

HOUSE FINANCE COMMITTEE
March 25, 2004
1:50 P.M.

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CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 1:50 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

Pete Ecklund, Staff, Representative Bill Williams; Bob Bartholomew, Chief Operating Officer, Alaska Permanent Fund Corporation, Department of Revenue; Robert D. Storer, Executive Director, Alaska Permanent Fund Corporation, Department of Revenue; Tamara Cook, Director, Legislative Legal and Research Services, Legislative Affairs Agency; Joe Balash, Staff, Senator Gene Therriault

PRESENT VIA TELECONFERENCE

Mike Williams, Tax Division, Department of Revenue, Anchorage

SUMMARY

HB 236 An Act imposing a tax on employment; and providing for an effective date.

CS HB 236 (FIN) was reported out of Committee with "individual recommendations" and with a new fiscal note by the Department of Revenue and indeterminate note #1 by the Department of Labor & Workforce Development.

HB 298 An Act relating to the distribution of appropriations from the Alaska permanent fund under art. IX, sec. 15(b), Constitution of the State of Alaska, and making conforming amendments; and providing for an effective date.

HB 298 was HEARD and HELD in Committee for further consideration.

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.

SB 291 An Act extending the transition period for activities involving unstamped cigarettes; and providing for an effective date.

SB 291 was reported out of Committee with a "do pass" recommendation and with fiscal note #1 by the Department of Revenue.

#SB291

SENATE BILL NO. 291

An Act extending the transition period for activities involving unstamped cigarettes; and providing for an effective date.

Vice Chair Meyer commented that his questions had been answered on the bill. He MOVED to report SB 291 out of Committee with individual recommendations and with the accompanying fiscal note. There being NO OBJECTION, it was so ordered.

SB 291 was reported out of Committee with a "do pass" recommendation and with fiscal note #1 by the Department of Revenue.

#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.

Co-Chair Williams introduced Amendment #3, #23-LS1006\V, Cook, 3/22/04. (Copy on File). He noted that the amendment would completely change the bill. His intent was to take testimony on Amendment #3 and take no action at this meeting.

Representative Hawker MOVED to DIVIDE the question proposed in Amendment #3, pointing out there are two distinct considerations proposed in the amendment.

Co-Chair Williams reiterated that no official action would be taken on Amendment #3 at this time.

ROBERT D. STORER, EXECUTIVE DIRECTOR, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, acknowledged that there are two components to the amendment. He offered to address the first component, which would in effect memorialize the principal in the Alaska Constitution by identifying the Earnings Reserve Account.

Mr. Storer provided a "history lesson" on how the Board came to the conclusion that a Percent of Market Value (POMV) without principal would be a better approach. There is no question that the Board recognizes the merit and would not be opposed to the proposed amendment, which puts principal into the Constitution. Three years ago when identified, the Board did opt to leave the principal in the Constitution. He emphasized that the key is the 5% spending limit. Principal puts a floor on what might be appropriated. Following a lengthy discussion with the Permanent Fund Board of Trustees, discussing the merits of continuing principal versus the 5% limitation, the Board concluded that having the percentage of market value payout with 5%, the principal would be their preferred approach. The Board believes that the 5% does memorialize inflation proofing in the Constitution and would not need a floor. It recognizes that on some occasions, there will be up and down markets, but over the long term, the purchasing power of the fund would be maintained. He noted that there is companion language, which gives the Legislature direction of when they would be moving below the 5% real rate of return.

Mr. Storer continued, if that language was maintained, there is a limited chance that there could be a small or no pay out at all, in a bear market. That could potentially limit how much is available for payout. At this time, there is a cushion in the fund. The principal is about \$23 billion dollars and the Permanent Fund is approximately \$27 billion dollars. As the market progress and the appreciation fund grows significantly greater than this concept of principal, then that would become less of an issue because the cushion would become greater over time. He observed that including the principal, will give decision makers a little more latitude in terms of the pay out, no more than 5% in the down markets. Also, by paying out the 5% in down & high markets, will treat all generations equally.

Mr. Storer concluded, it is important to note, but not as it applies to the proposed statute, there are proposals that would memorialize the dividend in the Constitution at a fixed rate. If the Legislature is contemplating putting principal back into the Permanent Fund that would create a limit on how much could be paid out. If there is a proposal for a fixed payout, there would then be competing formulas. He commented that could be worked with, however, it should be evaluated with other proposals.

BOB BARTHOLOMEW, CHIEF OPERATING OFFICER, ALASKA PERMANENT FUND CORPORATION, DEPARTMENT OF REVENUE, added, that he did not have anything additional to add to the concept of leaving in the principal and the protection of the principal. He observed that another change that the amendment proposes is to Section 2, where it actually provides for the dividend and public education as two of the uses for the money from the Permanent Fund. That was not in the previous version.

Co-Chair Harris clarified that Section 1 basically establishes an Earnings Reserve Account in the corpus and under the umbrella of the Constitution. It also establishes the fact that the only pot of money that can be used under constitutional protection is the Earnings Reserve Account. The second section then would establish in Constitution:

- The 5%,
- A dividend, and
- Allows the use of that 5% for public education and the administration process.

Co-Chair Harris added that if the public was asking for some sort of protection for a dividend, the amendment would provide that and protects it from going into the principal

of the fund. He knew that was the public's highest priorities.

Mr. Storer agreed that there is interest in those subjects. He pointed out that it would also memorialize the concept of the dividend. The public definitely understands the concept of principal protection, which he thought was a good thing. He urged members to keep in mind the concept of the worse case scenario and that the amendment memorializes the concept of the dividend but does not say that a dividend would not be paid, but if the market value was eroded, the floor would disappear. He emphasized that the language creates both a discipline and a floor. There is a limited chance that there could be a small or no dividend.

Mr. Bartholomew added that under the Board of Trustees proposal, they merged principal and Earnings Reserve into one account. From the administrative perspective, part of the benefit from that action would be only the records from the generally accepted accounting principals would tell the Legislature the size of the fund and the market value times 5%. Into the future, the Permanent Fund Corporation would continue to report as they are at this time. There are two sets of accounting records used, the generally accepted accounting principal and the accounting for the realized income. He assumed that was a difficult piece to understand. The existing process will remain in place. The protection of principal is out-weighting some of the other benefits.

Co-Chair Williams agreed that it is difficult to understand these concepts. He asked if the proposed legislation would put that language into the Constitution. Mr. Bartholomew acknowledged that it would and that the principal is included in the Constitution at this time. Co-Chair Williams questioned why the Legislature would want to place that language into the Constitution.

JOE BALASH, STAFF, SENATOR GENE THERRIAULT, presented a history on the proposal, which dates back to 2001. At that time, Senator Therriault was Chairman of the Legislative Budget and Audit (LBA) Committee, which has oversight of the Permanent Fund, and was responsible for introducing the first proposal by the Trustees to switch to the percent of market value (POMV) methodology. Then Senate President Halford rewarded Senator Therriault for that introduction by referring it to his Committee in Senate State Affairs. During the next fourteen months, public hearings were held statewide. During subsequent and current legislatures have spent much of the interim taking public testimony on current POMV language. The concept of principal keeps coming around to "haunt" the notion of POMV and why it is not the public's first choice as a way to preserve the fund. In order to preserve the notion of principal, the rest of the fund must

be accounted for in some manner. By doing so, the decision was to create an Earnings Reserve Account similar to what is around today. He added that realized versus unrealized income has not been distinguished in the bill.

Co-Chair Williams recommended that Senator Therriault be present at the next scheduled meeting for Monday, March 29th at 9 a.m. Mr. Balash indicated that he could arrange that.

Representative Hawker asked if the amendment was attempting to create two buckets of money within the Permanent Fund. Mr. Bartholomew responded that there have been many legal discussions over how many buckets of money there are. Currently, the Permanent Fund is accounted for in three separate pools. The principal pool, the unrealized earnings, and the realized earnings. Language on Line 13, of the proposed amendment addresses depositing earnings into the reserve. He understood that language would require them to continue as presently done and account for the Permanent Fund in the three buckets. The spending is driven by what is available in the realized earnings account.

Representative Hawker inquired why new language was needed to accomplish something already being done. Mr. Bartholomew stated that the constitutional amendment does achieve the 5% spending limit, which is the most significant action being taken by using the 5% spending limit, which protects purchasing power into the future. However, the manner in which it is accounted for will change.

Representative Hawker voiced his confusion regarding placing the 5% limit into constitutional language. Mr. Bartholomew reiterated that it was in original bill. He explained that on Line 10, leaves the word "principal" in the Constitution and requires that the principal not be spent. Mr. Storer added that it was true that the 5% limit existed before. It is consistent with the Permanent Fund's objective, putting a limit on how much could be appropriated at any given time. The amendment creates a floor, and if the value of the fund falls below that floor, no money could be used below the principal floor. Over time, as the profits of the fund grow and the difference between the value of the fund and the principal become wider and wider, then the point of principal becomes less important because the cushion becomes greater.

Representative Hawker understood that the 5% does not change and would only apply to a portion of the money in the fund. Mr. Storer replied that the 5% limit would apply to the entire fund. The definition of how much could be used, would be 5% of the 5-year moving average of the entire fund. The next step would be how much would be available above the floor, which is the second message clarifying if there are sufficient funds in order to reach the 5% requirement in

excess of that floor. If not, then they cannot take more than the floor.

Representative Hawker thought that the policy call would be the 5% of the entire value of the fund but only making a portion available to draw the 5%. He believed that language was inconsistent. Mr. Bartholomew agreed. Representative Hawker questioned limiting the source of that fund. Mr. Storer advised there are ways to provide insight when the fund does not earn the 5%. He pointed out that the Permanent Fund has been working with a number of elected officials, who could evaluate whether or not to use the entire 5% or instead make less of a policy decision.

Representative Hawker thought if there was inadequate money in the bucket, then nothing could be drawn. He questioned if that would be the same effect as using the "sidebar". Mr. Bartholomew explained that if the sidebars or guardrails were placed into statute, there would always be the option of the Legislature to not follow them. If the extra protection were placed into the Constitution, there would never be the option of not following it.

Representative Hawker suggested that was an "all or none" attitude. Mr. Bartholomew attempted to clarify, noting that had been the debate the Board went through when making their decision. As the Constitution is written today, there are market scenarios, where there can be short-term declines in the financial markets, which reduce the value of the earnings reserve. If that scenario was to repeat itself, when there is a principal limitation, which is hard and fast, there is a line or value of the Permanent Fund that can not be spent below, and is how it currently is and would continue with the amendment. He reiterated that there is a hard and fast line, which the Legislature cannot spend below. When the Trustees evaluated whether to remove principal or not, they recommended that the benefits must be evaluated from having a predictable, sustainable pay out from the Permanent Fund versus the risk taken by removing the principal protection and saying that there are near turn down markets, spending down into the Permanent Fund with the intention that it would be paid back in the future good years. That was the discussion. From the sponsor of the amendment and what the public wants, the Board is comfortable using the word principal. The experience of the Permanent Fund is that with time to educate and work with the public, the public then tends to support the concept of a sustainable and predictable payout.

Representative Hawker understood that the amendment was a trade off and would provide some inherent predictability and stability to the previous version of the bill for preservation of the notion of principal. He commented that the word "notion" troubled him and that he did not think

that the State really wanted to trade predictability and sustainability for such a vague thought.

Co-Chair Harris stressed that the reality is that the amendment would protect a value of the principal set at a certain period of time when it is voted on. That value could never be taken away. Any earnings of the Permanent Fund above and beyond that time would be deposited into the second account called the Earnings Reserve Account. Today, that account is not protected at all. Under the amendment, it would be entirely protected under the Constitution. The Earnings Reserve Account is the only pot of money that the 5% could be taken from. If there were a down market for a considerable period of time, it would not prohibit taking 5% of the fund. However, if the Earnings Reserve Account was depleted, then no more could be drawn from the Permanent Fund, as it would be constitutionally protected as the principal. He emphasized that there is no "notion" involved at all in the proposed language and emphasized that there is absolute value protected. He asked Mr. Storer if that was a correct interpretation. Mr. Storer responded that the only distinction would be when that point is hit, and then the citizens of Alaska would have to vote.

Co-Chair Harris pointed out that they would only have to vote on the constitutional question, which would require two-thirds of both Bodies's in order to place the question before the voters.

Co-Chair Harris noted that two concerns were being addressed. One is the constitutional protection of the corpus or principal value at a certain point. The Permanent Fund will have to determine whatever that number is at that point in time. Any amount above and beyond that is Earnings Reserve Account money. Mr. Bartholomew indicated that the question needing to be answered is how to address the State's on-going receipt of oil deposits. The Permanent Fund understands that the principal would have to grow from the on-going oil deposits; however, all the earnings of the fund would be what is placed into the Earnings Reserve Account.

Co-Chair Harris pointed out that that the Constitution already clarifies that 25% goes into the principal of the fund. That value is what is created by the investments and would become part of the Earnings Reserve Account. That is the pot of money that is constitutionally protected by the 5%. Mr. Storer stated that there is approximately \$4.7 billion dollars of realized and unrealized money in the account at this time.

Co-Chair Harris added that the Legislature still must determine how much of that 5% comes out of the Earnings Reserve Account that could be used for dividends, general

operations of the departments and education. Mr. Storer agreed. Co-Chair Harris added that the Legislature could adopt 100% for dividends and could be changed at any period in time by the Legislature if they wanted to face public scrutiny. He noted that the public is concerned about the erosion of the principal. They need assurance that the principal is not going away. The only way that they will get that assurance is if it is constitutionally protected. Under the proposed amendment, the Legislature would have no power, only the public would have that authority. Mr. Storer agreed.

Vice Chair Meyer asked the highest and lowest amount earned by the fund over the past twenty-five years. Mr. Storer stated that in March 2000, the principal was between \$19 & \$20 billion dollars and now the principal is \$23 billion dollars. Mr. Bartholomew responded that there is a return that the fund has earned under the generally accepted accounting principals. It is important to consider what the fund has earned under the realized earnings approach.

Vice Chair Meyer thought that 8% had been the average over that period. Mr. Storer commented that the fund has been through a substantial bull market for about fifteen years. The real rate of return for nineteen years is 6.9%, and is not sustainable. In the last ten years, there has been both bull markets and a severe down market. Over that period of time, the fund earned a return of 7.8% with inflation at 2.5%, which makes a 5.3% real rate of return.

Vice Chair Meyer understood Co-Chair Harris' concerns of eroding into the principal, however, pointed out that it had gone up to 5%. With inclusion of the proposed safeguards, it would not go up to the full 5%. Given the POMV concept, it is anticipated that during the next 50 to 100 years, the average earnings would be 8%. Mr. Storer interjected that a 5% real rate of return could be anticipated. That is how the 5% has been determined on what should be appropriated.

Vice Chair Meyer asked if the Permanent Fund supports the amendment. Mr. Storer responded that historically, the Permanent Fund supported the constitutional amendment with principal remaining in. After a long study, it was determined that there could be a better way to approach it. The Board has concluded that the percentage of market value pay out, as it now stands, is the recommended way, and will allow the Legislature to determine whether or not it is in the best interest to sustain the full 5% pay out or less depending on the market. At no time, has the Permanent Fund claimed that leaving the principal in would be inherently bad. That approach is considered to be second best and is viable.

Representative Hawker commented on the statement regarding the principal in as being the second best approach. He asked if that was a decision made from a financial policy point of view or a political perspective. Mr. Storer responded that he hoped it was a decision made from his financial hat perspective so as to insure the long-term viability. Discipline must be created to provide a cushion for both the good and bad times, which has been consistent for the Permanent Fund. They do recognize the importance of the principal to the citizens of Alaska.

Representative Hawker heard that the bill as originally presented was the first best approach, however, the Legislature wears a more political hat first. The political debate is one of preserving the notion of the principal. He recommended exploring how to manage it, while continuing to accomplish distribution of the wealth to all Alaskans. He asked if the Permanent Fund considered using the old three-column trust account system.

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Representative Hawker continued, that system consists of three columns, principal, earnings and expenses. The realized earnings would be shifted between the three columns. He acknowledged that the methods of accounting have evolved and changed. He pointed out that the fund has gone from the notion of principal to an accounting standard that measures funds by value instead of principal. Mr. Bartholomew explained that in 1997, the accounting standards that oversee all generally accepted accounting principals require the Permanent Fund to mark all of its assets to current daily price to guarantee knowing if value was being gained or lost. At the end of each month, a report is made available to the Legislature from the Permanent Fund.

Representative Hawker knew that accounting changes have evolved during the 1990's. In 1997, pronouncements mandated to take a new approach to the fund. He asked if that was the basis of the first best value based approach. He thought that the second best approach appears to be more outdated and does not reflect these fluctuations. Mr. Bartholomew agreed. He added that under the concept of principal, the Permanent Fund will maintain two sets of accounting records. That is what is done today. That methodology would have gone away under a pure market approach. Representative Hawker commented that would put the burden back on the Legislature.

Co-Chair Williams stated that HJR 26 would be HELD in Committee.

#HB298

HOUSE BILL NO. 298

An Act relating to the distribution of appropriations from the Alaska permanent fund under art. IX, sec. 15(b), Constitution of the State of Alaska, and making conforming amendments; and providing for an effective date.

Representative Hawker explained that HB 298 was the companion legislation to HJR 26. He requested that the bill be HELD in Committee until the final form of HJR 26 was determined.

Co-Chair Williams stated that HJR 26 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.

Co-Chair Harris MOVED to ADOPT work draft #23-LS0435\E, Cook, 3/25/04, as the version of the legislation before the Committee. There being NO OBJECTION, it was adopted.

PETE ECKLUND, STAFF, REPRESENTATIVE BILL WILLIAMS, explained the changes made to the work draft. Page 2, Line 19, incorporates Amendment #1, passed at a previous hearing. Page 2, Line 23, the previous version had the appropriation going to the Constitutional Budget Reserve (CBR) and being exempt, whereas, the current version places it in a reserve fund established by law. Mr. Ecklund pointed out that there is a legislative obligation to repay \$5.5 billion dollars to the Constitutional Budget Reserve (CBR), and cannot be satisfied through direct appropriations but rather through sweeps. If the Legislature chooses to appropriate that amount at this time, it will not go to satisfying the debt obligation. New language would be in place for a future date at which time the legislature would repay the CBR. There are on-going revenue surpluses to the State and any appropriations to the CBR would not be subject to an appropriation limit.

Co-Chair Harris asked if it was constitutional, not be able to place money from the general fund back into the CBR. Mr. Ecklund responded that an appropriation to the CBR would not count as a repayment of that obligation. If the money was left in the CBR and was swept, that would count toward the debt. Co-Chair Harris inquired why it would not count toward repayment. Mr. Ecklund explained that was the manner in which the constitutional provision had been constructed.

TAMARA COOK, DIRECTOR, LEGISLATIVE LEGAL AND RESEARCH SERVICES, LEGISLATIVE AFFAIRS AGENCY, advised that Section 17, Article 9, establishes the amount available should be deposited into the general reserve fund. Subsection (D) contains that sweep language. If an appropriation is made from the Budget Reserve Fund, until the amount appropriated is repaid, the amount in the general fund available for appropriation at the end of each fiscal year, shall be deposited into the General Reserve Fund. She noted the language used: "Until the amount is repaid". It does stipulate that the repayment comes from a separate appropriation or whether the source of money coming into the sweep may be construed as a growing Budget Reserve Fund. None of Section 17 was drafted in contemplation that there would be appropriations into the Budget Reserve Fund nor does that section specifically prohibit appropriations into that fund.

Ms. Cook advised that the question is whether the appropriation is considered to be a repayment or simply a decision made by the Legislature to add more money to the Budget Reserve Fund. The repayment structure suggests that a Court might find that the repayment occurs through a sweep. There is no obligation to repay it and becomes automatic. If money is appropriated out, then money flows back in as it is available.

Co-Chair Williams understood that is why there is a reverse sweep.

Co-Chair Harris pointed out the information indicates it would be until the amount was repaid, but does not indicate how. If the amount is repaid and satisfied, then the Legislature would not have to do a sweep. Ms. Cook responded that was plausible but she did not know if the Court would accept that.

Co-Chair Harris questioned the point made by Ms. Cook that the Legislature would not be allowed to replenish the CBR with general funds. Ms. Cook replied that the Legislature certainly would be allowed to if there were general funds sitting there. There is no question that anything left in the general fund on the last day of the fiscal year, could be swept. The legal question is, if the Legislature does appropriate it, would the Court find that to be an independent task that the Legislature did to grow the fund, but not eliminating the obligation under Section "D". She agreed that could be a possible argument.

Co-Chair Harris asked what would happen if the Legislature placed language into the budget to appropriate a certain amount of money to the Constitutional Budget Reserve to satisfy the terms and conditions in the constitutional

language under Section 17(D). That is the intent of the Legislature. Ms. Cook thought that would be a good argument to put before the Court. If you could clearly indicate that it is the intent of the Legislature to satisfy the 17(D) requirement, it would make a good case.

Co-Chair Harris presented a hypothetical situation in which the State had a natural gas pipeline and the amount of money coming into the State coffers was more than enough to satisfy the needs of the government and then that money was placed into a savings or placed into the CBR to cover the amount taken out over the years. That could satisfy the terms that the Constitution requires to sweep and the CBR could be repaid. Ms. Cook noted that she would be inclined to agree because she would assume that the Legislature also has the power to make the choice to make the appropriation to the CBR or to hold that fund, saying that it is not going to eliminate the sweeping obligation of the general funds. It could create a clear expression of legislative intent, in the particular appropriation act.

Representative Stoltze referenced Page 2, Section 19, asking the implications of that language in the amendment. Ms. Cook acknowledged the concerns regarding dueling constitutional provisions. She suspected that the Court would not construe it that way. If there were no POMV amendment, and Section 15 kept the same language, the Court would find that section to be clear, only income available. The enactment of the proposed language could not convince the Court that the Legislature could appropriate from the Permanent Fund for dividends for anything other than the income.

Representative Stoltze requested Ms. Cook to research that further. He noted that he did not have the same confidence in the five members of the Supreme Court. He thought that the decisions may be different than what was conceived in 1990. Ms. Cook concurred that the Supreme Court has many facets that change rapidly. She did not ever want to attempt to second-guess how they would face any problems. With the current language, the principal could only be used for investment and the income shall be put in the general fund unless provided otherwise by law. The Legislature has in fact, elected to provide that the income of the Permanent Fund go into a separate account located in the Permanent Fund. However, the Legislature could provide by statute that the income go to an account that is not in the Permanent Fund, which would only take a statute change. If confronted with that language, an appropriation from the Permanent Fund provides payment of the dividends to State residents. At that point, you could not appropriate from the Permanent Fund because it does not permit that. If the Legislature appropriated from the general fund, that appropriation might not be exempt under that exemption and

the limit might not apply. The problem is the fact that it might undo the spending limit itself.

Representative Stoltze cautioned that future legislatures could play chicken with the courts with regards to the use of the permanent fund earnings. Ms. Cook understood that Representative Stoltze feared that the language might allow an appropriation from the principal of the Permanent Fund. She did not think a Court would reach that decision. A Court might find that an appropriation from the Permanent Fund from a different source is not exempt from the spending limit. Ms. Cook did not see that the Court would find that if an appropriation occurred, the purposes of the spending limit would have any authority to actually make the appropriation. That is not what the language does. The language only says how to calculate an amount available for an expenditure for a succeeding fiscal year. The worst case scenario that could occur is that the State would elect to set up some program of Permanent Fund payments funded from a different source and be included within the spending limit calculation.

Representative Stoltze MOVED conceptual Amendment #3 to Page 2, Line 19, deleting "from the" and inserting "of", to read: "An appropriation of the Alaska permanent fund for payments of permanent fund dividends to State residents." Representative Hawker OBJECTED.

In response to a question by Representative Hawker, Ms. Cook advised that most likely, a Court would still find it subject to exclusion if moved to a POMV. If it could be demonstrated particularly to a specific year that the POMV formula actually invaded some of the principal, then someone might be able to present a case to the Court.

Representative Hawker spoke against the amendment, suggesting that it was more generic verbiage that encompassed to wide of possible latitudes.

Mr. Ecklund offered alternative language: Page 2, Line 19, deleting: "From the Alaska Permanent Fund". Representative Stoltze WITHDREW Amendment #3.

Vice Chair Meyer MOVED to ADOPT new Amendment #3: Page 2, Line 19, deleting "from the Alaska Permanent Fund". There being NO OBJECTION, the new Amendment #3 was adopted.

Mr. Ecklund spoke to the next change in the work draft, Page 3, Line 10, Subparagraph (13), adding an exemption to the limit. That language would describe the reverse sweep, and would not count against the appropriation limit. He asked Representative Hawker to describe the change made to Page 1.

Representative Hawker referenced the graph "CS HJR 9 (FIN) Spending Limit; Base Year of 3 prior year average and 3 year floating average for variables". (Copy on File). He discussed the basis for the accommodation of the spending limit and how much spending increase showed being allowed on an annual basis.

Representative Hawker stated that in the previous version of the bill, the index was created from a combination of what the average rate of change is in the State's population and personal income. The personal income line has risen substantially, which has pulled up the spending level line, if the spending limit was based on the cost of living and population increase. The committee substitute adopts the base spending inflator, the average rate in the growth of the population and the consumer price index and would provide a slower growth curve. He emphasized the importance of the personal income line, inflation and that the proposed limit recognizes the importance of that information. The work draft proposes to use the base inflation factor; the average population and the consumer price index (CPI). However, the manner in which the language is written makes it limited to the percent of change in personal income.

Representative Croft suggested that would be the most restrictive approach that could be taken. Representative Hawker replied that under the economic conditions that have existed in the past few years, it would not result in the lowest increment. He had extracted that methodology from the legislative exchange council's recommendation for standardized language.

Representative Croft countered, it indicates that the language was used because we have a tax system that is generally based on a personal income and we would not want spending to go up higher than that. Alaska is not based on that, but instead based on oil. It will be based on something totally independent from personal income in the future. He reiterated that other states have radically different fiscal systems.

Representative Hawker stressed that there is a need to look to other sources of revenue in the future. Interest is to provide the greatest assurance and possible protection with a practiced spending limit. The intent is to not let the government grow faster than the personal income does.

In response to Representative Croft's query, Representative Hawker explained that you would need to average the rate of change in the Consumer Price Index (CPI) and the rate of change in population.

Representative Croft commented that the reason to tie the spending limit to personal income is that it would limit the

amount taken from statewide residents. He agreed that there must be some limit in running government services. He did not think it would limit, cap, stop or defer any tax, any use of Permanent Fund earnings or any change in the dividend structure. It caps what government can do. He emphasized that he would rather limit the growth of government by how much is taken from his pocket. Government is limited in what it can spend, but not in taxation, which limits the amount that can be put into schools and other services.

Representative Hawker asked if Representative Croft's concern is the surrender of taxation. He stressed that the intent is to maintain a growth rate without tying the hands of future legislatures from appropriation or taxation.

Representative Croft interjected that the hands of future legislatures are not tied on taxation, but they should be. Instead, we are binding the hands of future legislatures to appropriate for schools and public safety. He stressed that the wrong things would be protected.

Representative Hawker shared Representative Croft's concern. He voiced concern that there is no way to know the future. He stressed that nothing should be done to restrict the future and noted that a forced renewal by the people would force a review of these issues.

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

TAPE HFC 04 - 68, Side A

#HB236

HOUSE BILL NO. 236

An Act imposing a tax on employment; and providing for an effective date.

Representative Hawker recommended that the bill was ready to move to the House Rules Committee.

Co-Chair Harris asked the amount of money a person would have to earn before they were assessed the \$100 dollar tax. Representative Hawker replied \$600 dollars. Co-Chair Harris voiced concern that a person would have to pay \$100 dollars out of \$600 dollars earned. He thought that was a substantial amount for a person to have to pay with such a small income. He recommended that the earned amount be raised, having a dramatic effect on someone earning only \$600 dollars.

Representative Hawker advised that at \$600 dollars, the tax would be zero; at \$610 dollars, the tax would be \$1 dollar.

After that, it would be a 10% incremental increase on the next \$1,000 dollars earned. An aggregate earnings of \$1,600 dollars, the tax is zero for the rest of the individual's earnings. He clarified that in order to pay \$100 dollars, the person would have had to make \$1,600 dollars.

Discussion continued between Co-Chair Harris and Representative Hawker. Co-Chair Harris asked if Representative Hawker would support raising the amount to \$1000 dollars. Representative Hawker replied that they had discussed that with the sponsor of the bill and that \$600 dollars was agreed upon, and that it is the federal level for recording of self-employment earnings. He stated it was not the substantive issue of the bill. Co-Chair Harris pointed out that the employer would have to deduct the amount from the person's check.

Co-Chair Harris MOVED to increase the amount from \$600 to \$1000 dollars. Co-Chair Williams OBJECTED.

Vice Chair Meyer voiced concern with the amount of overhead costs needed to generate such a small amount. He questioned how much the change would impact the total amount generated.

MIKE WILLIAMS, (TESFITIED VIA TELECONFERENCE), TAX DIVISION, DEPARTMENT OF REVENUE, ANCHORAGE, advised that the revenue would remain constant whether it comes in at \$600 or \$1000 dollars because it is a flat tax. The tax would generate approximately \$43 million dollars.

Co-Chair Harris asked at \$1000 dollars, would the Tax Division still need to hire 13 full time and 10 part time employees to administer the program. Mr. Williams replied they would. Regardless of the amount, the administrative structure would remain the same.

Co-Chair Harris maintained his motion on the amendment in order that low paid workers would be able to keep all their money.

Representative Croft sympathized with the intent of the amendment. He pointed out that the amendment would only help those people earning between \$600 and \$1000 dollars a year. He did not think that it would be helping anyone except unless their income was very low. He stated that he was most concerned with the person making \$12,000 dollars. Representative Croft elaborated that the effort would not have much of an effect on the real people who will be hurt by the bill.

A roll call vote was taken on the motion.

IN FAVOR: Stoltze, Joule, Meyer, Harris

CS HB 236 (FIN) was reported out of Committee with "individual recommendations" and with a new fiscal note by the Department of Revenue and indeterminate note #1 by the Department of Labor & Workforce Development.
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ADJOURNMENT

The meeting was adjourned at 3:47 P.M.