

SENATE FINANCE COMMITTEE
February 4, 2020
9:03 a.m.

[9:03:22 AM](#)

CALL TO ORDER

Co-Chair von Imhof called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Natasha von Imhof, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Lyman Hoffman
Senator Donny Olson
Senator Bill Wielechowski

MEMBERS ABSENT

Senator David Wilson

ALSO PRESENT

Senator Cathy Giessel; Caroline Schultz, Staff, Senator Natasha von Imhof.

SUMMARY

SB 104 APPROPRIATION LIMIT

SB 104 was HEARD and HELD in committee for further consideration.

#sb104

SENATE BILL NO. 104

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

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Co-Chair von Imhof recalled that the previous day the committee had considered the proposed Motor Fuels tax. She

asserted that if the state was going to discuss revenues, Alaskans needed to be assured that the state budget was not being bloated in response. She emphasized that the state still needed to look for savings and thought there was efficiencies to be found throughout the budget.

Co-Chair von Imhof continued her opening remarks. She opined that the state needed to hold down spending growth by selling unneeded state assets, consolidate real estate, and manage the vacancy rate through worker attrition.

Co-Chair von Imhof explained the SB 104 would put an effective spending cap in statute. The bill was first presented on April 10, 2019. There were two additional hearings on April 29, when public testimony was taken, and April 30, when the Committee Substitute (CS) version K was adopted.

[9:05:41 AM](#)

CAROLINE SCHULTZ, STAFF, SENATOR NATASHA VON IMHOF, gave provided an overview of the bill. She addressed a Sectional Analysis (copy on file):

Sec. 1: Amends AS 37.05.540(a) by deleting a reference to the existing statutory appropriation limit that is repealed by this bill.

Sec. 2: Enacts a new AS 37.05.545 - Appropriation Limit.

(a) Establishes the parameters of the limit:

- Includes all Unrestricted General Fund (UGF) appropriations for agency spending, Permanent Fund dividends, retirement obligations, and capital projects. Does not include reappropriations, federal funds, Designated General Fund (DGF) spending, program receipts, money received from nonstate sources for specific purposes, or the exclusions listed in (b).

- Starting point is \$6 billion for FY 2021, with a growth rate based on the average of the previous five-year's inflation. This rate was chosen because it provides a more stable rate than an annual inflation adjustment.

(b) Lists the exclusions to the appropriation limit:

- (1) Appropriations to the Permanent Fund principal (corpus);

(2) Debt payments;
(3) Disaster funding; and
(4) Deposits into savings accounts and transfers into accounts that require additional legislative action to spend.

(c) Allows an additional five percent above the limit to be spent on capital projects.

(d) Defines the terms "debt obligation", "program receipts", and "unrestricted general fund" for the purposes of this section.

Sec. 3: Adds a requirement to AS 37.07.020 that the governor submit, along with the annual budget, a report noting whether the proposal is within the spending limit. The report must be updated to include any supplemental appropriations and budget amendments.

Sec. 4: Repeals the current statutory appropriation limit, specifically AS 37.05.540(b); 37.05.540(c), and 37.04.540(e).

Secs 5 - 7: Applicability, transition, and effective date language that specifies when the new appropriation limit and reporting requirements would take effect. The limit would apply to the FY2021 budget and the governor would be required to file the necessary reports for the proposed budgets starting in December 2020.

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Ms. Schultz addressed the presentation, "Senate Finance Committee Presentation - 2/4/2020" (copy on file).

Ms. Schultz addressed slide 1, "Decision Points":

1. Starting Point
2. Growth rate
3. What is included under the cap
4. What is excluded outside the cap

Ms. Schultz tuned to slide 2, "Decision Points: current SB 104 (v. K)":

1. Starting Point \$ 6 Billion

2. Growth rate 5-year trailing average CPI
3. What is included under the cap
 - UGF, except the specific exclusions below, including Permanent Fund Dividends
4. What is excluded outside the cap
 - Appropriations to PF Principal, debt obligations, disaster, transfers that require further appropriation

Co-Chair von Imhof paused on slide 2 for discussion. She recalled the previous year that the starting point for the spending cap in the first bill was approximately \$5.25 billion. There had been committee discussion and an amendment to increase the amount to \$6 billion. She thought it was important to understand that the spending cap was not intended to be a spending goal and was also not meant to be punitive. She thought there needed to be a definitive line, then go forward with the CPI growth rate. The purpose of the cap was to constrain spending when there was higher than expected revenue. She observed that state revenues were currently steady, but in some years, there were extreme jumps in revenue.

Co-Chair von Imhof continued to speak to slide 2. She expressed the intent to save funds during times of excess revenue and have funds for down years. She reminded that the FY 20 budget, including the supplemental budget and the recently paid \$1600 Permanent Fund Dividend (PFD), was estimated to be approximately \$5.7 billion; so total spending was under the proposed cap. She qualified that technically only \$5.5 billion of FY 20 spending would apply to the cap, because certain debt payments were not included. She reiterated that the proposed \$6 billion cap was not a spending goal, but rather was to constrain spending.

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Senator Bishop mentioned the state's large repayment to the Constitutional Budget Reserve (CBR) and did not anticipate the state receiving a windfall anytime soon. He thought the bill was a good first step.

Co-Chair von Imhof reminded that any payments to the state's savings accounts were not included under the proposed cap.

Senator Wielechowski raised the issue of population change. He thought spending caps in other states were tied to population change. He asked if Co-Chair von Imhof had rationale for not including it as a metric.

Co-Chair von Imhof discussed the growth rate as shown on slide 2. She stated that she had looked at the 5-year trailing average CPI. She had looked at states that had spending caps or tax and expenditure limits. Some states had included just CPI, some states included just population, and some a blend of the two. Most states that had population included had some type of statewide tax. She asserted that as the population went up and down it did not affect the percent of market value (POMV) or oil revenues. She noted that the CPI showed a slow and steady rate of population growth.

Senator Wielechowski thought that in prior versions of the bill, the appropriation limit excluded the payment of PFDs. In the current version, the bill excluded appropriations to the principal of the Permanent Fund, but not dividends. He was concerned that the state would continue to have a fight over what the dividend should be and what should be available for government. He was curious about the rationale from taking the payment to the dividend out.

Co-Chair von Imhof thought it was important to consider all the state's spending obligations. She noted there had been discussion about changing the formula for the PFD. She referenced a Supreme Court ruling and thought that if agency spending was under the cap, then the Permanent Fund should be under the cap. She emphasized that having fiscal discipline required managing all obligations.

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Co-Chair Stedman was concerned about not considering population growth in the spending cap calculation. He mentioned the issue of the trailing CPI, which he thought was smoothing in constant dollars and freezing the purchasing power at the base rate being used. He thought the CPI index was heavily weighted to housing and therefore would be heavily weighted to the Anchorage housing market. He thought it should be considered that Anchorage was dissimilar economically to many areas of the state.

Co-Chair Stedman continued his remarks. He thought he had a slightly different view of the dividend. He thought the payout to the PFD should be unrelated, and if the fund grew it should be shared with the public, as well as the inverse. He thought embedding the dividend within the spending cap was destabilizing to the overall objective. He thought it may appear on the surface that the state had a trailing 5-year average growth rate, but in reality, the CPI was freezing spending at the local purchasing power today.

Co-Chair Stedman offered a counterpoint. He felt the best way to control spending was through controlling cash flow. He asserted that as long as cash flow swelled, there were needs from the agencies. He thought some agency budget had seen staggering changes. He recalled that some agencies had proposed 15 percent changes in spending.

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Co-Chair Stedman continued to discuss state spending. He posited that spending pressure did not solely reside within the legislature but came from agencies. He suggested if the legislature wanted to control spending at the municipal, state, or federal level; it was through controlling the cash flow. He referenced a large display of a check for \$4.9 billion in the committee room that represented the contribution to the principal of the Permanent Fund. He thought the proper course was to make sure there was not excess liquidity or excess spending of the ERA. He was cautious of a prescriptive plan for spending and was more comfortable with controlling cash flow.

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Co-Chair von Imhof advanced to slide 3, "Appropriation Limits: Article XI, Section 16 vs SB104," which showed a line graph that depicted the revenues and spending from 1982 to 2032. She noted that revenues were shown in green and spending was shown in orange. She pointed out that in 2006 and 2017, revenue had gone up precipitously then went down. Spending went up and was going down while cushioned using the CBR funds. She pointed out a gray line at the top, which represented the constitutional spending cap, which had both CPI and population at 100 percent for the growth rate. She pointed out the gray line that represented the current spending cap, and the growth rate was high. The

royal blue line was the recalculated spending cap using just the CPI.

Co-Chair von Imhof pointed out that during the time when revenues and expenses peaked, had the state kept to a spending cap, the state would have saved more money and spent less. She estimated that the state would have \$10 billion to \$15 billion more in the CBR if the state had a more effectual spending cap at the time. She commented that the Permanent Fund was steady with constant market growth and an annual 5 percent draw. She thought the Alaska Permanent Fund Corporation (APFC) had estimated that the fund would be at about \$80 million in ten years.

Co-Chair von Imhof pondered what the state would do if there was an increase in oil revenue. She considered alternatives such as implementing savings, spending for deferred maintenance, agency spending, or a larger capital budget. She thought there had been discussion over the years about maintaining fiscal discipline, particularly in agency spending, and reimbursing the CBR. She reiterated that the spending cap was not punitive, but was merely keeping a lid on growth in the event of high revenue years. She suggested that the committee could put a sunset on the cap and revisit it in five years.

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Co-Chair Stedman thought it would be nice to look at the chart on slide 3 with primary consideration of the operating budget. He thought the real underlying challenge was the state's handling of the operating budget. He mentioned deferred maintenance, which was building again after multiple minimal capital budgets. He thought it was important to keep a close eye on agency operations and it was an area of the greatest challenge.

Co-Chair von Imhof acknowledged that slide 2 was a "busy slide." She thought the slide showed the decisions made that put the state in the fiscal crisis it was currently experiencing. She thought DGF, UGF, and other state spending should be under the cap.

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Co-Chair Stedman wanted to put a finer point on Co-Chair von Imhof's comment for the public. He relayed that the

state had problems in the past with reclassification of funds, which had enabled an appearance of less growth in GF spending or reductions in GF spending which had not in reality taken place. He explained that there had been year after year of budget growth. He recalled that the legislature had gone forward with a process to reclassify and restate spending to get an accurate view of the magnitude and direction of the budget. He thought the practice of fund reclassification had started to occur again in the previous few years and thought the legislature had to practice continual vigilance.

Co-Chair von Imhof concurred with Co-Chair Stedman's remarks. She recalled legislation the previous year that pertained to tax revenues from marijuana sales. She mentioned designating some of the revenues to recidivism efforts, anti-drug efforts, and after-school programs. She thought only a quarter of the marijuana tax revenue went to the General Fund, and much of it was designated. She was a full believer and supporter of the spending cap and thought the cap would provide guidance for future legislators and help replenish the CBR and give discipline to find efficiencies in agency spending. She thought a spending cap would prevent large jumps in overall UGF spending in times of plentiful funds.

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Senator Bishop looked at Section 2 (c) of the committee substitute, which described an additional 5 percent above the cap limit to spend on capital projects. He referenced Co-Chair Stedman's comments relating to deferred maintenance. He could not recall if the 5 percent provision was modelled after the deferred maintenance schedule.

Co-Chair von Imhof stated that the committee came up with the provision the previous April, and the 5 percent amounted to about \$3 million. She referenced a capital limit in the constitution. The feedback that was received related to investing in capital when the state had enough funds, but not so much that there was not sufficient workforce to keep up with the demand. There had been a "sweet spot" discussed that was particular to the state. It was thought that \$300 million would allow the headroom needed to address deferred maintenance and the capital needs of the state. The amount also provided a slight bit of headroom to do geo bonds and leverage the funds more.

Co-Chair von Imhof reviewed slide 4, which showed a data table which showed a framework of the budget showing total UGF revenue, total operating and capital budgets, and the PFD payment. The total budget with the PFD payment was about \$5.7 billion, which yielded about a \$647 million deficit, which was a draw on the CBR. She considered the budget and implementation of the proposed spending cap for FY 21. The spending subject to the cap was \$5.4 billion. As the cap grew over time with the 5-year trailing CPI, it was possible to see how state spending was under or over the cap for FY 22 and FY 23. She summarized that there would be quite a bit of headroom with the proposed cap in place considering projected revenues based on the Department of Revenue forecast. She reiterated that if additional revenues came in, the state could choose to use them.

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Co-Chair Stedman clarified that there had not been a policy decision about the upcoming dividend appropriation. He thought the table on the slide showed a PFD check of \$1600, and reminded that the number was a placeholder for consideration of potential fiscal impacts of the proposed spending cap.

Co-Chair von Imhof concurred with Co-Chair Stedman. She pointed out that line J showed \$773 million that represented an approximately \$1100 PFD. For calculation, every \$325 million spent would add \$500 to each dividend check. She confirmed that line J was a placeholder.

Co-Chair Stedman mentioned that when the state had substantial revenue inflow seven years ago, there had been robust capital budgets to address deferred maintenance and build infrastructure that was needed around the state. There had been a discussion at the time to use bonded indebtedness and go forward with bond packages, which had been done a couple of times. He brought up the topic because the indebtedness would be outside the cap. He thought there was an extremely high likelihood that the legislature would add bonded debt for capital projects to get around a spending cap. He recalled that the topic had been discussed before, and some colleagues felt the public did not understand bond debt as part of the budget. He discussed debt service and was concerned about the

potential for budget "games" as mentioned by Co-Chair von Imhof.

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Co-Chair von Imhof agreed with Co-Chair Stedman. She recalled that state debt manager had discussed the state's low capacity for bonding. She thought it was important not to overuse the capacity and potentially not have available cashflow to pay the debt. She had asked Mr. Mitchell how the rating agencies would react if the state went to its capacity in bond debt yet utilized revenues for dividends. Mr. Mitchell had thought the situation could put a negative rating on the state.

Co-Chair von Imhof emphasized that it was important to look at all spending, including debt. She thought it could make sense to put debt under the cap. She pondered where the revenue would go to pay back the additional debt. She questioned the opportunity gained by paying a dividend versus capital and deferred maintenance.

Senator Wielechowski thought the state had classified some of its debt as "subject to appropriation" debt, such as oil tax credits. He referenced SB 331 [legislation passed in 2018 creating a public bond corporation to finance the purchase of tax credits]. He asked if it was the intent of the bill to include things such as tax credits under debt obligations such that they would be excluded from the appropriation limit.

Co-Chair von Imhof stated that the state had the headroom currently to pay the statutory tax credit payment if needed. She thought there would be more headroom if the constitutionality of paying with a bond was established. She thought the payments would be reduced even further if there were additional discounts as proposed by former Governor Bill Walker.

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Ms. Schultz addressed Senator Wielechowski's point. She pointed out that in Section 2 (d), debt obligation did not include state pension liability or appropriation for school bond debt reimbursement. The intent of including debt as an exception was in order to reassure any possible buyers of state debt that there was not something preventing the

state from paying the debt. She noted that there were some things included in the "debt" category that would not be excluded in the cap. The bill was written with the intent of having a narrow definition of state debt.

Senator Wielechowski asked how much "subject to appropriation debt" the state had and how much was being appropriated per year.

Ms. Schultz stated that in the FY 20 budget, there was roughly \$90 million in state debt in the budget, that included general obligation debt payments and other bond payments. There was also an appropriation for 50 percent bond debt reimbursement, which was included in the FY 20 budget following the governor's veto of half the payment. There was also a roughly \$300 million payment to the retirement obligation not included in the definition in the bill.

Co-Chair von Imhof set the bill aside. She asked committee members to contact her office with ideas and suggestions. She wanted to bring the bill back before the committee in ten days' time.

Co-Chair von Imhof discussed the agenda for the following day.

#

ADJOURNMENT

9:43:00 AM

The meeting was adjourned at 9:43 a.m.