

**ALASKA STATE LEGISLATURE**  
**HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

April 1, 2005

8:34 A.M.

**MEMBERS PRESENT**

Representative Bruce Weyhrauch, Chair  
Representative Norman Rokeberg  
Representative Ralph Samuels  
Representative Paul Seaton  
Representative Peggy Wilson  
Representative Max Gruenberg

**MEMBERS ABSENT**

Representative Carl Moses

**COMMITTEE CALENDAR**

HOUSE JOINT RESOLUTION NO. 12

Proposing amendments to the Constitution of the State of Alaska relating to the repeal of the budget reserve fund.

- HEARD AND HELD

OVERSIGHT HEARING OF THE SALES TAX

- SCHEDULED BUT NOT HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: HJR 12

SHORT TITLE: CONST. AM: BUDGET RESERVE FUND REPEAL

SPONSOR(S): REPRESENTATIVE(S) HARRIS

02/18/05	(H)	READ THE FIRST TIME - REFERRALS
02/18/05	(H)	W&M, STA, JUD, FIN
04/01/05	(H)	W&M AT 8:30 AM CAPITOL 106

**WITNESS REGISTER**

REPRESENTATIVE JOHN HARRIS

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as the sponsor of HJR 12.

TOMAS H. BOUTIN, Deputy Commissioner  
Office of the Commissioner  
Department of Revenue  
Juneau, Alaska

POSITION STATEMENT: Offered information on HJR 12.

#### **ACTION NARRATIVE**

**CHAIR BRUCE WEYHRAUCH** called the House Special Committee on Ways and Means meeting to order at [8:34:41 AM](#). Representatives Weyhrauch, Samuels, Seaton, and Wilson were present at the call to order. Representatives Gruenberg and Rokeberg arrived as the meeting was in progress.

HJR 12-CONST. AM: BUDGET RESERVE FUND REPEAL

[8:35:16 AM](#)

CHAIR WEYHRAUCH announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 12 Proposing amendments to the Constitution of the State of Alaska relating to the repeal of the budget reserve fund.

[8:35:36 AM](#)

REPRESENTATIVE HARRIS, Alaska State Legislature, speaking as the sponsor of HJR 12, related that he introduced HJR 12 out of frustration. Over the past few years the legislature has attempted to develop a fiscal plan for the state, but there have been stumbling blocks. One of those stumbling blocks is the constitutional budget reserve (CBR), which provides the state something to fall back on in times of need. The CBR was developed to absorb monies from oil industry lawsuits and royalties and in order to prevent [frivolous] dispersion of the funds it has a three-quarter constitutional vote requirement. However, when the legislature has been short of funds it has dipped into the CBR and utilized the three-quarter mechanism. He related his understanding that no other state, including the federal government, uses a three-quarter vote mechanism to pass a budget. He opined that no matter the party that's in the majority, it will use the CBR for its own reasons. In order for the legislature to predict revenues in the future, there has to be a stable method of doing so. However, the CBR diminishes the ability to do so because it's easy to utilize the CBR. Therefore, HJR 12 asks the public if they would like the CBR to be eliminated and any funds in the CBR deposited into the permanent fund. Still, the earnings from the permanent fund are

available for the legislature to use with a 51 percent vote of both bodies.

8:39:48 AM

REPRESENTATIVE SAMUELS inquired as to the sponsor's thoughts about depositing the CBR into fund types other than the permanent fund.

REPRESENTATIVE HARRIS replied that he is not opposed to depositing the CBR into other funds, However, he said he is opposed to the legislature having the ability to easily fall back on some other mechanism rather than address what will happen when there are no funds left in the CBR. As the base of the budget increases and the price of oil decreases, which he predicted as an eventuality, to \$35 per barrel, the legislature will be forced to dip into the CBR substantially, or obtain revenues from somewhere else, or cut the budget to balance. He said:

If that mechanism isn't available than we have to truly look at taking the interest of Alaskans into account. Do you want to spend some of the earnings of the permanent fund to balance the budget, do you want to have income taxes or sales taxes to balance the budget, or do you want to reduce the budget to balance the budget? And those are choices Alaskans ... will make ... by who they elect to the legislature not based upon the fact that we can fall back on this crutch of the three-quarter vote or of the CBR.

8:41:44 AM

REPRESENTATIVE WILSON related that she agrees with the concept of HJR 12. However, she expressed concern with the funds being inaccessible in the case of a national emergency such as [the terrorist attacks of September 11, 2001] or a catastrophe. She related her belief that the CBR should only be used in the instance of an emergency.

REPRESENTATIVE HARRIS related that the earnings reserve of the permanent fund is available by a simple majority vote. Furthermore, the legislature has the ability to borrow. He related his belief that Alaska's access to money is probably the best in the nation. He said the issue is whether or not the state wants a fiscal plan and in order to achieve such, the crutch of the CBR has to be removed.

8:44:11 AM

REPRESENTATIVE SEATON asked how this resolution would impact the CBR's ability to maintain a minimum balance for the purpose of cash flow ability and the use of balancing revenues.

8:44:48 AM

REPRESENTATIVE HARRIS replied that if the legislature spends the full amount of the CBR no balance will be left. He asked if the legislature wants 26 percent or 51 percent, like every other state, of a body determine how to spend the budget. Again, he highlighted that there are more than enough funds in the earnings reserve account. Although it's such a politically volatile account that no one wants to talk about it, he said that he wasn't so concerned because the only reason the permanent fund is as large as it is at this point is because the legislature deposits into it. Representative Harris acknowledged the need to have some funds available as a backup, but he pointed out that most other states have statutory deposits for backup accounts that are available by a simple majority vote.

8:46:34 AM

REPRESENTATIVE SEATON asked if this resolution eliminates the state's cushion.

REPRESENTATIVE HARRIS replied that \$1 billion could be taken from the CBR and placed into a statutory account to only be accessible for specific budget purposes, such as education, in the instance that no other funding is available. Other states utilize the aforementioned account types and it has worked for them.

8:48:38 AM

REPRESENTATIVE SAMUELS noted that he agreed with Representative Harris philosophically, politically, and practically. He said the job of the majority is to set the agenda and pass the budget. Representative Samuels said that he prefers the concept of going into a capital account. He highlighted that the governor warns that dipping below \$1 billion effects the financial bond rating of the state.

REPRESENTATIVE HARRIS replied that the aforementioned effect is due to the notion that the people of the state of Alaska don't support any use of the earnings of the permanent fund. He reiterated that eventually the CBR will be gone. If the CBR isn't available and the legislature is unwilling to tax the people or use the permanent fund [earnings], then what will the state do, he asked. He characterized it as a political decision and emphasized that the state isn't broke and the bond people know that. In fact, Alaska has a small bond indebtedness compared to most other states, but there's basically one source of revenue which is oil and gas. He recalled that the chief economic driver in Alaska used to be fishing and timber. He opined that the state is so dependent on oil that if the volume or the price of it drops, the state will be in crisis unless a fiscal plan is developed. He acknowledged that a fiscal plan will certainly hurt some people; many people oppose a fiscal plan because they believe it diminishes the value of the dividend. Representative Harris pointed out that the majority of the state's budget lies in healthcare and education, and therefore the public should realize that perhaps cutting the dividend or not instituting an income tax is better than cutting these programs. The time to develop a fiscal plan is now due to the surplus from oil, he added.

[8:54:00 AM](#)

CHAIR WEYHRAUCH said:

One of the proposals we have had before us ... is ... to take half the earnings of the earnings reserve account of the permanent fund and half the constitutional budget reserve anytime there is a gap between income and expenses; and to use that to extend out the way we address our fiscal gap as a policy matter and then that assumes then that given resource development through ANWR [Arctic National Wildlife Refuge], Stranded Gas Act, and ... reserves income stream to the state, that we won't have to implement any taxes just given those two pots of money and ... then will be saved by this future revenue stream from oil and gas development, even with increased budgets every year from approximately 2 percent .... This sort of transition ... relates to that, in that you're essentially transitioning out of the budget reserve fund one way or the other: either ... immediately or ... through a transition .... How does this resolution relate to that sort of philosophic

statement and really that bill was only a philosophic position, it wasn't specific.

REPRESENTATIVE HARRIS said although he didn't know the specifics of the aforementioned proposal, using both the earnings from the permanent fund and CBR would seem to complicate the budget. The legislature would need the three-quarter vote required for the CBR usage and have to deal with those opposed to using the earnings.

[8:56:06 AM](#)

CHAIR WEYHRAUCH surmised then that this resolution essentially gets "rid" of the political issue related to the use of the CBR.

REPRESENTATIVE HARRIS replied, "That's right." This resolution takes away the "political problem" of the three-quarter vote holding the budget hostage, he added.

[8:57:27 AM](#)

CHAIR WEYHRAUCH indicated his understanding that the public elects the legislature to make the decision [about spending]. He asked if this resolution plays into the mission of addressing alternative sources of revenue in order to gain long-term fiscal stability.

REPRESENTATIVE HARRIS emphasized that this resolution forces a long-term fiscal solution. If the legislature no longer has the CBR as a "crutch," it forces the legislature to figure out how to fund the proposed increases in the operating and capital budgets. [This resolution imposes] a basic balancing economic act in which revenues match expenditures, he noted. Currently, there is no obligation to balance the budget in the statutes or constitution. Therefore, the legislature has not been balancing the budget from reliable sources, but rather it has dipped into its savings annually. He related that, with the exception of this year, the legislature has essentially borrowed money to pay debt and the cost of government. He opined that many states don't have the aforementioned "luxury," and therefore have had to raise the revenue in order to balance the budget. Alaska has avoided that.

[9:00:11 AM](#)

REPRESENTATIVE SAMUELS posed a situation in which HJR 12 is placed on the ballot in 2006 and passes, and inquired as to the

effective date for the repeal of [Article IX] Section 17 [of the Alaska State Constitution]. He opined that during 2006 through 2008, if a special election is held for the purpose of a constitutional amendment adding the POMV methodology, the state couldn't tax enough to bridge the fiscal gap during that period.

REPRESENTATIVE HARRIS offered that one solution is to take \$1 billion from the CBR and place it in a statutory fund which can later be accessed by POMV. After the transition period is complete, the aforementioned statutory fund could roll into "whatever" fund the legislature decides to appropriate it, he added.

[9:02:30 AM](#)

REPRESENTATIVE WILSON asked whether a public vote or legislative action would be required if the funds from the CBR are placed into the education fund.

REPRESENTATIVE HARRIS replied statutorily it takes a two-thirds vote by the legislature to access the CBR, which is supposed to be paid back. Currently, the government owes the CBR approximately \$5 billion. "The point of the matter is that's why we do the reverse sweep every year and the sweep provisions ... in the budget," he stated. He explained the CBR could go into the education fund but the aforementioned fund only allows a specific amount to be deposited in the foundation formula.

CHAIR WEYHRAUCH, in response to Representative Wilson, said the education fund is called the Public Education Fund.

[9:03:50 AM](#)

CHAIR WEYHRAUCH highlighted that it's important to understand that HJR 12 is a constitutional amendment, which needs to pass both bodies with a two-thirds vote and then it would be voted on by the public. He also highlighted that HJR 12 has four committees of referral. He alluded that there is enough resources in the CBR through bonding to fund projects and programs in the state for a long time to come. "This certainly could be considered seed money for that," he related.

[9:05:45 AM](#)

REPRESENTATIVE WILSON recalled that five years ago the state's deferred maintenance totaled over \$1 billion and it has continued to grow. There's definitely a need to take care of

capital needs, she opined. Therefore, she suggested that HJR 12 should transfer the CBR into a capital construction and maintenance fund.

CHAIR WEYHRAUCH advised the committee to bring amendments forward during the next meeting.

REPRESENTATIVE HARRIS offered he is currently in the process of presenting a concept similar to a capital construction fund in the committee substitute (CS).

9:09:00 AM

TOMAS H. BOUTIN, Deputy Commissioner, Department of Revenue, informed the committee how the Department of Revenue utilizes the CBR in the following manner: as a cash flow buffer; as an indicator to credit rating agencies that, despite the volatility in Alaska's revenues and lack of a fiscal plan, the state deserves a AA credit. He added that the state deserves a AA credit rating because of the state's liquidity, which can largely be attributed to the existence of the CBR. He relayed that the state uses the CBR as a cash source to balance the budget and thus approximately \$6 billion has been withdrawn from the CBR and not repaid.

9:13:12 AM

CHAIR WEYHRAUCH asked if the state also relies on the earnings reserve account to bolster the state's AA credit rating.

MR. BOUTIN answered ratings include the earnings reserve in the permanent fund as well as the balance in the CBR. He explained that the credit agencies watch the state's financial policies closely and anticipate that eventually a fiscal plan that will match reoccurring revenues with expenditures will be adopted. In fact, one of the credit rating agencies so strongly believed in Governor Murkowski's plan to do so, it spoke about POMV at the Conference of Alaskans.

9:15:25 AM

CHAIR WEYHRAUCH asked whether the state's credit rating would be negatively effected if HJR 12 is adopted into law.

MR. BOUTIN related that HJR 12 is part of a process. If the state didn't have the liquidity it has with the CBR, then there would be severe consequences in both cash flow and the state's

credit rating. Mr. Boutin agreed with earlier remarks that absent some change, the CBR will eventually be depleted and thus will negatively effect the state's credit rating.

[9:16:55 AM](#)

CHAIR WEYHRAUCH asked if, at any point, the CBR is encumbered for purposes of bonding or future expenses. He pointed out that [Article XV] Section 30, reads:

Section 30. Budget Reserve Fund Transition. On the effective date of the repeal Section 17 of Article IX, the unencumbered, unappropriated balance in the budget reserve fund (art. IX, sec. 17) is transferred to the principal of the Alaska permanent fund (art. IX, sec. 15).

CHAIR WEYHRAUCH asked whether the aforementioned provision would leave a loophole that would require an encumbered portion to stay in the CBR.

[9:17:23 AM](#)

MR. BOUTIN responded the state's warrants are against the general fund (GF), so the state draws into the CBR as a cash flow buffer to cover encumbrances in the case of general obligation debt. The only general obligation debt was authorized in 2002 and the debt was sold in 2003. Some \$480 million of which is outstanding and for which the "full faith and credit," meaning all of the state's resources, are pledged to pay that general obligation debt, including the CBR as well as other funds. He noted that the state's other kinds of debt include lease debt. While lease debt is subject to appropriation, if the state didn't appropriate money to make the lease payment, then its general obligation rating would be suspended as would the state's ability to issue debt. He noted that the state also issues debt for which it carries a moral obligation. Although the state's moral debt hasn't been tested, if it were and there was a failure to replenish the CBR, the state's credit rating would be suspended. Mr. Boutin specified that the aforementioned doesn't fall within the accounting term "encumbrance," although he wasn't sure whether it would fall under a dictionary definition of the term.

[9:20:25 AM](#)

REPRESENTATIVE SEATON asked how would the state restructure a buffer account if the CBR didn't exist, and could a capital account act as the buffer.

MR. BOUTIN said the details of [proposed accounts] are necessary to address specifics. However, he related his belief that placing some of the CBR funds into a capital account which would become the cash flow buffer seems to have a neutral impact. He opined that eliminating liquidity without addressing the volatility of revenues and that recurring revenues don't match expenditures, there will be obvious consequences the extent of which are dependent upon the extent to which the liquidity is removed.

[9:22:12 AM](#)

MR. BOUTIN, in response to Representative Wilson, clarified that the state has a AA credit rating from Moody's, Standard and Poors, and Fitch, which is the highest ratings its ever had. The Department of Revenue's semi-annual forecast details when the CBR will be depleted. Should the CBR wind down, the credit ratings will anticipate its depletion. The Department of Revenue has the ability to issue revenue anticipation notes as a short-term measure, however, other states that use short-term borrowing to meet ongoing expenditures don't have AA credit ratings. The credit rating agencies prefer to see liquidity that is only utilized in rare circumstances and reoccurring revenues that match expenditures. He added that credit rating agencies also like the POMV methodology. He said that Michigan's credit rating was lowered by Standard and Poors because it persisted in using one-time revenues to meet ongoing expenditures. He reiterated that the state has the ability to issue revenue anticipation notes as a short-term "band-aid."

[9:26:57 AM](#)

REPRESENTATIVE WILSON asked how long would it take to institute an ongoing source of revenue such as an income or sales tax.

MR. BOUTIN recalled that the Department of Revenue has offered testimony on the amount of time and funds it would take to institute various tax types. He offered that he doesn't recall that information "off the top of his head."

REPRESENTATIVE WILSON opined that any tax type would take awhile to effect the ongoing revenue.

MR. BOUTIN said it seems like it takes a number of years to have a fiscal plan adopted by the legislature.

[9:29:04 AM](#)

REPRESENTATIVE SEATON asked if a dedicated capital account that generates interest for capital expenditures could be structured for use as a buffer account.

REPRESENTATIVE HARRIS replied, "I think you can structure it that way." He stated the aforementioned proposals intention was to deposit the balance of the CBR at the time of the election into constitutionally protected interest earning capital account. While this resolution takes the CBR balance and deposits it into the permanent fund. He related his belief that the public needs to be educated on the intent of the aforementioned proposals in order to avoid confusion. He highlighted that the legislature can be instructed for what the money in a constitutionally protected account can be used. This is similar to the school fund that was created. Representative Harris said that he didn't disagree that the state should have a cash flow reserve, but that's available with the permanent fund albeit it's cumbersome because it's politically volatile. He reiterated that the legislature has a fiscal, fiduciary, and legal responsibility to pay back the CBR, he added. He agreed that the state needs a buffer, which can be accomplished by either creating another account or using other mechanisms available such as the permanent fund.

[9:34:19 AM](#)

CHAIR WEYHRAUCH relayed that there have been discussions of having tax policies in place that kick-in when revenues don't meet expenditures.

REPRESENTATIVE HARRIS said the aforementioned is referred to as a "trigger mechanism." In further response to Chair Weyhrauch, Representative Harris related that if the public encumbers the CBR into another fund, where it's unavailable to the legislature, the legislature has little choice but to create ongoing revenue elsewhere. He added that ongoing revenue measures would take a minimum of a year to be instituted, go through the budget cycle, and receive the revenue. Therefore, something would need to be in place prior to the any such institution. He offered that he wants to raise the public's awareness of this resolution so they understand it.

[9:36:22 AM](#)

CHAIR WEYHRAUCH said that at the next meeting the committee can offer amendments.

[9:36:57 AM](#)

REPRESENTATIVE HARRIS, in response to Representative Samuels, replied the concept of a constitutionally protected capital account would protect the principal. In further response to Representative Samuels, Representative Harris explained that as long as the CBR is on the books, it's provisions have to be adhered to unless it's taken to the public for a vote.

[9:38:12 AM](#)

REPRESENTATIVE GRUENBERG asked why this repeals the CBR.

REPRESENTATIVE HARRIS replied there is no reason for the CBR if the funds are placed in a capital account or the permanent fund. In further response to Representative Gruenberg, Representative Harris replied the CBR or any CBR-type entity could be useful depending on its intended use. However, currently the CBR is used as a mechanism to balance the budget annually, which is not what the public wants the legislature to do. The public wants, he opined, to elect legislators based upon their social or fiscal policy platform; Alaska doesn't have that ability because it has limited imposed taxes on the public. Therefore, the intention of this legislature should be to develop a sound fiscal policy and in order to do so it's essential to remove the "crutch" that has been the CBR, he added.

[9:43:43 AM](#)

REPRESENTATIVE GRUENBERG opined that there may be possibilities for something like a CBR.

REPRESENTATIVE HARRIS responded the he doesn't have a problem with the concept of a capital fund. However, such should have a constitutionally protected principal, include the POMV methodology, and use the earnings, he added. In further response to Representative Gruenberg, Representative Harris replied that many states have a statutory fund with a "fence" around it and such doesn't require a constitutional amendment.

CHAIR WEYHRAUCH added that Nebraska has a statutory reserve fund.

[9:48:37 AM](#)

CHAIR WEYHRAUCH related his understanding that under HJR 12 litigation and royalty settlements that would've been deposited into the CBR, would be deposited into the GF.

REPRESENTATIVE HARRIS said, "That's correct." He added that if the legislature so chooses, it could deposit the aforementioned funds into the permanent fund, a capital account, or whatever.

[9:49:06 AM](#)

REPRESENTATIVE WILSON asked whether another cash flow account needs to be created [were the CBR eliminated].

REPRESENTATIVE HARRIS replied that could easily be accomplished statutorily.

[9:50:14 AM](#)

REPRESENTATIVE ROKEBERG asked what would be used as a cash flow reserve fund under HJR 12. He said he plans to propose a resolution that would repeal [Article IX] Section 17(c) which, is a repeal of the three-quarter vote for the CBR so the CBR could be drawn on by a simple majority vote.

REPRESENTATIVE HARRIS responded that the aforementioned repeal of the three-quarter vote would mean that the CBR would still be available.

REPRESENTATIVE ROKEBERG, in response to Chair Weyhrauch, replied his resolution would merely change the number of votes required to make a draw from the CBR.

[9:52:11 AM](#)

REPRESENTATIVE SEATON commented that [under Representative Rokeberg's] resolution the legal obligation the legislature has to repay the CBR and address the sweep and the reverse sweep mechanisms will remain.

REPRESENTATIVE ROKEBERG relayed that his resolution plans to address the aforementioned issue, particularly the sweep and repayment provisions. He related his belief that given the pressures on expenditures in the state, the legislature won't be

able to [repay the CBR] unless there is an extraordinary windfall.

[9:53:13 AM](#)

REPRESENTATIVE GRUENBERG added he is part of the small minority who is a recipient of the three-quarter vote. He noted that perhaps there should be a CBR provision in the constitution to include not only the oil settlements but also high oil prices. He characterized it as a spending limit, or a break on spending.

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:54 a.m.