

HOUSE FINANCE COMMITTEE
May 1, 2019
9:00 a.m.

9:00:18 AM

CALL TO ORDER

Co-Chair Wilson called the House Finance Committee meeting to order at 9:00 a.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Tammie Wilson, Co-Chair
Representative Jennifer Johnston, Vice-Chair
Representative Dan Ortiz, Vice-Chair
Representative Ben Carpenter
Representative Andy Josephson
Representative Gary Knopp
Representative Bart LeBon
Representative Kelly Merrick
Representative Colleen Sullivan-Leonard
Representative Cathy Tilton

MEMBERS ABSENT

None

ALSO PRESENT

Ed King, Chief Economist, Office of Management and Budget;
Representative Steve Thompson; Representative Louise Stutes.

SUMMARY

HB 131 APPROPRIATION LIMIT

HB 131 was HEARD and HELD in committee for further consideration.

Co-Chair Wilson reviewed the meeting agenda.

#hb131

HOUSE BILL NO. 131

"An Act relating to an appropriation limit; relating to the budget responsibilities of the governor; and providing for an effective date."

9:00:42 AM

Co-Chair Wilson relayed that she had asked the Office of Management and Budget (OMB) to testify on the bill. She wanted the committee to see the many different outcomes of a sending cap.

9:01:24 AM

ED KING, CHIEF ECONOMIST, OFFICE OF MANAGEMENT AND BUDGET, stated his understanding of the discussion. He did not have prepared materials. He offered to provide an introduction on the "levers" and options available when creating a budget spending cap.

Mr. King offered that three levers were available when considering a spending limit. The limit should include all funding that an appropriating body wanted to restrict. The current limit in the constitution and other spending cap proposals all excluded federal funds. There was no desire to restrict the amount of federal funds received by the state. He reiterated that all the appropriation limit proposals excluded federal funds. He mentioned that some of the proposals excluded the Permanent Fund Dividend (PFD) and some did not. He maintained that exclusion or inclusion was a matter of political philosophy; either include as a budget item or exclude the funds outside of the limit so it did not compete with other budget items. He stated that the other significant issue to exclude or include was designated general funds (DGF) versus undesignated general funds (UGF). He indicated that some proposals included all general funds (GF). He exemplified raising state park fees; if DGF was included in the limit it would restrict the ability to increase the fees. He noted that HB 131 excluded DGF.

Co-Chair Wilson asked whether the constitution excluded DGF. Mr. King answered that the constitution included all GF except for public corporate receipts that were excluded; e.g., University of Alaska (UA) tuition and Alaska Industrial Development and Export Authority (AIDEA) receipts.

Co-Chair Wilson determined that if a state tax was implemented and the revenue was included in the cap it would keep spending consistent and if the tax was excluded government could grow. She thought that taxes were a big lever either inside or outside of a cap. Mr. King answered that all spending limit caps were tied to the uses of funds, not the sources of funds. Raising a tax would not change anything in the limit, but how the taxes were used would. However, if a sales tax was used for a designated purpose there would be no check on the amount of growth that could occur.

Vice-Chair Johnston wondered whether the Department of Revenue's (DOR) fees for investment would be part of the cap.

[9:07:07 AM](#)

Mr. King answered that under current law, the management fees for a corporate entity were excluded. He commented that the language was similar in the statutory and constitutional measures before the legislature. He noted that it would ultimately depend on how the language was drafted in the limit. Mr. King referenced debt service and other items. In general, debt service payments were considered outside the cap. He recalled that in all the current limit and all other proposals they were excluded. He noted that the type of debt service mattered. For example, if the debt was a general obligation bond (GEO) the debt was excluded in all proposals. However, things like school reimbursement and other subject to appropriation bonds would depend on how the language was drafted as to whether it would be included or excluded. The debt service payments not voted on by the public were subject to the cap in the current constitutional cap.

[9:09:27 AM](#)

Vice-Chair Johnston deduced that he had answered the question. She was interested in whether bonding for oil tax credits and the unfunded pension obligation were under the cap. She deemed that they were included. Mr. King affirmed her conclusion. Vice-Chair Johnston wondered if pension obligation bonds would be included under the cap. Mr. King replied in the affirmative.

Representative Knopp referenced Mr. King's comment that federal funds were excluded. He ascertained that since the federal funds needed matching state funds, a cap would limit federal funds since the state matching funding was subject to the cap. Mr. King agreed that the state matching portion would be subject to the cap and federal funds could be lost. Representative Knopp remembered that initially the administration wanted to eliminate the DGF designation and had combined UGF and DGF. He determined that combining the funds would likely be an easy way to manage a limit. He asked about whether capital funds were excluded.

[9:12:19 AM](#)

Mr. King replied that there were three types of DGF. The constitution did not allow the full dedication of funds. He explained that one type of DGF generated from a business like function. The current limit and constitutional proposal excluded that type of DGF. He pointed to another type of DGF that involved business like activities not part of a public corporation; e.g., user fees collected from state parks when the funds were used to maintain the parks. The fees were included under the current constitution and the proposed constitutional amendment but was excluded in HB 131. He indicated that the state could collect more revenue from fees than needed to reinvest in the program and it was a policy call. The third type of designation was not tied to the program from which the funds were collected and could be excluded or included. The administration concluded that the later type should not be considered DGF. He furthered that under the constitution and the proposed constitutional amendment, the PFD was excluded and under the bill and senate proposals the PFD was included.

[9:15:24 AM](#)

Representative Knopp asked about capital funds and noted they were typically UGF. Mr. King answered that the constitution included some unusual language that had never been triggered. He relayed that in all proposals, capital funding was included in the cap and had been amended to provide some flexibility with either a 10 percent or 5 percent allowance over the cap.

Representative Josephson asked whether some states had a revenue cap. Mr. King asked for clarification. Representative Josephson explained that Colorado had a cap

on the revenue the state could generate. He assumed that a revenue cap correlated to ultimate expenditures. Mr. King responded in the affirmative and purported that the limit on government spending could be restricted in various ways; either restricting the ability to raise revenues or restricting appropriations. He agreed that Colorado had a restriction on the revenue it could generate, and other states made it difficult for a state to implement a new tax; therefore, limiting the ability to grow government. Representative Josephson contended that part of the reason for the proposed development of Alaska National Wildlife Refuge (ANWR) was that Alaskans wanted to get rich. He deduced that Alaska could implement a spending cap but still "get rich." He did not view revenue generation and a spending cap as a correlation. Mr. King answered in the affirmative. He agreed that revenues could exceed a spending limit especially in a resource-rich state where the imbalance was typically temporary. He advised against increasing spending with volatile revenue sources.

[9:19:16 AM](#)

Representative Josephson used Mr. King's hypothetical example of DGF that was derived from a source like a sales tax and used for a specific purpose. He surmised that the funds would be designated, not dedicated and each year the money could be rerouted to another purpose. He believed his scenario was "fundamental" to the state's constitution. Mr. King replied that the exclusions from the limit were not dedications of the funds. He added that revenue from a sales tax that was designated for a purpose was not dedicated but it would be excluded from the formula that calculated the cap.

Vice-Chair Ortiz asked whether the Department of Fish and Game (DFG) fees and taxes would be included or excluded from the cap. Mr. King answered that under HB 131, if the fees or taxes met the definition of program receipts under AS 37.05.146, they would be excluded. Vice-Chair Ortiz asked about the Alaska Marine Highway System (AMHS) fees or fares. Mr. King replied the same exclusion would apply under HB 131. However, it would not be the case under the proposed constitutional amendment - DGF would be subject to the cap and changed the dynamics of how the legislature may be able to alter what was under the cap or not. Vice-Chair Ortiz noted that the state's revenues fluctuated greatly from year to year. He advised caution regarding a

constitutional revision because it would be hard to adapt to changing revenue situations.

[9:22:45 AM](#)

Mr. King agreed that regardless of revenue volatility, the constitution was difficult to change and should be addressed with caution. He addressed the original constitutional spending limit proposed in 1982 and reported that the reasoning at the time was to "smooth out the volatility" in revenue and not increase spending when revenue increased. He judged that a spending limit stabilized government spending, which was the governor's reason for proposing the limit.

Co-Chair Wilson reasoned that the current spending limit had never really come into effect because it was too high. She wondered whether there was some merit in putting the cap in statute initially, to determine how it was working versus putting the cap in the constitution. Mr. King confirmed that there should be significant thought before putting something into the constitution. He offered that there were ways to ensure the limit would be effective and durable over time. In 1982, when the amendment had passed the first time, it had automatically gone back to the public for a vote in 1986. The vote meant to ensure the limit's efficacy. Co-Chair Wilson countered that it had not been working because it never went into effect. She wondered whether doing something like that and going back to voters every four years was better than a statute that required the legislature to test and adjust every year. Mr. King noted that the governor desired the constitutional amendment. Co-Chair Wilson favored a constitutional amendment but was trying to ensure the cap would work. She wondered if the limit should be a statutory change at first with the idea of a constitutional amendment in the future.

[9:28:30 AM](#)

Vice-Chair Johnston noted that in 1986 the cap had been voted on immediately prior to a drop in oil price. She had voted for both caps.

Co-Chair Wilson interjected and wondered if the vote had come a couple of years after the drop, would the vote have passed. Vice-Chair Johnston speculated that "the tax cap had been the last thing on peoples' minds because there

were so many other things going on." She believed that the portion of citizenry that were interested in fiscal sustainability and clamoring for a fiscal plan would have engaged and a robust discussion would have taken place.

Mr. King opined that in 1977, oil started flowing and revenues had started significantly increasing. As a result, the government had started to grow and by 1986 to 1988 when revenues fell, and "the problem" regarding government growth had gone away, it had stayed that way for many decades until 2005 when the prices spiked. Many realized that the limit put in place in 1982 was ineffective.

[9:31:26 AM](#)

Vice-Chair Johnston followed up on an earlier question by Representative Knopp related to the capital budget. She stated that the cap would exclude debt and if the capital budget was funded via a GEO bond, the debt payment would be excluded. Mr. King replied in the affirmative.

Representative Sullivan-Leonard asked for an overview regarding the existing budget reserve fund compared to the governor's proposal that included a savings reserve fund.

Co-Chair Wilson asked what fund Representative Sullivan-Leonard was referencing. Representative Sullivan-Leonard explained that reserve funds were part of the spending cap conversation and wanted a comparison of the idea proposed in HJR 7-Const Am:Approp. Limit; Reserve Fund. Mr. King answered that HJR 7- Const. Am.: Permanent Fund & Dividend and its companion bill SJR 6, contemplated situations when the state had more revenues than it was allowed to spend. He elaborated that under current law, Article 9, Section 7 and Section 16, provisions existed for a cap and a savings fund - the Constitutional Budget Reserve (CBR). The CBR held money from oil settlements and litigation. The legislature had the ability to borrow from the CBR with the understanding that the money would be repaid to the fund when revenues were sufficient. The proposed resolution would change the concept slightly - rather than paying back what was owed to the CBR it would always hold one year's worth in funds to act as a buffer. The fund was renamed as the Savings Reserve Fund in HJR 7. He added that if there were additional funds available, rather than holding significant amounts in the CBR the funds would be

automatically deposited into the corpus of the Permanent Fund (PF).

Co-Chair Wilson asked where the money to initially seed the savings account with one year's funding would come from if revenue was insufficient. She speculated that the funding would come from the ERA. Mr. King answered that the resolution in front of the legislature required spending cuts to meet the limit or finding additional revenue. A withdrawal from the ERA would be a legislative decision.

[9:36:35 AM](#)

Co-Chair Wilson thought that the limit could force the state into a taxation.

Vice-Chair Ortiz asked whether moving forward with HB 131, which did not include the PFD as part of the spending cap - if it by necessity negated SB 26-Approp Limit & Per Fund: Dividend; Earnings [CHAPTER 16 SLA 18 - 06/13/2018] that used part of the Earning Reserve Account (ERA) draw to pay for the dividend and government services. Mr. King corrected that HB 131 included the dividend in the limit. He believed that Vice-Chair Ortiz's broader point was sound and the limitation on the amount that could be drawn from savings impacted the amount of expenditure. He agreed that a strict appropriations limit would preclude the ability to draw from the POMV.

Co-Chair Wilson interjected that the PF corpus was excluded.

[9:38:21 AM](#)

Vice-Chair Johnston referenced the newly defined savings account. She asked if a "temporary sweep" of funds would exist in that situation. Mr. King answered that HJR 7 contemplated the elimination of the three-quarter vote and prohibited the reverse sweep. He elucidated that HJR 7 did not require a full sweep to repay the CBR but required a sweep of GF known as the "waterfall" to the either the corpus or the CBR. Vice-Chair Johnston stated that one of the aspects of the CBR was it acted as a cash management tool. The fund would still be used as a fund balance and a cash management tool, but the resolution required a full year's budget balance as opposed to merely a basic cash management tool. She asked whether he agreed. Mr. King

answered in the affirmative and elaborated that currently, the CBR acted as a stabilization fund. The question was what the balance needed to be to provide the stability. The current law did not have an upper limit to the CBR balance. He deemed that the question was about the right balance to maintain in the CBR and how the excess funds should be handled. The general idea of HJR 7 was that one year's worth of revenue was adequate and the CBR would "truly" become a stabilization fund rather than a holding account. He recommended that the legislature further analyzed what a proper reserve amount was.

[9:41:22 AM](#)

Vice-Chair Johnston addressed what qualified and what did not regarding the limit. The government could employ "Tax Anticipation Notes (TAN) that would be included within the tax cap because it was debt service. Mr. King replied that the administration had not talked about it specifically, he guessed that it would be under the cap, but he would have to follow up.

Representative Carpenter cited page 2, line 8 and read the following:

...of money to a state savings account or fund that requires a subsequent appropriation from that account or fund.

Representative Carpenter asked for an example of the type of fund. Mr. King answered that Power Cost Equalization (PCE) was the type of fund described. He noted that the Retirement Trust Fund did not require a subsequent appropriation. He maintained that lacking a subsequent appropriation meant that the money was already spent and should be subject to a cap. Representative Carpenter asked how a fund requiring a subsequent appropriation was created.

Mr. King replied that the type of fund was created by statute. Representative Carpenter surmised that the legislature could create a fund to avoid the cap. Mr. King clarified that the transfer from GF to the fund was not subject to the cap but the subsequent spend or appropriation from the fund was included in the cap. He maintained that it was not possible to avoid the cap.

[9:44:27 AM](#)

Representative Josephson spoke about a new state savings account. He surmised that the idea was to have one year's worth of spending in the account. Mr. King answered that HJR 7 contemplated maintaining one year's spending as the upper balance, which was about \$5 billion in the account. He recounted that the administration did not discuss whether the amount was adequate. Representative Josephson discussed the administration's goal to restore the full formula PFD from 2016 through 2018 to residents by drawing from the ERA. He referenced that Mr. King testified that the initial seed money for the new savings account would be withdrawn from the ERA. He worried about the burden on the ERA. He thought that the action would make it easier to expend funds from the new savings account. Mr. King clarified that HJR 7 did not proposed to withdraw money from the ERA and deposit it into the CBR.

Co-Chair Wilson interjected that it had been her comment when wondering where the initial extra \$5 billion would come from.

[9:46:51 AM](#)

Representative Josephson reiterated that he recalled Mr. King had stated that it would be necessary to find the money and it may come from the ERA. Mr. King clarified that he stated the legislature either must turn to the ERA, cut spending, or raise taxes if the CBR was empty and revenue was insufficient. He did not intend to say that money would be moved from the ERA to the CBR. He addressed the question about whether the money would be easier to spend and asked whether the query was still relevant. Representative Josephson deemed that changing the name of an account changed the way the public thought about it and how the media covered it. Mr. King supposed it could be a true statement. He answered that in terms of spending, a provision prohibited spending more from the CBR or SRF (as named in the proposed resolution) than the gap between the limited amount and the revenue available. The legislature "did not get free access to the money." The legislature could not fill the gap with the ERA and still access the CBR. He declared that the provisions did not allow easy access to the funds.

[9:49:43 AM](#)

Co-Chair Wilson indicated that Representative Louise Stutes joined the meeting.

Representative Carpenter asked if the change in inflation adequately reflected the demand in spending in the event of a population change. Mr. King referred to the three levers or options when establishing a spending limit. He would answer Representative Carpenter's question after he addressed the last two levers.

Mr. King continued that the second lever was what the limitation was based on and the third lever was how the base was escalated over time. He expounded that under the current constitution, the limit had been allowed to grow at the rate of inflation and population as a cumulative rate over time with the base set at \$2.5 billion. Therefore, the amount was about \$10.5 billion in current prices. The escalation happened based on the previous year's limit, which was how the limit became detached from spending. The fixed base was growing at a variable rate tied to a fixed value. He related that the constitutional amendment proposed by the governor had an adjusting base versus a fixed base that was recalculated each year based on the prior three years of actual spending. The base automatically adjusted down if the spending was below the limit and would never become detached like the current limit. He reasoned that it might not be necessary to readjust the amendment due to the nature of an adjusting base. Rather than using an adjusting base, HB 131 changed the fixed values to \$5 billion and grew at inflation only. He deduced that the fixed base still had the potential to become detached from actual need.

[9:53:02 AM](#)

Mr. King addressed Representative Carpenter's question regarding whether the inflation adjustment was adequate. He believed that it made sense to consider some amount towards inflation, it was a policy call that needed to be made. He considered whether population adjustments were necessary. He pondered whether government services needed to grow at that same rate as the population and if the population grew by 10 percent was the full proportional rate necessary. He noted the large population growth between 1990 and 2010. He delineated that there had been significant population growth in the past, but a significant increase in public services was unwarranted.

The governor's proposal included half the rate of inflation and in the amended SJR 6 the Senate included the full rate of inflation but eliminated the population adjustment; the same in HB 131. He thought that the answer was a policy call determined on what the requirements of government would be in a future with a different population.

Co-Chair Wilson wondered if it was possible to model the numbers using a mathematical equation. Mr. King answered that the bill could be structured in any manner. He offered that it depended on how reactive the legislature wanted the cap to be with changing circumstances. He suggested that the limit could be tied to revenue or various items such as inflation and population. He did not believe there was a right answer, there were numerous ways to approach the issue. Co-Chair Wilson thought that the voters did not have the opportunity to choose the levers unless there were several constitutional amendments offered. Mr. King responded in the affirmative.

[9:56:38 AM](#)

Vice-Chair Ortiz asked that if the capital budget was part of the limit whether there was a way to factor in existing deferred maintenance needs. Mr. King replied in the affirmative. He stated that deferred maintenance could be excluded, or the legislature could bond for it. Vice-Chair Ortiz spoke to the benefits of bonding for capital projects. He asked if the dollar costs to the state increased through a bonding process. Mr. King confirmed that there was a cost associated with bonding but to consider what the opportunity costs were. He commented that it was not clear cut whether bonding would be better for the state or worse.

Co-Chair Wilson asked about the possibility of using modeling to analyze the options for a spending limit. Mr. King responded that he was unaware of available software due to the unique nature of Alaska. He suggested that the Legislative Finance Division could develop some modeling. He offered to help.

Co-Chair Wilson wondered if the members wanted to have modeling and comparisons done. If there were other things the committee wanted to see in a modeling format, she invited them to let her know. She favored a spending cap but wanted to ensure that the spending cap was appropriate.

Representative Josephson understood that population growth and services did not warrant a one to one ratio. He asked about the 20 year period from 1990 through 2010 and noted things like school bond debt reimbursement, law enforcement needs, and the lack of a state income tax all impacted expenditures. Mr. King reiterated that even though the state experienced large population growth, the government did not grow. He questioned whether population growth as a factor was necessary in the overall limit.

10:03:31 AM

Vice-Chair Ortiz suggested that perhaps there was not a need for a limit and the hypothesis merited further discussion. Mr. King replied that if there were no revenues or savings the economics was creating the limit. He detailed that when there was volatility (e.g. a spike in oil price) the legislature had been a bit slow to react to the increase or decrease in revenue. During the prior revenue spikes, he noted that there had been some savings, but also a significant increase in spending. He asked whether legislators would have passed large budgets if the legislature knew that the price of oil would eventually plummet. He maintained that if they had known the downturn was coming, they would have adjusted the budget sooner. He believed that a spending limit forced the conversation.

Co-Chair Wilson asked what would happen if the legislature deposited \$12 billion from the ERA into the Permanent Fund corpus. She thought that the action would implement a spending cap. Mr. King affirmed her statement. He added that it did not address a future circumstance of increased revenues.

Co-Chair Wilson thought that the committee and the public were learning a significant amount from the conversation.

Representative Carpenter noted that HB 131 excluded designated or dedicated funds from the cap. He returned to his earlier question about creating a fund like PCE. He determined that the appropriation would be DGF and the expenditure would be excluded from the cap. He asked if his statement was accurate. Mr. King answered in the affirmative and explained that under HB 131 the exclusion of the designation made the scenario possible. He furthered that the legislature had the purview to designate funds any time. He believed that it was a question that should be

closely considered as the cap language was crafted. He emphasized that it was not the creation of a fund and its subsequent appropriation it was the exclusion of DGF that allowed the scenario.

10:08:05 AM

Representative Carpenter agreed. He was trying to point out that a spending cap that did not cap all spending was not a spending cap. Mr. King agreed with the statement.

Co-Chair Wilson used the Division of Motor Vehicles (DMV) funds as an example that collected more revenue than it needed. She used a scenario where departments would be as self-sustaining as possible. She wondered whether the DMV funds would be inside or outside the cap under HB 131 versus the governor's proposal. Mr. King replied that under HB 131 the DMV funds would be inside the cap. If the legislature took an action to designate the funds solely for DMV operations the funds would move from inside the cap to outside the cap. The governor's proposal kept the funds in both scenarios inside the cap. Co-Chair Wilson asked if it would still be possible if the DMV collected more revenue than needed for operations. Mr. King answered that the spending limit was tied to the appropriations, not revenues, any additional funds would lapse to the GF and the use of the funds would be subject to the limit.

Representative LeBon hypothesized a fuel tax that was not designated for road maintenance. He asked if there was a method short of changing the constitution that allowed the tax revenue to be dedicated to road maintenance. Mr. King answered that the legislature had the ability to designate the funds that were subject to yearly appropriation by the legislature. Dedicated funds required a constitutional amendment. Representative LeBon asked for verification that there was no proposal by the governor to designate a fuel tax for road maintenance. Mr. King was not aware of any such proposal.

10:11:29 AM

Representative Josephson was thinking about the "merits or demerits of including designated funds within the cap. He returned to his example about family finances. He questioned why revenue from a self-sustaining agency would

be included in the cap. Mr. King reminded the committee that the expenditure was limited and not the revenue.

Representative Knopp looked at agency receipts that often brought in more revenue than it expended. He thought that it was appropriate to include the revenue in a spending cap and share the excess revenue. He asked for comments. Mr. King answered that the governor's proposal contemplated the program receipts as part of the general fund and subject to the cap.

Co-Chair Wilson noted that all boards and commissions would be under the cap. Mr. King affirmed the statement. Co-Chair Wilson asked if it would include statutory designated fees. Mr. King answered in the negative - statutory designated program receipts would be outside the cap and were held in a trust.

Co-Chair Wilson thought agencies that taxed themselves should be able to use the funds as they wanted. She indicated that she would request modeling from LFD.

Co-Chair Wilson reviewed the agenda for the following meeting.

Vice-Chair Ortiz asked about the \$5 billion spending cap He wondered where the figure was derived from. Mr. King did not know - the bill had come from the House Finance Committee.

Co-Chair Wilson replied that the cap was based on a three year average and was a starting point. She characterized the base as the most important lever in building a spending cap.

HB 131 was HEARD and HELD in committee for further consideration.

ADJOURNMENT

10:16:43 AM

The meeting was adjourned at 10:16 a.m.