

MINUTES
SENATE FINANCE COMMITTEE
March 16, 2004
1:42 PM

TAPES

SFC-04 # 42, Side A
SFC 04 # 42, Side B
SFC 04 # 43, Side A

CALL TO ORDER

Co-Chair Lyda Green convened the meeting at approximately 1:42 PM.

PRESENT

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

Also Attending: SENATOR TOM WAGONER; SENATOR GARY STEVENS; SENATOR BERT STEDMAN; SENATOR RALPH SEEKINS; SENATOR HOLLIS FRENCH; BILL CORBUS, Commissioner, Department of Revenue; MICHELLE PREBULA, Cash Manager, Treasury Division, Department of Revenue; LUCKY SCHULTZ, Staff to Senator Fred Dyson; CHERYL FRASCA, Director, Office of Management and Budget, Office of the Governor

Attending via Teleconference: From an Offnet Site: DR. BARRY POULSON, Tax/Spending Consultant and Professor, University of Colorado

SUMMARY INFORMATION

Department of Revenue
Constitutional Budget Reserve Fund Presentation.

The Committee heard from the Department of Revenue regarding the establishment of a one billion dollar minimum balance in the Constitutional Budget Reserve Fund.

SJR 3-CONST AM: APPROPRIATION/SPENDING LIMIT

The Committee heard from the bill's sponsor, a tax/spending consultant, and the Administration. A committee substitute was adopted and the bill was held in Committee.

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Department of Revenue
Constitutional Budget Reserve Fund
Presentation

BILL CORBUS, Commissioner, Department of Revenue, stated that his power-point presentation [copy on file] would address the status of the Constitutional Budget Reserve (CBR) and the need to maintain a minimal balance in that account. A similar presentation that had included the history of the CBR and information regarding the volatility of the price of oil had been presented to the Conference of Alaskans at the University of Alaska in Fairbanks on February 10, 2004. However, the historical and volatility information would not be presented today, as this Committee is familiar with these issues. He informed that no major settlements resulting from oil tax or royalty disputes would be received by the State in the foreseeable future.

[NOTE: Co-Chair Wilken assumed chair of the meeting.]

AT EASE 1:46 PM / 1:46 PM

Commissioner Corbus stated that historically, the CBR has been utilized for three purposes: to cover budget deficits; to cover unexpected budget shortfalls resulting from unexpected downturns in oil revenues; and to provide cash flow to the general fund (GF). He noted that Governor Frank Murkowski has announced his desire to retain a one billion dollar minimum balance in the CBR.

Commissioner Corbus referred the Committee to the graph titled, "Projected vs. Actual CBR Draws" on which a red line depicts the forecasted CBR draw that was projected for each year from 1995 through 2004. The actual draws for the years 1995 through 1997 were below the forecasted amount; however, the actual draw in 1998 exceeded the projection due to a downturn in forecasted oil prices.

Senator Bunde asked whether 1998 was the year that oil prices dropped to approximately nine dollars a barrel.

Commissioner Corbus pointed out that the average oil prices per year are depicted on the chart titled "ANS Oil Price Differential, Change Year-to-Year, FY 1994-2003." There was a \$5.04 per barrel decrease in 1998 as compared to 1997 prices. An additional \$3.13 per barrel decrease occurred in 1999.

Commissioner Corbus again referred to the chart titled "Projected vs. Actual CBR Draws" and noted that in 1999, the decrease in the price of oil forced an additional \$325 million draw on the CBR, above what was forecast.

Senator Bunde understood from the chart that in excess of one billion dollars was withdrawn from the CBR in 1999. That fiscal year's total budget was approximately \$2.3 billion budget. Therefore the draw that was required equated to half of the FY 99 total budget.

Commissioner Corbus noted that less than the forecasted amount was withdrawn from the CBR in 2000 and 2001; the amount withdrawn in 2002 exceeded the forecasted amount; and the amounts withdrawn in 2003 and 2004 were less than the forecasted amount. The point is that projecting the price of oil is not an exact science. A reserve must be available to provide for the years when the price of oil is lower than forecast.

Senator Bunde asked whether the total amount that has been withdrawn from the CBR, since its inception, is available.

Commissioner Corbus replied that a total of \$5.5 billion has been drawn.

Senator Bunde stated that according to law, this amount must be repaid to the CBR.

Commissioner Corbus concurred.

Commissioner Corbus reiterated that the primary purposes of the CBR are to provide money when there is a revenue shortfall and to provide cash flow during the year for such expenses as construction projects for which the State would eventually receive federal reimbursement. This borrowing process is depicted on the chart titled "General Fund Cash Sufficiency With CBR borrowing" which illustrates the bi-weekly general fund borrowings from the CBR for the fiscal year 1997. The graph titled "General Fund Cash Sufficiency Without CBR Borrowing" depicts how the balance of the GF would have fared without the CBR borrowings that year. While the yearend balance is the same in either scenario due to the fact that the monies borrowed from the CBR are entirely reimbursed, the GF balance in the second graph would have reflected a cash deficit position in the summer and fall months. It is a State policy that the GF balance not be lower than \$100 million dollars. In summary, these two charts depict how the CBR has been used to provide "a line of credit to the State" in times when the income deposited into the GF is less than the money being spent.

Senator Bunde, noting that the CBR is an interest bearing account, asked whether the funds borrowed from it are paid back with

interest.

Commissioner Corbus replied that interest is not paid on the borrowings.

In response to a question from Senator Olson, Commissioner Corbus stated that the short-term borrowings from the CBR are paid back without interest.

Commissioner Corbus expressed that the argument favoring a one billion dollar minimum CBR balance is further expressed in the chart titled, "Should We Set Minimum for CBR," which depicts that \$300 million to \$400 million is needed on an annual basis to provide for fluctuating GF cash flows. The additional \$600 million to \$700 million balance would maintain the desired CBR balance were the price per barrel of oil to decrease by up to ten-dollars. A one-dollar reduction or increase in the price per barrel of oil for one year would equate to a loss of or an increase of \$65 million to the State, respectfully. The aforementioned chart "ANS Oil Price Differential" depicts the year-to-year change in the average price of oil from 1995 -2003. The 1998/1999 cumulative total loss, for that time period, was eight dollars price per barrel of oil. This is one reason to establish a \$600 million to \$700 million buffer balance in the CBR.

Commissioner Corbus referred to the chart titled "Should We Set Minimum for CBR" that presents a forecast for the oil revenue that the State might receive. Revenue anticipation notes could be sold based on the projected sources of revenue.

Commissioner Corbus concluded that the State is making a case in support of maintaining a minimum CBR balance of one billion dollars, as it would be the "appropriate" amount with which to provide for the fluctuations in oil prices as well as to provide the required cash flow for the GF.

Senator Bunde understood that were a one billion dollar minimum balance mandated and then breached to provide funding for the fluctuating cash flow, the lone alternate through which to reimburse the CBR, were insignificant revenue to be received, "would be for the Legislature to follow the law and repay the CBR some of the five billion we owe it."

Commissioner Corbus replied that that is a fair analysis. In addition, the comment opens discussion regarding a "replenishment plan" which is an issue that has been raised by financial rating agencies. Another concern raised is that the State does not have an overall financial plan. This must be in place before a reimbursement plan could be developed. Absent these, specifying that the CBR maintain a one billion dollar balance "is better than nothing."

Senator Hoffman, noting that the presentation highlights the fluctuating price of oil, asked whether the fluctuating number of barrels flowing through the pipeline is also an important factor. This would have a correlating affect on the revenue.

Commissioner Corbus noted that one million barrels a day has been the norm for production. In the next year, production is projected to be 996,000 barrels a day and would be sloping off thereafter. Production is not as significant a factor as price.

Co-Chair Wilken surmised that another factor would be the yield of a field. The three pieces therefore would be price, production, and yield.

Senator Olson asked whether there is a penalty for not reimbursing the CBR for the amounts owed.

Commissioner Corbus stated that there is no penalty.

Senator Olson observed that the chart titled "Should We Set Minimum for CBR," depicts that revenue would be generated from oil production in the Arctic National Wildlife Refuge (ANWR) beginning in approximately 2011.

Commissioner Corbus stated that the chart depicts all "possible" revenue sources. The Governor Murkowski Administration is very committed to developing the State's resources.

Co-Chair Wilken asked how fiscal years 2003 and 2004 would look were a chart similar to the FY 1997 "General Fund Cash Sufficiency Without CBR Borrowing" chart developed, specifically in regards to how often the GF balance would have "dipped below the zero line."

MICHELLE PREBULA, Cash Manager, Treasury Division, Department of Revenue, responded that during the six years she has worked in the Department, the State has, annually, been required to borrow funds from the CBR. She noted that the chart was developed based on the fact that 1997 was a year in which the budget balanced. It currently appears that FY 04 would have a balanced budget; however, to date, \$300 million has been borrowed from the CBR due to cash flow demands. This amount would be repaid.

Co-Chair Wilken asked the lowest balance that the GF has attained, during the past six years, before the CBR funds were accessed.

Ms. Prebula responded that in addition to being able to access CBR funds, there is a cash flow contingency in place to assure that the GF balance would not reduce below zero. Therefore, the lowest balance would be approximately \$28 million.

Co-Chair Wilken asked how the GF balance would fare were there not CBR borrowings.

Ms. Prebula replied that without CBR borrowings, the balance of the GF would have dipped into the negative territory each year. The amount would vary by year. FY 04 would have reached a negative \$400 million were no CBR borrowings conducted.

Co-Chair Wilken, noting that the CBR is an interest bearing account, asked whether the Department has a breakout of the interest earnings on the contributions that have been made to it for the last five years.

Commissioner Corbus responded that this information is available and would be provided. As he recalled, the return has been favorable and could be in the five-percent range.

Senator Hoffman pointed out that this information is located in the presentation's information titled "CBR History." It specifies that the "State has deposited \$5.6 billion into the CBR and has earned \$1.6 billion in interest on the money."

Co-Chair Wilken asked that a breakout of this information be provided.

Commissioner Corbus stated that the Department would provide this information.

Senator Bunde asked whether the interest earned by the CBR is deposited into the CBR or the GF.

Commissioner Corbus clarified that it is deposited into the CBR.

Co-Chair Wilken stated that after it is deposited into the CBR, it would be available to the Legislature.

Senator Hoffman, in reference to the request that a minimum one billion cash balance be specified for the CBR, asked why this high level is required in these days of such things as electronic transfers.

Ms. Prebula responded that this amount would be required to insure that sufficient GF cash flow monies would be available in order to prohibit the GF balance from falling below a zero balance. She stated that the State's accounting system would not allow a transaction to be processed were it to have the affect of making the GF balance to fall below zero. Even with electronic funds transfers, it could be possible that several large transactions might occur on the same day as such things as State payroll, that amounts to approximately \$75 million, might be being processed. Were that to occur, a "tight" balance would result that could

prevent a transaction from occurring.

Senator Hoffman pointed out that, with CBR borrowings, the GF balance depicted for FY 97 had sufficient cash funds well above a \$100 million dollar level and even approached the \$200 million level. This "appears to be quite a large buffer."

Ms. Prebula expressed that the Department strives to retain a GF balance with \$100 million as the floor and \$200 million as the ceiling. Were the cash balance projected to exceed \$200 million for more than a 30-day time period, the CBR would be repaid.

Senator Seekins shared that while the concern is that the CBR balance would be eventually be reduced to zero, in reality, that "zero amount" would be in the \$400 million or \$500 million range due to the GF cash flow demands. That would be the point where the account would cease to be a CBR and would become primarily "a cash management account."

Commissioner Corbus stated that the forecast is that the CBR would be exhausted by May 2007. However, the Office of Management and Budget recently suggested an earlier date might occur were a \$100 million minimum GF balance factored in.

Senator Seekins stated that there are two issues that must be considered. One is that, because the Legislature could not appropriate a deficit budget, it would depend on the CBR to provide funding for a budget. Second, it is also a dual-purpose management tool in that it serves as a cash flow account for the GF.

Commissioner Corbus agreed.

Senator Seekins opined that the balance of the CBR, in its role as a cash management account, must maintain approximately a \$400 million or \$500 million balance in order to provide for oil price fluctuations and the cash flow.

Commissioner Corbus supported there being \$300 to \$400 million for cash management purposes and \$600 to \$700 million for oil price fluctuations.

Senator Seekins asserted that it would be irresponsible of the Legislature to allow the CBR balance to fall below \$400 million, as that would negate its ability to provide for cash management.

Commissioner Corbus stated that that level would not provide sufficient funding to allow for the unexpected fluctuation of oil prices.

Senator Bunde surmised, therefore, that a \$400 million CBR balance should be viewed as a zero balance.

Commissioner Corbus voiced agreement with that concept.

Senator Hoffman asked what cash management funding mechanism was utilized prior to 1989 when the CBR was established.

Ms. Prebula understood that prior to the creation of the CBR, a budget deficit was not an issue.

Co-Chair Wilken surmised that were the CBR to disappear tomorrow, there would be alternate funding options. The Legislature could, overtime, establish a GF balance and, as a matter of policy, prohibit it from falling below \$400 million. The State could establish a line of credit from the Alaska Housing Finance Corporation or a financial institution. He acknowledged that while it is nice to have the CBR, were it to dissipate, the State would have other options available to it.

Mr. Corbus responded that the only problem with Co-Chair Wilken's observation is that it does not take into consideration the possibility that a downturn in oil prices might occur. Speaking on behalf of the "conservative side of the State" he "would prefer not to do business that way."

Co-Chair Wilken acknowledged; however, stated that with \$30 billion dollars in the bank, the State would have the ability to secure a line of credit.

Co-Chair Green asked how other states manage their cash flow situations.

Commissioner Corbus informed that other states are also "wrestling with this issue." However, while Alaska is unique in that 80-percent of its revenue comes from one industry, other states, "have a better balance and more predictable revenue sources."

Co-Chair Wilken noted that the State could learn from how local borough governments operate in that, while they might borrow from their fund balance, they always reimburse it.

Senator Olson recalled that when the price of oil declined in the mid 1980s, the Administration quickly addressed it by developing some very creative funding alternatives as well as some "deep cuts."

Commissioner Corbus stated that the Department would develop a report depicting how the State funded its cash flow needs prior to the establishment of the CBR.

Co-Chair Wilken characterized the 1980s revenue decline as a period that was "not very pretty."

Senator Bunde exclaimed that the actions of the State at the time resulted in a serious depression: a lot of people lost their homes and numerous businesses closed.

Co-Chair Wilken voiced that this subject is worthy of the discussion as the CBR is "our cushion." He thanked Commissioner Corbus and the Department of Revenue for the presentation.

AT EASE: 2:25 PM / 2:38 PM

#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 second hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken explained that this legislation would establish in the State's Constitution a spending limit based on the sum of the Anchorage Consumer Price Index (CPI) and the change in the State's population. The State's budget could exceed the spending limit were it determined by the Governor, with concurrence of a two-thirds vote of the Legislature, that an emergency warrants it.

AT EASE: 2:40 PM / 2:41 PM

Co-Chair Green moved to adopt the Version 23-LS0296\X committee substitute as the working document.

There being no objection, Version "X" was adopted as the working document.

Senator Dyson, the bill's sponsor, apologized for the laborious process involved in the development of this bill. This version of the bill was just completed. The Department of Revenue has directly participated in the process and has conducted quality work in its regard. He stated that the Committee's review of this committee substitute would lend to the development of a better bill.

Co-Chair Wilken communicated that the Committee recognizes that the development of this type of legislation "is no small task."

Senator Dyson commented that while a spending limit has been incorporated in the State's Constitution since 1981, it really has not accomplished what it was intended to do. Previous Legislators have struggled to address this issue with no resolve. Amending the

State's Constitution should be conducted in a very careful manner, as it is one of the better Constitutions in the United States.

Senator Dyson explained to the Committee that since 1976, 31 states have introduced legislation dealing with spending limits. This information is included in a Legislative Research Report, Report Number 03.100, dated February 11, 2003 [copy on file]. Alaska is unique in that it receives little income from broad-based taxes as the majority of its income is derived from oil royalties. One of the changes incorporated into Version "X" is that the base year for the formula is specified as being two-year's prior due to the fact that the immediate year's appropriation information is incomplete until after the year is concluded.

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Senator Dyson continued that, in addition, to specifying the beginning base year, the formula would be calculated as the average of that year and the two-years prior to that in order to provide a smoothing affect. Another factor in determining the spending limit would be the number of people who must be served and the change in the cost of providing services to that population. This cost factor could be likened to an inflation and CPI factor. He pointed out that resulting from the fact that the population and cost of services do not align with each other, Version "X" would determine this calculation based upon 90-percent of the CPI and 75-percent of the population. While he acknowledged that this assumption might not be easy to defend, what would be "easy to defend" would be the fact that the cost of providing services does not rise in unison with inflation. For example, many of the State's operations are based on long-term contracts and fixed prices that are not affected by inflation. Similarly, it could be argued that each person moving into the state does not increase the State's cost of doing business. The exception to this might be the young and the elderly. He was convinced that a one-to-one relationship in these components would not adequately portray the true affect. A spirited discussion in regard to this percentage theory would be welcome.

Senator Dyson noted that the components that would be exempted from the spending limit are identified in Section 1, subsection (c) on page two, beginning on line ten. Language in Section 1, subsection (d) on page two, beginning on line 22 would allow the Governor to declare an emergency and expend money beyond that specified in the spending limit, provided it were to receive an affirmative vote of at least two-thirds of the members of the Legislature. He noted that he might propose an amendment that would replace the word "emergency" with the words "extraordinary circumstance" as is incorporated into the State of Connecticut's Constitution. Also, not included in this version is language that was previously

considered in similar legislation proposed by Senator Dave Donley, in that the amount that could be provided in this manner could be up to two percent of the budget more, were it approved by a three-quarter vote of the Legislature.

Senator Dyson also noted that this legislation would eliminate the Constitutional mandate that one-third of the budget be designated to support capital projects. In addition, Version "X" would require that any money above the appropriations limit be deposited into the Constitutional Budget Reserve (CBR) fund.

LUCKY SCHULTZ, Staff to Senator Dyson, explained that currently, in regards to the CBR, the Constitution specifies that any withdrawals from the CBR must be repaid. The language in the Version "X" committee substitute specifies that any excess funding would be deposited into the CBR regardless of whether any withdrawals are owed or not.

Senator Dyson noted that the Department of Law and the Governor Frank Murkowski Administration "take exception to" language in Section 1, subsection (e) on page two, line 27. Therefore he assumed that this language would be eliminated, as the concern is that this language would allow the Legislature to appropriate whatever amount they desired. This would make the Governor "the bad guy" by requiring him to eliminate items in the budget. Removal of the language would require both the Governor and the Legislature to share in the budgeting responsibility. In addition, its removal would eliminate the Legislature's jeopardy "in the Bess Omar challenge."

(e) If appropriations for a fiscal year exceed the amount validly appropriated under this section, the governor shall reduce expenditures by the executive branch for its operation and administration to the extent necessary to avoid spending more than the amount validly appropriated.

Co-Chair Wilken asked whether the sponsor would like to entertain an amendment to this effect.

Senator Dyson preferred to delay action in this regard until after the Administration has presented its testimony.

Senator Dyson noted that Dr. Poulson, who is recognized as one of the nation's foremost authorities on governmental taxation and spending limit concepts, would now present testimony. Dr. Poulson was instrumental in the development of Colorado's "Taxpayers Bill of Rights" (TABOR), which has been recognized as a national taxation/spending model. Furthermore, Dr. Poulson is "uniquely qualified" to answer Members' questions on policy matters and what concepts have or have not proven successful.

Co-Chair Wilken re-capped, for Dr. Poulson's benefit, that the Committee is conducting a weeklong focus on fiscal planning and methods through which to incorporate the State's assets in long term fiscal budget planning. The bill being discussed would implement a Constitutional spending limit as a method through which to address long-term budgeting needs.

DR. BARRY POULSON, Tax/Spending Consultant, and Professor, University of Colorado, testified via teleconference from an offnet site in Colorado and stated that he would share some of the experiences that other states have had in the development of tax and spending limits; would discuss Colorado's TABOR amendment; would provide his recommendations for a well-designed tax and spending limit would entail; and provide comments regarding SJR 3.

Dr. Poulson stated that his conclusion is that spending limits are effective and, "if properly designed," would positively affect fiscal policy. Some policies have effectively restrained the growth of government, which is of particular importance in times of economic recession. "States that have effective tax and spending limits have had to rely less on tax increases as a way to offset revenue shortfalls." The crucial element is the design of the tax and expenditure limit (TEL): some states have poorly designed spending limits and others have well-designed limits that have been eroded due to Legislative action or Court interpretations of the limit. An example of a poorly designed spending limit is one that would return any fiscal year's monetary surplus to the general fund as it serves to negate any funding constraints in the long run. Another example would be that special interest groups might influence the process and have certain funding earmarked and exempted from the spending limit in order to benefit their cause. Therefore, in order to effectively design a spending limit, the requirements are that the language must be included in the Constitution rather than in statutory provisions; the limit itself must be defined in terms of the sum of population and inflation; if surplus revenue above the limit is generated, it should be immediately refunded to taxpayers; and TEL would be most effective when linked to other budgetary rules such as balanced budget provisions and budget stabilization funds.

Dr. Poulson explained that TABOR was initially introduced in Colorado in 1992 and was enacted in 1997. "TABOR is regarded as the most effective tax and spending limit in the country," and many states are using it as a model. It has served to restrain the growth of government spending in Colorado. In the years between 1997 and 2000, the limit was met and more than three billion dollars was rebated or refunded to Colorado's citizens. Some problems that are being addressed include developing a mechanism through which to stabilize the budget over a business cycle. Another thing that has served to erode TABOR is the legislature's decision to rebate one year's surplus revenue the following year.

Unfortunately that was a year in which the State experienced a revenue shortfall. This served to exacerbate the state's fiscal crisis. Several interest groups have also influenced modifications to TABOR "in ways that way eroded its effectiveness," as while, currently most of Colorado's surplus revenue is generated from broad-based sales and income taxes, legislation has been introduced that would provide rebates to special interest groups.

Dr. Poulson concluded that TABOR has served to align the growth of state government in Colorado with the state's economy. California, on the other hand, "gutted" their TEL in the late 1980s and allowed state government spending to grow in double-digit rates in the 1990s. As a result, when California experienced its recession and revenue shortfalls, it was forced to make "really draconian cuts" or to borrow \$20 billion dollars." Colorado has been able to "avoid that kind of catastrophe," and in that aspect, TABOR has been an important component of the state's policy.

Senator Hoffman asked regarding Colorado's growth rate in the 1990s.

Dr. Poulson responded that the growth rate average exceeded eight percent after 1992, and some years experienced double-digit growth.

Co-Chair Wilken asked for clarification whether that was eight percent growth per year.

Dr. Poulson concurred that that was the average for total income.

Dr. Poulson noted that he has been working in conjunction with the American Legislative Exchange Council to develop a model TEL. In addition, he has worked with Senator Dyson on this legislation. The next generation of TEL should include the following "critical" provisions: it should be a Constitutional provision; must be defined on the sum of inflation and population growth; the broader the base utilized in determining the spending limit the better as it would curb the ability of special interest groups to erode the base and "carve out privileged positions" by having their spending exempted from the limit; the use of actual and historical measures of expenditures and revenues rather than projected or estimated amounts; and to link the TEL to both a balanced budget provision and a budget stabilization fund. The idea being that a portion of any surplus revenue would be either rebated or placed in a reserve fund. The reserve fund could be utilized to offset any revenue shortfalls in periods of recession. "The objective is not to restrain the growth of government but to stabilize the budget over the business cycle."

Dr. Poulson opined that the committee substitute Version "X" embodies these concepts and is a good TEL. In addition, the committee substitute provides for spending above the limit were an

emergency situation to occur. In addition, it provides that any money spent from the reserve fund must be repaid. The goal is to arrive at an "optimum tradeoff between constraining government and stabilizing the budget over the business cycle."

Senator Bunde, noting that he is supportive of this bill, commented that rather than this being a tax and spending limit bill, this is a spending limit bill, as the State does not have a broad general tax base.

Dr. Poulson responded that the bill is appropriately titled, as the limit refers to the total amount that could be spent as determined by a formula that is tied to the previous year's appropriation. Given Alaska's recent pattern of spending, the bill would provide a "more stable growth in spending and certainly constrain the growth "as compared to the spending that occurred in the previous decades.

Co-Chair Green asked for further information regarding the term "rebate."

Dr. Poulson explained that between the years 1997 and 2000, Colorado experienced revenue above the TABOR limit. TABOR requires that this surplus must be refunded to taxpayers either in the form of tax cuts or tax rebates. Reducing the state's income tax rate from five-percent to four-point-six-seven percent lowered the amount of the surplus; the state's sales tax rate and business personal property tax rates were lowered; and a rebate in the form of a check was sent to taxpayers based on a person's income. Therefore the three-point-two-five billion dollars of surplus revenue that was refunded to taxpayers was comprised of both tax cuts and rebates.

Co-Chair Green asked whether Alaska's CBR would equate to the budget stabilization fund presented in the testimony.

Dr. Poulson responded that one criticism of the Colorado TABOR is that it does not have a true budget stabilization fund but rather has established numerous funds such as a Medicaid reserve fund and an emergency reserve fund that could only be accessed in the case of a natural disaster. Efforts are underway to establish a true budget stabilization fund to which a portion of any surplus revenue would be allocated in addition to the tax cuts and rebates.

Dr. Poulson understood that the Version "X" committee substitute would allocate any surplus revenue into the CBR, and that any money removed from that fund must be repaid. Therefore, as currently defined, the CBR could not be used as a budget stabilization fund when there is a period of a decrease in revenue, but would rather require budget reductions to be made.

Co-Chair Green asked whether Colorado's reserve funds could be

accessed by a simple-majority.

Dr. Poulson responded that the rules of how to access money from the budget stabilization funds vary from state to state: some authorize it to be at the discretion of the legislature and some have formulas that are triggered by various factors that would allocate the funds in a variety of manners.

Senator Dyson stated that one of the criticisms of the formulas presented in this bill is the belief that recent spending has not provided an acceptable or appropriate level of basic services.

Dr. Poulson responded that in 1992, the argument in Colorado was that the TABOR amendment would result in draconian reductions at both the state and local level. In reality, that has not occurred. An important provision in the Colorado TABOR amendment is that, were the legislature to determine that the TEL is too low to support services, the issue could be presented as a ballot initiative to the people either to approve a tax increase or to approve spending above the limit. A tax increase was turned down by the voters in 1992 and the fact that none has been approved since is a good indicator that the public accepts the current TEL. Recent surveys indicate that people approve of the TABOR amendment. A proposal to increase the spending limit was placed on the ballot in 1997 and voters, also, rejected it. Were the State to include in this legislation, the ability to place taxation and spending limit issues on a statewide ballot, the voters could provide the answer as to whether the limits were appropriate.

Dr. Poulson noted that Colorado's TABOR amendment also limits local government TAL. They have been more successful in acquiring voter approval of local taxation or spending limit increases. The smaller the government, the more likely voter approval of taxation or spending increases. In summary, he stated that TEL "returns direct democracy to citizens in deciding how much taxes they are willing to pay and what levels of revenues and spending they are willing to see at both the local and state level."

Senator Bunde understood that economists "generally" believe that taxation and spending limits are "inappropriate or bad for the economy."

Dr. Poulson shared that one of the nation's leading economists, Richard Bedder of Ohio State University, has compared states that have successful TEL programs to states that have not implemented successful ones and found that the successful states are out-performing the others. They are more successful in terms of attracting business and in-migration. Therefore, the best economic analysis suggests that TEL could be "a very important part of your fiscal discipline."

Senator Dyson originally thought that the formula should work in reverse, in that were there a net decrease in population or deflation it "would ratchet down the State's spending." However, he negated that approach as he realized that the State might be required to increase services in the event of a downturn. Therefore the ratchet down factor was eliminated.

Dr. Poulson agreed that when a recession is being experienced, providing the legislature with sufficient flexibility with which to offset some portion of the revenue shortfall funds from the rainy day or reserve fund would be desirable. He stated that Colorado's "TABOR amendment is pretty stringent in that it does ratchet revenue and spending down" as the limit is required to be the lower of either the limit set by inflation and population growth or actual revenues. In recent years, the state's revenues and expenditures have been ratcheted down approximately 19-percent due to revenue shortfalls. One of the changes being considered in Colorado is that in times of a revenue shortfall the limit should either be suspended or remain constant until such a time revenues exceed the level that occurred prior to the shortfall. This would assist in stabilizing the budget over the business cycle.

Dr. Poulson stated that the proposed legislation contains two provisions, not included in the TABOR amendment: the first being that Alaska has a no ratchet down provision and the second being that Alaska has a CBR whereas Colorado does not.

Senator Dyson noted that Version "X" contains language that would allow for exceeding the spending limit in the case of an emergency. Consideration is being given to changing the language to "extraordinary circumstance" in order to expand spending in situations in which the State should expend a large amount of money, such as in support of an Alaska gas-line. In that case, it might take a few years to regain sufficient funds with which to repay the rainy day account.

Dr. Poulson stated that Colorado approaches this in a different manner as the TABOR amendment specifies that, upon voter approval, a tax increase or an amount exceeding the spending limit could be implemented in a given year. He expressed that a vote might result either by a citizen or legislative initiative. In one instance, an amendment to the constitution was adopted that specified that some spending for K-12 education would be exempt from the spending limit. Therefore, numerous options are available to address specific needs. The state of Michigan has established a system in which surplus money is deposited into a rainy day account, which could be accessed to fund an emergency. He preferred the Colorado mode of providing emergency funding, because rather than a decision being made by the Governor with support from the Legislature, it would also require the State's citizens' approval.

Senator Dyson shared that the Administration has suggested that a termination or re-ratification date be included in this legislation.

Dr. Poulson voiced support for this suggestion, for, in the case of Colorado, citizen approval has increased over time. In addition, local governments in the state have approved provisions that would allow some components of the spending limit to exceed it on a permanent basis.

Senator Dyson asked whether there is any method through which to prohibit state government from downloading responsibility to lower governments in order to allow the state government to spend money in a desired fashion.

Dr. Poulson responded that Colorado and other state's TELs contain provisions that preclude this from occurring in that, were the state to impose mandates that would require local governments to increase spending, the State must provide the additional funding. For example, when Colorado lowered its business personal property tax, the action negatively affected local revenues. TABOR required the State to "backfill that loss of revenue" with State general fund revenue. This provision "has been successfully upheld in the courts." It is important that the state not shift the burden of programs to local governments.

Senator Dyson countered, however, that certain programs should be administered at the local level.

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Senator Dyson continued that, while some communities could and should provide certain services, as long as the State is providing those functions, the local entity does not assume them. Police protection is an example of a program that should be managed locally. Therefore, mirroring the Colorado format might not in the best public policy for Alaska, particularly as it is a fairly young State.

Dr. Poulson agreed that local governments best administer some programs such as law enforcement. He stated that most states are in an opposite position as the state government has mandated that local governments provide certain services without providing adequate funding. He would provide a more thorough answer after further research.

Senator Dyson agreed that the Alaska has unique situations.

Senator Dyson understood that every state that has TEL has based its formula on the sum of inflation and population growth. Therefore, he asked Dr. Poulson's opinion of the proposal to utilize the sum of 90-percent inflation and 75-percent population growth as the growth of government and demand for services should not be on a one-to-one ratio with these two factors.

Dr. Poulson responded that inflation and population growth are "stringent limits" that have "certainly constrained the growth of government in states" that utilize these factors in their formula, particularly the states of Washington and Colorado. In periods of economic growth, a one to one TEL would serve to hold governmental revenues and spending below the level of income and the private economy; however, this might not be true in a time of recession these factors might permit a growth of government in excess of private income. He voiced being unsure whether utilizing a percentage of these factors would be necessary as the one to one formula is stringent.

Co-Chair Wilken noticed that while Colorado's formula utilizes the sum of 100-percent of both inflation and population, the spending is limited to a maximum six-percent increase.

Dr. Poulson stated that at the time TABOR was being voted on by the state's citizens, the Colorado legislature adopted a separate general fund statutory spending limit with a maximum growth of six percent. Therefore the State has a Constitutional spending limit that is based on population and inflation and a general fund statutory spending limit of six percent. TABOR implements a Constitutional spending limit to total revenue and spending. The six percent statutory limit applies only to the general fund spending per year.

Co-Chair Wilken asked, therefore, how a half a billion dollars of federal funding could be utilized were the TABOR amendment in effect.

Dr. Poulson clarified that federal funds and debt repayments are both excluded from the provisions of the TABOR formula. With the exception of exemption of money received in the form of tuition for the University of Alaska, the other exemptions denoted in SJR 3 mirror that of TABOR.

Senator Bunde voiced that the term "Alaska Disconnect" is defined as being that the State spends approximately \$6,000 per each new person in the State whereas each citizen generates approximately \$5,000 in income. New research conducted by the University of Alaska indicates that each new job in the State costs the State and local governments approximately \$6,300 while it generates \$5,200 in tax and revenue. This is the Alaska Disconnect. He voiced being unsure whether this information supports the percentages of

inflation and population growth proposed in the bill.

Co-Chair Wilken referenced language in Section 1, subsection (a)(1) on page one, beginning on line ten that reads as follows.

(1) the lesser of

A) ninety percent of the average annual percentage rate of change in the Consumer Price Index for all urban consumers for the Anchorage metropolitan area compiled by a federal agency for the second, third, and fourth calendar years preceding the calendar year during which the immediately preceding fiscal year began; or

(B) the average percentage of the change in the average personal income of State residents for the second, third, and fourth calendar years preceding the calendar year during which the immediately preceding fiscal year begins; plus

Co-Chair Wilken stated this language would balance the lesser of (A) which is the CPI against (B) which is the change in personal income. The sum would result from adding one of those two to the 75-percent of the average annual percentage rate of change in the State population for those same years. Therefore, he asked regarding the connection between personal income and State spending.

Senator Dyson stated that Cheryl Frasca, the Director of Office of Management and Budget, had suggested that rather than incorporating an inflation factor, growth in personal income should be substituted. However, he decided, upon review, that the growth in personal income would not increase, but would in fact decrease, the demand or need for government services.

Senator Dyson stated that in a prior draft, the calculation was that the growth in CPI could not exceed the growth in personal income. It was his intent that the growth in personal income "would be a limiter rather than choosing the less of." This would have the same result. He stated that Ms. Frasca's comments would be forthcoming.

Co-Chair Wilken, referencing the fact that the legislation discounts inflation and population, asked Dr. Poulson whether any other state has done likewise.

Dr. Poulson replied that Washington and Colorado utilize total inflation and population growth. Other states have incorporated the less stringent limit of the rate of growth in personal income, as a state that is experiencing a rapid growth in personal income could permit a large increase in revenues and spending. He also advised that this could present the problem as experienced in Florida where for three years there was a growth in personal income, which resulted in three years of an increase in revenues and spending.

This period was then followed by a recession and a downturn in the economy. Therefore, while revenue was declining, spending was not. He was not supportive of this approach. Therefore the design of a tax and spending limit is crucial. He voiced support for the approach being presented in SJR 3.

Senator Dyson conveyed that he was intrigued with the development of the formula, particularly when he recalled the economic expanse and decline experienced in the State in the 1980s. He would not support the inflation portion of the formula driving the limit.

Co-Chair Wilken voiced appreciation for Dr. Poulson's presentation.

CHERYL FRASCA, Director, Office of Management and Budget, voiced that Governor Frank Murkowski is supportive of a Constitutional spending limit. It is difficult to compare Alaska to other states as they have more revenues generated by taxation. Another challenge is the expectation "that revenues would automatically increase to the level approved in the spending limit." This "is not always the case." As referenced by Dr. Poulson, when a list of exemptions is developed, there is a tendency to categorize under those categories and thereby, increase the number of exemptions. In addition, there is a tendency to exclude funds for special interest groups. Other than the exemption of tuition for the University of Alaska, the Version "X" committee substitute does not list specific exemptions. Some elements that should be considered as additions to the exemption list would be Trust funds, the inflation proofing of the Permanent Fund, and dedicated fund sources.

Ms. Frasca echoed Senator Dyson's comments regarding the Administration's concern about language in Section 1, subsection (e) on page two, lines 27 through 30 that would require the Governor to singly make reductions to programs rather than that being conducted by both the Governor and the Legislature.

Ms. Frasca spoke in favor of the re-ratification language in the bill. She also voiced that an area of concern in the current Constitutional spending limit language is that each year it is ratcheted up dependent on the prior year's limit rather than being based on actual expenditures. Therefore, consideration should be given "to making the limit realistic" by basing the limit on the actual appropriations.

Senator Dyson agreed that this is the problem with the current Constitutional spending limit. It "accelerates toward infinity." In contrast, the SJR 3 proposal is based on the average of the prior three years' appropriations in combination with population and inflation percentages. Were it strictly based on, for example, a two-percent population and inflation increase, the growth rate would equate to four-percent. He agreed that careful consideration to the formula must occur.

Ms. Frasca reiterated that even though the limit might be increased five-percent, "the reality is we may only have a one-percent increase in our budget and so the idea is that the next year's limit would be based on that one-percent increase not the five-percent." She stressed that this process should be clearly understood.

Ms. Frasca stated that in its approach to developing the factors that would influence a spending limit, the Administration had considered a fifty-percent change in the rate of personal income growth as the theory was that were individual Alaskans doing well in terms of the economy then the State should be able to spend a little more. Upon consideration, the Administration accepted Senator Dyson's argument that in times of a recession, there could be an increase of State program assistance as people's incomes reduce. In summary, the approach taken by the Administration as compared to that taken by Senator Dyson is very similar in terms of the outcome, and that population and inflation factors are acceptable.

Co-Chair Wilken mentioned that in a memorandum [copy not provided] he had received from Ms. Frasca, it was mentioned that a drafting error has been identified in the bill.

Ms. Frasca responded that the error in question was in the Version "B" committee substitute and has since been corrected. She noted that the only other Administration suggestion would be that further consideration be given to providing flexibility in the process of exceeding the limit. She noted that this State, unlike Colorado, does not provide its citizens the ability to vote on appropriations. She also noted that the Municipality of Anchorage has a limit on the annual percentage increase that could be levied on all taxes so that its spending is limited to its revenue sources. Colorado has two limits; one as mandated by TABOR and the spending limit as reflected in regulation. It should be noted that in both Anchorage and Fairbanks, when a bond proposal is approved, the amount of funding needed for maintenance of the project would be exempt from the limit.

Co-Chair Green asked about language in Section 1, subsection (d), beginning on page two, line 22.

(d) An appropriation that exceeds the appropriation limit under this section may be made for any public purpose identified by the Governor in a declaration of emergency upon affirmative vote of at least two-thirds of the members of each house of the legislature. Appropriations under this subsection may be made only for a fiscal year identified in the declaration of emergency.

Co-Chair Green noted that this language might be a conflict with existing statute and suggested that this section be reviewed by the Department of Military and Veterans Affairs and the Department of Law.

Ms. Frasca asked for confirmation that the conflict would be in regard to the process through which the Governor would declare an emergency.

Co-Chair Green affirmed and stated that another concern would be in regards to how an emergency would be financed.

Senator Dyson asked the Administration to review this language as it might pertain to the State undertaking a huge building project such as a gas pipeline or a road and the efforts that would be required in advance of that endeavor.

Ms. Frasca concurred.

Co-Chair Wilken asked how this language would effect action in the case of an emergency such as a major earthquake.

Ms Frasca stated that currently the process through which the costs of responding to an emergency such as an earthquake is conducted in via a ratification process, "after the fact." The only difference is that the two-thirds vote of the Legislature, as specified in this legislation were the situation to exceed the spending limit, is not currently required.

Co-Chair Wilken understood that this legislation would require something akin to "a super supplemental" to be ratified by a two-thirds vote of the Legislature.

Ms. Frasca confirmed.

Co-Chair Wilken stated that the issues brought forward by the Administration would be considered.

Senator Dyson stated that he "is encouraged" by the progress of this legislation.

Co-Chair Wilken noted that Senator Bert Stedman has developed a "sensitivity analysis" [copy not provided] and noted that a change in variables does affect funding.

Senator Dyson appreciated Senator Stedman's professional input. In addition, he shared that comments from the oil industry indicate a desire that the State strive to develop a stable financial environment. He stated that this and other industries should be encouraged that, were the State to experience a new economic boom, the State's spending would not be extreme. Echoing Dr. Poulson's

comments, he stated that those states that have effective spending limits have been exceeding the average national growth.

Co-Chair Wilken ordered the bill HELD in Committee.

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ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 04:02 PM