SENATE FINANCE COMMITTEE
June 11, 2021
1:33 p.m.

1:33:13 PM

CALL TO ORDER

Co-Chair Bishop called the Senate Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Senator Click Bishop, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Donny Olson
Senator Natasha von Imhof (via teleconference)
Senator Bill Wielechowski (via teleconference)
Senator David Wilson

MEMBERS ABSENT

Senator Lyman Hoffman

ALSO PRESENT

Senator Peter Micciche; Senator Mia Costello; Senator Josh Revak; Representative Kelly Merrick; Lucinda Mahoney, Commissioner, Department of Revenue; Mike Barnhill, Deputy Commissioner, Department of Revenue; Alexei Painter, Director, Legislative Finance Division.

SUMMARY

SJR 6 CONST. AM: PERM FUND & PFDS

SJR 6 was HEARD and HELD in committee for further consideration.

#sjr6
SENATE JOINT RESOLUTION NO. 6

Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund, appropriations from the permanent fund, and the permanent fund dividend.

1:34:32 PM

Co-Chair Bishop reviewed the meeting agenda. He recognized the senators in the room.

1:36:01 PM

LUCINDA MAHONEY, COMMISSIONER, DEPARTMENT OF REVENUE, asserted that the governor had developed a plan that would protect the Permanent Fund and enshrine the Permanent Fund Dividend (PFD) in the State Constitution, along with the Power Cost Equalization Fund (PCE), protecting the funds for future generations. She hypothesized that with the proposed 50/50 split would result in an estimated $3 billion draw from the ERA, and the generation of $300 million in additional revenues, which would position the state for a balanced budget within 5 years.

Co-Chair Bishop asked the presenter to hold for questions at the end of each slide.

1:38:16 PM

Commissioner Mahoney provided a PowerPoint presentation titled "Constitutional Amendment: Permanent Fund and Permanent Fund Dividends" (copy on file).

Commissioner Mahoney showed slide 2 titled "Goals":

1. Protect the Permanent Fund and Permanent Fund Dividend (PFD)
2. Determine Consistent PFD for Alaskans
3. Establish Strong Reserves
4. Achieve a Sustainable Balanced Budget

Commissioner Mahoney spoke to slide 3 titled "Comprehensive Fiscal Plan Steps":

Step One - First Special Session
- Permanent Fund Structural Fix – Permanent Fund, ERA, PCE Protected
- Establish Strong Reserves w/Bridge Funding
- Consensus on Deficit Size – Required Spending/Revenue Targets

Step Two - Second Special Session

- Revenue/Reduction Initiatives to Achieve Balanced Budget

Commissioner Mahoney clarified that "bridge funding" meant a one-time draw from the Permanent Fund Earnings Reserve Account (ERA). She spoke of landing on targets to determine necessary revenues for support. She said achieving a balanced budget would require further cuts to the operating budget.

1:41:26 PM

Co-Chair Stedman noted that the committee had a process to go through which it would maintain. He considered that one operation would not fix all problems. He thought clearly step one would not be successful as the legislature would be adjourning the following week and there was much work to be done. He thought it would be helpful to have the Department of Revenue (DOR) to come back with more structure detailed for the different phases outlined on slide 3. He expressed concern over the timing of the events listed on the slide. He noted that there were issues other than the PFD that Alaskans wanted constitutionally protected such as, education and public safety.

1:43:17 PM

Commissioner Mahoney referenced slide 4, "Permanent Fund: Endowment Structure":

- It's time for a true Permanent Fund endowment.
- Endowment approach is an internationally accepted best practice.
- Stabilizes both revenues and the PFD with a smoothed five-year average.
- Limits government spending at 50% of the 5% POMV draw.
- Protects Power Cost Equalization (PCE) by depositing the PCE endowment (~$1.1B) into the Permanent Fund.
- Constitutionally protects Permanent Fund & PCE for future generations.

Commissioner Mahoney emphasized that that the trustees supported the endowment plan.

1:45:10 PM

Co-Chair Stedman wanted further definition of why 5 percent had been chosen. He referenced projections from Callan and Associates indicated that the rate of return was lower for following decade.

Commissioner Mahoney deferred the question to the DOR deputy commissioner.

1:46:05 PM
AT EASE

1:46:32 PM
RECONVENED

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, addressed Co-Chair Stedman's question with respect to the 5 percent distribution. He stated that the Permanent Fund Board of Trustees supported 5 percent being put in the constitution. He explained that the 5 percent number had been controversial. He said that for the past few years there had been a bull market and there were concerns that it would not persist into the next 10 years. He noted a market crash in 2020, which recovered rapidly, and currently the fund was experiencing positive returns. He said that it was premature to reduce the 5 percent rate and that the fund would grow at the rate of inflation. He said that inserting "not more than" before 5 percent in the bill language would allow the legislature to choose a lesser number.

1:49:29 PM

Co-Chair Stedman recalled that the initial figure when POMV was established was 5.25 percent, which dropped to 5 percent. He expressed concern about declining returns for the next decade, which could result in a 5 percent draw rate taking the potential for growth from the fund. He thought there would be years with lower returns and before the rate was set as proposed, it was important to have conversations about setting the rate to maximize the outflow. He was leery of locking in a number that allowed for no margin and could stifle the growth of the fund. He thought more modeling should be done to determine the best interest of the fund and not the spending appetite of the legislature.

Senator von Imhof understood Co-Chair Stedman's concern about the 5 percent rate. She thought currently the choice was more of an academic exercise since there was such a long way to go to implement a plan such as proposed in SJR 6. She thought that taking 50 percent of the percent of market value (POMV) draw would yield more than a billion-dollar deficit, which she believed what a more immediate issue.

1:53:59 PM

Co-Chair Bishop asked about the proposal to deposit the PCE Fund into the Permanent Fund and the earnings used on the 50/50 calculation. He asked whether the change meant that half of PCE earnings would be used for PFDs.

Commissioner Mahoney stated that the intent was that the PCE would become part of the Permanent Fund and the 50 percent would be drawn from the fund total.

1:55:00 PM

Commissioner Mahoney turned to slide 5, "Permanent Fund Dividend: Consistency":

Current Challenge:
- Public Mistrust: Too much spending on Government
- Political Impasse: Results in a PFD Based on Politics - Not Laws

Solution:
- Restore Public Trust: Consistent PFDs and Spending Limits
- Establish a Fair Resolution: 50/50 Split
- Constitutionalize PFD

Commissioner Mahoney addressed the graph entitled "Historical Dividend Payments," which showed PFD payments since the first dividend in 1982. She drew attention to the green line, which represented the statutory calculation for the PFD. She said that the red line was representative of the diverging from the statute that occurred in the determination for the dividend amount. The governor's proposal was signified by the dashed line. She said that there were many schools of thought surrounding the dividend. She contended that there was public mistrust surrounding the use of the fund’s earnings. She said that

the governor's proposal was representative of his philosophy.

Co-Chair Bishop referenced public mistrust and pointed out that individuals did not have the information that members had. He referenced the $4.9 billion the legislature had moved into the corpus of the fund, which protected the money for future generations. He highlighted the proposed transfer of $4 billion into the corpus currently included in the budget under consideration by the conference committee. He noted that the legislature had moved $7 billion total into the corpus for protection and had never drawn from the fund for government use until the passage of the POMV.

1:58:23 PM

Co-Chair Stedman recalled that when the Permanent Fund started, the asset allocation was different. He stated that in the beginning when 50 percent went to dividends and 50 percent went to the state, the state had reinvested its percentage. He asked Commissioner Mahoney to discuss the history of the fund surrounding the state reinvestment.

Mr. Barnhill offered to provide a quick history. He relayed that first Permanent Fund statute had been enacted in 1980, limiting investment of fund assets to fixed income. Unfortunately, the interest rates were skyrocketing, and trustees were concerned about eroding principal value, so they requested permission to invest in equities. Also, in 1980, the only cash that went out of the Permanent Fund was for bonds and PFDs. There was no transfer of realized capital gains from sale of assets. In 1982, the legislature had amended the statute, which enabled net realized capital gains to move to the undistributed income account. He stated that with the change came the understanding that anything in the form of capital gains would potentially erode the inflation adjusted value of the assets, which lead to an inflation proofing adjustment. Inflation proofing of the fund began in 1982.

Mr. Barnhill continued his remarks. He related that over the period of 1982 to 2006, the legislature gave the Alaska Permanent Fund Corporation (APFC) more latitude on the types of investments it could invest in; however, there was always a legal list until the early 2000s. In the early 2000s institutional funds began discarding their legal

lists and embracing the "prudent investment rule." The legislature adopted the rule in 2006 and the fund had maintained full control of investment choices since that time. Since 1982, there had always been an inflation appropriation back to the fund to ensure the fund principal kept up with inflation.

2:02:30 PM

Mr. Barnhill continued discussing the history of the Permanent Fund. He stated that the enactment of SB 26 in 2018 nearly converted the fund into a full endowment. He explained endowment methodology and the current practice of the fund.

Co-Chair Stedman reiterated that the state had not taken its 50 percent out for nearly 40 years but had reinvested the money in the portfolio of the fund, which had grown the fund and increased the size of dividends paid out to residents.

Co-Chair Stedman requested numbers that reflected what the fund and dividend stream would have been if the state had never reinvested the 50 percent. He asserted that the dividend stream on the chart was grossly distorted when the state’s reinvestment was considered.

2:05:14 PM

Mr. Barnhill offered to bring back any data requested by Co-Chair Stedman. He stated that the legislature intended for some portion of the 50 percent to go to inflation proofing. He recognized that there was excess after inflation proofing that the state never appropriated for another purpose, which had allowed for the fund to grow over-time.

Senator Wielechowski understood that under the proposal, the PFD in 2021 would be $2,354. He asked what the statutory dividend would be.

Commissioner Mahoney responded that under the proposal, the PFD would be $2,354 in FY 22; the statutory amount would be $3,064.

Senator Wielechowski asked how much money from the ERA would be needed to bridge the gap between the proposed plan and statute. He considered $700 million.

Commissioner Mahoney replied $700 million sounded correct.

Mr. Barnhill interjected that in the most recent projection, there was an estimated $2.3 billion for statutory dividends, which meant the figure would be closer to $800 million.

2:08:03 PM

Senator Wielechowski understood that the projected amount for oil tax credits was $762 million.

Commissioner Mahoney affirmed that the number was correct.

Senator Wielechowski observed that if the deductible oil tax credits were eliminated there would be funds to pay out a statutory dividend.

Commissioner Mahoney replied in the affirmative.

Senator von Imhof wanted to address a comment about inflation. She said that the fund was invested as a whole, so inflation was being invested the same whether it was in the corpus or the ERA. She stated the reason to move inflation from the ERA into the fund corpus was because the legislature did not have the ability to withdrawal inflation or annual earnings from the ERA. She remarked it was inaccurate to say the fund would be less or more because inflation had not been moved.

Co-Chair Bishop recognized Representative Kelly Merrick in the room.

2:10:19 PM

Senator Wielechowski spoke of the Ballot Measure 1 oil tax debate. He had not seen any bills on behalf of the governor to fix the oil tax structure. He asked why the governor had not proposed any legislation to eliminate oil tax credits, which would free up funds for dividends.

Commissioner Mahoney stated that for 2022, the governor had proposed payment for the statutory amount of oil tax credits.

Co-Chair Stedman clarified that the $114 million in the governor's proposed budget was to pay a liability on the books of approximately $730 million. He thought the state needed to parse liability from previous credits created and put against the treasury compared to future credits. He remarked there was a per barrel credit that was an ongoing issue in the profit side of the severance tax. He thought the liability issue related to the ~$730 million was a different issue.

2:12:26 PM

Commissioner Mahoney considered slide 6 titled "Permanent Fund Dividend: Consistency":

- Alaskans deserve certainty concerning annual PFD payment.
- State needs PFD consistency to attain budget stability and sustainability.
- Absent certainty, determining future achievable revenues/reductions is difficult and may result in over/under collecting/taxing.
- 50% POMV dividend is an equitable distribution of Alaska's wealth between its citizens and government.
- Resolving the PFD allows a discussion of required revenues/reductions to close the remaining budget gap (Fall Special Session)
- Redirects the legislative conversation to growing Alaska vs. debating PFD.

Commissioner Mahoney stated that the point of the slide was to illustrate the need for consistency with regard to the PFD.

Co-Chair Bishop asked whether the state would be better served to take a $1 billion draw per year rather than $3 billion all at once.

Commissioner Mahoney stated that while there was a $3 billion bridge requested to solve the fiscal issue, the funds could be drawn as needed so that the dollars could remain invested in the fund.

2:15:55 PM

Commissioner Mahoney displayed slide 7 titled "Bridge Funding":

- One-time use of our strong financial asset – the Permanent Fund - positions Alaska for long term fiscal sustainability
- With $3.0 billion in bridge funding from the ERA, a forecasted FY25 fiscal gap of ~$300M can be managed with a combination of revenue measures and spending reductions
- Other endowments are considering one-time increases in draws to capitalize on exceptional market performance:
- Harvard's $42 billion endowment increased from 5% to 7.5% on one-time basis
    - https://www.thecrimson.com/article/2021/5/3/draw-further-endowment-fy22/
    - https://www.nytimes.com/2020/06/02/arts/endowments-coronavirus.html
- This plan avoids the need for a new broad-based tax
- Constitutionalizing a 5% POMV prevents overdraws in the future

Commissioner Mahoney pointed out that with the deposit of $1.1 billion from PCE into the fund, the net reduction to the fund would be $1.9 billion. She spoke of fiscal challenges due to COVID-19.

Commissioner Mahoney relayed that Mr. Barnhill had some research to share regarding COVID-19 and the economy.

2:17:52 PM

Senator Wilson asked whether the state would need $300 million or $500 million total to bridge the state through FY 26.

Commissioner Mahoney replied that the $300 million had been developed based on the 10-year fiscal plan that was submitted with the budget. The 10-year fiscal plan had incorporated $200 million in reductions to the operating budget in FY 23 and FY 24. The administration had assumed that those reductions were a given, but not everyone looked at it that way. She said that the model, based on the governor's philosophy and policy decisions, recognized that

an additional $300 million in revenues or reductions would be needed in addition to what was presented in the 10-year plan.

2:19:32 PM

Senator Wilson considered the idea of a broad-based tax. He thought that each working person in the state would end up paying $2,100 in tax to fill the $500 million gap.

Commissioner Mahoney was not familiar with the thought exercise.

Senator Wilson explained a broad-based tax would need to be paid by each working Alaskan, ranging from $1,300 to $2,100, in order to fill the gap and provide for a $2,300 dividend.

Commissioner Mahoney stated that the governor's plan did not incorporate a broad-based tax of any sort, and there had been no calculations such as the ones suggested by Senator Wilson. She said that the governor’s plan assumed a different approach to fill the gap.

Co-Chair Bishop asked when the governor might share his plan with the legislature.

Commissioner Mahoney believed the plan would be shared during the August 2021 special session.

2:21:17 PM

Co-Chair Stedman considered the $300 million to be a raid on the Permanent Fund. He referenced the statutory spending cap that allowed a draw of only 5 percent from the fund. He was cautious about overdrawing the Permanent Fund. He contended that taking $3 billion from the fund would affect future generations of Alaskans and the future of the fund. He hoped to have further conversation on the issue. He emphasized the need to protect the Permanent Fund and reminded the committee that it had saved and spent billions of dollars from the Constitutional Budget Reserve (CBR). He recognized that the administration was not suggesting any broad-based tax.

Co-Chair Stedman addressed budgetary reductions and noted that the operating budget had not been reduced since the

second year of the former Walker administration. He noted that the committee had struggled with the operating budget, which was flat funded. He was curious where the reductions in the governor's budget could be found. He wanted to see where the proposed budget reductions were by department, including debt service, fund capitalizations, and retirement. He did not believe $500 million could be cut from the budget or it would have already been done.

2:25:52 PM

Co-Chair Stedman emphasized the need to embrace reality. He explained that budget reductions made in the past to the University and the Alaska Marine Highway System had been added back with retirement payments and the Department of Corrections. A net zero to the state.

Co-Chair Stedman was curious about the governor's proposed revenue sources. He was not excited about taxes. He thought operating costs should be flat. He said that there were clear structural problems with the state's oil taxes. He discussed moving cash flows that warranted review to assure sure that the system was as fair as it was before former President Trump lowered corporate income taxes. He was not interested in legalizing gambling or sex-work. He looked forward to finding a solution. He stressed that once the Permanent Fund was breached for $3 billion it would be mined for more funds in the future. He reiterated the need to give future Alaskans an intact Permanent Fund and the importance of not spending all the wealth of the oil basin in our lifetime. He commented that things were improving financially.

2:29:29 PM

Senator Olson acknowledged Mr. Barnhill's credentials and experience. He echoed Co-Chair Stedman's comments about the billions that he, Co-Chair Stedman, and a previous finance committee had worked to reinvest in the CBR, only to have it spent by a finance committee of a different make up during a past session. He thought the proposed "bridge funding" was a non-starter and that there was little to no support for the idea at the table.

Mr. Barnhill discussed the workings of endowment funds; how endowment funds worked, how popular they were, and how they had weathered COVID-19 in terms of spending increase

percentages. He said that the 5 percent rule was being examined elsewhere and discussions were occurring concerning limited or one-time adjustments being made to meet the challenges presented by COVID-19.

2:33:30 PM

Co-Chair Stedman stated that one could always justify spending money for the good of the public. He thought it came down to the prudency factor. He understood that it was difficult to say no to the public. He recalled the robust markets in the 1990s when shortsighted choices had been made in the management of Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS), which had resulted in $10 billion in liability. He remarked that when working with long averages in the financial market - skimming off the top in strong years, while the return regresses to the mean in the slim years - would destroy a portfolio.

Co-Chair Stedman noted that the $3 billion was not going to be set aside while the market readjusted so the state could buy in at a lower rate. He contended that the $3 billion would be taken out and spent. He reminded the committee of the excessive PERS and TRS liability. He did not believe that turning the Permanent Fund into an endowment would be comparable to an endowment of an ivy league school as suggested by Mr. Barnhill.

2:37:02 PM

Senator Olson suggested Mr. Barnhill continue with his thoughts.

Mr. Barnhill stated that the sustainability of the fund was of paramount consideration. He said that the governor's plan managed the needs of the present with the sustainability that protected the future.

Co-Chair Bishop noted that the commissioner had implied that people relied on the PFD for basic needs. He said that everyone in the room agreed on that point. The question was how to get to a sustainable solution.

Commissioner Mahoney pointed out that the governor recognized that there were many different opinions and more than one way of making the budget work. She offered that

the governor was open to all suggestions. She stated that the current presentation was the starting point for a conversation.

2:39:19 PM

Commissioner Mahoney highlighted slide 8 titled "Bridge Funding":

- As the Permanent Fund grows, so does the POMV which closes the deficit organically.
    - 2022 POMV: $3,069.3
    - 2030 POMV: $4,171.8
- The gap closes significantly due to increased POMV revenues

Commissioner Mahoney looked at slide 9 titled "Establish Strong Reserves":

- Reserves are essential to manage State's revenue volatility
- ~66% of UGF is POMV – Lagged five-year smoothing reduces market risks
- ~27% of UGF is Oil – Price volatility presents near term risk. This 27% will decrease over time as the Permanent Fund and POMV grow.
- $1.0 billion in reserves can assist near term volatility over two fiscal years.

Commissioner Mahoney addressed the graph on slide 9, which represented what the CBR would look like in the future with the bridge funding only. The dashed line represented the minimum balance of reserves that were needed. The circled area represented the timeframe in which new revenues and reductions were needed to be sustainable. The $1 billion had been developed by examining revenues such as POMV, which was smoothed over a rolling five-year average and provided some certainty. She highlighted the volatility of oil revenue, which represented 27 percent of the state's revenue.

2:43:17 PM

Commissioner Mahoney addressed slide 10, "Achievable Revenue/Reductions":

- $3.0 billion in bridge funding provides time to transition into a sustainable fiscal plan.
- Revenues/Reductions of $300 million are needed by FY24-25 to balance budget and maintain sufficient reserves
- Absent new revenues/reductions the CBR balance will fall below $1.0 billion

2:43:56 PM

Co-Chair Stedman struggled with the reality of the proposed expenditure reductions. He asserted that to reduce agency costs statutory changes had to be made. He required more detail surrounding real expenditure reductions.

Co-Chair Bishop stated his understanding that the expenditure reduction detail would be presented in the August special session.

Commissioner Mahoney relayed that the objective of the August special session was to talk about solutions. She remarked that the administration was open to the legislature's suggestions beforehand.

Co-Chair Stedman stressed that the legislature could not come up with solutions, that solutions needed to come from the administration. He expressed concern that the administration did not have a plan, or any solutions, to bring before the committee. He shared the process the legislature had gone through to compose a transparent budget.

2:47:28 PM

Senator Wilson clarified his understanding that anytime the presentation referenced $300 million, it really signified $500 million.

Commissioner Mahoney replied that if the $200 million from the 10-year plan was considered, the number was $500 million.

Senator Wilson asked about the likelihood the administration would provide the legislature with the information it needed by August. He wondered whether the administration had a 100 percent certainty that all proposals and plans would be ready by August 1, 2021.

Commissioner Mahoney thought the question was difficult to answer because she was not sure what the legislature needed. She said that she could honor requests. She could not identify a percent of certainty.

Senator Wilson commented that he thought the committee was hearing the fourth presentation from the administration in which the same questions and themes had arisen. He related that he had hoped for more from the administration in the way of solutions. He emphasized that the legislature needed more information form the administration to make sound fiduciary decisions for the state. He believed that past use of the ERA had been unnecessary due to high oil revenues. He thought that there were oil tax credits that could be changed but that previous concepts and statute changes had taken years and not 30 days. He felt that the sooner the administration made details on revenues or cuts available to the legislature, the better.

2:51:16 PM

Senator von Imhof wanted to build upon Senator Wilson's comments. She reiterated that approximately $300 million in revenue was needed, and $500 million in reductions.

Commissioner Mahoney stated that amounts were not correct.

Senator von Imhof asked whether the commissioner could provide clarification on the numbers needed in terms of budget cuts and new revenue.

Commissioner Mahoney stated that the 10-year plan expenditure component included $200 million in reductions to the budget. As the fiscal plan was developed, it had been determined that an additional $300 million would be needed to close the fiscal gap. The $200 million in expenditures and the $300 million in either expenditures or revenue was a combined $500 million.

Senator von Imhof thought she was looking at the numbers differently. She considered the current budget prepared by the legislature, which was balanced before paying out dividends. She said that as soon as dividends were added the state went into deficit spending. She related that with the governor's numbers, half of the POMV draw was taken for the PFD. She thought that the current draw would be $3

billion, half of which was $1.5 billion. She asserted that, using the governor's numbers, if $1.5 billion was taken from the $3 billion the state was left with a $1.5 billion deficit. She summarized that taking 50 percent of the POMV off the top would yield a $1.5 billion deficit. She did not understand how $500 million total could close the fiscal gap, particularly when the governor's numbers had shown otherwise.

2:56:00 PM

Commissioner Mahoney advanced to slide 11 titled "Achievable Revenue/Reductions." She thought the slide could help with Senator von Imhof's questions. She noted that the following slide provided the numbers to support the graph shown on slide 11. She stated that the orange bars on the graph illustrated the anticipated POMV growth thorough 2030.

Commissioner Mahoney explained that the following slide would provide numbers to support the graph. She pointed out to the committee that the blue lines represented traditional revenues, which grew small into the future. The revenues that drove the success of the model were the POMV revenues, which were projected to grow significantly over time due to the larger starting balance of the fund. The yellow on the graph represented the CBR draw proposed by the governor. The funds would be used over time to bridge the state through anticipated deficits. The gray area represented new revenues and reductions. The green line represented expenditures.

2:59:06 PM

Co-Chair Bishop asked how much analysis was put into the scenario depicted on the graph.

Commissioner Mahoney affirmed that a Monte Carlo simulation had been run. She wanted to confirm the information with Dan Stickel, the department's chief economist, who had run the scenarios.

Co-Chair Bishop asked if he was online for questions.

Commissioner Mahoney replied in the negative. She offered to get back to the committee.

3:00:00 PM

Commissioner Mahoney looked at slide 12 titled "Financial Details":

- $3.0 billion in bridge funding provides time to establish achievable revenues/reductions.
- Beginning in FY2024, $150 million to $300 million in revenues/reductions balances the budget and begins to grow reserves.

Commissioner Mahoney noted that slide 12 showed the numbers that correlated with the graph on slide 11. She asserted that mathematically, the model worked. She said that the difference between the model and those done by LFD, were different assumptions and different inputs. She shared that what was represented on the slide was the governor's philosophy and policy measures related to how the structural deficit would be fixed.

Commissioner Mahoney said that the POMV in a 50/50 split environment was reflected in FY 22 as 50 percent. She stated that the $4.6 billion represented the governor's proposed budget. She noted that the CBR grew overtime and stayed above the $1 billion target throughout the model. The plan supported a 50/50 dividend for Alaskans of $2,354 in FY22, growing to $3,000 in FY30. She added that FY24 and FY 25 reflected the need for new revenues and reductions. The necessary additional revenues were $150 million in FY 24, increasing to $300 million in FY 25. The graph incorporated the bridge funding in FY 22, which was why the CBR balance increased. She relayed that the last line assumed the starting point for determining the POMV at the end of FY 21 of $77.6 billion of the Permanent Fund. She said that the fund balance was currently $81 billion. She stated that when the model was updated the June 2021 balance would be used to recalculate what the POMV revenues would be in the future. She thought that the revenues would increase due to the increased starting point.

3:03:25 PM

Co-Chair Bishop asked whether the proposal included a $2 billion draw from the ERA and $1 billion from PCE to get to the $3 billion total.

Commissioner Mahoney stated that the net effect to the Permanent Fund was $2 billion in regard to a reduction. She said that $3 billion would be drawn to enable fiscal sustainability but $1 billion would be deposited, the net reduction to the fund would be $2 billion.

3:04:12 PM

Co-Chair Stedman observed that when looking back on flat budget since FY 17, the legislature had struggled with budget reductions. He thought the proposed 10-year plan would be a flat budget when considering the numbers on the slide, which he felt was unrealistic. He remarked that there were salary increases and contract negotiations that pushed the budget up. He thought a flat operating budget over 13 years was hard to imagine. He wanted to see more agency detail in the forecasts.

Co-Chair Stedman expressed concern about a projected linear balance for the Permanent Fund. He wanted adjustments to the models to incorporate real market returns. He thought that if budget reduction or tax increases did not happen the Permanent Fund would be in jeopardy. He worried that the proposal could result in a tax burden that would fall on state residents.

3:08:00 PM

Commissioner Mahoney thought Co-Chair Stedman raised several good points. She asserted that there were ebbs and flows related to debt from year-to-year. She thought it would be important to discuss budget details in the August special session.

Co-Chair Bishop whether Commissioner Mahoney could have Mr. Stickel provide the failure rate from the model analysis. He noted that the capital budget had yet to be discussed. He looked at the numbers on the slide and felt that the numbers failed to approach the 1 percent replacement rule for the deferred maintenance on the state’s assets.

3:09:54 PM

Commissioner Mahoney showed slide 13 titled "Financial Considerations":

Upside Fiscal Benefits:

- Increased PERS & TRS investment earnings of approximately $5.0 billion may reduce unfunded liabilities ($6.5 billion) and decrease the State's future assistance payment (FY22 payment = $336.2 million).
- Gains will be smoothed over five years per policy
- Potential for decreased state assistance in the future use of Federal stimulus to offset Unrestricted General Fund (UGF).
- Lapsing funds are not taken as savings - the state lapses tens of millions of unused funding back into the general fund every year
- Maintaining downward budget pressure to reduce programmatic formulas
- Market returns in excess of 6.25% projection

Downside Risk:
- Inflation increases
- Market correction decreasing Permanent Fund and Retirement Trust values
- Failure to realize downward pressure on budgets
- Oil price and volume volatility

This presentation presumes a "mid-case" scenario. There are multiple events that are not considered in these numbers that could drive increases or decreases in the state's budget position. For this reason, several hundred million in expected budget savings have not been included before they are realized.

Commissioner Mahoney discussed forecasts and the inherent changeability due to unforeseen circumstances. She noted that there were lapsing funds that were not incorporated into the numbers. She added that the downsize risk was not incorporated into the model. She noted that the state's retirement funds had performed well and maintained healthy balances. She suggested that after actuarial analysis, the state could reduce its contribution rate relating to those funds, which would be a reduction of state expenditures. She said that the governor's philosophy was to continue to seek out budget cuts. She said that when the model was updated in August 2021, the inflation assumption would be changed if necessary. She asserted that the forecast was a starting point for conversation.

3:13:24 PM

Commissioner Mahoney referenced slide 14, "$3.0B Bridge Funding, 50/50 PFD":

- The above graphs depict the impact of the bridge fund distribution ($3.0 billion CBR transfer, $1.1 billion PCE deposit, $1.9 billion net) on the POMV and the Permanent Fund Balance

Commissioner Mahoney stated that the slide, with two graphs, was a representation of what the POMV impact would be as a result of the $2 billion draw. She pointed out that the graph on the right represented the change in Permanent Fund balance. She shared that the department had reformatted their graphs to mirror Legislative Finance Division (LFD) graphs.

3:14:32 PM

Commissioner Mahoney turned to slide 15 titled "Summary, Governor's Plan: Financial and Political Solution":

- Constitutionally protect Permanent Fund and PFD
  - Limit annual draw to 5% POMV
  - Dedicate 50% of POMV to PFDs
  - Combine Principal and Earnings Reserve Account into one endowment
- Constitutionally protect Power Cost Equalization
  - Deposit PCE endowment ($ into Permanent Fund
  - Dedicate revenue to equalize power costs in Alaska
- Provide bridge to balance budgets through FY2025
  - Transfer $3 billion from ERA to CBR
- Discuss achievable revenues/reductions in Second Special Session

3:14:55 PM
AT EASE

3:15:09 PM
RECONVENED

Co-Chair Bishop shared that the committee would abbreviate the presentation in the interest of time. He moved to a presentation by the Legislative Finance Division (LFD).

ALEXEI PAINTER, DIRECTOR, LEGISLATIVE FINANCE DIVISION, provided a PowerPoint presentation titled "Analysis of

Governor's Fiscal Plan" (copy on file). He began on slide 2 titled "Review of LFD Baselines":

- In LFD's Overview of the Governor's Budget back in January, we presented two budget baselines: current law and current policy. These are designed to provide a neutral starting point for the year's budget discussions, separate from any policy choices made in the Governor's budget request.
- Our fiscal modeling is currently based on versions of the FY22 budget that are very similar to those baselines.
- Legislative Finance's fiscal model is designed to show policy makers the longer-term impact of fiscal policy decisions.
- The baseline assumptions are essentially that current budget levels are maintained, adjusted for inflation.

Mr. Painter reviewed the division's budget baselines.

3:17:10 PM

Mr. Painter turned to slide 3 titled "Review of LFD Baselines (cont.)":

Revenue Assumptions

- LFD's baseline revenue assumptions are the Department of Revenue's Spring Revenue Forecast.
  - This assumes $61 oil in FY22, growing with inflation in future years.
  - DNR oil production forecast projects that Alaska North Slope production will increase from 459.7 thousand barrels per day in FY22 to 565.5 thousand barrels per day in FY30.
- For the Permanent Fund, we assume actual FY21 returns through the April 30 APFC statement and Callan's 6.20% assumption for FY22 and beyond.

3:18:05 PM

Mr. Painter addressed slide 4 titled "Review of LFD Baselines (cont.)":

Spending Assumptions

- For agency operations, we are currently using the Senate's first committee substitute as our baseline

($3,872.7 million UGF), growing with inflation of 2.0%.

- This budget is used because it did not include any one-time fund sources present in other versions of the budget, so it represents a reasonable starting point.
- This number is very close to our Current Law and Current Policy baselines from January.

• For statewide items, our baseline is to assume that all items are funded to their statutory levels.

- This includes School Debt Reimbursement, the REAA Fund, Community Assistance, oil and gas tax credits, and the PFD.
- We also include a baseline Fund Transfers amount that represents the ongoing cost of DEC's Spill Prevention and Response program.

• For the capital budget, we assume the Senate's first committee substitute ($176.7 million UGF) growing with inflation of 2.0%.

- This budget is used because it represents the Governor's original amended request without one-time fund sources.

• For supplementals we assume $50.0 million per year. This is based on the average amount of supplemental appropriations minus lapsing funds each year.

3:20:39 PM

Mr. Painter reviewed slide 5 titled "Comparison of Governor's 10-Year Plan to LFD Baselines":

• The Governor's 10-Year Plan for the budget makes several policy choices to reduce spending:

- 50% funding of school debt reimbursement and REAA Fund capitalization;
- $65.7 million less UGF agency operations in FY22 than original Senate budget;
- $100 million of additional reductions in each of FY23 and FY24;
- Grows agency operations in FY24+ at 1.5% rather than with inflation; and
- Supplementals and lapse are assumed to balance out.

• See handout entitled "OMB and LFD Fiscal Model Assumption
Comparison."

- This level of budget reductions is not unattainable, but these are significant policy choices.

Mr. Painter noted that the $65.7 million less in UGF agency operation in the governor's budget consisted of one-time fund source changes that were reversed in subsequent years, which meant the ongoing impact was less. He stated that there were some policy choices made by the governor to reduce the budget, that were not reflected in the baseline. He remarked that the governor's proposed $100 million reductions in FY 23 and FY 24 did not account for inflation. He referenced a handout titled "OMB and LFD Fiscal Model Assumption Comparison" (copy on file) showing the difference in the LFD baseline assumptions and the OMB 10-year plan with an item-by-item comparison. He noted that the proposed level of budget reductions was not necessarily unattainable, but the proposals were significant policy choices. There had been annual debates in the legislature over how to fund school debt reimbursement, the Regional Educational Attendance Area (REAA) Fund, and other items. He relayed it was not the default or baseline to assume the reductions would happen.

3:23:14 PM

Mr. Painter looked at slide 6 titled "Comparison of Governor's 10-Year Plan to LFD Baselines (cont.)." He noted the negative numbers in the table reflected where the governor's 10-year plan was below the LFD baseline and positive numbers (appearing only in FY 22) reflected where the governor's plan was higher. He pointed to the top line showing agency operations and noted it contained the bulk of the difference between the governor's plan and the LFD analysis. He highlighted -$65.7 million in FY 22 that grew over subsequent years due to the $100 million reductions versus LFD's assumption of growth with inflation. The number continued to grow with inflation over time due to the difference in the lower base and the different rates of inflation (2 percent versus 1.5 percent). He pointed to a $3.1 billion difference in total (agency operations) spending [through FY 30].

Mr. Painter moved to the second line in the table on slide 6 showing the statewide difference between the governor's proposal and the LFD baselines. He highlighted that the governor's numbers were approximately $1.1 billion below the LFD baseline. He explained much of the difference was

reflected in the governor's 50 percent funding of school debt reimbursement and the REAA Fund as well as reduced funding for community assistance in the first couple of years of the plan. He detailed that part of the difference was a technical difference in retirement funding. He elaborated that the governor was using the official Alaska Retirement Management Board (ARMB) numbers, while LFD's analysis used the board's draft numbers from December, which were slightly higher. He noted ARMB would meet the following week to adopt the official numbers. He assumed that after the numbers had been adopted OMB and LFD's numbers should align.

Mr. Painter addressed the capital budget difference on slide 6. The governor's proposed capital budget was higher by $56.5 million [for FY 22]. In subsequent years the governor's plan used $150 million growing with inflation, while LFD used $176 million growing with inflation. He moved to the fund transfer line of the table and noted that after FY 22 the governor's plan and LFD agreed on fund transfers. He briefly mentioned the difference in supplementals at the bottom of the table. The total difference between LFD's baseline and the governor's proposed numbers was relatively minor in the first couple of years and grew significantly as the governor's proposed cuts compounded. The governor was proposing a total of $4.856 billion lower spending than the LFD baseline for the current budget growing with inflation [through FY 30].

3:26:04 PM

Co-Chair Stedman remarked that it was hard to project ten years in the future with any accuracy. He looked at the projected $591 million difference in FY 25. He reasoned that even if the actual spread was half the number, it would still be $300 million the state would need to make up. He remarked the number was significant. He suggested that LFD include agency and statewide growth rates with more detail on a slide in the future. He wanted to hear where the cuts would be if someone talked about agency reductions in the hundreds of millions of dollars. He remarked that the legislature had struggled at the table on every single agency.

Mr. Painter showed slide 7 titled "Fiscal Model: Governor’s PF Plan with LFD’s Baseline Spending Assumptions." The slide showed the effect of the Permanent Fund portion of

the governor's plan without the spending reductions or new revenue to illustrate the importance of the two items to pay for the plan. The lines in the top left chart reflected spending assumptions and the bars reflected revenue sources. The chart on the bottom left showed state reserves. He pointed out that the LFD analysis assumed the constitutionalizing of the Permanent Fund; therefore, the ERA shown in green disappeared [in FY 23]. The chart on the top right showed the PFD check compared to the current statutory PFD. The chart below that showed the Permanent Fund and its growth. He highlighted that the fund grew significantly faster than inflation compared to FY 20, primarily due to large market returns in the current year. The next chart near the bottom of slide on the right showed the impact of the $3 billion draw on the percent of market value (POMV). He detailed that taking an additional $3 billion out of the fund would cause a reduction of around $150 million in POMV over time as it was worked into the average.

Mr. Painter continued to speak to slide 7. The slide demonstrated that if the plan only included the 50/50 dividend and bridge funding, the bridge funding would run out quickly. He noted the result was a broken model where [expenditure] lines and [revenue] bars did not match up [shown in the top left chart on slide 7], meaning there was not sufficient funding to pay for the budget due to persistent deficits that could not be filled. He noted that the slide only included the Permanent Fund portion of the governor's proposed plan. Slide 8 showed the same charts with the governor's assumptions built in.

3:29:45 PM

Mr. Painter spoke to slide 8 titled "Fiscal Model: Governor’s PF Plan with Governor’s Spending Plan and New Revenues." The slide showed the governor's Permanent Fund plan in addition to the proposed spending plan and $300 million in new revenue. He noted the numbers were very close to the governor's model. He remarked there was a slight difference in the growth rate of the Permanent Fund [between the LFD analysis and the OMB numbers]; the numbers were within a few million dollars. He stated that the slide indicated that the differences between the LFD and OMB modeling was a matter of the administration's policy choices. The slide showed that state revenue would go from deficits to surpluses and a CBR balance would be retained

and rebuilt throughout the given period as surpluses were deposited into the account. The model demonstrated that if the proposed reductions could be made and the new revenue came in, the numbers presented in the governor's plan worked.

Co-Chair Bishop highlighted that the governor's plan assumed a 1.5 percent inflation rate, 50 percent school bond debt reimbursement, and an REAA reduction from the current amount. He stated the data shown in the middle column [on slide 8] reflected the governor's numbers.

Mr. Painter agreed.

3:31:10 PM

Mr. Painter briefly highlighted slide 9 titled "Analysis of Governor's Comprehensive Fiscal Plan":

- OMB 10-year plan for spending, which has $4.86 billion less spending over FY22-30 than current policies reflected in the LFD baseline.
- Adds $300 million in new revenue (or additional budget reductions) beginning midway through FY24.
- Constitutionalizes PFD at 50% of POMV draw (about $2,350 per recipient in FY22).
- Transfers PCE Fund to Permanent Fund and makes some funding for power cost equalization a constitutional mandate.
- One-time transfer of $3 billion from ERA to CBR as "bridge."

Co-Chair Stedman remarked that the administration had been talking about taking $2 billion out of the Permanent Fund and liquidating the Power Cost Equalization (PCE) Fund. He thought it would in essence be transferring the payout to the Permanent Fund and liquidating and spending the PCE endowment.

Mr. Painter explained that in LFD's models and administration's models, the PCE program had been switched to a UGF expense, which added to spending. Additionally, the community assistance program would become a UGF expense; the program was currently funded primarily with the PCE Fund.

3:32:45 PM

Mr. Painter addressed slide 10 titled "Analysis of Governor's Comprehensive Fiscal Plan (cont.)":

- LFD's modeling and the Governor's modeling do not have significant differences – the numbers presented by the Governor are technically sound. The question for the legislature is whether you agree with the policy choices in the plan.
- Currently, the legislature has four main levers to use to balance the budget: drawing from savings accounts (including the ERA), reducing the PFD, reducing the budget, or increasing revenue. The Governor's plan removes the first two options, leaving only the last two.
  - Over the past nine years of deficits, we used three of the four levers: budget reductions, PFD reductions, and savings draws. We are now essentially out of savings beyond the ERA.
  - If existing revenue sources do not meet DOR's projections, the Governor's plan would require additional budget reductions or new revenue.
- The $3 billion "bridge" allows time for increases to existing revenue sources, the $300 million in new revenue, and the spending reductions to balance the budget while paying a 50/50 PFD. Without it, the CBR would not have sufficient funds to avoid an ERA overdraw during the transition period under this plan.

Mr. Painter elaborated on the last bullet point on slide 10. He communicated that the CBR's current balance was not sufficient to get through the transition period. He explained that for the administration's plan to work, the $3 billion was an essential component of the governor's overall plan to get to a balanced budget.

3:34:45 PM

Co-Chair Stedman was concerned about the opportunity cost of the $3 billion overdraw or looting of the Permanent Fund. He wanted to see a growth projection on the $3 billion going forward for 30 years and the payout that would come out. He wanted to see the cost for future generations.

Mr. Painter agreed to provide the information. He noted that LFD's rule of thumb associated with the 5 percent POMV

was that every $1 billion taken from the Permanent Fund reduced the POMV by $50 million. The $3 billion transfer would reduce the POMV by $150 million in real terms. He noted that it would take time to take effect due to the five-year average and lag.

3:35:52 PM

Mr. Painter spoke to slide 11 titled "Analysis of Governor's Comprehensive Fiscal Plan (cont.)":

- Evaluating a fiscal plan requires clear goals and metrics: what problems are we trying to solve?
  - We can imagine a wide variety of goals or metrics the Legislature may have in designing a fiscal plan. Making those explicit may make evaluating fiscal plans easier.
  - For example, is the goal to balance the budget at current prices, or are current oil prices high enough that we should be trying to generate surpluses to rebuild the CBR? Is it more important to avoid taxes or to have distributional equity? Is it important to maintain downward pressure on spending, or have we cut too far already?

Mr. Painter elaborated on slide 11. He spoke to the first bullet point and noted there were many ways to approach designing a fiscal plan. He added that the success of a plan would depend on the goals that needed solving. He stated that depending on whether the legislature thought current oil prices were a target, it would make a big difference for the spending reductions and revenue needed to make a plan work. He continued to review questions in the last bullet on slide 11. A discussion the legislature and public had heard frequently was about whether certain options were regressive or progressive. The governor had stated the goal was to avoid broad-based taxes; therefore, he speculated the governor's $300 million in new revenue would not include additional taxes. He remarked that others would say a broad-based tax was acceptable. He believed resolving the conflict would be important to creating a plan that had majority support.

Mr. Painter addressed the final question on slide 11. There had been discussion in the other body about the various spending needs of the state such as deferred maintenance

and other. There could be debate over whether maintaining the downward spending pressure was important or whether it was no longer really possible. The differences would make it difficult to say whether a fiscal plan worked or did not work from a policy standpoint because the answer would be different to different people.

3:38:36 PM

Mr. Painter provided a list of rhetorical questions on slide 12 titled "Analysis of Governor's Comprehensive Fiscal Plan (cont.)":

> Some questions to consider:
> • Which elements of a plan should be constitutional, and which should be statutory?
> • If the Legislature does not agree with the Governor's spending reduction plan, should the difference be made up with more revenue or with lower PFDs?
> - This question could be flipped around in any direction.
> • If (when?) oil revenue declines substantially in the future, will this system still be sustainable?
> • Would voters approve this constitutional amendment (HJR 7, Permanent Fund)? What about HJR 6 (spending limit) and HJR 8 (voter approval of taxes)? Are all necessary for the Governor's plan to work?

Mr. Painter elaborated on the first question. He asked if it was important to set a new PFD formula in the constitution versus in statute. He asked whether PCE should be in the constitution or statutory. He asked if a new constitutional spending limit was needed or whether a statutory limit was sufficient. There were many differences of opinion on what should be included in the constitution versus statute. He noted that the bill number in the last bullet point could be replaced with SJR 6 rather than HJR 7.

SJR 6 was HEARD and HELD in committee for further consideration.

Co-Chair Bishop provided concluding remarks. There was currently no future meeting scheduled.

#

ADJOURNMENT
3:41:17 PM

The meeting was adjourned at 3:41 p.m.