

MINUTES
SENATE FINANCE COMMITTEE
January 28, 2004
9:05 AM

TAPES

SFC-04 # 2, Side A
SFC 04 # 2, Side B

CALL TO ORDER

Co-Chair Gary Wilken convened the meeting at approximately 9:05 AM.

PRESENT

Senator Lyda Green, Co-Chair
Senator Gary Wilken, Co-Chair
Senator Con Bunde, Vice Chair
Senator Fred Dyson
Senator Donny Olson
Senator Lyman Hoffman
Senator Ben Stevens

Also Attending: BRUCE TANGEMAN, Fiscal Analyst, Division of Legislative Finance; DAVID TEAL, Director, Division of Legislative Finance; CHERYL FRASCA, Director, Office of Management and Budget, Office of the Governor

Attending via Teleconference: There were no teleconference participants.

SUMMARY INFORMATION

SJR 3-CONST AM: APPROPRIATION/SPENDING LIMIT

The Committee heard from the sponsor, the Division of Legislative Finance and the Office of Management and Budget. The bill was held in Committee.

[Note: Audio malfunction at start of meeting, introductory portion not recorded.]

#SJR3

CS FOR SENATE JOINT RESOLUTION NO. 3(JUD)

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

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken announced the purpose of this meeting was to overview the resolution and present concerns. He referenced a handout titled "Points of Consideration" [copy on file], which Senator Dyson would speak to. Co-Chair Wilken stated the Committee, with the assistance of the Division of Legislative Finance and the Murkowski Administration, would develop arguments for and against the points outlined in the handout. He added that additional issues could be added as they arose.

Senator Dyson, sponsor of this resolution, presented the bill. He informed that a constitutional spending limit was adopted in 1981, although it "appears to not work. He told of earlier efforts to rectify this, including previous legislation sponsored by former Senator Dave Donley.

Senator Dyson informed that at the start of the twenty-third legislative session he subsequently reintroduced the resolution authored by Co-Chair Donley.

Senator Dyson outlined the aforementioned handout, which he characterized as identifying policy issues the Committee could address, beginning as follows.

1. What factors should be used in the formula to determine the allowable change (increase or decrease) to be applied to the appropriations or expenditures?

- A. Tied to population increases or decreases?

We need to answer the question: "What portions of the state's budget change directly when the population grows (or decreases)? The school foundation formula and people seeking government assistance and the PFD do increase linearly with population. What portions of the operating budget are impacted by changes in population, and how much? How does this tie to our aging population or increases (or decreases) in school age children?

Senator Dyson pointed out that new residents of school age would affect the State's education foundation funding formula and

"medically fragile" and disabled new residents would affect the need for medical services.

B. Tied to per capita income?

Should growing wealth equate to expanding government? What are the components of government that remain fixed regardless of citizen personal income? Do people need more government assistance when their income decreases? Does the need for more government decrease with more personal wealth, and if so, by how much?

He relayed that the Governor has suggested that per capita income be utilized as a factor in determining appropriation limits. He noted this method has been "popular" in other states that operate with spending limitations. However he argued that each of those states also has an income tax and therefore the amount of personal income earned by residents affects the amount of revenue collected by that state. He also questioned the need for increased government services proportionate with increased personal income.

C. Budget increases tied to Consumer Price Index (CPI)?

If tied to CPI, how reasonable is it to use what OMB calls the "CPIU Anchorage" (Consumer Price Index for all urban consumers for the Anchorage metropolitan area compiled by the Bureau of Labor Statistics, United States Department of Labor)? We should answer the question: "What portions of the operating budget are affected or unaffected by inflation, and how are such portions affected? Leases, long term contracts, etc. are typically not affected by yearly inflation.

Senator Dyson stated that some expenditures would be unaffected by inflation, such as long-term leases that do not contain an inflation escalator and long-term contracts.

D. It's the opinion of Legislative Finance that all of these factors have advantages and disadvantages. We need to understand these factors, perhaps consider other factors, and craft the most valid and reasonable formula.

Senator Dyson expressed the need to clarify whether to limit the growth of appropriations or to base future appropriations on current year real expenditures. He explained that some unexpended funds carry-forward or are transferred to cumulative accounts.

Co-Chair Green asked how to prevent the manipulation of statistics for the purpose of attaining a specific goal.

Co-Chair Green also questioned the assumption that leases would not be affected by inflation.

Senator Dyson stressed that lease payment amounts would not increase, nor would terms of four-year contracts with employee bargaining units.

Co-Chair Green countered that "catch up" would be necessary at the conclusion of the contract to adjust for inflation that occurred over the term of the original agreement.

Co-Chair Wilken stated this issue should be noted for further review.

AT EASE 9:17 AM /9:17 AM

Co-Chair Wilken called upon Division of Legislative Finance staff to join the discussion.

Senator Hoffman spoke to increases and decreases resulting from federal mandates, cautioning that if the State did not meet the amended obligations, federal funding would be lost. He asked how this proposal addresses the situation.

Co-Chair Wilken clarified that if the federal match ratio requirement increased, the State would be required to contribute a larger portion of funding for a program or project to be eligible to receive the federal portion, thus increasing the budget of the affected State agency.

Senator Dyson noted Co-Chair Donley addressed this issue by providing that if there was need for an increase due to extraneous circumstances beyond the amount allowed in the appropriation formula, the legislature could vote to increase the operating spending limit. He commented that the decision must be made as to whether a simple majority, two-thirds majority, or super majority vote would be required to make such allowances.

Senator Hoffman opined that the allocation limit should be "lifted" or increased accordingly, in those instances to accommodate the changed federal requirement.

Co-Chair Wilken added this issue to the matters requiring consideration.

2. We'd like to make the formula state that the limit will be based on the previous appropriation or actual expenditures,

whichever is less.

- A. Legislative Legal staff says that actual expenditures would always be less because not all appropriations are spent by the end of the fiscal year.
- B. Some moneys are put in trust and are not expended.
- C. Some moneys go to purposes that do not lapse at the end of the year.
- D. How can we delineate or define such "expenditures" so that we can incorporate this concept?

Senator Dyson noted that two years could be required to secure accurate expenditure data. He added that a two or three-year average formula were other options.

3. What exemptions should be made? The Office of Management and Budget are recommending that we eliminate the following that were in the Donley Constitutional Amendment:

- A. Railroad? On the one hand it increases the overall appropriation, thereby increasing the amount represented by the limit calculated. On the other hand, to exclude it may mean they aren't limited like those Government exemptions who are not exempted and are thus not subjected to the same constitutional discipline.
- B. University and Alaska Vocational Technical Center? Only a portion of their funds come from state appropriations. Some of their revenue comes from tuitions and other sources. Should the general fund contributions to these institutions be limited like other state government functions, and if so, how?

Senator Dyson noted Co-Chair Donley proposed several exemptions that would not be included in the appropriation limitation; however, the Office of Management and Budget suggested the aforementioned three be excluded from the list of exemptions. He emphasized these are policy decisions.

Senator B. Stevens asked if the spending limitation would apply only to the State portion of the funding for these organizations or to their entire budgets.

Senator Dyson responded this was a matter to be addressed.

BRUCE TANGEMAN, Fiscal Analyst, Division of Legislative Finance, relayed that Co-Chair Donley's proposal and subsequent versions of similar resolutions have excluded federal funds and included non-duplicated funds in appropriation limitations. Therefore, he

concluded that interagency receipts would not be "counted".

Senator B. Stevens asked if the appropriations limit would include authorization to expend freight and passenger receipts and asked whether this would limit the growth of those functions.

DAVID TEAL, Director, Division of Legislative Finance, informed that the Legislature appropriates no State funds to the Alaska Railroad Corporation and has no oversight in the budgeting and operation of the agency. He explained that if the railroad were included in the appropriation limitation, and permitted to continue to determine fund expenditure, any increased expenditures would affect the State's overall appropriation and thus other budgets must be reduced accordingly. Conversely, he noted, that reduction in spending by the railroad or the University would allow for increased appropriations elsewhere in the State budget. He emphasized that the inclusion or exemption of the Railroad, University and Alaska Vocational Technical Center (AVETC) would be a policy call to be made by the Legislature.

Senator B. Stevens expressed he would need to be convinced that agencies that do not receive State funds should be included in spending limits.

CHERYL FRASCA, Director, Office of Management and Budget, Office of the Governor, testified the intent was to "narrow" the number of exemptions. She explained that when exclusions are provided; an incentive is made to categorize funding into the exempted entities to allow for increased funding. She asserted that past behavior of the Legislature has demonstrated this.

Senator Dyson agreed with Senator B. Stevens' point, questioning why growth should be limited in the event of increased demand for Railroad or University services, or receipt of increased federal funding for expansion that would not impact the State's operating budget.

Ms. Frasca noted the State "invests" over \$200 million in the University. She suggested that if tuition receipts were to be excluded from the appropriation limitation, this must be specified to prevent categorization of other funds as university receipts. She qualified that some federal funding and trust fund incomes must be expended in specified manners.

Senator B. Stevens noted the Legislature allocates a single line item appropriation to the University, which the Board of Regents then expends as it determines. He therefore surmised that a limitation should only be imposed on the amount of funding provided

by the State.

Co-Chair Wilken understood and shared this concern and included the issue for further consideration, noting the arguments would not be debated at this hearing.

Senator Bunde recalled that a handout was distributed to the Committee the previous year showing the amount of federal funds received by the State [copy not provided at this time]. He spoke to complaints about the significant amount of total funds included in the State budget, although the Legislature does not control a majority of the funding. He predicted, that despite the implementation of an appropriation limit, complaints would continue to be made by uninformed Alaskans, because the total budget would continue to increase. He supported a spending cap to demonstrate that the legislators are "good stewards" of the State's funds and that exemption of federal funds could be confusing.

Co-Chair Wilken added this matter to the issues to be discussed further.

Senator Dyson agreed with Senator Bunde's observation.

Senator Hoffman asked why the federal Airport Improvement Programs (AIP) funds were not included as an exemption, suggesting that limiting airport expansions would limit the number of travelers able to utilize the facilities and come to Alaska.

Co-Chair Wilken noted this would also be included as a topic of discussion.

Senator Dyson also pointed out that expenses incurred to pay off bonds for capital projects are exempted in this legislation.

Senator Hoffman stressed that additional operating expenses are necessary to maintain and operate expanded facilities. He remarked that a two percent increase, as proposed in this resolution, would be insufficient.

Senator Bunde commented that the permanent fund dividend program is the largest single appropriation made each year and must also be included as an exemption. He asserted that any growth in spending should acknowledge growth of the Permanent Fund Dividend.

Co-Chair Wilken added this point to the items of discussion.

Senator B. Stevens asked if the exemption would apply to expenses relating to revenue anticipation bonds or just to general

obligation bonds.

Ms. Frasca replied that the Office of Management and Budget recommends exclusion of revenue bond debt payment, distribution of the proceeds, and general obligation bond proceeds; however debt service for general obligation bonds, school reimbursement and certificates of participation would not be excluded from the appropriation limit. She reiterated that any exclusion would create an incentive to "exhibit that behavior," and would encourage future legislators to incur debt for capital projects and discourage cash payment for such projects. This, she stated, is because cash appropriations would be subject to the spending limit, although revenue would be required to fund the projects regardless of whether bonds were issued.

Co-Chair Wilken added this topic to the list of talking points to illustrate different types of bonds and how they would be addressed under the proposed appropriation limit.

Senator Dyson furthered that a determination should be made as to acceptable operating funding increases in the event of expanded or new facilities.

Ms. Frasca argued that the opening of a new facility does not necessarily generate increased revenue. She exemplified the recently opened Kenai Peninsula Juvenile Facility and the need to reduce funding elsewhere to provide funding to operate this new facility. She stated that new and expanded facilities therefore "compete for dollars" with existing facilities to cover operating expenses.

Senator Hoffman commented that the Alaska Constitution requires that the Legislature appropriate no more funds than what is available and therefore questioned the need for this resolution.

Senator Bunde opined that the State has not practiced diligence in maintaining facilities and surmised that an appropriation limitation could result in poorer maintenance of new facilities if adequate funding were not allowed for operating purposes.

4. Should the number of legislators required to approve exceeding the limit formula be 2/3 or 3/4?

A. If the party in power wants to spend more money irresponsibly, are we giving enough power to the responsible minority to stop the spending spree?

B. If we give too much power to the minority, will they be able to hold the majority hostage and demand personal or irresponsible special interest pork, when good public

policy would necessitate increased spending to meet unusual circumstances?

5. Should we keep the second 2% limit in place? Is 2% the right absolute limit to exceed the formula limited increases?

A. Should it be higher or lower?

B. Under what circumstances would we want to override the limit so drastically that we would violate the constitution to do so?

B. Should this limit apply also to capital projects?

Senator Dyson noted Co-Chair Donley's proposal would have required a three-quarters majority of both houses of the legislature and would have limited any increase to two percent.

Senator Dyson spoke to times when abundant funding was available and the subsequent expanded role of state government. He asserted that as a result, the current legislature must determine which functions to continue to fund and at what level, with less income available. He suggested this provision could restrain exponential growth in the event of future increased revenue.

Senator Olson asked if historically, a provision existed to change the requirement from a two-thirds majority to a three-quarter majority in the event of a "super majority."

The existence of such a provision was unknown.

Senator Dyson asked whether the appropriation limitation adopted in 1981 required a super majority to override the limit.

Mr. Tangeman emphasized that the amount of funds available for expenditure far exceeded the limitation stipulated in the 1981 limit. Therefore, he asserted, the original allocation limit is of "clearly no use" at the present time.

Ms. Frasca listed that 29 states have a limitation of either revenues or spending: of those 12 states require a two-thirds majority to override the limit, two states require three-fifths majority, seven states require a simple majority, six states have no provision to allow waivers, and no states require a three-quarters majority.

Co-Chair Wilken referenced a graph titled, "Draft-Spending Limit Proposals" provided by the Division of Legislative Finance [copy on file.]

Mr. Teal explained this graph demonstrates the impacts of various approaches to a spending limit. He indicated that a cumulative approach, such as the existing limitation, is unrelated to actual spending and allows for no self-correction for actual expenditures. He stated that over time, this results in a limit "far away from anything resembling reality". He noted the authorized appropriation amount for FY 04 under the 1981 provision is \$6 billion, whereas actual expenditures would be approximately \$2.2 billion. He suggested this could be remedied by reducing percentages.

Co-Chair Wilken clarified the line on the graph labeled "cumulative" represents Article IX, Section 16 of the Alaska Constitution.

Mr. Tangeman added that the cumulative line accounts for most exemptions contained in the various proposals, such as federal receipts, dedicated funds, etc., and therefore differs from the existing constitutional provision.

Mr. Teal pointed out that all of the methods demonstrated in the graph have been adjusted to account for exemptions in the same manner. He furthered that the trend demonstrates the pattern for each method if enacted in 1997.

Mr. Teal next addressed the line item labeled "annual", explaining it represents the method proposed in Senator Donley's earlier legislation, SJR 23 and would result in the "opposite extreme" to that of a cumulative approach. He stated that the annual approach is based only on actual expenditures and if spending decreased in one year, future appropriations would be limited to increases based upon the lower budget, although actual requirements increase and decrease every year. He suggested adjustments could be made, but cautioned such actions would be "arbitrary, complex" this would require continual overrides.

Mr. Teal then spoke of "a number of middle ground options" between the extreme cumulative and annual approaches. He asked whether the Governor had a recommended method made public.

Ms. Frasca responded that the Administration chose to make suggestions to the legislative proposals.

Mr. Teal also suggested that "benchmarks" could be placed to make periodic adjustments stated that because the two aforementioned approaches were not viable, a third method is demonstrated on the graph as "recent growth" and was recommended by the Office of Management and Budget. He explained that a fixed base would be established, as with the cumulative approach, although "growth

calculations" would be made to the previous three to five years to prevent the incremental increases to "get out of control". He pointed out the data on the graph shows a decrease for FY 97 and FY 98 under this method despite the growth calculations based on population and personal income, both of which variables had constant increases. He explained this is because the allowable spending increase is calculated on the rate of growth.

Mr. Teal expressed that this method itself is not necessarily good or bad, but dependant upon the various factors to determine success.

Mr. Teal suggested that "benchmarks" could be placed to make periodic adjustments noting the information contained on the graph is based on 1981 expenditures. He listed another option of allowing the budget to increase by a set amount or certain percentage each year. However, he recommended development of a theory to adopt a spending limit based on determined variables, such as the need for services, cost of providing those services, and available revenue.

Mr. Teal continued that population affects the need for services and the Consumer Price Index (CPI) is adequate for determining the cost of services, although not all government services are affected by population or the CPI. He stated that accommodations could be made to account for the exceptions.

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Mr. Teal spoke to revenue as a component of determining allowable appropriation amounts. While personal income reflects the state of the economy, he warned that it is only applicable for states that impose a broad based tax: either a sales or income tax. He explained that when personal income rises, revenue generated from these taxes increases. He noted that personal income is often reflected in the CPI, and therefore both variables should not be used.

Mr. Teal further questioned the option of basing appropriations partly on revenue, saying that a significant portion of Alaska's revenue is from oil proceeds, and that oil prices are volatile. He furthered that in those states that base appropriation authorizations to revenue, residents understand that increased taxes allow for increased spending and subsequently pass initiatives restricting tax increases.

Mr. Teal reiterated that many options exist and he was unsure if

the Committee would debate them and amend this resolution, stressing that the Committee must decide what should occur with regard to a spending limit. He posed additional considerations, including determining the importance of stability, contingency in the event of declining revenue or revenue "spikes" generated from a natural gas pipeline for example. He also emphasized the need to address the current structural deficit of \$400 million to \$600 million each year. He warned that this fiscal gap could not be maintained indefinitely because the CBR would be depleted. Upon depletion of the CBR, he noted a spending limit would be unnecessary because the amount revenue to appropriate would be limited.

Mr. Teal answered Senator Hoffman's question of why a spending limit is necessary, stressing that the existence of the CBR equates to unlimited revenue for current years.

Co-Chair Wilken commented this is a subjective and complex issue.

Senator Bunde cautioned prevention against a hidden incentive to spend the maximum amount appropriated to various programs and projects.

Senator Dyson cited the Alaska Constitution Art IX Sec. 16 in suggesting the basis for a three-quarters majority option. This section provides that the legislature may exceed the appropriation limit if the Governor signs such a bill or a gubernatorial veto is overridden by a three-quarters majority vote. He surmised this demonstrates historical precedent of a three-quarter majority.

Senator Hoffman disputed Mr. Teal's argument of the necessity of a spending limit, because a three-quarters majority vote is required to withdraw funds from the CBR.

Senator Hoffman asked number of states with provisions in the constitution to limit spending to the amount of revenue generated. He suggested that limitations of other states should be reviewed.

Senator Olson commented that although other states have spending limits, many of those states also have fiscal problems considerably worse than that in Alaska. He attributed some of these situations to spending limits.

6. This proposal eliminates the current wording that 1/3 of appropriations should go to capital projects. Do we want to agree to that?

Senator Dyson characterized this item as a housekeeping matter,

although he encouraged legitimate discussion.

7. Should we keep the requirement that the governor reduce expenditures as necessary after the legislature approves a 2% increase over the formula limit?

Senator Dyson noted this issue should be discussed.

Senator Bunde clarified this provision requires that the Governor veto any legislative action to increase funding above the allowable two percent.

Mr. Tangeman affirmed that in the event the legislature appropriates more than a two percent increase, the Governor is required to reduce expenditures through line item veto.

Co-Chair Wilken asked if this would apply in the event the legislature approves an increase by a three-quarters majority vote.

Mr. Tangeman responded that the requirement of the Governor still applies.

Senator Dyson pointed out this is the existing provision.

Senator B. Stevens understood page 2 of bill

Senator Bunde remarked this furthered the need for a constitutional spending limit because one legislature could not bind future legislatures. He explained that in the event a legislature overrode such a gubernatorial veto and a cycle ensued, the courts would rule according to the Alaska Constitution.

Senator Hoffman instead suggested the proposal in item #7 could be furthered to allow appropriations of greater than two percent in the event the legislature overrode a gubernatorial veto of such an action.

Senator B. Stevens was unsure whether the legislature should relinquish its ability to override vetoes.

Co-Chair Wilken surmised this item needs further review.

Ms. Frasca informed that the Attorney General has advised that this provision would result in the legislature relinquishing its power of appropriation and could be unconstitutional.

8. What do we do with excess funds above the two tiered operating budget limits? What funds do we consider (general

funds, other)?

A. The constitution currently says, "The governor shall cause any unexpended and unappropriated balance to be invested so as to yield competitive market rates to the treasury." [Last sentence of Art. IX, Sec. 16]

B. Should the governor be required to deposit such funds to the Constitutional Budget Reserve?

C. The constitution says that if funds have been withdrawn from the CBR (as is currently the case), that money in the general fund available for appropriation at the end of the year will be deposited in the CBR. What about when we have paid back the CBR and no longer "owe" the CBR? [Article IX, Section 17(d)]

Senator Dyson surmised that depositing unexpended and unappropriated balances into the CBR would meet the provision of A. He posed the question as to whether this should be required as suggested in B. He cited Senator B. Stevens's analogy of the CBR as a "bridge to the future" and opined that such actions would return the legislature to the role of "promise keepers" in "rebuilding" the CBR. He explained C as a consideration that if the balance of the CBR reached a certain amount whether excess general funds could be expended for other purposes.

Senator Hoffman recommended discussion of whether funds should also be deposited to the permanent fund.

Co-Chair Wilken added this to the list of items for consideration.

Senator B. Stevens restated the question as to whether excess funds should be deposited into the permanent fund before the total amount of funds withdrawn from the CBR in past years has been "repaid".

Co-Chair Wilken restated other issues added for consideration: #9, whether federal dollars should be included in a spending limit; and #10, how different types of bonds would be included.

Senator Dyson also noted points raised about inclusion of permanent fund dividend payouts, and the escalating cost of operating expanded and new facilities.

Ms. Frasca indicated she would provide a handout containing a summary of the appropriation and revenue limits of other states.

Ms. Frasca expressed that in event of revenue "windfall" she wanted

to insure that the size of government would not grow, regardless of the fund source. She noted several programs she did not consider essential state services, but are somehow exempt from budget reductions because they are not funded with State funds. She remarked it is difficult to justify elimination of State Trooper positions at the same time funding is increased to a State corporation.

Senator Bunde speculated on the current size of State government if such a growth restriction were in place during the 1970s.

Senator Dyson appreciated Committee's patience and anticipated these efforts would result in a better process. He was "personally challenged" by the idea that increases in the individual wealth of Alaskans would reciprocate a lesser demand for government services, such as public assistance. He analogized his attempts to "set the guardrails on public policy", to protect against "falling in the ditch" as a result of poor decisions.

Senator Dyson noted he and Ms. Frasca worked under similar guidelines in the Municipality of Anchorage with its tax limitation, which he opined forced "healthy discipline". He suggested that with proper planning "unfortunate and unintended" consequences of a spending limit could be avoided.

Co-Chair Wilken requested Senator Dyson address the questions posed during this hearing. Co-Chair Wilken noted that the House of Representatives was considering companion legislation.

Co-Chair Wilken ordered the bill HELD in Committee.

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ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 10:17 AM