

MINUTES
SENATE FINANCE COMMITTEE
March 18, 2004
9:06 AM

TAPES

SFC-04 # 48, Side A
SFC 04 # 48, Side B
SFC 04 # 49, Side A

CALL TO ORDER

Co-Chair Gary Wilken convened the meeting at approximately 9:06 AM.

PRESENT

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

Also Attending: SENATOR JOHN COWDERY, SENATOR BERT STEDMAN, SENATOR GARY STEVENS, SENATOR TOM WAGONER, SENATOR RALPH SEEKINS, SENATOR HOLLIS FRENCH; D.H (DAN) CUDDY, President, First National Bank Alaska; NEIL FRIED, Economist, Department of Labor and Workforce Development; CHRIS MILLER, Chief, Research & Analysis, Division of Administrative Services, Department of Labor and Workforce Development; LUCKY SCHULTZ, Staff to Senator Fred Dyson; CHERYL FRASCA, Director, Office of Management and Budget, Office of the Governor

Attending via Teleconference: There were no teleconference attendees.

SUMMARY INFORMATION

Conference of Alaskans Resolutions

The Committee heard presentations from Dan Cuddy, President, First National Bank Alaska and from the Department of Labor and Workforce Development

SJR 3-CONST AM: APPROPRIATION/SPENDING LIMIT

The Committee heard from the sponsor and the Office of Management and Budget. A committee substitute was adopted and the bill was held in Committee.

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Conference of Alaskans Resolutions

Co-Chair Wilken noted that the Committee would be hearing presentations from Mr. Dan Cuddy, President, First National Bank Alaska and from Mr. Neil Fried, an economist from the Department of Labor and Workforce Development.

Senator Bunde referenced information in a March 17, 2004 letter [copy on file] that Committee members received from Bill Corbus, Commissioner of the Department of Revenue. It is interesting to note that when equating previous State budgets to today's dollars, there is a significant difference. One example is that Governor Bill Sheffield's proposed \$2,719,000 FY 87 budget would equate to \$7,200,000,000 today when adjusted for population growth and inflation.

Co-Chair Wilken noted that the two amendments [copies on file] to the State Constitution that were suggested by Mr. Roger Cremo during his March 17, 2004 testimony have been provided to Members.

D.H. (DAN) CUDDY, President, First National Bank Alaska read his presentation as follows.

Paying the Cost of Alaska State Government

Thank you for allowing me to come before you today.

The State of Alaska is not presently facing a fiscal crisis. Resources are presently available to pay the cost of State Government. Thanks to the higher price for oil, state royalty income is much higher than expected; and, thanks to the wisdom of the legislature in making judicious use of the Constitutional Budget Reserve, there are ample reserves in addition to royalties to pay the current expense of State Government. Add to that the income of the Permanent Fund and the State of Alaska has more than ample resources to pay for any proposed version of the next State Budget. However, that doesn't solve the current problem, which is UNCERTAINTY.

UNCERTAINTY NOW is surely contributing to what will become far more than a "Fiscal Gap" in the future; what will become a true crisis of major proportions, if the legislature does not do something to avoid it now. There is uncertainty now in financial markets about Alaska's future. There is uncertainty now among oil producers who contribute the bulk of State Revenue in the form of royalties. The same can be said of other resource extraction enterprises. And there's uncertainty among your constituents about the economic future of Alaska, in light of the potential for seemingly unlimited governmental spending.

At present the bond rating of the State of Alaska remains relatively stable. The financial markets look to the Constitutional Budget Reserve and the Permanent Fund as security for payment of the cost of State Government, including bonded indebtedness. The decision of the markets about Alaska's credit worthiness will change quickly, and for the worse, if the Budget Reserve is further depleted, or you show reluctance to resort to income from the Permanent Fund to pay part of the anticipated cost of State Government - worse yet if the State of Alaska does something permanently to make Permanent Fund income unavailable to pay part of the cost of State Government when its needed.

Deterioration of the State's bond rating will of course increase the expense of bonded indebtedness - the cost of funding State Government. What makes matters worse is that that rating will be deteriorating at the same time that interest rates generally are increasing. I can't tell you specifically how much interest rates will increase in the next few years, or precisely when they will start to go up. But everyone with any knowledge about current national economic circumstances will confirm to you that interest rates will be on the rise (they can't go any lower) and soon. If not at the conclusion of national elections, then certainly as the national trade deficit increases and the value of the dollar declines against all major currencies. The impact on the cost of funding state government will be doubly bad unless you act to bring certainty to Alaska's fiscal situation now. That includes both the source of State income for appropriation, and the cost of State Government.

Talk now of a change in the State tax laws affecting oil and gas producers in the State is causing them to rethink their strategy in Alaska. I assure you that changes in current tax laws affecting oil producers will cause them to spend their resources for oil and gas production elsewhere. All at a time

when Alaska can least afford any further decline in oil and gas revenue. Drive a harder bargain in connection with future oil and gas development, if you think it prudent. That will allow the producers to plan development. Changing what is, in effect, a bargain that already exists will cause them to abandon development in Alaska. The same can be said for miners. Whether it be oil and gas or other mineral extraction, development and return on investment, involves a long-term process. One that will not go forward unless variables are reduced to a minimum. If producers cannot count on a stable tax structure for the life of an oil field, or a mine, they won't begin to develop it in the first place. By changing Alaska's current bargain with the producers, you will jeopardize prospects of further development and jeopardize revenue that will be critical to the State of Alaska in the future.

There is just as much uncertainty among your constituents. As long as there is no stated strategy for funding State government and no plan for limiting State government expenditures, there will be no potential for economic development in the State of Alaska. And as long as there is a common perception that there is no potential for economic development in the State of Alaska, the State will encounter the same cycle of booms and busts, and the same transient population that has been the constant in Alaska throughout the history of the State. There will be no economic development or growth of business in Alaska able to sustain the anticipated increased cost of State Government as long as there is the threat of broad based taxes in an unspecified amount. And there will be an immediate demand by your constituents for distribution of all of the income of the Permanent Fund as long as there is no articulated strategy for funding State Government, and even more so, as long as there is no potential check on State Government spending.

I'm sure it occurs to you. There is no recorded success of any government fostering economic development by instituting or increasing an income tax or sales tax. And further economic development is what this state needs to establish a stable source of income to pay the cost of State Government.

Just putting an end to uncertainty now about the extent and means of paying for State Government will be a valuable contribution to the State of Alaska. I warrant to you that it will reduce the cost of borrowing to pay for State government, and foster economic development in the State - certainty in connection with resource extraction. It will also create a

more favorable climate for small business. And that will attract and keep industrious people in the State and encourage our children and their children to live and work here as well.

But like everyone else, I think you can do better than just bring about certainty. I have my own suggestions for a strategy. A lot of it is based on history, and thankfully I have a lot of history in this State. I know because I was here. The Permanent Fund was created so that there would be a source of revenue to pay a portion of the cost of State government, when revenues from oil production declined. No not the principal portion of the fund, the income from the fund. Likewise, I know, because I was here, that the dividend program was instituted when there was seemingly no effort whatsoever to limit government spending. Since folks thought that the only thing that could limit State government spending was a limit on available revenue for appropriation, the ideal to pay a portion of the income of the Permanent Fund directly to Alaska residents was born. By that means at least, some limit on government spending could be imposed.

You can still achieve all of those objectives. By judiciously avoiding appropriation of Permanent Fund earnings and inflation proofing the Fund, you have provided a stable source of income to pay a portion of the cost of State government and pay a dividend to citizens of Alaska as well.

The Trustees and staff of the Permanent Fund have done their job as well. By judiciously investing the principal and a portion of the annual income of the fund there is now a source of State Revenue and dividends as well.

The Percent of Market Value approach to management of Permanent Fund earnings should be adopted. It has been the successful means of managing many other endowments, and there is every reason to believe that it will be an equally successful means of managing the Permanent Fund. What's even more important is that it increases the certainty of revenue available to pay a portion of the cost of State Government and a Permanent Fund dividend. We have seen the potential dramatic effect available revenue of the current approach to management of the fund. Distributions based on realized earnings are always a function of the vagaries of the market and the notions of current investment managers. The POMV approach evens out those variables over a rolling ten-year period that lends predictability to available revenue and the degree of certainty that financial markets demand, if there is to be stability in the cost of funding state government.

How that income is divided between State Government and residents should be left to the legislature to decide. The State's legislature should have the opportunity to determine the use of all available State income as well as state spending .The legislature can maintain that control if it adopts a plan for division of the earnings of the permanent fund and limiting State spending. An articulated plan to limit budget increases according to identifiable indexes will go a long way to quell uncertainty among dividend recipients. Assuming a POMV approach to management of the Permanent Fund, and a plan for limiting budget increases according to an index, permanent fund recipients will have some degree of certainty not only that a dividend will be paid, but also the amount of the dividend payment they can expect from time to time.

One additional benefit of bringing about a greater degree of certainty now in respect of fiscal matters is that it will give the legislature time to deal with a far greater problem that will appear in the future. That problem is the unfunded liability for pension and welfare benefits that will be owed to State and Municipal employees in the next ten years.

In my view there is a deficit now in available resources to pay those obligations. My prediction is the liability will grow worse if the matter is left untreated. I expect there will soon be more retired government employees entitled to benefits than working government employees.

Once again I thank you for the opportunity to express my views at this time.

Senator Dyson voiced appreciation for Mr. Cuddy's wisdom as well as his family's contributions to the State. He asked for further details regarding how a spending limit would encourage investment in the State.

Mr. Cuddy responded that the current budget shortfall, increased spending, discussions regarding implementing an income tax and/or a sales tax, and the possible "raiding of the Permanent Fund" have caused people and businesses to be concerned about the financial condition of the State. Allowing the Legislature to allocate the earnings from the Permanent Fund to support State government would address this uncertainty.

Senator Dyson countered, however, that individuals and businesses could assume that the Legislature would increase State spending and

then be required to implement such things as business taxes to supplement the Permanent Fund money. This would be a deterrent to future business investments in the State.

Mr. Cuddy responded that he is correct. This is the uncertainty of which he speaks.

Senator Dyson understood the testimony to be that the Permanent Fund was established as a mechanism with which to restrain government spending.

Mr. Cuddy responded that the Permanent Fund program was established as a result of this concern, for, were some of the money re-directed in that manner, the Legislative could not spend it.

Co-Chair Wilken thanked Mr. Cuddy for his presentation.

Alaska's Economy-
The 1980s And Now

NIEL FRIED, Economist, Department of Labor and Workforce Development, presented a slideshow, titled "Alaska's Economy - The 1980s And Now" [copy on file].

Mr. Fried referred the Committee to the slide titled, "Alaska is in its 16th year of Uninterrupted Growth-the Longest Run in Our History," which indicates that other than the approximate three-year "economic bust" that began in 1986, the State's economy has steadily climbed. The State has just completed its sixteenth year of uninterrupted economic, or employment, growth. The next slide, "Since 1985 Alaska's Rate of Growth has Slowed," reflects the fact that the past sixteen years have experienced more steady growth than had occurred in previous decades. The average growth for the periods 1960-1970, 1970-1980, and 1980-1985 was a "pretty impressive" six percent. A two-percent per year growth rate has occurred since 1990. "We are in a different environment now."

Mr. Fried stated that in the 1980's real estate was a major issue, as it had a tremendous run-up, and then in 1986, a dramatic decline as the economy fell. This is depicted in the graph titled "Residential Housing Activity in Anchorage." In 1983, more than 9,000 residential building permits were issued in Anchorage. This is more than the last five years of building permits combined. The next graph, titled "Fairbanks Does Not Look Much Different" reflects the fact that a similar trend occurred in Fairbanks. Other communities in the Railbelt area depict similar scenarios.

Mr. Fried stated that the graph titled "AHFC Foreclosures

Statewide" reflects what happened in the housing market as the number of foreclosures climbed in 1986 and peaked in 1988. The average price of condominiums peaked at \$100,000 in 1995 then fell to approximately \$34,000 in 1987 and 1988.

Mr. Fried stated that in addition to the decline in the housing market, the overall economy of the State declined after 1985. As reflected in the graph titled, "The Boom and Bust Years," the State lost 20,000 jobs between 1985 and 1987. The biggest loss the State has experienced since records began at Statehood. In the mid-1990s, the economy re-obtained the employment levels of 1985. The chart titled "Job Gains and Losses" reflects the employment losses. Fifty percent of the jobs lost were in the construction industry, as reflected in the chart titled, "Where the Jobs Were Lost in the 1980s Crash". There are fewer people employed today in construction than there were in the 1980s. In addition, the retail, finance/insurance/real estate industries lost a substantial number of jobs.

Mr. Fried stated that the graph titled, "Construction Growth has been Very Different During the Past Decade", reflects the fact that the construction industry is playing a different role today than it did in the 1980s as it "is more accommodating" to the State's growth, and as a result, it does not have as severe an impact on the State's economy as it did in the 1980s. In 1983 construction employment grew by 30-percent, now a growth level of four or five percent is "pretty impressive."

Mr. Fried stated that the graph titled, "Lots of Migration in the 1980s, Much Less Over the Past Decade" mirrors the Construction Growth chart. This chart depicts the net migration of people leaving and entering the State. The early 1980s reflects the strongest influx of population. A population outflow occurred from 1986 through 1989. The past few years reflect a small net increase in population, with an overall growth in the last ten to 15 years of about one-percent.

Mr. Fried stated that the chart titled, "Population Growth During the Past Decade Slowed Considerably" reflects the State's population growth according to the ten-year census. He noted that it was not until the 1990-2000 decade that Alaska's growth aligned with national statistics.

Mr. Fried stated that in addition to the economic changes the State has experienced, the chart titled, "Alaskans are Getting Older," reflects how the State's population would look in the future. In 1980, the median age was 26, meaning that half of the population were younger than 26 and half were older. The State's citizens are

aging and Alaska's median age now is getting closer to the national average.

Mr. Fried also noted that the chart titled, "Alaska's Population has Become Much Less Footloose" reflects the fact that while still being a transient population in comparison to the rest of the country, the number of those residents who have lived in the State longer than five years is increasing. There are far more multi-generational families. This would affect how the State's population might react to a large economic event.

Mr. Fried concluded his presentation.

Senator Bunde recalled a previous Department of Labor and Workforce Development demographic analysis that had predicted that, in the year 2015, the vast majority of Alaskans would be over age 65 and under age five. "The producers," those between the ages of 30 and 50, would comprise the smallest portion of the population. He worried that this might result in "an inverted pyramid of income producers."

Mr. Fried responded that the largest growing segment of the population is those over the age of 65. The "dependency ratio," which consists of those over 65 and children, is "definitely increasing." He noted that a new population overview was recently completed.

Senator Bunde asked that that new forecast be provided, as its information is an important factor in Legislative actions; particularly in regards to revenues and taxes, specifically considerations regarding an income tax.

Mr. Fried clarified that while these segments are rapidly growing, they would continue to be a small percent of the overall population.

Senator Bunde understood, from Department data, that approximately 90-percent of the wages earned in the State are earned by resident Alaskans. There are those citizens who believe that non-resident workers should be contributing more to the State and therefore favor the implementation of an income tax. However, he noted that non-resident workers earn less than is perceived, with an average of approximately \$13,000 annually.

Mr. Fried agreed that the non-resident annual wage is considerably less than that earned by resident workers.

Senator Bunde reiterated that the new data would be valuable.

Co-Chair Wilken requested that this information, to include the percentage of out-of-state worker and their earnings, be provided.

Senator Dyson asked whether the average wage of the non-resident worker has significantly declined.

Mr. Fried suspected that, with inflation adjustments, they have fallen. Wages overall have declined.

Senator Dyson asked whether the demographic trends projected in the Department of Labor and Workforce Development presentation would continue.

Mr. Fried commented that the demographic trends would continue unless something very dramatic, such as a huge economic boom or influx of young people, occurred. However were an economic boom to occur, its impact would not have as significant an impact on the economy as the State's economy has gotten larger. Economic growth is less predictable than predicting demographic trends. However, it could be assumed that the State would continue its 16 years of moderate growth.

Senator Dyson asked whether the Department tracks State gross productivity.

Mr. Fried stated that this is one of the economic indicators utilized by the Department. The price and production of oil has a tremendous impact, however, he warned that this should not be viewed as the lone indicator, as it would appear to indicate that the State's economy has not grown at all.

Senator Dyson asked the Department to develop a graph depicting gross State productivity, to include an oil price/productivity component.

CHRIS MILLER, Chief, Research & Analysis, Division of Administrative Services, Department of Labor and Workforce Development, reaffirmed that the State's current demographic trends mirror the rest of county in that the Baby Boomers are aging. The next demographic group, referred to as "Generation X", is a much smaller group. This group is followed by "the Boomlets." These smaller groups of people would be a workforce issue, as there would be fewer workers in the transition from the Baby Boomers to the Boomlet workforce.

Co-Chair Green asked whether the demographic data could be used as a school enrollment predictor, in that the number of students would

reduce over time as the population ages. This would assist in new school planning and district forecasting.

Mr. Miller affirmed that close watch of these "age cohorts" would be required. While the number of children is growing, it is a smaller number than experienced in the previous generation.

Senator Olson asked for further information regarding non-resident workers, as he understood that the majority of these people are part-time/seasonal employees.

Mr. Miller commented that the average wage for a year-round, "entire economy" worker is in the mid \$30,000 salary range, while, seasonal/part-time workers average in the mid \$20,000 range.

Senator Olson asked what the year-round non-resident salary would be were part-time and seasonal workers removed from the equation.

Mr. Fried responded that that information would be provided.

Mr. Miller noted that the factors in this would be that different industries compensate their employees at different rates: the oil and construction industry compensate their seasonal employees at a higher rate than, for instance, the fishing industry's seasonal employees.

Mr. Fried interjected that the service industry, such as tourism, also has a low-end wage.

Senator Olson stated that this is the reason that part-time/seasonal employment should be excluded from the calculation.

Senator Hoffman asked regarding the trend in family size in the most recent decades.

Mr. Fried responded that family size has lowered slightly and that as the population has aged, there are more families without children. Fertility has also lowered and leveled off with the aging population.

Senator Hoffman inquired as to how this compares to the national average.

Mr. Fried responded that Alaska continues to be more fertile than the national average, and that Alaskan family size continues to be larger than the national average household size.

Co-Chair Green noted that future projections are a consideration in

the State budgeting process.

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Co-Chair Green asked whether the Department, in making its projections, reviews or incorporates other indicators that might influence the price of oil, as the State has a fairly poor track record in regards to forecasts verses the actual. "While it is the nature of the beast," is there any mechanism through which oil projections could be more accurate as this is the primary projection utilized in determining the State budget.

Mr. Fried replied that employment and population data would be a better indicator of what is happening in the State's economy. However, he was unsure how these could be utilized to support budget decisions.

Co-Chair Green asked whether a formula could be developed that could factor in this data, as it historically has remained reliable and steady.

Mr. Miller responded that population and labor force trends "react more slowly than other international economic events which are out of our control and unfortunately" could have a very significant economic impact on the value of State resources. While the Department could provide fairly accurate population and workforce trends, the value of products such as oil are oftentimes unpredictable.

SENATOR TOM WAGONER asked whether an overlay could be applied to the "Growth in Jobs" chart that could depict the trend, average number of jobs, and income that is experienced due to the influx of box stores that have lower paying jobs without benefits. These types of jobs place another form of pressure on the government to provide services.

Mr. Fried responded that this information is included in a graph [copy not provided] that compares the State's average annual wage to the national average. In 1995, the State's wages were 28-percent above the national average. Today, the State's wages are comparable to the national average. He noted that the cost of living has also decreased. This is a significant trend and has a definite affect on the State's economy.

Senator Wagoner stated that while job growth is important, the types of those jobs is also important, as it could indicate

increased costs to the government. He asked that a copy of that chart be provided.

Mr. Fried stated that the chart would be provided.

SENATOR BERT STEDMAN asked for an explanation regarding how fishing industry wages are factored into the economic trends, as oftentimes, the industry's wages are not included in wage analysis due to the complexity of the associated calculations. He stated that this industry has a huge impact on the State.

Mr. Miller affirmed that, while the fish harvesting industry has a significant part in the State's economy, by definition, it is considered a non-agricultural industry, and as such, is not included in the routine data collection the Department conducts with the US Bureau of Labor & Statistics. However, the Department is working with the Department of Fish and Game to develop a process whereby estimates could be made in regards to the harvesting sector. This is an ongoing process. The Department of Fish and Game does have revenue reports.

Senator Stedman asked whether a rough calculation reflecting the industry's percent of the economy could be developed.

Mr. Miller stated that this could be possible.

Senator Stedman asked how the recent downturn in fish prices might affect recent year's income data.

Mr. Miller responded that declining fish prices is a trend that has resulted in some people leaving the industry.

Mr. Fried stated that the Department recently developed a population trend overview that indicates that population out-migrations are occurring in areas that historically have supported the fishing industry.

Senator Bunde asked whether information regarding the net return of the fishing industry to the State is available.

Mr. Miller expressed that the Department of Revenue could best provide that answer.

Senator Hoffman asked whether a job growth chart could be developed that would reflect the growth of State government employees.

Mr. Fried replied in the affirmative.

Senator Dyson asked that such a chart also depict federal and municipal employee growth. He asked that the federal workforce chart include military employees.

Senator Bunde additionally requested that these charts reflect the trend from 1980 to the present.

Co-Chair Wilken voiced appreciation for the manner in which Mr. Fried conducts his presentations.

Senator Dyson asked whether there is validity to the "Laughfer Curve" theory.

Mr. Fried responded that this theory is difficult to apply to Alaska as it consists of large economic theories.

Senator Dyson asked whether it might be applicable in the future were the State to implement a variety of taxation methodologies to increase revenue.

Mr. Fried was uncertain.

Co-Chair Wilken stated that this concludes the presentation.

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

Co-Chair Wilken informed that Version 23-LS0296\B and its accompanying Sectional Analysis is before the Committee.

AT EASE 10:07 AM / 10:07 AM

Co-Chair Green moved to adopt Version "B" as the working document.

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

Senator Dyson, the bill's sponsor, highlighted the changes in the committee substitute to include: in Section 16, page one, lines nine and ten, the elimination of the fractions in the calculations

pertaining to population and inflation factors; the addition of language in Subsection 1(c), on page two, lines nine through 22 that would exempt all Permanent Fund appropriations including inflation proofing, as well as other dedicated funds and Trust Funds; the addition of language to Subsection 1(a)(1), on page one, lines ten through 16 that would limit the inflation factor to not exceed the per capita income for Alaskans; and the expansion of the "extraordinary circumstance" definition in Subsection 1(d), on page two, lines 23 through 29. In addition, a section of the bill was deleted "that gave the Governor the responsibility of cutting back the budget if the Legislature had, in my view, acted irresponsibly" and had submitted a high budget. Removal of this language would revert the language to what currently exists in State law.

Senator Dyson noted that other issues have been raised to which further language adjustments might apply.

Senator Hoffman commented that, in previous testimony, it was mentioned that appropriations made in the prior two years would be a factor. He asked the location of this language.

Senator Dyson clarified that either he had misspoken or the issue was confused in translation. In actuality, the timeframe is three years.

Senator Hoffman agreed that, while a three-year average was discussed, reference to a prior two-year timeframe was discussed.

Senator Dyson noted that confusion arises in respect to the fact that the prior year is not included in the calculation. The two-years, three-years, and four-years previous to that are used to obtain the average. The reason for this is that the data for the immediate prior year is incomplete. This language is located in Section 1, Subsection 16 on page one, line 12 of Version "B".

Senator Hoffman asked that consideration be given to including in the calculation the most recent ten-year's consumer price index (CPI) and its comparison to the budget for the last ten years. This would provide an analysis of how the current system is following the CPI; specifically whether it would be larger or smaller were the proposed calculations imposed.

LUCKY SCHULTZ, Staff to Senator Fred Dyson, informed that this information is available for the years since 1997. Information prior to that is difficult to incorporate due to different categories of expenses and appropriations. This information is depicted on a handout, prepared by the Division of Legislative Finance, titled "Draft - Spending Limit Proposals" [copy on file]

that depicts three charts.

Senator Hoffman, noting the multitude of changes that the proposal has undergone, asked whether the information depicted on the charts would continue to apply.

Senator Dyson stated that this would be clarified.

Senator Bunde referenced an earlier discussion in which it was stated that, were a spending limit previously implemented, the excess funds could have been allocated to the Permanent Fund. This would have served to make it substantially larger. He asked that a graph be provided to reflect that scenario.

Senator Dyson responded that a graph could be developed.

CHERYL FRASCA, Director, Office of Management and Budget, Office of the Governor, commented that the bill's progress has been substantial and has evolved into a workable framework. As mentioned by Senator Dyson, some changes, including those suggested by Co-Chair Green, would continue to be discussed.

Senator Hoffman asked whether further discussion has occurred in regard to establishing a termination date or a review at some future time.

Senator Dyson stated that, as specified in Section 3(b) on page three, line 14, this proposal would be placed on the Statewide ballot four-years after its initial adoption. This would force the Legislature to review the outcome of the proposal, as to whether it had become "an unbearable restraint" or assisted the effort to which it was intended.

Ms. Frasca pointed out that Section 1, subsection (c) on page two, beginning on line nine, specifies the variety of items that might be exempt from the spending limit. Language in subsection (3) of that section would allow the exemption of such things as money from donations, gifts, or grants to the State for purposes specified by the terms of those donations, gifts, or grants. This language would provide the various departments the ability to receive and expend those monies without affecting their regular budgetary process by "displacing other spending." She noted that this language would address one of Co-Chair Green's concerns.

Ms. Frasca also noted that, as specified in Section 3, on page three, line 13, the original proposition language would be placed on the Statewide ballot every four-years. This would allow the Legislators to propose changes as deemed necessary.

Senator Hoffman voiced concern that utilization of the average annual percentage rate of change in the Anchorage metropolitan area consumer price index (CPI), as specified in Section 1(1) on page one, line ten and eleven would not be "a true index of the inflation rate" for the balance of the State, as Anchorage's numbers "are always lower" than those of Rural areas. He also voiced concern regarding language on lines 13 through 15 of that section that indicates that the rate must not "exceed the average percentage of the change in the average personal income..." This would, in effect, "tie the rate of increase to how successful the bargaining units are in the State of Alaska," as average incomes are affected by those negotiations. Tying the spending limit to this factor is of concern.

Senator Dyson deferred to Ms. Frasca to address the Anchorage CPI concern. However, he noted that due to the fact that Anchorage has half of the State's population, and because "it is so difficult to conduct CPI data in other areas," "it still ends up being quite accurate." In addition to being influenced by bargaining contracts, State spending is also driven by such things, as Medicaid, Medicare, and other health care cost changes. "All of these are volatile components of State spending."

Ms. Frasca stated that the United States Bureau of Labor & Statistics develops the data used for the Anchorage CPI. The Anchorage CPI information is the lone element that is available and as such is the one commonly utilized.

Senator Hoffman acknowledged that; however, continued to question whether this is fair representation of the rest of the State. He contended that it is not a true indicator, and therefore, the growth rate should not be tied to it.

Ms. Frasca expressed that it would be difficult to find a replacement, as this is "the only reported indicator." The challenge is to have an appropriation limit that would establish a ceiling on State spending from one year to the next. "It is not a precise science." The Department of Labor and Workforce Development presentation indicated that there are approximately 300,000 employed people in the State, of which approximately 19,000 are State employees.

Senator Hoffman argued that this language would calculate on the low end rather than the mean average. This could potentially create a problem as it relates to growth.

Senator Dyson stated that this concern is one reason that he

removed the point-nine percentage factor associated with the inflation calculation. He stated that it could be successfully argued that the requirement for delivery of State services does not always align with the change in the CPI. The point-nine percentage factor would have been at the low end of it and changing that to "unity" would better provide a more generous limit that would take into account the fact that delivery of service in Rural areas does inflate faster than urban areas. He also noted that, were it thought to be more accurate, discussion in regard to increasing the percentage factor to one-point-one times the inflation rate would be welcome.

Senator B. Stevens asked, in reference to Senator Hoffman's question about the influence of bargaining units, the number of workers in the State who are members of a collective bargaining unit. Also, that the number be divided into State and non-State employees. He anticipated that, of the total number employed, the percentage of collective bargaining unit employees would not be a large number.

Senator Hoffman questioned why, were that the case, this language should be included.

Mr. Schultz stated that some of the parameters that the Division of Legislative Finance was asked to include in its research was population and CPI as well as "population and keeping the CPI below personal income." Data in this regard is only available from 1997 forward. As depicted on the aforementioned chart, there is no significance difference between these two variables to this point. The reason the language was included is because of the high rate inflation in the 1980s. This would be a concern in regards to the appropriations limit.

Mr. Schultz stated that the aforementioned chart reflects three different scenarios in determining the base year. The first chart uses the fixed base year of FY 96 and a three-year floating average for variables. While the chart appears favorable, "there is a ratcheting down effect" realized in the first few years. This has been determined to have a negative impact on the state economy in other states. The second chart reflects a base year of two years prior and a three-year floating average for variables. This has proven to have the negative affect of making it difficult to determine what the limit would be for the following year. Therefore, the third chart was developed utilizing a base year of the average of the three prior years and a three-year floating average for variables. Since this would provide a more predictable limit, it should be "more attractive" to businesses and residents.

Senator Hoffman stated that his suggestion for a ten-year timeframe was based on the fact that "these years include the quarter of a billion dollar reduction" that the State experienced. As a result of this monetary reduction, the legislature implemented a plan to hold the level of government spending, and, for five of these years, the mandate was to reduce government spending quarter of a billion dollars. The time periods utilized in this formula incorporate "the lowest standards of growth in Alaska's history" and do not accurately portray a true growth in State government.

Senator Dyson asked whether Senator Hoffman would desire charts developed that would reflect how these proposals would appear were they based on those years' budgets as proposed by the Governor.

Senator Hoffman preferred that the charts be developed based on actuals for a ten-year span as opposed to ones based on hypothetical information that was not acted upon. Charts based on actuals would provide "a true indicator of growth."

Senator Dyson determined that three different charts could be developed: one reflecting State growth were there no \$250,000,000 reduction; one based on actuals; and one to depict the billion dollar increase as proposed by the Governor.

Senator Bunde recalled that while there was a quarter of a billion dollar reduction over a five-year period, that money was reinstated during the sixth year. In addition, use of the Anchorage CPI as a base could be valid due to the fact that the Port of Anchorage serves 80-percent of the State, and therefore, it could be stated that 80-percent of the State's economy is dependent on what's going on in Anchorage.

Senator Dyson stated that that might be; however, Senator Hoffman raises a valid point. Perhaps utilizing the federal CPI would negate the accusation that the State government's calculation was slanted in order to allow or disallow more spending.

Co-Chair Green stated that when the Version 23-LS0296\Y committee substitute was being discussed, her staff had developed a ten-year look-back population/inflation/per capita income statistic analysis that compared the growth per year. She assumed that that information could be updated to reflect the language included in Version "B" and thereby, might provide the information requested by Senator Hoffman. She noted that it would be interesting to view that chart as, while numbers might appear to be steady, they could become volatile depending on what factors are incorporated. She stated that this chart would be updated and provided to Members.

Senator Dyson understood that Senator Stedman has produced a chart [copy not provided] that also might be helpful to the discussion.

Co-Chair Wilken asked that, prior to any further material being provided to the Committee, information should be updated to reflect Version "B" language.

Senator B. Stevens noted that, historically, State spending, including such things as payroll and government cost of living allowance allocations for regions has been benchmarked on the Anchorage CPI indicator. Therefore, he understood that any adjustments in the Anchorage rates would, by utilizing a geo-differential, affect Rural areas.

Co-Chair Wilken voiced being uncertain as to how to develop the baseline requested by Senator Hoffman.

Senator B. Stevens responded that were the Anchorage benchmark adjusted to reflect inflation and then a geo-differential applied to that rate, it would affect Government spending in other areas of the State.

Senator Hoffman stated that he would be more comfortable with tying the rate to the "breadbasket measure" which is currently available for cost comparisons for grocery items in Anchorage, Fairbanks, Juneau, Bethel, and Nome. This would provide more accuracy in regards to the true cost of living in various regions of the State. For example, it is documented that a grocery item might cost one dollar in Anchorage, \$1.80 in Bethel and \$1.90 in Nome. He noted that the wages of correctional officers in Bethel are 1.3 times those paid in Anchorage.

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Senator Dyson expressed that while the cost of fuel and food might affect a family's budget, these costs do not significantly affect the cost of delivering State services.

Senator Dyson stated that adjusting costs up ten percent, as proposed in the Version "B" committee substitute, would adequately address the cost differentials of Rural Alaska, particularly as it is unlikely that the cost of State government services would increase ten percent in those areas.

Co-Chair Green understood that this language is applicable to the total expenditure rather than being region specific.

Co-Chair Green referred the Committee to language in Section 2, on page two, beginning on line 30 that addresses appropriations to the Constitutional Budget Reserve (CBR). She asked regarding the reason that the Legislature should support the deposit of any money in the General Fund that is available for appropriation at the end of each fiscal year into the CBR, particularly in a year in which the State experienced "another windfall" and had received a substantial amount of money.

Senator Dyson replied that presently, the Constitution mandates that any excess funds be deposited into an account that bears interest. This is true of the CBR. As presented in recent testimony by nationally renowned economist, Dr. Poulson, it was stated that the most successful State programs having spending limits, are those that implement a "shock absorber" or rainy day account that could provide funds or replenish funds as incomes rise and fall. The CBR could provide this "very valuable" function. It would also provide substance to favorable bond ratings. He cautioned against depositing money into the CBR as a mechanism to prevent "political difficulties." In addition, were the CBR to reach a point that would support bond ratings and sufficiently address State funding needs, then consideration could be given to determining whether excess funds could be deposited into an alternate account. In summary, he stated that the CBR is a good place to place those excess funds. It would also replenish the money that was borrowed from the CBR, that have not, of yet, been reimbursed. This process would also provide funds with which the State could address "extraordinary circumstances" such as earthquakes or support infrastructure and major projects such as a gas pipeline or a road to the Arctic National Wildlife Refuge [ANWR].

Co-Chair Wilken shared Co-Chair Green's concern that money that could be accessed by a majority vote would be deposited into a savings account that could "create turmoil in the budgeting process."

Senator Bunde opined that, "the maximum allowable growth rate would become the minimal growth rate." In the future, Legislators might decide that a two-percent growth rate is too much. Therefore, he argued that perhaps it is a good thing that the funds in the CBR could not be leveraged. This could serve to prevent additional spending that might not be overwhelmingly supported. The sword does "cut both ways."

Co-Chair Wilken asked how this legislation would allow for unexpected and uncontrollable expenses such as a \$80 million Medicaid bill or, more recently, the \$94 million Public Employee

Retirement System (PERS) and Teachers Retirement System (TRS) debt.

Ms. Frasca stated that the appropriation limit does not solely apply to General Fund spending. She cautioned that while expenses might increase, revenues do not always follow. In those cases, choices must be made. This year for example, in order to provide funds for the PERS/TRS expenses, reductions were required in other areas. This is the reality of having limited resources. This legislation would assure voters that government "would not go on a spending spree and grow" were significantly more revenue to transpire. This would force the government to make choices.

Co-Chair Wilken voiced concern "that an avenue" would be available through which the Legislature could address unexpected and extraordinary expenses without negatively affecting other priorities.

Mr. Frasca understood that the section of the bill regarding extraordinary circumstances would address this concern.

Co-Chair Wilken stated that further discussion ensue in this regard.

Co-Chair Wilken noted that another concern is that the bill provides no distinction between the capital and operating budgets. "The operating budget builds bureaucracy and the capital budget builds Alaska." Therefore, he argued that further distinction should be included in this regard.

Senator Dyson stated that this Constitutional amendment would eliminate the Constitutional mandate that requires one-third of the budget to be allocated to the capital budget. He doubted, however, that this mandate has been upheld.

Co-Chair Wilken ordered the bill HELD in Committee.

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ADJOURNMENT

Co-Chair Gary Wilken adjourned the meeting at 10:54 AM