THE STATE of ALASKA

GOVERNOR MICHAEL J. DUNLEAVY

Department of Revenue

COMMISSIONER'S OFFICE

State Office Building
333 Willoughby Avenue, 11th Floor
P.O. Box 110400
Juneau, Alaska 99811-0400
Main: 907.465.2300
Toll free fax: 888.224.4538

February 26, 2019

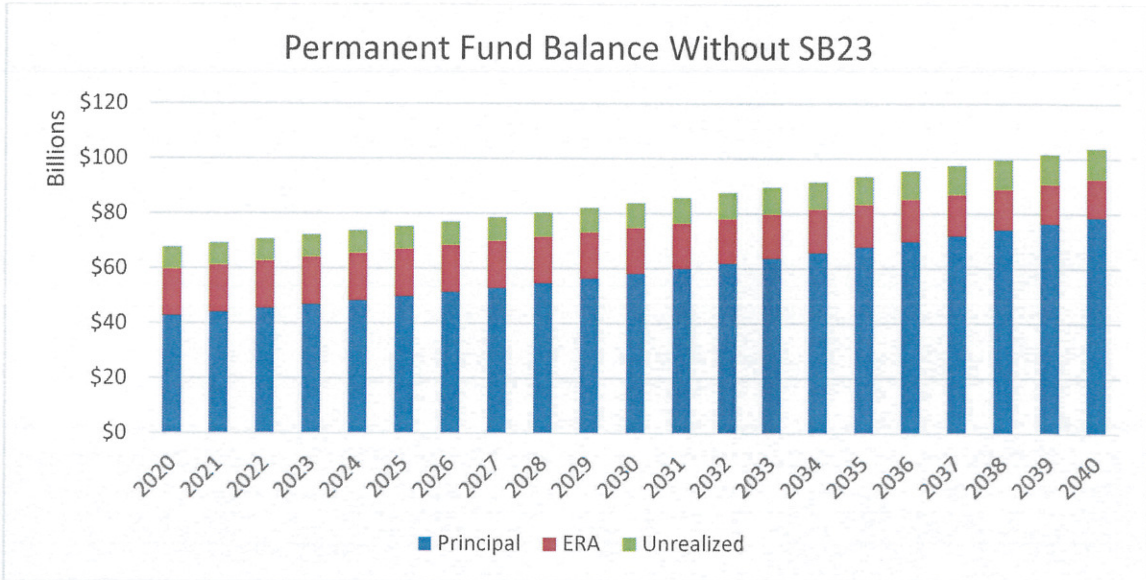
Chair Shower and Members of the Senate State Affairs Committee:

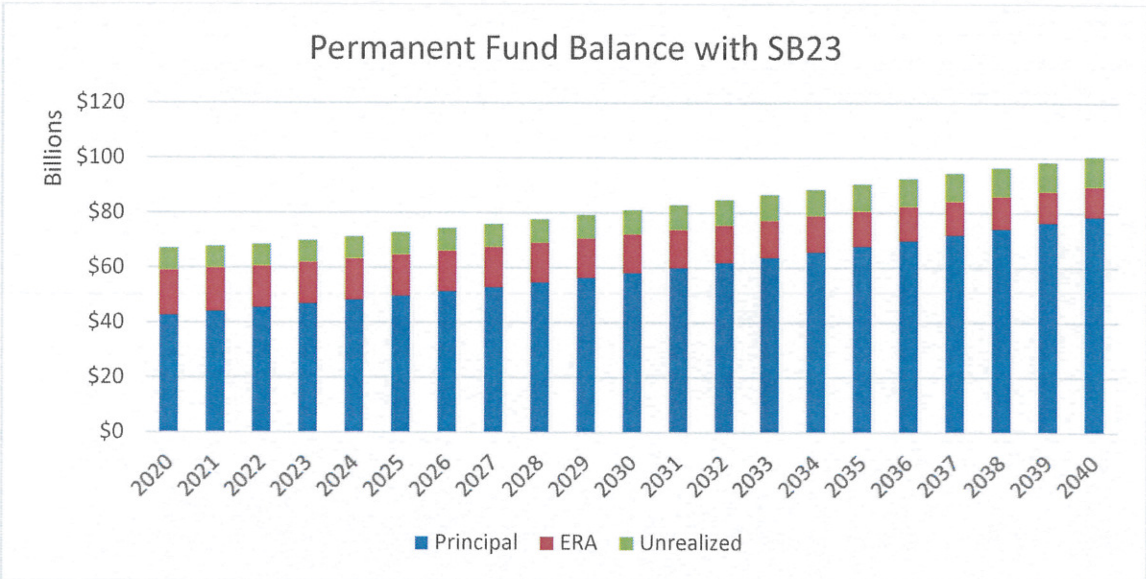
The purpose of this letter is to provide you with additional information regarding SB23/24, in response to the questions asked during the bill introduction on February 5th, 2019. I hope this information proves useful.

1. *Anticipated Change in ERA Balance Over Time*

	Status Quo	With SB23
FY20 Starting Balance	$18,991	$18,991
Transfer to Dividend Fund	-$1,944	-$2,509
Transfers to General Fund	-$989	-$989
Transfer to Principal Account	-$941	-$941
Transfer to Alaska Capital Income Fund	-$27	-$27
Statutory Net Income	$4,169	$4,160
FY20 Ending Balance	$19,259	$18,685
FY21 Starting Balance	$19,259	$18,685
Transfer to Dividend Fund	-$2,086	-$2,769
Transfers to General Fund	-$1,004	-$1,004
Transfer to Principal Account	-$971	-$971
Transfer to ACIF	-$27	-$27
Statutory Net Income	$4,215	$4,176
FY21 Ending Balance	$19,386	$18,090
FY22 Starting Balance	$19,386	$18,090
Transfer to Dividend Fund	-$2,297	-$2,996
Transfers to General Fund	-$794	-$793
Transfer to Principal Account	-$1,001	-$1,001
Transfer to ACIF	-$27	-$27
Statutory Net Income	$4,269	$4,192
FY22 Ending Balance	$19,536	$17,465

The table above is meant to demonstrate the transactions of the Earnings Reserve Account (ERA) over the next few years. When looking further into the future, here is how the fund balances compare, given the Alaska Permanent Fund Corporation (APFC) assumptions for rates of return (6.55% total return and 6.4% statutory return), inflation (2.25%), and assuming the Legislature follows current laws:

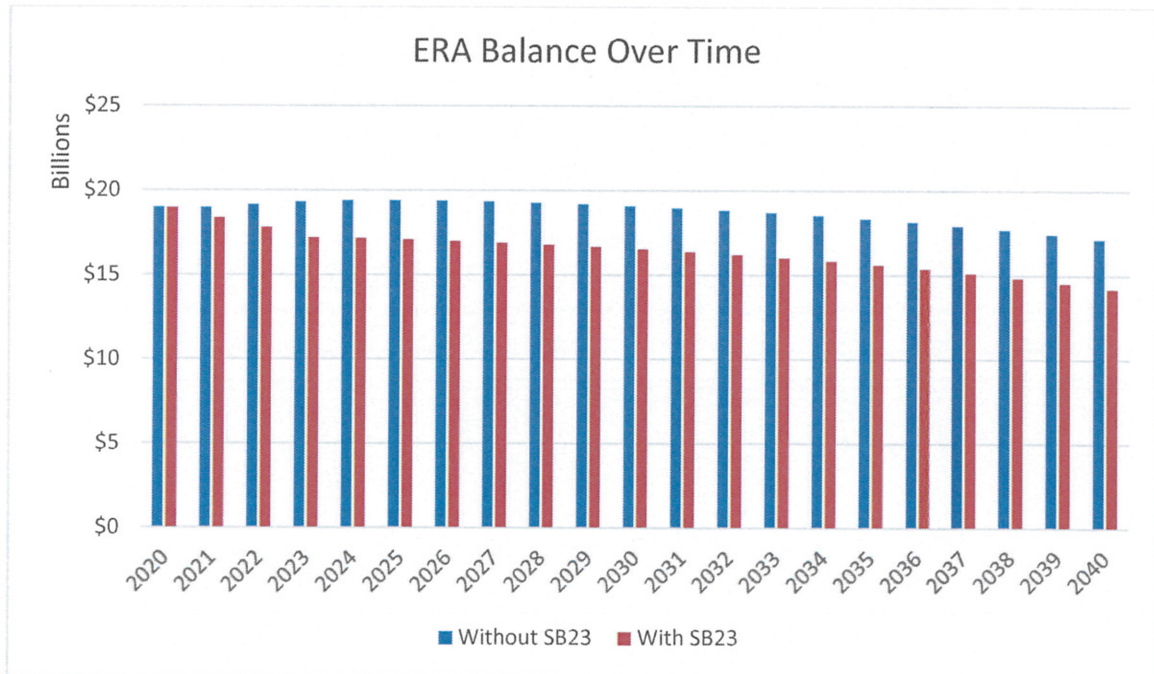




Note that the fund balance grows over time in either scenario, and the general health of the total fund is not projected to be in jeopardy.

However, the ERA balance is projected to decline at the rates of return provided by the APFC (and published in their projections), regardless of the proposed draw to return past Permanent Fund Dividend (PFD) payments.

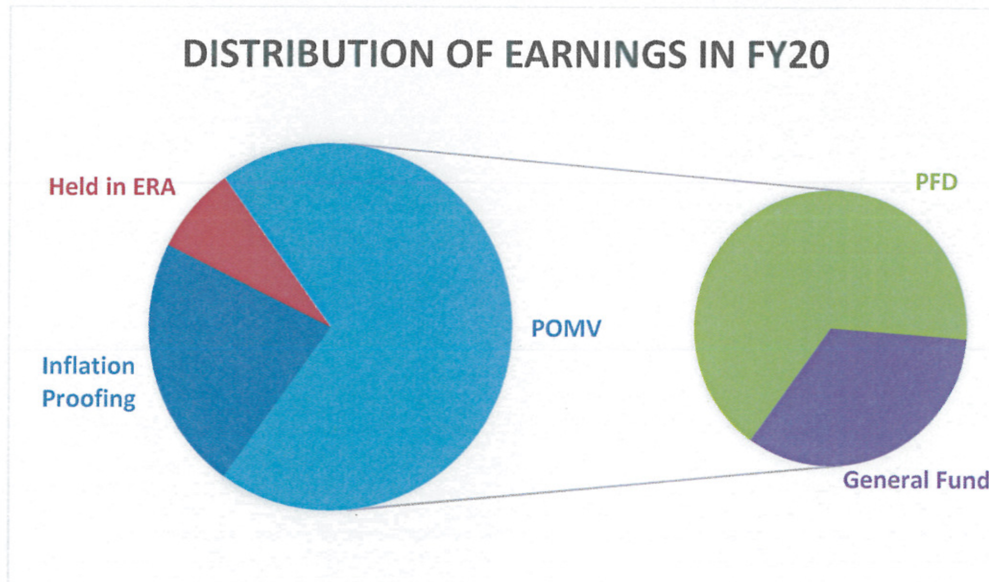
This does not represent a general weakness in the fund's health. Rather, it represents the fact that money currently held in the ERA will eventually migrate to the principal account via inflation proofing under the current projections.



2. *Use of Draws*

There was a question regarding the amount of the earnings that are being used for various purposes. We hope this illustration helps clarify the issue.

The FY20 Percent of Market Value (POMV) of $2.9 billion represents 73% of the anticipated earnings for the year. Of that, 66% of the POMV would be required to pay the statutory PFD.



If SB23 is enacted, the total transfer out of the fund would increase to $3.5 billion. Under that scenario, 88% of the anticipated earnings for the year would be transferred out of the fund. Of that, 71% of the transfer would be used to pay the PFDs.

3. *Where is the money now?*

There was a question from the committee regarding where the reduced PFD amounts are now.

In 2016, the statutory calculation of the PFD called for a transfer to the dividend fund of $1.3 billion. The actual transfer was $0.6 billion. Statutory net income in FY16 was $2.2 billion. Therefore, the ERA grew by $1.6 billion, partly from the $0.7 billion withheld from the PFD.

In 2017, the statutory calculation of the PFD called for a transfer to the dividend fund of $1.5 billion. The actual transfer was $0.7 billion. Statutory net income in FY17 was $3.2 billion. Therefore, the ERA grew by $2.5 billion partly from the $0.8 billion withheld from the PFD.

In 2018, the statutory calculation of the PFD called for a transfer to the dividend fund of $1.9 billion. The actual transfer was $1.0 billion. However, an additional amount of $1.7 billion was used from the ERA to balance the budget. Statutory net income in FY18 was $6.3 billion. Therefore, the ERA grew by $3.6 billion, while $1.0 billion was withheld from the PFD and $1.7 billion was used to balance the budget. It is therefore reasonable to conclude either that the withheld PFD money is still in the ERA, or that it was part of the money used

to balance the budget. The Governor takes the most direct position that the withheld PFD money is still in the ERA.

4. *Stress Testing*

During our testimony, we provided a graphic that was meant to illustrate that the near-term risk of depleting the ERA was currently small and that the increased risk by making the appropriations under SB23 would slightly increase that risk.

In response to that graphic, we received some constructive criticism. First, we recognize that there is a desire to look further into the future than the 10-year window we provided. Second, we realize that the simple graphic did not fully communicate the rationale for the conclusion.

As a result, we are working to find better ways to communicate the complexity of the situation so that legislators can better understand the risks they are weighing. That exercise will take considerable time and effort. But the point we were trying to make is that any potential risk created directly from this bill is *de minimis*.

5. *Risks from Unstructured Draws*

The comment regarding unstructured draws, is well received. Our analysis of the fund health concludes that under the status quo and SB 23 assumptions of future performance, the fund is stable.

However, if the legislature is considering a perpetual increase in the draw amount, the fund would not be able to support those draws without better than projected performance or reduced calls for draws in the future. We hope to explore this topic deeper in Senate Finance.

In other words, some form of structure must be in place in order to protect the fund. That structure does not necessarily need to be the current POMV approach, but *ad hoc* draws on the fund will increase the risk of failure.

The Governor does not view SB23 as an *ad hoc* draw on the fund and does not support funding government growth or special projects from the fund. The Governor views SB23 as a way to return the withheld money - which should not be in the fund - to the people of Alaska.

6. *Importance of Cash Reserves*

A point was made during the committee hearing that some form of accessible cash reserves must be available to deal with any number of potential future events.

We wholeheartedly agree. With the extreme volatility of oil prices and stock market returns, the State's cash flow is more volatile than almost any other government. And, with the potential for unpredictable events to increase the need for government funds, the volatility extends to the expenditure side of the income statement.

It is for these reasons that some form of accessible cash reserves must be maintained, or some other form of reducing volatility must be employed. Historically, the CBR has been the source of stabilization. With that account nearly empty, the ERA is now being looked at for this purpose. However, the money in the ERA should not be viewed as money that can support higher levels of recurring spending.

But if the budget is reduced to match revenues and an effective appropriation limit and savings rule is put in place, the CBR balance can continue to serve as a stabilization fund. Regardless, SB23 does not pose a risk for the ability for the State to manage its volatile revenues or meet future unpredictable expenditures considering the ERA contains a healthy account balance. Furthermore, the administration does not view SB 23 as an additional spend on the ERA, as the bill calls for returning money that should have been distributed to the people as part of their statutory PFD.

7. *Correction to FY22 Number*

We rechecked the calculations for the back-pay amounts and discovered that there is an error in the bill.

The number on page 1, line 13 of the initial version of the bill, which reads "$1,328" should read "$1,388". We would like to thank Legislative Finance for bringing the error to our attention.

8. *Eligibility Numbers*

During the hearing, some numbers were read into the record. Here are those numbers (with corrections) in writing for the committee:

FY	FY20	FY21	FY22
Projected Eligible for Back Pay	532,496	529,688	530,724
Amount of Back Pay (per person)	$1,061	$1,289	$1,388
Expected Total Back Pay	$564,977,863	$682,767,497	$736,645,481
Total PFD Recipients in Original Year	641,561	638,178	639,427
Amount of Back Pay (per person)	$1,061	$1,289	$1,388
Maximum Total Back Pay	$680,696,221	$822,611,442	$887,524,676

9. *Alternative Options*

A question was raised regarding repaying of the reduced PFDs over a time other than the proposed three-years in the bill.

We have run some scenarios and estimate the following:

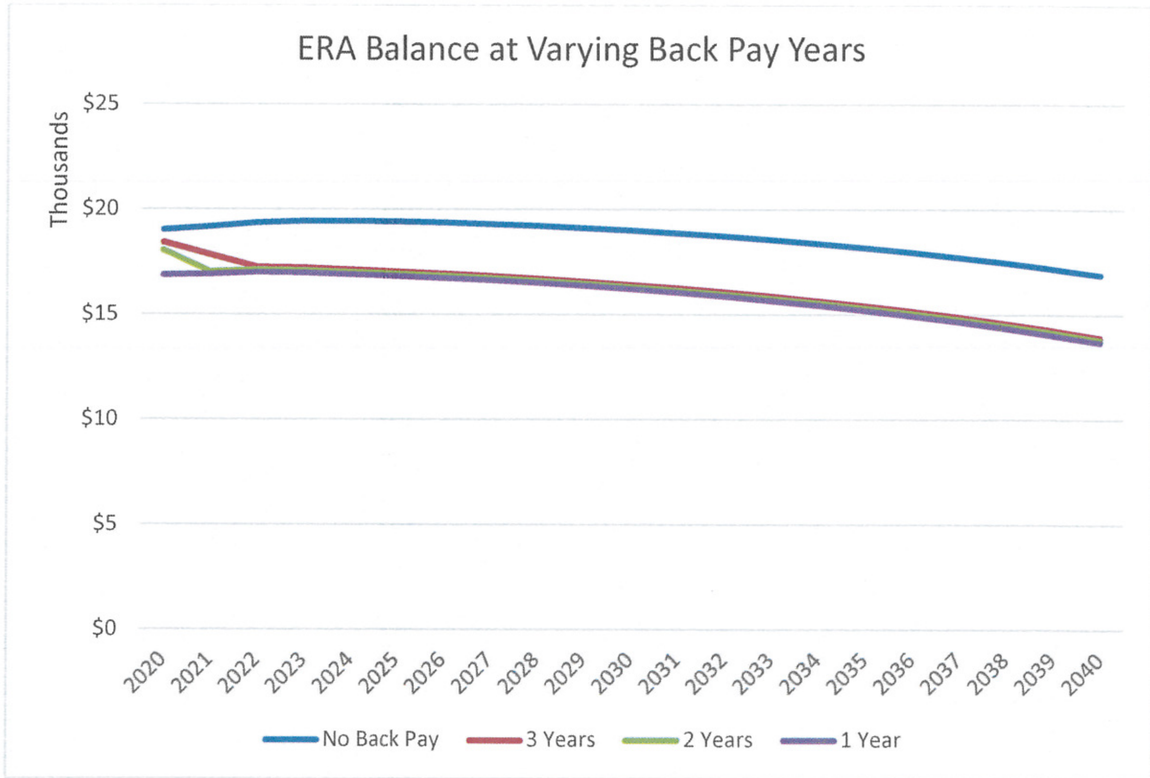
A lump sum payment, assuming the same eligibility requirements remain in place as are currently in the bill, would distribute roughly $2.1 billion in FY20. The additional amount that a person would receive would vary from $1,061 to $3,738, depending on which years they were eligible.

The increased total distribution is a result of less attrition than would be observed over the next two years, meaning that more people would be eligible for part or all of the repayments. If the eligibility requirements were removed, the total cost would be about $2.4 billion.

A two-year repayment scenario would depend on how the structure was created. For example, it could be that the 2016 repayment happened in FY20 and the other two in FY21. Or, it could be 2016 and 2017 in FY20 and 2018 in FY21. Or, it could be some sort of averaging across the two years.

In any event, we would expect the total cost to be somewhere around $2 billion, spread over the two years.

Regardless of how the funds are distributed, the account gets to basically the same place after FY22.



Respectfully,

Bruce Tangeman
Commissioner
Department of Revenue