

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

April 30, 2003

8:15 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Jim Whitaker, Co-Chair
Representative Cheryll Heinze
Representative Norman Rokeberg
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Vic Kohring
Representative Bruce Weyhrauch
Representative Peggy Wilson

OTHER LEGISLATORS PRESENT

Representative Paul Seaton
Representative Dan Ogg
Representative Ralph Samuels
Representative John Harris

COMMITTEE CALENDAR

PUBLIC EMPLOYEE RETIREMENT SYSTEM: ACTUARIAL VALUATION - GUY BELL

- HEARD [See 7:10 a.m. minutes for this date]

HOUSE JOINT RESOLUTION NO. 9

Proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit.

- HEARD AND HELD

HOUSE JOINT RESOLUTION NO. 26

Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from and inflation-proofing the Alaska permanent fund by establishing a percent of market value spending limit.

- HEARD AND HELD

PREVIOUS ACTION

BILL: HJR 9

SHORT TITLE:CONST AM: APPROPRIATION/SPENDING LIMIT

SPONSOR(S): REPRESENTATIVE(S)STOLTZE

Jrn-Date	Jrn-Page		Action
01/31/03	0102	(H)	READ THE FIRST TIME - REFERRALS
01/31/03	0102	(H)	STA, JUD, FIN
02/11/03		(H)	STA AT 8:00 AM CAPITOL 102
02/11/03		(H)	Heard & Held MINUTE(STA)
03/28/03	0687	(H)	COSPONSOR(S): ROKEBERG
04/04/03	0797	(H)	W&M REFERRAL ADDED BEFORE STA
04/09/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/09/03		(H)	Heard & Held
04/09/03		(H)	MINUTE(W&M)
04/17/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/17/03		(H)	Heard & Held
04/17/03		(H)	MINUTE(W&M)
04/24/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/24/03		(H)	Heard & Held
04/24/03		(H)	MINUTE(W&M)
04/29/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/29/03		(H)	Heard & Held -- Location Change --
04/29/03		(H)	MINUTE(W&M)
04/30/03		(H)	W&M AT 8:00 AM HOUSE FINANCE 519

BILL: HJR 26

SHORT TITLE:CONST. AM: PF APPROPS/INFLATION-PROOFING

SPONSOR(S): RLS BY REQUEST OF LEG BUDGET & AUDIT BY

Jrn-Date	Jrn-Page		Action
04/17/03	1025	(H)	READ THE FIRST TIME - REFERRALS
04/17/03	1025	(H)	W&M, JUD, FIN
04/22/03		(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/22/03		(H)	Heard & Held

		MINUTE(W&M)
04/24/03	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/24/03	(H)	Heard & Held MINUTE(W&M)
04/25/03	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/25/03	(H)	Heard & Held MINUTE(W&M)
04/29/03	(H)	W&M AT 7:00 AM HOUSE FINANCE 519
04/29/03	(H)	Heard & Held -- Location Change -- MINUTE(W&M)
04/30/03	(H)	W&M AT 8:00 AM HOUSE FINANCE 519

WITNESS REGISTER

ROBERT BARTHOLOMEW, Chief Operating Officer
Alaska Permanent Fund Corporation
Juneau, Alaska

POSITION STATEMENT: Testified in support of HJR 26 and answered questions.

RON LORENSEN, Attorney at Law
Simpson, Tillinghast, Sorensen, and Longenbaugh
Juneau, Alaska

POSITION STATEMENT: As outside counsel to the Alaska Permanent Fund Corporation, he testified in support of HJR 26 and answered questions.

JAY HOGAN, Deputy Director
Office of Management and Budget
Office of the Governor
Juneau, Alaska

POSITION STATEMENT: Testified on HJR 26 and answered questions.

ACTION NARRATIVE

[For the overview on the Public Employee Retirement System: Actuarial Valuation by Guy Bell, see the 7:10 a.m. minutes for this date.]

TAPE 03-19, SIDE A
Number 0001

CO-CHAIR JIM WHITAKER called the House Special Committee on Ways and Means meeting to order at 8:15 a.m. Representatives Hawker, Whitaker, Heinze, Rokeberg, Gruenberg, and Moses were present at the call to order. Also present were Representatives Seaton, Ogg, Samuels, and Harris.

HJR 9-CONST AM: APPROPRIATION/SPENDING LIMIT

CO-CHAIR WHITAKER announced that the first order of business would be HOUSE JOINT RESOLUTION NO. 9, Proposing amendments to the Constitution of the State of Alaska relating to an appropriation limit and a spending limit.

Number 0037

REPRESENTATIVE CO-CHAIR HAWKER moved to adopt committee substitute (CS) for HJR 9, Version 23-LS0435\H, Cook, 4/29/03, as the working document. There being no objection, Version H was before the committee.

[At this point there is a motion to adopt CSHJR 26, Version 23-LS1006\I, Cook, 4/29/03, as the working document. The discussion related to HJR 26 happens later, which is where the motion is noted.]

CO-CHAIR WHITAKER said HJR 9 is a constitutional appropriation limit, which is one of the components of a long-term budget solution. He told the members his intent is to move HJR 9 [out of committee] tomorrow.

Number 0346

REPRESENTATIVE ROKEBERG suggested an amendment to the [10] exemptions under subsection (a), Appropriation Limit, that would include appropriations for capital projects. He explained that there will be times when the legislature decides that investments in state infrastructure may be important. For example, the legislature may need to match abnormally high federal appropriations or use public works monies to help [recover from] an economic disaster. Having some flexibility with capital projects may be warranted, he said.

CO-CHAIR WHITAKER announced that the committee will take action on amendments tomorrow.

Number 0609

REPRESENTATIVE SAMUELS asked about the changes in Version H of HJR 9.

CO-CHAIR WHITAKER said he would prefer to answer those questions tomorrow, giving committee members time to review the CS.

CO-CHAIR HAWKER offered to summarize the differences between Version H of the committee substitute and the original bill.

Number 0649

REPRESENTATIVE GRUENBERG asked if the committee will be discussing the differences between the 4/16/03, Version D, and the 4/29/03, Version H, committee substitutes.

CO-CHAIR HAWKER recalled that the Version D draft was not adopted, although it was discussed. The substantive difference between the two versions is that in Version H on page 1, line 7, the option of a 2 percent increase in the base level of appropriations can be passed each year by a simple majority. Subsection (b) on page 2, starting on line 11, adds a second 2 percent [increase] that can be achieved with a two-thirds vote of each house; and the last 2 percent increment is subject to a three-quarters vote of each house of the legislature.

REPRESENTATIVE ROKEBERG pointed out that the budget could grow a maximum of 6 percent in one year.

CO-CHAIR WHITAKER suggested considering that increase in light of the presentation earlier today by Guy Bell, Director of Retirement and Benefits, Department of Administration. Given the rising costs of the Public Employees' Retirement System (PERS), the first 2 percent increase would have to absorb the increasing costs of the retirement fund.

CO-CHAIR HAWKER noted that the hurdles to achieve 4 and 6 percent increments are substantial with a two-thirds and then a three-quarters vote of the members of each house of the legislature.

Number 0847

REPRESENTATIVE GRUENBERG said on page 2, line 28, there appears to be a sunset in [FY] 2013. He added that there is a difference in language between the two proposed committee substitutes: on page 2, line 29 of Version H and on page 2, starting on line 28 in Version D.

CO-CHAIR WHITAKER suggested delaying these questions until the next meeting.

REPRESENTATIVE ROKEBERG said it might be helpful to compare the differences in the two committee substitutes with a chart or table.

Number 1051

REPRESENTATIVE GRUENBERG echoed Representative Rokeberg's concern that the legislature retain some flexibility in the capital budget. However, he said he is not sure how to do it in the constitution.

Number 1200

REPRESENTATIVE ROKEBERG asked if the legislature will be repealing the existing constitutional spending limit.

CO-CHAIR WHITAKER replied yes, the intention is to repeal it; however, he is not certain that it is in this draft of the resolution.

[HJR 9 was held over.]

HJR 26-CONST. AM: PF APPROPS/INFLATION-PROOFING

Number 1233

CO-CHAIR WHITAKER announced that the last order of business would be HOUSE JOINT RESOLUTION NO. 26, Proposing amendments to the Constitution of the State of Alaska relating to and limiting appropriations from and inflation-proofing the Alaska permanent fund by establishing a percent of market value spending limit.

[The following motion occurred at the beginning of the meeting, immediately after the motion regarding the adoption of the CS for HJR 9. The motion is as follows: REPRESENTATIVE CO-CHAIR HAWKER moved to adopt committee substitute (CS) for HJR 26, Version 23-LS1006\I, Cook, 4/29/03, as the working document. There being no objection, Version I was before the committee.]

Number 1346

RON LORENSEN, Attorney at Law, Simpson, Tillinghast, Sorensen, and Longenbaugh; testifying as outside counsel to the Alaska

Permanent Fund Corporation, testified in support of HJR 26 and answered questions. He told the members that a working group convened yesterday afternoon at the direction of Co-Chair Whitaker to review a couple of alternate formulations of language. The main focus was subsection (b) on the top of page 2 of the committee substitute draft. He explained that as a result of that discussion there was unanimous agreement as to what the appropriate substitution for the language in subsection (b) should be. He told the members that is what is before the committee now in the new work draft, Version I. Mr. Lorensen said that in order to make the title consistent with that change the title has been adjusted slightly. The last two words "over time" that were in Version H have been removed. Otherwise, he commented, the title remains the same. He noted that there is a minor change in Section 1 of the bill. The new language that has been provided changed the language in Version H from "Except as provided in (b) of this section", to the language in Version I which says, "Except as appropriated under this section". He said he believes this an appropriate change.

Number 1612

REPRESENTATIVE ROKEBERG commented that he does appreciate the efforts of Mr. Lorensen, Mr. Bartholomew, and Mr. Hogan, and the members who worked on the committee substitute. However, he maintained his discomfort with the objective. He said he understands the corporation's desire to give some assurance to the public that there will be some constraint on the part of the legislature in terms of determining what the appropriation should not exceed. Representative Rokeberg told the members he understands the political implications in offering the public some comfort; however, he is still not convinced that litigation might not rise out of this legislation if there were some disagreement in the amount appropriated by the legislature. It appears that while this language certainly preserves a policy objective of offsetting inflationary impacts and maintaining the real value of the fund, he said he is not sure that is the proper economic policy that the legislature should pursue. Representative Rokeberg emphasized that he does not disagree with the policy objectives put forth in the bill, but he is concerned about possible litigation.

REPRESENTATIVE ROKEBERG said he would prefer to have the bill's language default to that presented in Version D and would offer amendments that would eliminate the first sentence in subsection (b). He recommended that the committee and the corporation

focus on the statutory framework which needs to go with the amendment to be put forth before the people [of the state].

Number 1957

REPRESENTATIVE ROKEBERG told the members that he believes that in order for the people to understand this legislation, there will need to be more than a stand-alone constitutional amendment. He said that the policy issues the corporation puts forth, that he agrees with, can be addressed through the statutes, rather than the constitution.

REPRESENTATIVE GRUENBERG opined that there needs to be more discussion about this issue.

CO-CHAIR HAWKER commented that Representative Rokeberg's position is consistent with the conceptual vision of a long-range fiscal plan that was discussed in committee a couple of days ago. In those discussions the members envisioned an accompanying statute to explain what the legislative intent is regarding this constitutional amendment, as well as, what to do with the appropriations that would be made subsequent to this amendment. He summarized his comments by saying that he agrees with the position put forth by Representative Rokeberg.

Number 2235

ROBERT BARTHOLOMEW, Chief Operating Officer, Alaska Permanent Fund Corporation, testified in support of HJR 26 and answered questions. He told the members that Representative Rokeberg's statement does bring to focus one question that needs to be addressed, which is the purpose of the proposed language. Both the original version and Version I, try to blend the two sentences together so that there is one standard from which to weigh what should be appropriated from the permanent fund, instead of two [standards], he said. Mr. Bartholomew told the members that the board supports having one concept. The policy statement that this sentence makes is that it is important to maintain the real value of the permanent fund and protect it against inflation. He pointed out a question that needs to be answered by the committee and legislature. If the language is taken out and only the 5 percent spending limit remains, could there be policies stated in statutes that would be different than the policy statement here, of protecting the real value of the permanent fund, he asked. That is why the board believes it is important to have the language [in the constitution], and it is up to the legislature to decide if it is the policy it wants

also. He urged the members to focus on that issue and not move the policy statement to statute.

CO-CHAIR WHITAKER asked if the option provides that a mandatory 5 percent of the value [of the fund] will be allocated or up to 5 percent [will be allocated].

Number 2424

MR. BARTHOLOMEW replied that the when saying 5 percent will be allocated, he reads that as saying a mandatory 5 percent. There are other options. He commented that [the language should be] up to 5 percent may be allocated.

REPRESENTATIVE ROKEBERG replied that he completely agrees with Mr. Bartholomew that the amount should not exceed 5 percent. A policy call by each legislature would be required; however, there would be a cap on how much can be appropriated. He commented that there may be a tendency to default to the 5 percent. Representative Rokeberg told members he does not disagree with this policy, but the question is where to put it. If it is placed in the constitution, then it may give rise to litigation if someone thinks the legislature missed the target. He pointed out that the policy the legislature has used over the last 20 years has included inflation-proofing and protecting the fund which is in statute. Representative Rokeberg asked where the problem is. Perhaps it is with the public, he said. He emphasized that the corporation has done a wonderful job of creating and growing the fund; and the legislature has done a good job of keeping its hands off of the fund.

Number 2706

CO-CHAIR WHITAKER noted that Representative Rokeberg's concern is with the definition of real value and subsequent potential litigation. He asked if Representative Rokeberg is satisfied with the language that the appropriation may not exceed 5 percent.

REPRESENTATIVE ROKEBERG agreed. In response to Co-Chair Whitaker's request, Representative Rokeberg said he would provide an amendment to that effect.

Number 2744

JAY HOGAN, Deputy Director, Office of Management and Budget, Office of the Governor, testified on HJR 26 and answered

questions. He directed the members' attention to Section 1 where two key words: "principal" and "income" are being deleted from the constitution. This language has been in place since the [Alaska permanent fund] was adopted in 1976. According to the constitution the income was to be deposited in the general fund, but as Representative Rokeberg pointed out the legislature has not done that. Mr. Hogan said it was [the administration's] feeling that with the principal gone and with income gone, it would be appropriate to put the term "real income" in the constitution. This would become the standard for the percent of market value (POMV), as opposed to the standard of the previous concept which differentiated between and relied upon the concepts of principal and interest. He explained that the removal of these two terms are the strongest reason for inserting the words "real value".

REPRESENTATIVE ROKEBERG commented that Mr. Hogan's argument has merit.

CO-CHAIR WHITAKER stated for the record that Representative Harris had joined the meeting.

Number 3000

MR. LORENSEN stated that both he and Tamara Cook, Director, Legislative Legal and Research Services, agree that this language creates a single standard which is 5 percent [payout]. The introductory language is really an explanation of why the 5 percent is there. While it was an important issue for the board, it no longer provides that second, independent standard, he said. Mr. Lorensen said he believes that the only standard that is enforceable with respect to the actions of the legislature is the 5 percent POMV rule.

Number 3110

REPRESENTATIVE ROKEBERG said he believes that the courts would find that there are two standards in place one of which is [the 5 POMV] and the other is that real value is maintained.

MR. HOGAN, as a person who was there when this decision was debated originally, said it has always been a disappointment to him that the original concept of money flowing into the general fund really never happened. One of the main assumptions was that the permanent fund would be available at such a time as a legislature and governor felt it was necessary to draw upon it. By statute, the legislature has made use of the otherwise

provided by law, rather than money flowing into the general fund. He said he believes that the term "real income" is one that is generally understood within the financial world. He said a financial expert could appear in court and make a convincing argument that it does mean something. It could be shown to have a direct relation to what the legislature is trying to do, which is to protect the fund against inflation; thereby, only using the average real income of that fund which turns out to be 5 percent.

Number 3331

REPRESENTATIVE ROKEBERG asked Mr. Bartholomew about a hypothetical market situation in which there is a period of very high, double-digit inflation. He asked if the market typically acts negatively to inflationary trends and in turn drives the value down.

MR. BARTHOLOMEW responded that the executive director of the Alaska Permanent Fund Corporation has previously testified that what Representative Rokeberg described is a worst-case scenario. He said that has happened in the past when there is high inflation and dropping asset values.

Number 3433

REPRESENTATIVE ROKEBERG remarked that in a situation in which the corpus and principal of the fund was being eroded by a hyper-inflationary situation, which would also drive value down, this kind of language would mean the legislature would not be able to draw out any funds.

MR. BARTHOLOMEW replied that if the board was making a recommendation in a one- or two-year period such as the one Representative Rokeberg described, he said he believes the board's recommendation would be to take the long-term view and continue to recommend that the legislature would still be protecting the fund by allowing an up to 5 percent distribution. However, as Representative Wilson previously discussed, if this kind of situation lasted for five, eight, or ten years, then it would be prudent to review that. He emphasized that it is important to maintain a long-term view because there will be good and bad years in the future. The board looks at this in five-, ten-, and fifteen-year periods, and he believes the board would continue to recommend [the 5 percent payout].

Number 3626

REPRESENTATIVE ROKEBERG asked why the "over time" language was removed from the bill.

MR. LORENSEN responded that the "over time" language was removed as a result of the comments made by Ms. Cook yesterday. It was her view that "over time" is an ambiguous term and did not add anything to the bill.

CO-CHAIR WHITAKER commented that it is important to have the leeway to make judgments about language that would [minimize] potential litigation.

Number 3800

REPRESENTATIVE ROKEBERG pointed out that the easy way to avoid litigation is to payout 100 percent to dividends.

CO-CHAIR HAWKER commented that he is in agreement with Representative Rokeberg on the importance of the long-term view. He said that he is concerned that without the over time or long-term concept in this clause, there does not seem to be any indication that real value is to be measured over time; assuring that real value is being preserved could mean that there can never be a decline in value however temporary. This is a grave concern to him, he said.

Number 3911

MR. LORENSEN responded that he understands the concern Co-Chair Hawker raised. He commented that perhaps there is another way to describe that longer period of time without using the "over time" language.

MR. HOGAN told the committee that current state law describes what "income" from the permanent fund means. He said he thinks the statute in Alaska is the appropriate place to fill in the details and explanations of terms such as real income. He pointed out that the current statute describes income for the permanent fund. Mr. Hogan said he also believes that if it is the legislature's intention to have these two terms travel as a pair, then that presents a different legal argument at some point in time because the details of what the legislature is thinking is all included, if not in the constitutional amendment, in the statutes that accompanies it.

Number 4049

REPRESENTATIVE HEINZE commented that this is a delicate piece of legislation, and she expressed the need to make the language very clear so there is no question [as to its meaning].

REPRESENTATIVE HARRIS asked why the first line in Section 2(b) is included, as he believes it only serves to confuse the public. He said all that really needs to be said is that no more than 5 percent of the value of the fund averaged over five years is to be used as a stream of revenue. He reiterated his belief that the first line does not need to be in the bill at all.

Number 4241

MR. BARTHOLOMEW responded that the 5 percent was not included to take money off the table from the legislature. That first sentence addresses why 5 percent is used and that has to do with asset allocation and the investment philosophy of the permanent fund [corporation] which shows that there will be 5 percent in real income available for distribution over the long term. He commented that this [sentence] is explanatory language which could be related via the "record" rather than the constitution.

REPRESENTATIVE HARRIS opined that the words "ensure the real value" in that first sentence could be interpreted differently by lawyers. For instance, in a year in which the rate of return is less than 5 percent, the funds would actually be taken from the principal of the fund. He questioned whether the aforementioned would be interpreted as ensuring the real value of the fund. He told the members he believes [including this language in the bill] would be a bad thing.

Number 4519

REPRESENTATIVE GRUENBERG said in his experience courts construe constitutional provisions differently than statutes. Constitutional provisions are usually very short and very broad while statutes are normally more detailed. He used the analogy of a body in which the constitution forms the backbone, the statutes provide the skeleton, and the regulations provide the flesh while the agencies and the legal interpretations provide the meat, bone, and skin. Although this kind of language [Section 2(b)] generally would not be in a constitution, occasionally, it is. For example, in the [Alaska] Constitution the right to keep and bear arms [includes explanatory language] as follows:

A well regulated militia being necessary to the security of a free state, the right of the people to keep and bear arms shall not be infringed.

TAPE 03-19, SIDE B

REPRESENTATIVE GRUENBERG pointed out that the first phrase is the purpose section. He added that the constitution was amended to ensure that there was an individual right to keep and bear arms because the people of the state believed the proposed section might be unduly restrictive. He said it is important to be careful what is put into the constitution because it could later be used against [the purpose of the amendment]. He summarized his comments by saying there is precedent for placing [explanatory language in the constitution].

Number 4624

CO-CHAIR HAWKER noted that the Second Amendment has been one of the most heavily litigated, and may be a good argument in opposing the inclusion of this [explanatory clause].

REPRESENTATIVE GRUENBERG said he would like to examine the perceived problem that this language is intended to cure. He said he thinks the problem boils down to the question of how the legislature politically prevents the people from going into the corpus [of the permanent fund]. If the concept of the fund is changed to an endowment, there will be less concern if there is no dividend because it guarantees a payout. If this were not the case, there could be a need to go to the [corpus of the fund]. He asked Mr. Bartholomew if that is the primary purpose of the amendment.

MR. BARTHOLOMEW responded that is the secondary reason for the amendment. The primary reason, he said, is to assure that inflation-proofing of the fund moves from an optional annual appropriation to [mandatory] inflation-proofing. This would be done by moving [inflation-proofing] into the constitution and ensuring the fund's protection against inflation is the top priority. However, inflation-proofing could be done without achieving the second objective, which is to assure an annual distribution. He said it is the board's recommendation to achieve both objectives. This effect on the economy can go from zero to a billion dollars and is very dramatic.

Number 4314

REPRESENTATIVE GRUENBERG commented that he prefers options that allow the people who govern to use [whatever tools are available] to govern well, although that, too, is a risk because those that govern can do so badly. He stated that he is not a fan of dedicated funds and he does not support amending the constitution very often. The permanent fund is the exception to the rule, he said. If this amendment passes, this would more stringently dedicate funds by imposing more requirements. Although the dividend is not in the constitution, it might as well be because it is so politically protected. He pointed out that the legislature still has the legal option to do whatever is necessary to govern. He asked if there is a way to achieve these goals without amending the constitution, thereby giving the legislature the ability to do what it must at some future time when faced with unforeseeable circumstances.

MR. BARTHOLOMEW responded that the board believes that the proposed changes, which passed through the Alaska House of Representatives last year in a statutory version, proves two points. The statutory option to inflation-proof or not, truly does not improve the protection of the permanent fund, he said. The second objective, which would take out that word "principal" which would allow the legislature in a short-term down period to have an annual distribution, definitely cannot be achieved without amending the constitution. In summary, he said, the board believes these two objectives cannot be achieved without a constitutional amendment.

Number 3934

REPRESENTATIVE ROKEBERG asked if leaving the word "principal" in the first section while deleting all references to real value and inflation-proofing would send a message to the public that the principal would be maintained.

MR. BARTHOLOMEW responded that there is an attorney general's opinion that is currently being worked on to determine whether the permanent fund's historical interpretation of principal and income are accurate. Currently, there is no legal opinion saying that the legal interpretations are incorrect, he said, but by leaving the word principal in and removing the introductory phrase [out], this brings the members back to the proposal that was submitted to the legislature two years ago.

Number 3738

REPRESENTATIVE ROKEBERG pointed out that if the 6 percent override in HJR 1 was deleted, the committee would have the exact language he believes is needed now.

[HJR 26 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:20 a.m.