the earnings reserve belongs in the General Fund.

Page 2, lines 11 - 13 states that if the constitutional amendments pass the Legislature, they will be placed before the voters at the next general election in November 2004.

Co-Chair Williams commented that the Mental Health Trust Board has a Percent of Market Value plan that pays out 3-1/2%, and asked Mr. Storer his thoughts on it. Mr. Storer replied that the Permanent Fund manages a substantial portion of the Mental Health Trust (MHT) assets, and MHT has done a good job of creating the discipline being proposed here. The Mental Health Trust has language in policy instead of constitutional language. He said that his goal is to create a variant and to memorialize it in the Constitution rather than in policy.

In response to a question by Co-Chair Williams, Mr. Storer said that the 3-1/2% is conservative to create an arbitrary cushion. The Permanent Fund doesn't propose that all 5% be appropriated, and anything beyond 5% would create overspending for a period.

Mr. Bartholomew added that 5% was the statutory direction to balance the benefits of the Fund between current and future generations. Spending less than 5% in the near term equates to less need now and future generations benefiting from a larger Fund. Spending more than the 5% equates to a larger need today that will lead to a smaller Fund in the future.

Co-Chair Williams commented that the Mental Health Board has proposed 3-1/2% and he needs an argument against it. He referred to the slide showing the June 30, 2003 realized income of \$100 million and asked how a dividend would be paid out if it decreased. Mr. Storer replied that under the existing formula, the Fund does run the risk of fewer funds available for distribution. Under the POMV, the payout would be more predictable. The Legislature could evaluate the

markets and the real income and determine an appropriate payout.

Co-Chair Williams questioned whether the Mental Health Board would have to take money out of the corpus of the Fund after the bear years of 2001-2003 if the market goes up in 2004. Mr. Storer explained that the Mental Health Trust manages for a 5% real rate of return and takes a conservative approach by only spending 2/3 of the real income. The Permanent Fund proposal cushions for potential down years by not overspending in the good years, and it suggests that 5% is that balance.

Mr. Bartholomew added that the Mental Health Trust is proposing to build up a reserve by spending 3-1/2%, but under POMV that's inherent in the long-term average. The Permanent Fund came out of a 3-year down market with barely a cushion and it almost hit zero. People ask if three more down years would eat into the principal. He pointed to history, noting that to protect the Permanent Fund and make it grow, the Legislature swept \$5 billion out of the earnings reserve account into principal in addition to what was needed for inflation-proofing. Under the Constitution and the statute, in the early 1980s and as late as 1999, the Legislature swept away the reserve for the down years. There is the risk of going to zero because the Legislature made the principal bigger, which doesn't work under the current rules. The real rate of return over the 20-year history of the Fund has been well over 5%. Mr. Bartholomew asserted that over time it is not an issue that 5% will prove to be the sustainable yield. He expressed that good intentions and rigid rules led to potential problems with the Fund.

Representative Croft discussed the four-year reserve POMV approach of the Mental Health Trust to ride out the bad years and not have to invade principal. He expressed that their approach has the advantage of not needing a constitutional amendment, and that one of the criticisms of POMV is the potential of invading principal. Mr. Storer restated the original intent of Percent of Market Value to memorialize inflation proofing in the Constitution. He said that there are mechanical problems in creating reserve pools that involve a statutory distinction to do what Representative Croft proposed. He lauded the intent of the Mental Health Trust Fund, but noted that their approach makes it incumbent on future administrators and trustees to share the present philosophy.

Mr. Bartholomew responded to Representative Croft that this is one of the main policy questions before the Legislature. It would be possible to begin creating a reserve out of the future earnings of the Fund before spending. The reserve would earn over the next few years and grow quickly if it

was not spent on dividends, but it would have to be left intact to establish a 4-year cushion. The Board struggled with removing the word "principal" because it's not under their policy purview, but the trustees needed to make a recommendation on how to manage the Fund. They recommended 5% balanced with a dividend or other payment into the economy to buffer any shock to the economy of going to zero. It is a policy question for the Legislature. The POMV works whether "principal" is left in the Constitution or taken out. He stated that he feels that in 5 or 7 years, it won't matter and the Permanent Fund will grow a reserve as it has done historically. The reserve was swept clean and protected by being put back in the Fund.

**TAPE HFC 04 - 56, Side B**

Mr. Bartholomew continued, it's a policy call and both a reserve and a payout could be possible if great earnings are expected for the next three years, but he felt it would not be realistic.

Mr. Storer clarified that the Mental Health Trust Board adopts their spending plan instead of the Legislature, while the Legislature adopts the spending plan of the Permanent Fund. He said that it is natural to assume that the Legislature would appropriate the entire 5% if that were the limit.

Co-Chair Williams asked how the POMV five-year average would protect the principal. Mr. Bartholomew explained that the Board felt the current rules don't protect the principal. He gave the example of the June 30, 2000 balance of over \$3 billion or 15% available to be spent in the earnings reserve after dividends and inflation proofing. He pointed out that the principal was only protecting 85% of the Fund in 2000. The trustees felt that 15% available for spending in one year was too much, given how it was invested. They questioned whether they were taking on too much risk as a board, and they needed more assurance to stay in the conservative fully invested asset allocation. The Board feels that this policy balances the risks of the markets and how to determine payouts. Principal can provide protection, but POMV can provide more in the long term.

Co-Chair Harris asked if the enshrinement of the dividend in the Constitution has concerned the trustees. Mr. Storer stated his "mantra" is that how the funds are distributed is the prerogative of the Legislature.

Co-Chair Williams questioned whether enshrining the dividend in the Constitution with a subsequent erosion of principal through payouts or a bear market would be a problem that could be remedied. Mr. Bartholomew replied that enshrining the dividend under the current rules would result in

conflicting provisions and the most restrictive one would win. If one provision is not to spend below principal, and another is to pay a dividend, the dividend wouldn't be paid if you didn't have the earnings.

Co-Chair Williams asked for clarification of how to protect the principal after several years of a bear market. Mr. Storer said it's vague how the market will do. There would be some risk over the near term of dipping into the current principal, but over the long term, if no more than 5% were paid out, the concept of principal would be protected.

Representative Hawker asked if the POMV concept that was brought before the Legislature last year is a new response to current fiscal situations or if it had been around longer. Mr. Storer explained that the Board is not reinventing anything. At a Board retreat in 2000, the recommendation to ask the Legislature for a Constitutional change was discussed. In 1984, Trustee Hugh Malone proposed the POMV payout, and endowments and universities have been using POMVs for some time. The Ford Foundation started discussions in 1968, and Roger Cremo identified the issue in 1970.

Representative Stoltze asked if it was mandated by court order that the Mental Health Trust couldn't invade the principal. Mr. Storer was unsure how they define principal and offered to get back to Representative Stoltze on the question.

Representative Stoltze asked if there would be a problem with adding a period after "market value" on line 3 of the title in order to remove subjectivity. Mr. Bartholomew replied that from a technical perspective it wouldn't affect the constitutional amendment. The Board's intent is to show why to adopt POMV and he offered to check with the trustees. The trustees debated keeping the title as short and clean as possible or to provide some explanation in it, and they decided to provide explanation.

Representative Stoltze hoped he hadn't been unfair in calling the title subjective but explained that he'd heard debate on the best approach. Mr. Bartholomew replied that the Board believes their proposal is the best way to protect the Permanent Fund from inflation and to preserve its purchasing power. The change in asset allocation from 25 years ago brought the Board to this proposed change. Six or eight years of research led to their proposal but the Board is aware of other perspectives.

Representative Croft suggested requiring inflation proofing in the Constitution according to the Consumer Price Index (CPI) last year, for the actual inflation. Mr. Storer asked Representative Croft if he suggests the 5% limit plus CPI,

or only the CPI. He commented that last calendar year the Fund earned over 20%, with an 18% real rate of return, and asked how Representative Croft would envision that language.

Representative Croft suggested retaining the current system and paying out of the accumulated annual earnings for the actual inflation each year. He expressed concern that 7 years of predicted oil prices have always been incorrect and he doubted that the numbers could be accurately predicted over the long term. He commented that there likely would be a different market structure that is more global and "high tech" in the future. With the POMV formula and with substantially higher inflation numbers, he felt that the Fund would not be adequately protected.

Mr. Storer shared his perspective that from the Great Depression through the hyperinflation of the 1970s, purchasing power has been more of a problem than hyperinflation. He said that purchasing power is at risk with either the current method or the POMV, and lower real rates of return can't be avoided. The late 1970s inflation rate was 8% or 9%, and the 30-year Treasury bond yielded over 14%. Given the price depreciation, the actual return on fixed income securities like bonds was negative, and that asset class was not covering inflation despite the high cash flow. He stated that equities carry a greater risk than bonds. In his opinion, it is reasonable to expect to achieve a 5% real rate of return, with more options in the future for achieving 5%.

Representative Croft noted that under the current methodology, inflation proofing would be at the actual rate rather than a created rate of 3% under POMV. Mr. Storer commented that if the Fund is not achieving a real rate of return under the existing system, it is a question of whether the dividend or inflation-proofing the Fund comes first. He questioned whether future elected officials would make the same decisions as those of past officials.

Representative Croft commented on riding out a bear market, and continuing to pay out of the Fund while eroding the principal. Mr. Storer expressed that POMV is not about the concept of principal, or the mineral wealth and appropriations, but the purchasing power of the Fund. In either the current method or POMV, elected officials must decide whether to maintain the purchasing power or have a distribution in a hyperinflation situation.

Mr. Bartholomew added that in either scenario during hyperinflation, the Fund would not earn enough money to cover the effects of inflation. Under POMV, the Legislature would still have the option to make appropriations during that period when the purchasing power of the Fund has not been covered first. The first choice under the current

statute is to decide whether to spend out of the earnings to pay the dividend. Under either scenario, there is the risk of not making enough money during hyperinflation.

Representative Croft expressed concern over the tough decision between inflation proofing or distributing the dividend. He said that in a continued bear market under the POMV, the Legislature would be unable to do either, because it would dip into the "principal" and continue to spend 5% when the Fund isn't realizing it.

Co-Chair Williams observed that the Legislature could decide not to pay out a dividend in situations of hyperinflation, but it couldn't if the dividend is enshrined in the Constitution.

Mr. Storer stated that under the existing system, the potential exists for no payout for several years. Under Percent of Market Value, the decision-makers have the option. He noted a distinction between the concept of principal and maintaining the purchasing power of the Permanent Fund.

Representative Croft suggested adding protection for the principal in this resolution, and he provided an example that in no case it could be lower than \$25 billion. Mr. Storer replied that guidance or benchmark language has been requested, using the concept of principal existing in statute.

Representative Croft also suggested protective language stating that 5% may be appropriated if the average performance over the past 5 or 10 years has netted a real rate of return of at least 5%. Mr. Storer pointed out that the Fund worked with language identifying the 10-year rolling average. He said that he would prefer 20 years but it is unreasonably long.

Representative Foster recalled the hyperinflation in April 1977 when the rate was 2-1/2% over prime and the prime was 24%.

Representative Stoltze asked if the Board formally considered inflation proofing and whether to constitutionally protect it. Mr. Storer replied that the cornerstone of POMV is to maintain the Fund's long-term purchasing power and to memorialize it in the Constitution. By statute, it now occurs after the dividend distribution. Inflation proofing was actually the motivation for the Board's proposal. Board discussions did not go forward regarding adding additional formulas such as CPI impact on a year-to-year basis.

In response to the question by Representative Stoltze, Mr. Bartholomew added that currently inflation-proofing is done by statutory formula subject to legislative appropriation. The Board wanted to prioritize inflation proofing over other payouts and place it in the Constitution. Representative Stoltze clarified that he asked whether the Board of Trustees had discussed it. Mr. Bartholomew replied that the Board's discussions involved moving the current option to inflation-proof into the Constitution as a requirement. He noted that some funds, including the Mental Health Trust, had a lower spending limit than 5%, giving higher confidence of more protection in the future against inflation. The Board focused their discussions on the rate for POMV.

Mr. Storer stated that the Board did not discuss perpetuating the existing formula with the CPI as the way to inflation-proof.

Representative Stoltze doubted that the dividend distribution would not have come up in Board discussions. Mr. Bartholomew had thought Representative Stoltze had asked about CPI. He clarified that when the Board discussed the POMV effect on the dividend, it focused on investing and generating earnings and stayed away from policies on the dividend calculation. When the Board debated leaving in or removing "principal", it discussed the option of making a distribution from the Fund each year, either for a dividend or other payout. The Board felt it was important to make the dividend option available to the Legislature in good or bad years.

Mr. Storer said that in early discussions, the Board identified moving to POMV without changing the dividend formula in statute. He asserted that the POMV would smooth the dividend payout.

Representative Stoltze asked if the Board philosophically supports the proposals to constitutionally dedicate the dividend. Mr. Storer replied that the trustees are clearly not taking a position on how the funds are used. If the POMV and the enshrinement of the dividend are passed, the Board's position will be evaluated in May. He said that it would be a big policy issue.

Mr. Bartholomew added that six or eight years ago there were proposals to constitutionalize the dividend, and in the past the Board of Trustees weighed in on the issue.

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Mr. Bartholomew continued, the new Board obtained an updated legal analysis, and the opinion was that putting the dividend in the Constitution would not affect the tax-exempt status. The Board moved from historical opposition

to putting the dividend in the Constitution to a neutral position. The Board felt that staff should not speak on the use of the earnings, or about a combined proposal.

Representative Hawker commented on past legal theory that enshrining the dividend in the Constitution would violate the public purpose test and expose the Fund to federal taxation. He asked for absolute assurance that enshrining the dividend would not expose the Permanent Fund to taxation. Mr. Bartholomew replied that the simple answer is no, it would not, but he deferred to the Attorney General. He doubted that this is an instance in which the Attorney General could give absolute assurance.

Mr. Storer added that the old legal opinion was ambiguous but there was reasonable probability that enshrining the dividend would make the Fund taxable. Recently it appears there is greater probability the Fund would not be taxable. The IRS will not give an answer until it has happened, and probably not until two years after enshrinement of the dividend.

Representative Hawker asked if the Permanent Fund Corporation had requested a private letter ruling from the IRS. Mr. Storer replied that it had not. Representative Hawker commented that the Legislature is currently presuming that the lawyers are correct. Mr. Storer agreed.

Co-Chair Harris asked the percentage of the Fund outside of the corpus in the past. Mr. Storer responded that in February 2000, about \$8 or \$9 billion of Fund value was in excess of the corpus. The current statement for February 2004 reflects \$23.191 billion in principal, and Fund value at \$27.958. March of 2000 marked the beginning of the bear market.

Co-Chair Harris asked if over 15% of the value of the Fund was outside of corpus. Mr. Bartholomew said that it approached 20% at its peak. Co-Chair Harris expounded that if the state continues to deficit spend and not use earnings of the Fund except for inflation proofing and the dividend, it will deplete the Constitutional Budget Reserve and have to tax the people. He discussed the break-even point with taxation and asked how the state will ultimately fund health care and education programs without a gas line or without using the Permanent Fund. He asked if the concern is protecting the value of the Fund, wouldn't it be better that a maximum of 5% can be spent at any time instead of having 15-10% of its value available for appropriation.

Mr. Storer answered that he suspects sustainability and predictability relate to taxes, the dividend or use of the Permanent Fund. He asserted that having sustainability embedded in the process would allow everyone to make better

informed decisions instead of waiting until there is an urgent need to address expenditures.

Representative Joule asked for examples of other funds using Percent of Market Value that have not been successful. Mr. Storer said there have been a few that were in the bull market and were caught overspending in excess of the real rate of return. Retirement plans boosted their benefits because of the bull market as well.

Representative Croft noted the legal opinion commissioned by Attorney General Gregg Renkes on the tax issue. He urged adding language that states that if there is an adverse tax ruling, this provision falls out. He didn't think it's a legal issue anymore, but noted there are mechanisms to protect the dividend while protecting the tax-free status.

Representative Fate questioned whether in rolling the earnings and income into the Fund there was extensive discussion by the Board on the future needs of the State. Mr. Storer replied that the Board of Trustees always has made it a goal to assure the Fund's purchasing power for all generations. Mr. Bartholomew added that the historical intention was to grow the Fund. A public policy decision to do more than that in any one year could not be done under the present proposal. The public policy challenge is balancing long-term protection with short-term flexibility. The Board looked at it from the asset management standpoint, to maintain the purchasing power of the existing asset versus making more of it available.

ROGER CREMO, ANCHORAGE, provided an historical summary of the POMV concept mentioned earlier, and the creation of the Permanent Fund. He noted that he had written the proposed constitutional amendment that included POMV, and added that he has been interested in it since 1984. He recommended looking at the constitutional provision that the amendment would become part of. He stressed that he supported the amendment and that 5% was not the correct number. He did not think that the trailing average approach should be used.

Mr. Cremo continued, arguing for ending the year on December 31<sup>st</sup>, instead of June 30, so the Legislature would know how much Permanent Fund money would be available. Five years does not encompass an investment cycle, and he recommended six or seven years. The 5% is the real rate of return after inflation and that is not the same as the rate of withdrawal. He gave the formula for the rate of withdrawal that would equal 4.31%. He asserted that 5% would cause an eventual erosion of the fund.

Mr. Cremo suggested that before accepting the POMV, the Legislature should look at the constitutional provision. He said that it deserves extreme treatment and must be based on

sound analysis and good drafting. The state's track record in the fiscal area in constitutional amendments is not good. There have been two since 1965. The provision limiting appropriations was so flawed that it never came into play. The other amendment established the budget reserve fund, which he feels has facilitated, if not promoted, deficit spending in most of the years since 1990. The voting requirements have resulted in special sessions costing millions in deficit spending.

Mr. Cremo discussed endowments. According to the present constitutional provision, 25% of royalties should go into the Fund but Section 15 allows that provision to be circumvented. Increasing the production tax diverts billions of dollars from the Fund. It is a matter of analysis. Mr. Cremo read from Section 15, "the Fund's principal can be used only for those income-producing investments specifically designated by law for permanent fund investment." The Permanent Fund Corporation has invested billions in stocks that don't pay dividends. The Corporation does a very good job and has been forced to resort to a liberal interpretation of the constitutional provision. The income-producing requirement applies to the principal, and the earnings reserve account is exempt from the requirement of investment. Mr. Cremo stated that the greatest fault with Section 15 is in not requiring all of the oil money to go into the Fund.

Co-Chair Harris asked for clarification. Mr. Cremo explained that the oil money comes from various incomes including royalties, rents, severance taxes and bonuses received from the oil.

Mr. Cremo added that endowments have two purposes. One purpose is to perpetuate the flow of money going into it, which would go into the operating entity if not perpetuated. The other purpose is to smooth out the flow of money and to keep it going after the original source of money has ended. The Permanent Fund provides a good example of the endowment with the perpetuation purpose. It will be producing revenue in the long term.

Mr. Cremo discussed the university endowment in relation to the Permanent Fund endowment. The university endowment alleviates uncertainty and it will stabilize the flow. In the case of Alaska, oil revenue is volatile. About 15% to 20% of the oil money goes into the Permanent Fund and the rest goes to the General Fund. As a consequence, the State has been fiscally unstable for many years. He suggested that the state could stabilize the flow of that money by routing it all through the Permanent Fund. The income produced by conservative investment would be more stable than the oil money. The constitutional amendment would provide a new system for allocating to all government

services, including the dividend, according to the priority assigned by the Legislature. The amendment would not dictate how the money would be spent. A transitional period is needed to lead into that system. Currently, the wealth of the state is being spent in the 9% to 10% range. He questioned what is sustainable. Currently, the principal is being invaded at a great rate. The transition period rate of withdrawal would be at 8% to 9% for several years until it worked down to what is sustainable.

Mr. Cremo mentioned Section 17 of Article 9, and an amendment that would transfer the bulk of the assets of the budget reserve fund to the Permanent Fund while leaving a balance. If excess were collected, that amount would go into that fund. It would fund deficits and it would help in meeting natural disasters. It could not be used as a bridge for fiscal gaps or for borrowing.

Mr. Cremo reiterated that making any changes to Section 15 of Article 9 of the Constitution should be reconsidered until the time comes that it can be done correctly.

Co-Chair Williams stated that the bill would be HELD in Committee for further consideration.

#HJR9

HOUSE JOINT RESOLUTION NO. 9

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

Representative Stoltze introduced HJR 9, commenting that this may be the fifteenth hearing on the measure. He stated that a constitutional spending limit is appropriate among the other fiscal plan measures being advanced. He believes that the public will support the measure, bringing an added responsibility to make it especially well crafted. The measure has evolved since he first introduced it and it incorporates provisions requested by the Governor's Office. He has tried to include enough exemptions, accompanied by the limitation, to anticipate the needs of the state along with the anticipated growth in population. He expressed his hope that the measure would allow for the controlled growth of government.

**TAPE HFC 04 - 57, SIDE B**

KELLY HUBER, STAFF TO REPRESENTATIVE STOLTZE, explained the changes in the Judiciary Committee Substitute. Section 1 outlines (indisc. -tape change) Page 2, lines 2-5, state "The total amount of appropriation under this subsection made for a fiscal year may not exceed two percent of the amount appropriated for the fiscal year two years preceding

the fiscal year for which the appropriations are made." Ms. Huber noted the exclusions from the calculation of a spending limit that follow on lines 7 through 29 of page 2.

Section 2 adds a new section stating that the spending limit would go to the ballot in 2004, be applied to appropriations in FY 06 and be reaffirmed by the voters every six years thereafter. Ms. Huber stated that the constitutional amendment is based on the two preceding fiscal years' average, with the calculations set forward by the Governor's Office.

CHERYL FRASCA, DIRECTOR, DIVISION OF MANAGEMENT & BUDGET, OFFICE OF THE GOVERNOR, stated that spending limit discussions have considered using inflation versus population, instead of this proposal that includes change in the personal income rate. The rationale for using personal income rate as one indicator is that if citizens throughout the state were doing well and their income went up each year, it would be appropriate for the state to increase its spending. Then, if citizens were going through a retrenchment due to recession, the state should cut back as well. Earlier discussions indicated that when the state is in a recession, ironically some of the state costs go up for public assistance and other responsibilities. Ms. Frasca said it's a toss up which indices to use. Costs and revenues don't always go up at the rate of inflation. This measure puts forth using 50% of the rate of change in personal income for three calendar years averaged out, and the percentage equal to the percent of change in the state's population, linking it to the demand for services.

Ms. Frasca commented on lines 1-2, page 2, and she encouraged the committee to think seriously about continuing to use a three-fourths vote threshold because no other state requires such a high threshold to exceed a spending limit.

In terms of setting 2% spending cap, Ms. Frasca mentioned there might be extraordinary unanticipated events requiring additional spending by the state. Ms. Frasca felt that setting the 2% threshold would bind future legislatures when looking forward to events such as the buildup for a gas pipeline. She questioned whether the Legislature wants to lock that in.

Ms. Frasca encouraged selectivity regarding what is excluded from the limit because it sets up an incentive to categorize spending under things that are excluded from the limit. Instead of being considered off budget, items will be considered off limit. One addition in the Judiciary version first excluded University receipts and then narrowed it down to University tuition. She concluded that it is an excellent idea to have re-ratification of the provision in the future to allow the revisiting of concerns.

Vice-Chair Meyer asked why six years was chosen for bringing it to a vote again. Representative Stoltze explained that it was a subjective judgment based on a bill before the Senate in 2000 with a provision allowing safety valves. It would give the voters a chance to reaffirm their support or back out of it.

Ms. Huber clarified that the current spending limit in the Constitution has only one re-approval by the voters after four years.

Vice-Chair Meyer expressed his support for HJR 9. He agreed with Ms. Frasca that a three-fourths vote in each house is a "high hurdle" and asked the sponsor if he intended that. Representative Stoltze replied that it is arbitrary, and he acknowledged that he is cognizant of unintended consequences.

Co-Chair Harris asked whether the appropriations to pay general obligation and revenue bonds are included in the spending cap. Representative Stoltze replied it is exempted under (c)(6) on page 2, lines 17-18.

Representative Stoltze commented on the 2% limit under the three-fourths vote, and expressed concern about setting any percentage limit. He suggested that it should be part of the committee's discussion whether the 2% becomes a cap or a floor.

Ms. Huber noted that debt service may not be excluded under the Judiciary version, but it was excluded in a previous version. In response to a question by Co-Chair Harris, Ms. Frasca clarified that (c)(6) excludes the revenue bond proceeds. One consideration for discussion is that this does exclude the proceeds from the bonds. She advised that increased costs of debt service don't mean increased revenues to the state. Under the spending limit, debt service would still need to be paid, which competes with everything else for the same dollars.

Co-Chair Harris expressed that the public has voted for a revenue bond appropriation in an election that authorizes the incurrence of this debt, and he asserted that it should be placed outside of a spending cap imposed on the Legislature. Ms. Frasca replied that it would create the incentive to incur debt to pay for costs because it's outside the spending limit, as opposed to paying cash. Co-Chair Harris argued that the public has voted to do that, and should understand that whenever it votes on general obligation bonds.

Representative Croft agreed with Ms. Frasca that the proceeds in general obligation and revenue bonds are

excluded, but it is only the revenue bond appropriation that is excluded. He felt that general obligation (GO) debt service makes more sense than revenue bond debt service. He asked why the appropriation to pay GO bonds is not excluded along with the appropriation for revenue bonds. Ms. Frasca explained that revenue bond proceeds are excluded from the spending limit because an outside entity, such as an airport, would be collecting the revenues to pay for that debt.

Co-Chair Harris expressed concern with the spending cap and how to keep under control the costs of services that lack a continuous source of income. He noted that a revenue bond generates its own revenue by charging fees. If there is no payment of fees, there is no service. He reiterated that if the public votes to incur debt service, they have informed the Legislature of their wishes.

Representative Stoltze commented that the Anchorage tax cap exempts debt service. Ms. Frasca agreed, but explained that the voters are approving additional taxes to be collected from them to pay the debt service.

Representative Croft asked if the tobacco settlement involved revenue bonds. Ms. Frasca affirmed. He then asked if the student loan that was recently sold would be considered a revenue bond under this measure. Ms. Frasca affirmed. Representative Croft noted that he understands revenue bond exemptions for airports, but questioned the tobacco settlement and student loans being under this exemption. Ms. Frasca explained that the tobacco bond debt service is being paid by the tobacco settlement. The repayments of student loans are paying the student loan corporation bond debt service. She made the distinction that in each case, an external entity is providing the revenues to pay the debt service, as contrasted with GO bonds or school reimbursement bonds where the state comes up with general revenues or a mix of other sources, including corporate receipts or dividends.

Representative Croft questioned exempting AHFC, AIDA, or the student loan corporation, which he feels are almost an interchangeable source of General Funds. He asked if exempting them creates an incentive, pointing out that that the student loan corporation can either pay a dividend included in the spending limit, or it can bond on that revenue stream and it won't be included in the appropriation limit. He asked if it doesn't create a way around the spending limit.

Ms. Frasca replied it is important to distinguish that this proposal is an appropriation limit on the spending side. A corporate dividend from AHFC is a fund source, while revenue bonds and the federal government are distinct revenues from

external sources. It is prescribed how they can be spent and these are excluded from the spending limit.

Representative Croft noted that in (c)(5) the proceeds are exempt, and in (c)(6) the appropriations made each year to pay for the bonding are exempt. He questioned if this isn't a way around the spending limit itself. Ms. Frasca said that he was correct, that in this measure, the tobacco settlement in the future would be a way to circumvent the spending limit. She said that AHFC is different, in terms of revenues generated for general government purposes that are fungible.

Representative Croft asked why AHFC is different. Ms. Frasca clarified that (c)(5) relates to revenue bonds, and the mechanism by which you raise the money and repay the cost. The annual AHFC dividend is calculated on a statutory formula, and it's not tied to selling bonds. The state ends up paying AHFC's debt service on their bonds out of the dividends. This governs the appropriation. Revenue bonds where a third party pays debt service are excluded under this. The chairman has indicated that he also wants to exclude the state paying the debt service.

Representative Croft reiterated his concerns about AHFC using revenue bond proceeds on the capital budget, which would be excluded from the limit. He questioned whether always revenue or GO bonding the capital would circumvent the appropriation limit. Ms. Frasca indicated that she couldn't track his scenario, but explained there are rules governing revenue bonds. There must be a source to repay the bonds, and GO bonds can only be used for certain purposes. She couldn't say if the AHFC dividend, which is a fund source, would be excluded from the appropriation limit.

Representative Croft brought up a past proposal to borrow against future federal transportation money in order to fund big projects. He asked if that was a revenue bond. Ms. Frasca explained that it was the GARVEES and that the debt service was paid by the state. She was unsure if the Department of Revenue categorized it as a revenue bond. She commented that voters approved it on the ballot, and there were competing opinions by the attorneys general.

A discussion ensued between Representatives Stoltze and Fate and Co-Chair Harris. Ms. Frasca noted that it was the kind of debt service that concerns the chairman.

Co-Chair Harris walked through the spending limit, noting that an increase in the appropriation would require a three-fourths vote of both bodies to increase it by 2%. He asked if it is 2% above the amount appropriated two years previously plus 2%. [Answer indisc.]

Co-Chair Harris asked the sponsor if he had considered a stair-step provision, noting that a three-fourths vote is a high threshold. He suggested having one spending increase requiring a two-thirds vote and a higher benchmark at three-fourths. Representative Stoltze asked Representative Hawker if he had explored it in a Ways and Means Committee version of the proposal.

Representative Hawker stated that Ways & Means reported out a version with a stair-step mechanism of a fixed 2% at a fifty percent vote, another 2% increase at a two-thirds vote, and an additional 2% increase at a three-fourths vote.

Co-Chair Harris asked how much a 2% increase would total today, and then noted that it would be \$40 million of \$2 billion dollars. He asked if it is cumulative. Representative Stoltze replied that it is.

Representative Hawker advised that this draft has changed substantially since last session. He explained that it would be cumulative only on the amount of increase that actually occurred. It would be cumulative but not compounding.

Representative Croft asked in Section 16(a) if the numbers were negative in both the population growth and personal income, would it bring the appropriation limit down. He discussed a scenario of a net increase of zero if population and personal income zero each other out, resulting in a zero increase appropriation.

Representative Stoltze commented that the limit must also counterbalance where the money is coming from.

Co-Chair Harris expressed that there is no negative downside in the amount of money that could be spent. He quoted "Appropriations made for a current fiscal year shall not exceed the amount appropriated for the fiscal year two years immediately preceding by more than fifty percent," --of those two factors. He stated that there would be a "ceiling" that you couldn't go above, but you wouldn't have to go below it either.

Representative Croft asked for a technical explanation when there are negative numbers for population or income in (1) or (2). Co-Chair Harris responded that it means the appropriation can't be more than in the previous year.

BRUCE TANGEMAN, FISCAL ANALYST, LEGISLATIVE FINANCE DIVISION responded to Representative Croft that based on his scenario, the appropriation could go down.

Representative Croft asked for clarification on whether negative numbers in (1) and (2) would reduce the base. Mr. Tangeman replied yes, it is possible that the appropriation

limit would go down if both income and population are going down, and the previous three-year average is added together and halved.

Representative Croft commented that this could mean the appropriations have to be reduced from the base year. Mr. Tangeman briefly noted that 37 states have spending limits. Their revenue sources are income or sales taxes, or both. If their population or personal incomes decrease, the states generate less tax, or revenue, and the spending limits would need to go down. He said that Alaska is unique because it is not linking the spending limit to revenue, although this measure is using similar scenarios.

Representative Croft noted that the University of Alaska federal research grants are excluded, and asked if research grants from nonprofits are also excluded. Representative Stoltze replied (c)(10) probably addresses it. Ms. Frasca recalled that the example she had discussed with Representative Stoltze was the University Foundation, not research grants from nonprofits. She confirmed that federal grants are excluded but was unsure how nonprofit research grants are categorized.

Representative Hawker questioned (c)(11) exempting tuition. The University of Alaska creates receipt authority and appropriates money in excess of what they expect to receive, and not just federal receipt authority but in the area of private contributions and funding. He recalled that it is more than \$65 million. He said it would seem that receipt authority is subject to the spending limit, and it might be one of the first to go, setting the University up with the inability to receive private grant monies.

Ms. Frasca explained that the assumption is that the \$65 million in "empty receipt authority" would be the base for the future spending limit. Only when the University got up to \$65 million in actual receipts would it be limited by the percentage change in the spending limit in the future. In previous versions, University receipts were excluded. She predicted that in the future, new expenditures would get categorized as University receipts. She advised that any time an off-limit category is set up, there is an incentive to recategorize spending, and she urged caution in deciding what is excluded from the limit.

Representative Hawker posed a hypothetical dilemma, asking whether the Legislature would increase Medicaid or keep this empty receipt authority at the University, and he suggested that the Legislature would sacrifice the empty receipt authority. It would pump up the Medicaid appropriation in the current budget by \$65 million but in the following year, there would no receipt authority. He advised using extreme caution

Representative Hawker noted that (c)(10) is extremely vague and asked what is money held in trust. Ms. Frasca gave the example of the public school trust fund, which has a dedicated stream. She said there aren't a lot of trust funds. Representative Hawker observed that the Mental Health Trust is a true trust fund. He asked if "money held in trust by the state" isn't much broader language. He suggested that designated funds are also monies held in trust. Ms. Frasca offered to check with the Department of Revenue, but she didn't expect that designated fund sources would fall into that category. In response to a question by Representative Hawker, Ms. Frasca concurred that the legal intent of the language in (c)(10) is to tie down specific trusts.

Representative Hawker pointed out that money held by debt covenant or by other legal covenants of the state would clearly be money held in trust.

Representative Hawker brought up the base formula in Section 16(a)(1) and (2) on page 1, and agreed with Representative Croft that with mathematical logic, it has the potential to go negative. He asked the number for this year and the projections for the next two years. Ms. Frasca stated that it was calculated for FY 06 at a 3.47% increase.

Representative Croft asked who estimated personal income. Ms. Frasca replied the source is the U.S. Bureau of Economic Analysis. The data for 2003 will not be available until this April.

Representative Hawker requested a hypothetical projection using the numbers through 2002, with 3.47% for FY 06 and extrapolating on the presumption that would remain steady. He asked if there have been any attempts to contrast it to increasing state expenditures that are known and quantifiable. He noted that there is a footnote on all the projections stating, "this projection is based on level General Fund spending of \$2.3 billion dollars a year." He argued that there is a fallacy in that presumption, with 15% compounding increases in Medicaid and the issue of the public retirement systems.

**TAPE HFC 04 - 58, Side A**

Representative Hawker continued. He asked if the State would be "setting itself up" with the budget spending limit to have to close schools because there isn't money to meet the State's contractual obligations.

Mr. Tangeman explained that he had gone backward to 1996 to determine the projection. Representative Hawker argued that there were forward projections the last time this measure was discussed.

Representative Fate brought up the University of Alaska research grants and pointed out that the Board of Regents has broad constitutional powers to determine how the accounting is done. He thought it was problematic to place it in a spending limit because of those constitutional powers, absent any statutory language demanding the University do that. If the language exists, then the University must comply, but he was not aware of any existing language.

Co-Chair Harris thought the concern was that the Legislature provides yearly authorization to the University to spend and receive. All monies the University receives must come through the Legislature. He voiced concern with the amount of general funds authorized from year to year without knowing what the recurring revenue sources will be, saying some revenues are a one-time occurrence that shouldn't be built into the base.

Ms. Frasca stated that she had misspoken regarding the funds held in trust, clarifying that those are retirement appropriations for the administration of retirement programs for FICA, PERS and TRS, JRS, National Guard retirement system, and the Mental Health Trust.

Representative Croft asked if the Marine Highway Fund and oil spill contingency are held in trust. Ms. Frasca did not think that any of those would apply. Representative Hawker stated that it is a definition issue of "trust and agency funds."

Co-Chair Harris stated that if the funds are spent, they are not recurring sources of revenue. Representative Croft asked if appropriations into the trust would still be within the appropriation limit.

Ms. Frasca replied that deposits into the endowment would also count in the limit, but not the endowment balance itself. Representative Croft asked if there was a firmer definition of "trust," because he was curious about Power Cost Equalization (PCE) and the Marine Highways.

Representative Croft noted excess authority in the Kodiak Launch Facility. He asked if it would be exempt. Ms. Frasca replied that they are primarily federally funded and statutorily designated. Representative Croft thought that the Facility could be increasing the civilian satellite launches from a base of 5 launches per year. He expressed concern that with the constitutional amendment, \$50 million would need to cut from other areas because Kodiak received \$50 million in business. Ms. Frasca stated that it does not appear that Kodiak would be excluded. Representative Croft thought that it did not make much sense.

Co-Chair Harris expressed concern with the definition of general funds. He stressed that when there is not a known source of revenue, the Legislature should not depend on it. He suggested that the revenue sources should be defined.

Representative Stoltze interjected that when the measure was conceived, it attempted to grasp actual funding. There are drafting challenges and the original version addresses the general fund spending.

Co-Chair Harris asked if this is an attempt to address annual spending when there is not the backup for the money. He thought that grants and business charges should be encouraged. He noted that the Kodiak Launch Facility operates on the amount of business it can generate even though it receives authority to spend money. A parallel example is the receipt authority given to the University for general funds while being expected to raise tuition and apply for grants. He did not want to discourage that.

Ms. Frasca stated that the challenge is to determine if the Legislature wants to limit the growth of government, which HJR 9 addresses, or to limit how much the spending from certain revenue sources can increase from one year to the next. She gave the example of the tax limit in Anchorage, which limits how much taxes can go up from one year to the next. It is a limit on a fund source. She cautioned that the proliferation of designated fund sources over the past decade has eroded the General Fund and set up gross in non-General Fund areas. Those monies go to particular programs. The pure general funds tend to be spent on the traditional responsibilities of government that include education, transportation maintenance and operation, corrections, public safety, the Legislature, the Governor's Office, and the court system. The challenge, she said, is whether to apply the limit to only the general fund portion, and allow the non-general fund activity to go unchecked. It would create an incentive to re-categorize funding.

Co-Chair Harris noted that the difference is that the Legislature has the appropriation authority to determine where the money will be spent. He commented on the small cost of operating the Division of Motor Vehicles while the receipts charged to the public are relatively large. It is general funds, but annual revenue that is counted on. He questioned how to control the costs but not penalize the agencies.

Mr. Tangeman commented that it is Alaska's dilemma compared to other states whose appropriation is directly connected to their revenue source. Other states generate new revenues.

Representative Stoltze agreed to continue discussion of the measure with Representative Hawker and other committee members. Co-Chair Harris stated that he is supportive of the concept of containment of government growth but expressed that it is a difficult concept to address.

Representative Fate noted that there had been discussion regarding revenues rather than expenditures. He voiced appreciation of the revenue approach discussion, and applauded Representative Stoltze's work on the bill.

Representative Croft asked if the bills would be moved at the next meeting. Co-Chair Harris stated that they each measure needs a fair amount of work before being reported out of Committee. Co-Chair Williams asked Representative Croft for his changes before the next meeting.

Co-Chair Williams stated that HJR 9 would be HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 5:17 P.M.