

HOUSE FINANCE COMMITTEE
February 12, 2008
1:55 P.M.

CALL TO ORDER

Co-Chair Meyer called the House Finance Committee meeting to order at [1:55:19 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Harry Crawford
Representative Les Gara
Representative Mike Hawker
Representative Reggie Joule
Representative Mike Kelly
Representative Mary Nelson
Representative Bill Thomas Jr.

MEMBERS ABSENT

Representative John Harris

ALSO PRESENT

Representative Ralph Samuels; David Teal, Director,
Legislative Finance Division

TESTIFIED VIA TELECONFERENCE

Tamara Cook, Director, Legislative Legal and Research
Services, Juneau

SUMMARY

#HB347
HB 347 An Act relating to the regional cruise ship impact
fund; and establishing the Regional Cruise Ship
Impact Fund Advisory Committee and prescribing its
duties.

HB 347 was SCHEDULED but not HEARD.

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HJR 28 Proposing an amendment to the Constitution of the
State of Alaska relating to the production tax
revenue fund, dedicating a portion of the
petroleum production tax to the fund, and limiting
appropriations from the fund.

HJR 28 was HEARD & HELD in Committee for further consideration.

1:56:19 PM

#HJR28

HOUSE JOINT RESOLUTION NO. 28

Proposing an amendment to the Constitution of the State of Alaska relating to the production tax revenue fund, dedicating a portion of the petroleum production tax to the fund, and limiting appropriations from the fund.

REPRESENTATIVE RALPH SAMUELS, SPONSOR, commented that saving surplus cash that Alaska is receiving from the high oil prices is the most important consideration legislators can discuss this session. HJR 28 would put before the voters, the opportunity to save a large portion of that money, while maintaining the ability to provide for essential government services such as education, transportation and public safety. The bill gives the voters the opportunity to create an endowment established as a separate fund in the State treasury and providing a cash flow mechanism into perpetuity.

If the idea is supported by a majority of voters, all of the "windfall profits" or the money gained as a result of the progressivity feature of Alaska's severance tax - AS 43.55.011(g), would be deposited into an endowment fund. The fund would then spin off 4.5% of its total value into the General Fund, which could be used for government services. The endowment concept is widely accepted as the methodology for large scale endowments ranging from the Ford Foundation to Yale University. There will be a time when the State needs the progressivity money & dollars constitutionally mandated would go into the account, setting up a pay-out mechanism of about 5% and providing a steady cash flow from the account. There would only be one pot of money invested over time and which, hopefully would generate about 8% profit, while paying out about 5%.

Representative Samuels urged that the Committee think long-term, which is imperative for the economic health of the State. Passage of HJR 28 would put the issue of the constitutional amendment before the people of Alaska, which mandates that those funds go into the account until January 1, 2015. After that, it becomes legislative prerogative whether to put money into the account. The legislation provides for an approximate six year window in which, the money would be constitutionally placed into the fund. The cash flow provides for generations to come and would constitutionally protect the "seed-corn".

Representative Samuels spoke to the cash flow payout that would happen in five years. He referenced the handout provided by the Legislative Finance Division (LFD) indicating the revenue flow: "HJR28-Setting up a Production Tax Revenue Fund and POMV Payouts". (Copy on File). In the first five years, the amount would automatically be reinvested. The assumption is, for that period, there would sustain a cash flow to pay for the State's finances, which would provide an opportune time to build up the fund. The cash flow mechanism would spin-off the money as indicated in column 1 of the handout. A cash flow would exist into perpetuity. He claimed that HJR 28 was the best long-term savings plan on the table. If the funds were placed into the Constitutional Budget Reserve (CBR), eventually, when needed, it would be politically easier to spend than attempting to address revenue sources. He urged that a long term mechanism be put in place.

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Representative Samuels addressed the 5% payout, patterned after the Permanent Fund Dividend (PFD). He requested that the departments address payout considerations. The original recommendation was 4.5%; the House Judiciary Committee raised that amount to 5%. The 5% is standard for a constitutional mandate and having no pay-out the first five years.

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Vice-Chair Stoltze asked if the Mental Health Trust had been used as a pay-out type model. Representative Samuels responded that he had chosen 4.5% because back-up information stipulates that overtime, a 5% pay-out could deteriorate the strength of the fund. He recommended a pay-out between the 4% - 5% range; he believed that 4% would be safer. He recommended a five-year rolling average so that the Legislature could determine the cash flow into the General Fund.

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Representative Samuels opposed tying-up how the cash flow works and removing the decision making power from the Legislature.

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Co-Chair Meyer discussed consolidating the State's many savings accounts into one. He noted sub accounts contained in the Alaska Housing Finance Corporation (AHFC), the Capital Budget Reserve (CBR) and the Capital Income Fund, too mention a few. He asked if HJR 28 intended to allow consolation of other saving funds. Representative Samuels

advised that the Legislature could choose to appropriate any money they saw fit into the fund. The Constitution states that the windfall profits, associated with the progressive feature of the tax system, would have to be placed into the fund for 5 years, as mandated. The Legislature could also choose to appropriate other monies into the fund.

Representative Samuels supported taking the CBR dollars, changing the language and the payout method. The time to make that change would be over the next several years, when funds are not needed. There are various mechanisms to do that. He emphasized that the more the fund is capitalized now, the stronger the cash flow would be when the funds are tapped.

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Representative Nelson mentioned discussions in the Senate on the number of legislators needed to sign off for use of the CBR and changing the amount from $\frac{3}{4}$ to $\frac{2}{3}$. She asked if HJR 28 intended to recommend numbers needed to tap the fund. Representative Samuels advised that if the payout was changed, the dollars would go into the General Fund and there would be no percentage vote. The money would automatically come into the General Fund. The payout method would be structurally changed in the proposed legislation.

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Co-Chair Meyer asked what department would manage the fund. Representative Samuels replied the Department of Revenue and that the management fees would come out of the earnings.

Representative Nelson asked if the fund would be inflation proofed. Representative Samuels explained, overtime, it is assumed that it would make 8%, spending 5%, and automatically inflation proofed.

Representative Gara asked if the proposed legislation would change the $\frac{3}{4}$ vote on the CBR. Representative Samuels explained that the original version of the bill established a sub-account in the CBR; people worried about having two different funds. The fund proposed would be completely new. He maintained that money would be saved. The manner in which the bill is structured has nothing to do with the CBR. It would be a new account and windfall profits would be placed into it; the CBR would be left alone.

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Vice-Chair Stoltze pointed out that by a $\frac{3}{4}$ vote, the Legislature could decide to put the CBR into the proposed account. Representative Samuels replied that could happen, however, realized it could turn into a political issue.

Vice-Chair Stoltze appreciated the innovative work accomplished with the endowment. Representative Samuels advised as it is currently written, the money would go to the Department of Revenue to invest. He did not believe an enabling statute was needed for the management. During a lower payout, the fund could be safer from inflation. Federal statutes require that charitable foundations spin-off 5% of the money. Vice-Chair Stoltze understood that inflation proofing was part of the formula, which makes it work and is inherent in the plan. Representative Samuels affirmed.

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Representative Crawford indicated his excitement, however, anticipated problems with the approach in attempting to combine the proposal with the CBR. Representative Samuels agreed.

Representative Crawford supported the concept of a State savings account. He favored having a majority vote rather than the $\frac{3}{4}$ vote. He anticipated in future years, the amount saved would be used; he did not want it to be an automatic withdrawal.

Representative Samuels explained that initially, language was included to require the vote. That language was removed during the committee process; he questioned if that could create a political problem. The intent of the bill is to create cash flow. The dollars could be reappropriated back into the fund itself. He hoped to avoid the political consequences on budget issues. He reiterated that the savings account is meant for a long-term cash flow.

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Representative Crawford wanted to see a debate, addressing the simple majority vote; he hoped that party politics would not get in the way.

Representative Joule recalled that the first attempt to address the situation was in 1976 with the creation of the Permanent Fund. In 1990, another attempt was made, creating the Constitutional Budget Reserve (CBR). He observed the creative ways the Legislature has found to "park" dollars. He noted he was divided on the issue, which does not address the unintended consequences. He anticipated it could create a steady-stream funding, but didn't think that possible.

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Representative Samuels agreed with comments made by Representative Joule, however, pointed out that if the

proposal is implemented, the options are to place money into the CBR and then eventually spend it. He maintained that in fifteen years, the money would be available, yet the cash flow mechanism would not be to the State. The political downside by taking action brings the day closer to the discussion of when the revenue sources dwindle. He observed that the proposed methodology is used around the world for creation of endowments. Representative Joule hoped that the results could be attained.

Representative Gara asked the intended formula for the out-years, when the State does not know the price of oil, the surplus or deficit. He inquired if there was access to that information. Representative Samuels observed the information from LFD indicates the initial deposit of approximately \$1.5 billion dollars. After that, the projected price & production forecast decreases from 400 million to 200 million in August 2015. If the price of oil drops, the numbers will decline as the progressive amounts drop. He did not foresee many problems in the next five years. He suggested that either the Department of Revenue or the LFD address the numbers.

Representative Gara requested the figures of the projected budget deficit and/or the surplus over the next few years. Representative Samuels offered to provide those numbers at the next meeting.

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Representative Hawker commented that if HB 125 is passed, it requires that each year, the Administration present a 10-year projection. He worried about the "hostage negotiation" currently happening on the Senate side.

Representative Hawker discussed the amendment sunset. Representative Samuels explained that as production declines, it is likely the State will need the wind-fall profit. He hoped that for the next five years, dollars will be placed into that savings account. After that time, it is not be imperative the money is used; it then becomes a legislative prerogative to determine the use.

Representative Hawker noted for the record, he was not comfortable with that interpretation. Representative Samuels stated that eventually, there will be a 7.2% production decline and unless the price goes up more than 7% a year, revenue will drop.

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Vice-Chair Stoltze wondered if a 2/3 majority vote could be achieved, adding that the proposed language would do no damage, yet would provide more public confidence.

Representative Samuels asked if Vice-Chair Stoltze was proposing that for tapping into the cash-flow money. Vice-Chair Stoltze thought the process was simple.

Representative Samuels agreed the language had been written appropriately placing the dollars into the General Fund. Whatever the verbiage regarding the cash-flow, the point is, the more complicated it is, the worse it can become. He maintained that the Legislature is the appropriating body and should decide how those funds are placed. It is solely a cash-flow mechanism; the more complicated it gets, the less desirable it becomes. Right now, the proposal is only for an endowment. He agreed with the assessment recommended by Vice-Chair Stoltze to keep it simple.

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Representative Thomas questioned why the change was proposed to come before the voters. Representative Samuels indicated concern on how to access the funds if it was not a vote by the people. He thought that creating a statutory fund could make it easier to access.

In response to comments made by Vice-Chair Stoltze, Representative Samuels explained that the principle of the Permanent Fund exists because the Legislature chooses to place money into the corpus. He encouraged members to think long-term. He thought that the proposal could equalize State revenue overtime.

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Representative Kelly agreed there are interesting elements to the bill; however, anticipated criticism from the voters that the legislation was an attempt to access the Earnings Reserve Account. He asked the unintended consequences.

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Representative Samuels responded that was "purely a political" question. He reiterated that passage of the bill is the right thing to do. When addressing the Permanent Fund, we are addressing people's dividends; whereas, HJR 28 only addresses State government money. He maintained that the correct thing to do is to set up an endowment. If the bill fails by the vote of the people, then there is no harm done; however, if the Legislature can get it implemented, it sends a good message to the public that there is a cash flow mechanism that works.

Representative Kelly agreed with comments made by Representative Samuels. He recommended that the legislation tie in with the other 10-year proposed plans. He noted that

HJR 5 provides a spending control on the revenue stream. He was encouraged by the work done by Representative Samuels.

Representative Joule asked if the bill would be moved at the meeting. Co-Chair Meyer said no. Representative Joule noted the FY2015 anticipated balance of \$100 million dollars. He asked to see where dollars are currently "parked" in the system and how it could be better built upon.

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Representative Samuels advised that LFD had provided a spread sheet indicating a roll of 100% the first day of the CBR. In 2015, it would spin-off \$155 million dollars; when restructuring the CBR with a payout methodology, \$340 million dollars will be spent. He thought that would be the same spin-off that a 4% sales tax statewide would generate. He did not know of any State accounts with a \$4.5 billion dollar balance amount.

Representative Joule acknowledged that the State currently, does put dollars away. A percentage of the oil revenues are put into the Permanent Fund. Every year, the value of that money is protected at 3%. As the fund grows, the percentage gets bigger. The value of the fund is protected. He emphasized the State will be saving and that is good.

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Co-Chair Meyer recalled that the revenue sharing bill SB 72, requires 6% of the progressivity. There could be complications if that bill passes from the House Finance Committee on 2/14/08.

Representative Gara mentioned the legendary battles over passage of the CBR and getting the $\frac{3}{4}$ vote. Spending money on one end and then placing it into savings, it could still be there in the CBR. There will be a fight over getting the $\frac{3}{4}$ vote. He did not imagine the proposed bill would change spending patterns.

Representative Samuels responded that passage of the bill would "speed up the day that there will be discussion" regarding where the revenue comes from. Referencing the chart, in the first year not counting the dollars placed into the CBR, the State would receive \$123 million dollars; in 2034, there could be up to \$500 million dollars in that account. If the dollars only go into the CBR, there will be a fight and the money will be spent and the \$500 million will not spin off. He argued that HJR 28 proposes a better plan for the long-term; however, it might be more painful to achieve that goal.

Representative Gara referenced the handout and that under the proposed legislation, \$20 million dollars would be taken out of the General Fund and placed into the Petroleum Tax Fund (PTF). If that year is an even year, in the proposed bill, there could be a \$400 million dollar deficit, which would require the Legislature to go to the CBR to acquire the funds required for the PTF.

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Representative Samuels affirmed that in the transition year, there could be some problems. He recommended placing the entire CBR into that fund & phasing it in. He acknowledged that there are different ways to look at it and that each way has a trade-off.

TAMARA COOK, (TESTIFIED VIA TELECONFERENCE), DIRECTOR, LEGISLATIVE LEGAL AND RESEARCH SERVICES, JUNEAU, offered to answer questions of the Committee.

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Representative Crawford believed that taking the dollars off the table and saving them for future spending is a good plan, which saves for the future. He hoped to see the CBR turned into an endowment. He noted approval for the proposal.

Representative Kelly agreed that there would be more funds available to place up-front. He recommended that as much money as possible be placed into the fund during the high years. He suggested that the expenditure column be reconstructed so that if not spent, it could be reinvested.

Representative Samuels agreed it could be reinvested, but would be decided by the Legislature. The fear is that making a separate vote to appropriate, problems could occur breaking the savings account. In drafting the bill, Representative Samuels had attempted to avoid politics and urged that the State let the money work for itself.

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Representative Kelly favored placing the CBR into the fund, including with a ten year plan to improve the State's savings.

Representative Samuels noted that he had intended to speak with each of the members, however, timing issues made it impossible. He wanted to understand the Committee member's comfort-level with including the CBR into the proposal. He requested amendment recommendations be made for the proposed bill.

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PUBLIC TESTIMONY CLOSED.

Co-Chair Meyer noted that there could be future testimony on changes made but only by invitation.

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Representative Gara worried about establishing a formula for the constitution based on only the known dollars for the next few years. The money time-line, consideration should be made including future the gas and oil taxes with inflation. He asked if \$2 billion dollars this year could be placed into the fund and not now worries about the out-years.

Representative Samuels thought that scenario would depend on how much is placed in each year. Placing the \$4 billion dollars currently in the CBR and adding another \$4 million during the next few years, could work with not tying it to the Constitution. He worried that future legislatures might not appropriate the money into that fund. The political benefit is to have the dollars available, creating a middle ground. There will always be a fear of the price of oil staying high and production dramatically dropping, which would be the worse case scenario and the Constitution requiring that the funds be placed in.

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Representative Gara referenced the LFD estimate, including the numbers between now and 2015. He asked what those totals would total in today's dollars. He proposed that all those funds be estimated for the year and factoring in the time-value, not creating a formula for the Constitution. Representative Samuels agreed that mathematically that could roughly achieve the same place.

Vice-Chair Stoltze recalled a previous year process. He addressed the issue of the CBR, placing it into the Constitution so that the public can decide if the existing system is better or not than what is being proposed. Representative Samuels did not object to including the five year consideration. If the entire CBR is not phased out in the first year, he thought it would be mute. Vice-Chair Stoltze believed he and Representative Samuels were on the same page.

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Representative Crawford looked forward to seeing the benefits of the proposed action and hoped that the next generation could also experience those benefits. He

recommended that the CBR be included plus 50% of the State's surplus dollars over what was spent last year & including inflation. He reiterated support for the legislation.

Representative Kelly confirmed that the bill captures production tax on oil and gas with any progressivity piece. Representative Samuels replied, in the original legislation, the exact sight was quoted regarding tax collected; the House Judiciary Committee did not approve of a statutory inclusion reference in a constitutional amendment, so hence, it includes only the description. The constitutional imperative ends in five years.

Representative Kelly noted that presently, it is handled on the barrel of oil equivalent (BOE) and asked if that would be continued. He thought it could flow well into the future. Representative Samuels believed it could stop the flow in. In the net profit system, anything above the base rate would go into it.

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Representative Thomas mentioned his personal retirement account and the discipline needed for making the deposit into those accounts. He maintained that any investing requires flexibility.

Representative Kelly advised that no young person who has put money away for retirement ends up criticizing the person who made the recommendation.

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Representative Gara asked when the Committee could anticipate hearing testimony from the LFD and the Department of Revenue.

Co-Chair Meyer stated that HJR 28 would be HELD in Committee for further consideration.

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ADJOURNMENT

The meeting was adjourned at 3:09 P.M.