

**ALASKA STATE LEGISLATURE
HOUSE STATE AFFAIRS STANDING COMMITTEE**

February 23, 2002

10:05 a.m.

MEMBERS PRESENT

Representative John Coghill, Chair
Representative Jeannette James
Representative Hugh Fate
Representative Gary Stevens
Representative Peggy Wilson

MEMBERS ABSENT

Representative Harry Crawford
Representative Joe Hayes

COMMITTEE CALENDAR

HOUSE BILL NO. 35

"An Act relating to the market value of the permanent fund and to distribution of income of the permanent fund; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 304

"An Act relating to disposition of income of the permanent fund; and providing for an effective date."

- HEARD AND HELD

HOUSE BILL NO. 398

"An Act relating to disposition of income of the Alaska permanent fund; and providing for an effective date."

- HEARD AND HELD

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 199

"An Act relating to taxation, including taxation of income of individuals, estates, and trusts."

- HEARD AND HELD

PREVIOUS ACTION

BILL: HB 35

SHORT TITLE: DISTRIBUTION OF PERMANENT FUND INCOME

SPONSOR(S): REPRESENTATIVE(S) HUDSON

Jrn-Date	Jrn-Page		Action
01/08/01	0033	(H)	PREFILE RELEASED 1/5/01
01/08/01	0033	(H)	READ THE FIRST TIME - REFERRALS
01/08/01	0033	(H)	STA, FIN
01/08/01	0033	(H)	REFERRED TO STATE AFFAIRS
02/23/02		(H)	STA AT 10:00 AM HOUSE FINANCE 519

BILL: HB 304

SHORT TITLE: PERM. FUND INCOME/ DIVIDENDS/ FUNDS

SPONSOR(S): REPRESENTATIVE(S) WHITAKER

Jrn-Date	Jrn-Page		Action
01/14/02	1954	(H)	PREFILE RELEASED 1/4/02
01/14/02	1954	(H)	READ THE FIRST TIME - REFERRALS
01/14/02	1954	(H)	STA, FIN
01/16/02	1992	(H)	COSPONSOR(S): FATE
02/16/02		(H)	STA AT 10:00 AM BUTROVICH 205
02/16/02		(H)	-- Meeting Postponed to 2/23/02 --
02/23/02		(H)	STA AT 10:00 AM HOUSE FINANCE 519

BILL: HB 398

SHORT TITLE: DISPOSITION OF PERMANENT FUND INCOME

SPONSOR(S): REPRESENTATIVE(S) SCALZI

Jrn-Date	Jrn-Page		Action
02/08/02	2184	(H)	READ THE FIRST TIME - REFERRALS
02/08/02	2184	(H)	STA, FIN
02/08/02	2184	(H)	REFERRED TO STATE AFFAIRS
02/11/02	2211	(H)	COSPONSOR(S): STEVENS
02/23/02		(H)	STA AT 10:00 AM HOUSE FINANCE 519

BILL: HB 199

SHORT TITLE: INCOME TAX: INDIVIDUALS/TRUSTS/ESTATES

SPONSOR(S): REPRESENTATIVE(S) HUDSON

Jrn-Date	Jrn-Page		Action
03/19/01	0650	(H)	READ THE FIRST TIME - REFERRALS
03/19/01	0650	(H)	STA, FIN
03/23/01	0712	(H)	COSPONSOR(S): SCALZI
01/18/02	2002	(H)	SPONSOR SUBSTITUTE INTRODUCED
01/18/02	2002	(H)	READ THE FIRST TIME - REFERRALS
01/18/02	2002	(H)	STA, FIN
01/18/02	2002	(H)	REFERRED TO STATE AFFAIRS
02/14/02		(H)	STA AT 8:00 AM BUTROVICH 205
02/14/02		(H)	Heard & Held -- Location Change -- MINUTE(STA)
02/23/02		(H)	STA AT 10:00 AM HOUSE FINANCE 519

WITNESS REGISTER

REPRESENTATIVE BILL HUDSON
Alaska State Legislature
Capitol Building, Room 502
Juneau, Alaska 99801

POSITION STATEMENT: Testified as sponsor of HB 35; testified on
HB 304 and HB 398; testified as sponsor of SSHB 199.

LARRY PERSILY, Deputy Commissioner
Office of the Commissioner
Department of Revenue
PO Box 110405
Juneau, Alaska 99811-0400

POSITION STATEMENT: Answered questions regarding HB 35;
testified on HB 398.

REPRESENTATIVE JIM WHITAKER
Alaska State Legislature
Capitol Building, Room 411
Juneau, Alaska 99801

POSITION STATEMENT: Testified as sponsor of HB 304.

REPRESENTATIVE KEN LANCASTER
Alaska State Legislature
Capitol Building, Room 421
Juneau, Alaska 99801

POSITION STATEMENT: Testified briefly on HB 304.

REPRESENTATIVE DREW SCALZI

Alaska State Legislature
Capitol Building, Room 13
Juneau, Alaska 99801

POSITION STATEMENT: Testified as sponsor of HB 398.

REPRESENTATIVE ETHAN BERKOWITZ

Alaska State Legislature
Capitol Building, Room 404
Juneau, Alaska 99801

POSITION STATEMENT: Testified regarding HB 398.

CARRIE WILLIAMS

PO Box 539

Cooper Landing, Alaska 99572

POSITION STATEMENT: Testified regarding HB 398; emphasized the need to raise more revenue.

ED MARTIN, JR.

PO Box 521

Cooper Landing, Alaska 99572

POSITION STATEMENT: During hearing on HB 398, testified in opposition to HB 35 and HB 398; suggested other revenue-raising measures such as a lottery should be considered.

MIKE SIGLER, Member

Harborview Site Council

1505 Crest Court

Juneau, Alaska 99801

POSITION STATEMENT: Testified during hearing on HB 398 in support of using the permanent fund and broad-based, new taxes to support education.

SHERMAN C. "RED" SMITH

PO Box 770

Cooper Landing, Alaska 99572

POSITION STATEMENT: Testified during the hearing on HB 398, saying he would be more in support of HB 304 and suggesting there are other sources of income.

JOE SONNEMAN

324 Willoughby Avenue

Juneau, Alaska 99801

POSITION STATEMENT: Testified in opposition to HB 398.

JIM KELLY, Director of Communications

Alaska Permanent Fund Corporation

Department of Revenue

PO Box 25500

Juneau, Alaska 99802-5500

POSITION STATEMENT: Testified on HB 398, providing information on the permanent fund.

ACTION NARRATIVE

TAPE 02-16, SIDE A

Number 0001

CHAIR JOHN COGHILL called the House State Affairs Standing Committee meeting to order at 10:05 a.m. Representatives James, Fate, Stevens, Wilson, and Coghill were present at the call to order.

HB 35-DISTRIBUTION OF PERMANENT FUND INCOME

[Contains discussion of SSHB 199]

Number 0185

REPRESENTATIVE BILL HUDSON, Alaska State Legislature, sponsor of HB 35, thanked the committee for the opportunity to present "a series of options." He noted that he was bringing before the committee the second half of what he'd presented the previous week in the form of SSHB 199. He reminded the committee that his efforts have been to try to bridge, or fill, the impending fiscal gap of \$850 [million] to \$1.1 billion.

Number 0331

REPRESENTATIVE WILSON moved to adopt the proposed committee substitute (CS), version 22-LS0289\L, Cook, 2/6/02, as a work draft. There being no objection, Version L was adopted.

Number 0429

REPRESENTATIVE HUDSON explained that [Version L] incorporates the permanent fund board of trustees' recommendation to change the method used to calculate the annual dividend distribution to the method used by most large, managed funds. He continued:

By distributing a percentage of the market value of the funds averaged over five years - as opposed to an average of the earnings of the permanent fund over five years - we believe ... we can balance out and smooth out the distribution, ... with an expected

average rate of return on the permanent fund's investment of 8.25 percent. And we heard from the permanent fund board of trustees and the experts that were hired by the board that 8.25 was the anticipated annual earnings.

Paying out 5 percent ensures an annual inflation-proofing factor of around 3 percent. So, the first thing the bill tries to do is to adopt a method or measure in distributing income from this ... multibillion-dollar ... permanent fund.

Number 0558

The board of trustees recommended the 5-percent payout limit. HB 35 statutorily fixes a distribution stream for that 5-percent payout. And then it goes further in order to try to both maintain the permanent fund dividend over long periods of time, and also to provide for some makeup of the deficit that is currently between our recurring spending and our annual revenues. We have a 50-percent contribution to the general fund.

So, we take and automatically inflation-proof the fund by limiting the payout, and then we split the payout 50-50: 50 percent into the dividends and 50 percent into the general fund. This will pay for approximately one-half of the \$1 billion budget deficit each year, while allowing for the continuation of the permanent fund dividend.

Number 0648

The permanent fund dividends would be reduced initially, but would continue to grow with the infusion of inflation-proofing dollars. This is not capping the dividend. This is, essentially, statutorily constraining the amount of money that goes into the dividend - 50 percent of the earnings - and how much can go in to make up the deficit loss that we have on an annual basis.

We believe that HB 35 will give the permanent fund strength, security, and stability far into the future. It will ensure the commitment to pay dividends to

Alaska, while also [ensuring that the] infrastructure of the state will not fall into further neglect.

Number 0735

And I point out that some of you have served on that special committee that went around the state of Alaska to find out what the condition of our schools and all other governmental assets were. And an excess of a billion dollars was determined to be in deferred maintenance. And so, this would allow the continuation to that.

REPRESENTATIVE HUDSON remarked that Representative Fate had spoken eloquently regarding the need to "grow the State of Alaska" to provide new opportunities, for example. Representative Hudson offered his belief that maintaining the Constitutional Budget Reserve (CBR) and substituting "the essence of HB 35" would provide [the state] with a "pretty good guarantee" of over \$1 billion for at least the next seven to ten years. [That money] would be available for the following: catastrophic emergencies; growth, development, and taking advantage of new opportunities; deferred maintenance; and giving the next governor the opportunity and time to attempt to find new income.

REPRESENTATIVE HUDSON summarized the combination he'd put before the committee as follows:

\$285 million from the ... minimal income ... tax stream - which is 2.25 percent of the adjusted gross earnings, [a] flat tax [that] hits everybody, essentially, the same way - coupled with HB 35, taking 50 percent of a 5-percent payout and distributing it to dividends, and 50 percent to the state.

Number 0916

REPRESENTATIVE HUDSON referred to charts provided by the Department of Revenue. He said although the "split" proposed is 50-50, anyone in the House or Senate could [change that ratio]; it would depend on the goal. He explained that his goal has been to attempt to fill a major portion of the fiscal gap.

Number 1022

REPRESENTATIVE HUDSON referenced a past remark of former Governor Hammond that if income is going to be used from the permanent fund, it shouldn't be the first source. He noted that the first thing he'd presented to the committee was an income tax, which he believes fits with Governor Hammond's ideas. He also noted that Governor Hammond had said if income of the permanent fund is to be used, it ought to be specified in law "so that any future legislators would not be able to just willy-nilly modify that thing and cause disrepair to the dividend program." He mentioned Governor Hammond's strong commitment and concern regarding the growth and sustaining of the permanent fund dividend (PFD).

REPRESENTATIVE HUDSON mentioned that the "50-50" [split] is "because of today's conditions." He indicated losses in the permanent fund and the [subsequent] reduction in the amount of money the permanent fund has available for distribution, between \$1.2 billion to \$1.4 billion "at the 5-percent payout." He said that has been testified about by the permanent fund [trustees]. He remarked, "So, we've essentially developed the proposal that the permanent fund trustees desire to do constitutionally, and that may go forward - there's a separate bill to do that." He opined that "this bill absolutely fits ... hand in glove into that concept." He continued:

We have not modified anything or put anything into this bill that will alter or negatively affect the board of trustees' efforts to try to constitutionally fix the inflation-proofing. That's their goal, ... to guarantee that the permanent fund continue on and continue to grow. ... They say nothing about the distribution, because that's not their ... business. That's our business; that's what we do.

Number 1145

CHAIR COGHILL recalled that the constitutional amendment came through the House State Affairs Standing Committee the previous year and is in the House Judiciary Standing Committee. He indicated part of the policy call was in regard to the constitutionality of the issue.

Number 1227

REPRESENTATIVE HUDSON said he'd supported that measure's coming forward for public hearings, and he emphasized the need to have it be a major policy consideration. Whether or not that

happens, he said, [HB 35] can stand on its own; it provides the permanent fund trustees what they want, but not in the constitution. He explained that it defers to future legislatures the option of modification regarding [the percentage]. He reiterated that "all we're talking about here" [in regard to HB 35] is the 5-percent payout split between the dividend and the government.

REPRESENTATIVE HUDSON acknowledged that this legislation wouldn't fill the entire \$1 billion gap. Even if the income tax and the distribution of 50 percent of the earnings of the [permanent fund] are adopted, it's still only about \$825 million of a billion-dollar gap. He posited that the current legislature and those to follow would be required to cut almost all of the inflation out of government for the next five to ten years, or until a major income stream is discovered, such as [through opening to oil and gas exploration the Arctic National Wildlife Refuge (ANWR)].

Number 1393

CHAIR COGHILL referred to a comparison in members' packets of the three [proposed plans entitled "CBRF Balances FY2002-FY2010," with Representative Hudson's plan "A" and the Department of Revenue's plans "B" and "C"]. He asked Representative Hudson to review the comparison for the committee.

REPRESENTATIVE HUDSON requested that his staff and Mr. Persily, who had prepared the graphs, join him at the witness table. He referred to the "A" plan, the first page of graphs, labeled "POMV 5% (50% to dividend program / 50% to state government): approximately \$630 million starting FY 2003." He noted that he'd asked Mr. Persily to provide two other plans whereby the [legislature] chooses to make a split of 60 percent to the dividend and 40 percent to government, or 70 percent to the dividend and 30 percent to government - plans "B" and "C," respectively. He said, "The arcing line is the Constitutional Budget Reserve."

REPRESENTATIVE HUDSON reminded members that he is attempting to eliminate [the current legislative practice] of balancing the budget through use of the CBR, and [to prevent] elimination of the CBR. He noted that former Governor Hammond's sentiment is that if the legislature continues to balance the budget through use of the CBR and it is consumed by 2004, the only funding source will be the earnings reserve of the permanent fund; when

that occurs, the PFD will suddenly be at risk, and will very likely be the next thing to be consumed. Representative Hudson explained that there are probably not enough people in Alaska to pay enough taxes to fill this gap.

Number 1644

REPRESENTATIVE HUDSON noted that the "A" plan shows the CBR fund at just under \$2.5 billion, dropping by the year 2007. Also shown as an element in the graph is a \$25-per-passenger cruise ship fee, which wasn't part of his own bill but was put in by the governor. He indicated the [proposed] 10-cents-per-drink alcohol tax would bring in \$30 million and would be implemented for three quarters of fiscal year 2003, if adopted. Mentioning the effects of HB 35, he pointed to the bottom-line amount of \$1 billion and told the committee that was his target. He noted that his plan ["A"] "does not succeed when it gets out ... a little past [the year] 2009."

REPRESENTATIVE HUDSON called attention to the "B" plan, which gives 60 percent to the dividend. The graph shows that the dividend would be \$1,237 in 2002 and would grow to \$1,334 by 2010. He said the 40 percent [in this plan] "reflects less money to make up that cap." He said one of former Governor Hammond's concerns was not wanting the PFD to be capped, but Representative Hudson indicated that would require using up the CBR sooner. He noted that under all three plans, there is time for the future legislature and the next governor to act and "still have a billion dollars out there."

Number 1924

REPRESENTATIVE JAMES asked what the Department [of Revenue's] calculation was that resulted in the numbers shown.

Number 1990

LARRY PERSILY, Deputy Commissioner, Office of the Commissioner, Department of Revenue, answered that [the graph before the committee] assumed none of the following: population growth, inflation, or additional economic activity other than oil fields that are known to be coming online in the next few years.

REPRESENTATIVE JAMES remarked, "Representative Coghill was so great to ask Scott Goldsmith for some information about the job loss on the various different options." She asked Representative Hudson if he had considered that at all.

REPRESENTATIVE HUDSON said a 1-percent growth had been left "down there." He indicated the inflation is about 2.25 percent to 2.5 percent currently. He remarked, "We believe, as the chairman has stated a number of times, that government is going to have to suck it up, so to speak, here." He noted that just the day before he'd seen the aforementioned paper of Mr. Goldsmith, which indicates the number of jobs that would be lost by cutting the budget, [adding] an income tax, and reducing the CBR. Representative Hudson said he had taken all of that information into consideration. He again cautioned against balancing the budget from the CBR for two more years, at which time there would be steep decline and then "the terrible decline in the economy and the number of jobs that are lost."

Number 2200

REPRESENTATIVE JAMES indicated agreement that nothing much really happens if the CBR is used to fill the fiscal gap for the next two years, after which the "real mess hits the fan." A great hole will be created if no action is taken now, she opined. Representative James stated concern that income tax or sales tax won't solve the billion-dollar problem. She said no matter where "you take that from" out of the economy, there will be some immediate job loss. She indicated some people may leave to look for better opportunities.

Number 2309

REPRESENTATIVE HUDSON indicated open-town meetings had been held throughout the summer, the last of which was in Anchorage; 25 people met, including Democrats, Republicans, Senators, and Representatives. He mentioned people from the oil industry and facilitators who "really come from business." The essential [message], he said, was that if nothing is done, the PFD likely will be lost by 2007 or 2008. He said, "We think it's a whole lot better to have a small income tax, use some of the earnings of the permanent fund, [and] still have that \$600-\$700 million annual infusion of dividends hitting the street out there."

REPRESENTATIVE HUDSON mentioned letters on record from corporations, from Alaskans United, and from "the 20-20 people," for example. He reemphasized former Governor Hammond's message not to use the dividends first or the earnings of the permanent fund, without specified limits. He indicated it would be difficult for future legislators to automatically take the PFD away, if it were put into law.

Number 2259

REPRESENTATIVE JAMES remarked that she didn't necessarily have the same confidence in former Governor Hammond. She added, "But what I don't like to see is this sort of thing going out to the public, because it shows a real disaster, no matter what we do, when we get down there." She mentioned the need to factor in population growth and questioned the ability to hold the budget flat or at 1 percent. She also indicated the need to assist industry.

Number 2647

REPRESENTATIVE HUDSON acknowledged that this isn't a pleasant thing to recommend to Alaskans, but said it is "extremely responsible." He pointed out that [the possibilities of] increased oil revenues, a gas line, and [opening] ANWR, for example, were not included. He said, "You have to almost depend upon the next administration to come in and figure out how they're going to fit the bodies that they will inherit to the money that they will have available to them - providing we make it available to them."

REPRESENTATIVE HUDSON mentioned potential problems with the pipeline, earthquakes, or natural disasters that must be responded to, should they occur. He cautioned about the need to have the CBR and permanent fund available. Given that oil reserves are finite, he said the level of spending has grown beyond the state's ability to sustain it over the long term.

Number 3000

MR. PERSILY referred to the discussion by Representative James and mentioned the \$285 million in fiscal year 2004 and the same amount in 2010. He said [the department] had spent considerable time attempting to figure out if there is some way to show how much income tax might be taken in during fiscal year 2010. However, [the department] had concluded that it is nearly impossible to know what the economy will look like in 2010; it would depend on many factors, including the price of oil, [oil and gas] production, [whether there is drilling in] ANWR, the National Petroleum Reserve - Alaska (NPR-A), and [the potential] gas line.

MR. PERSILY offered that the economy and the revenues would "closely track." If new development occurred and there were an

increase in population - and therefore a greater need for public services such as "school, reimbursement, and the rest" - expenses would increase. With a broad-based tax, however - in this case, an income tax - because of that activity the income tax revenue and some other revenue would increase as well. He said "income and the need for that income" would run parallel, and "for the sake of models, we'd just leave it flat, because what we're trying to show here is the balance in the CBR." He said Representative James was correct that "we could end up with more revenue out here than we show."

Number 3207

CHAIR COGHILL concurred [with Representative James], adding that if [the legislature] had the ability to "get our hands around something that we knew was coming, we could factor it in," but that there were many unknowns regarding forestry, oil, and mining, for example. He remarked, "In fact, some of the state growth has been in direct relation to our inability to produce on our public lands."

Number 3255

REPRESENTATIVE WILSON pointed out that there are more expenses than shown in the equation. For example, there is more than \$1 billion in deferred maintenance, including harbors that are deteriorating and buildings that have recently caved in.

CHAIR COGHILL offered his belief that it is part of "the other \$200 million," as Representative Hudson had previously mentioned, which is going to be "squeezed into some kind of action," for example, reducing government services or even selling assets. He said, "We'll have this discussion when we have all three of them on the table."

CHAIR COGHILL said the policy call would be the 5 percent, which mirrors the constitutional amendment proposed by the permanent fund board, and the 50-50 payout of that 5 percent, which will go half to the state general fund and half to dividends, "having already settled the inflation-proofing question." He asked if he was correct in the "mechanism of that."

Number 3440

REPRESENTATIVE HUDSON told Chair Coghill he was correct. He indicated a recent hearing during which the permanent fund trustees discussed the 5-percent payout and the automatic

inflation-proofing, versus the present system, which is the average of the [most recent] five years' earnings. He noted that recently there had been 14-15 percent in earnings [during times of high economic growth nationwide], which dropped by 3.5 percent. The amount of the PFD therefore has varied. The same would happen to the income stream if the decision were made to use some of the earnings of the permanent fund on a percentage basis, unless the 5-percent payout is adopted. He suggested it would create an almost impossible task for future legislators, because "how in the world are they going to know what programs to put into effect this year, that goes for the next three."

Number 3607

REPRESENTATIVE STEVENS stated his appreciation of the visual aids supplied by Representative Hudson. He surmised that Representative Hudson hadn't chosen to put more [money] into state government and reduce the dividend because of wanting to maintain approximately \$1,000 a year into the foreseeable future [for PFDs].

REPRESENTATIVE HUDSON concurred that that was his goal. In response to a question by Representative Wilson, he said the income tax incorporated [would be] at 2.25 percent.

Number 3700

CHAIR COGHILL said that is in keeping with SSHB 199. He stated his intention that if there were sufficient time at the present hearing, he would entertain a motion to "adopt an amendment into it that we can discuss on Tuesday."

REPRESENTATIVE HUDSON said he would like to speak to the amendment on SSHB 199 whenever it is ready. [HB 35 was held over.]

CHAIR COGHILL called an at ease at 10:44 a.m. and called the meeting back to order at 10:46 a.m.

HB 304-PERMANENT FUND INCOME

[Contains discussion of SSHB 199]

CHAIR COGHILL announced the next order of business, HOUSE BILL NO. 304, "An Act relating to disposition of income of the permanent fund; and providing for an effective date." He noted that Representatives Berkowitz and Lancaster were present.

Number 3819

REPRESENTATIVE JIM WHITAKER, Alaska State Legislature, sponsor of HB 304, presented the bill. He referenced Representative Hudson's earlier allusion to the significant fiscal problem before [the legislature]. He offered that four options exist: cost control; broad-based taxes; utilization of some earnings of the permanent fund; and most important, economic growth. He concluded that all four options must be used to ensure a successful result.

Number 3904

REPRESENTATIVE WHITAKER gave a PowerPoint presentation. He noted the importance of understanding Alaska's finances - how the general fund works in relationship to the Constitutional Budget Reserve (CBR) and how the permanent fund works in relationship to the earnings reserve account (ERA). The general fund receives revenues from oil royalties, severance tax, property tax related to the oil industry, corporate income tax, a number of fees, and miscellaneous sources. Because these aren't sufficient to pay the state's bills in times of deficit, however, the CBR is used as a shock absorber; for example, in the current fiscal year \$865 million of drawdown must be absorbed. He continued:

The permanent fund has a corpus of \$21 billion, and the fund principal is protected. So what can come out of the principal? The answer is a resounding "Nothing." It cannot be used. ... What's the relationship with the earnings reserve account which ... at the end of this fiscal year will have \$2.8 billion in it? It, too, acts as a ... shock absorber for the permanent fund.

Debits and credits to the permanent fund are realized by the earnings reserve account; that is, earnings, losses, and dividends all relate to draws or deposits to the earnings reserve account. If the permanent fund corpus realizes a loss, it is not the corpus that absorbs that loss; it is the earnings reserve account. That's an important point to remember - the corpus never loses; it comes out of the earnings reserve account.

Number 4119

REPRESENTATIVE WHITAKER mentioned the ongoing budget deficit and emphasized that the funds are related. At the current spending rate, the CBR will be gone in 2004. Therefore, the ERA will become the shock absorber for both the general fund and the permanent fund; that is not sustainable. If the ERA functions as a shock absorber for both funds, it likely will be effectively drained by the end of the decade, and the dividend program will therefore cease. He remarked, "At that point, there is only one way to fund government, and that is directly with the earnings of the permanent fund ... to the general fund."

CHAIR COGHILL asked if this was discounting any tax [that might be instituted].

Number 4312

REPRESENTATIVE WHITAKER answered in the affirmative. He said:

If we do nothing, that's what will happen by the end of the decade. ... Those who stand in front of us and say "by doing nothing, we are saving the permanent fund dividend" are simply wrong. If we do nothing, the dividend is gone by the end of the decade. And the only hope that we have to save that segment of the Alaskan economy is by doing something now. So, as you can see, then, there were two - and those two are the permanent fund and its earnings going directly to the general fund. ...

If nothing is done by the end of the decade, the dividend program is gone, government spending will be significantly reduced by necessity, and our economy will shrink. Now what does a shrinking economy mean? It means less prosperity; it means less opportunity; and I really don't want to go there, and I think it would be terribly irresponsible of us to let us go there. Having said [that], what can we do? ... That takes us back to the point at hand.

Number 4414

REPRESENTATIVE WHITAKER offered that the state first needs to control costs, and some form of broad-based taxation is necessary. He commented:

I'm a conservative Republican, and it is a painful experience for me to have to say that the way that we must go in the state of Alaska is to tax ourselves. But I'm also a responsible Republican. And if I'm responsible, I have to stand up and say this is what we must do.

REPRESENTATIVE WHITAKER emphasized that economic growth has to be a significant part of any plan put forward. He noted that HB 304 utilizes \$200 million of the earnings of the ERA, which is transferred to the general fund. That is all the bill does, he concluded.

CHAIR COGHILL asked whether the \$200-million transfer is sustainable.

REPRESENTATIVE WHITAKER expressed that this was his understanding based on information received from the [Alaska] Permanent Fund Corporation. He added that his own analysis draws the same conclusion.

CHAIR COGHILL asked, "And that would be under the existing formula as we stand right now?"

Number 4632

REPRESENTATIVE FATE inquired what - according to permanent fund personnel - is the maximum, sustainable amount that could be taken from the ERA.

TAPE 02-16, SIDE B
Number 4625

REPRESENTATIVE WHITAKER offered that the [Alaska] Permanent Fund Corporation has indicated the state can utilize \$1.25 billion; currently, over \$1 billion is being used for the dividend program. Therefore, a \$200-million level is sustainable.

Number 4553

REPRESENTATIVE FATE asked if other scenarios that include varied amounts from \$150 million to \$300 million have been tried. He asked whether the 200 [million dollars] seems to Representative Whitaker to be the optimal amount to take out of the ERA.

REPRESENTATIVE WHITAKER replied yes.

Number 4525

CHAIR COGHILL offered that using \$200 million [from the ERA] leaves at least a \$660-million question. He surmised that it is a part of the solution, according to Representative Whitaker.

REPRESENTATIVE WHITAKER answered in the affirmative.

CHAIR COGHILL stated that Representative Whitaker's point was well taken regarding [the state's] spending above what it is able. He speculated that the [decline] in oil [revenue] has precipitated this. He expressed his opinion that [the legislature] has to lead with a good-faith effort of reducing government. These questions become significant, he said, because [government spending cannot be reduced by \$1 billion]. This would offer a \$200 million fix. He offered that he thinks this is a legitimate discussion.

Number 4414

REPRESENTATIVE JAMES asked Representative Whitaker whether it is his assumption, with this legislation, that changing the calculation of the dividend isn't on the table.

REPRESENTATIVE WHITAKER replied:

This is an idea in search of a better idea. If there's a better way to approach it, then we should. And certainly reformulation of the distribution of permanent fund earnings is something that should be on the table. It is not inclusive to this bill. No.

REPRESENTATIVE JAMES asked if this is or can be made available to the public.

CHAIR COGHILL said it could be made available. He noted that he has testimony from Mr. Goldsmith regarding what would happen under the various scenarios with regard to job opportunities and the economic impact in Alaska. He offered to make that available as well.

REPRESENTATIVE JAMES expressed concern that taking a billion dollars from the economy will have a disastrous impact. Therefore, there has been the suggestion to [withdraw it] over time, which has been done with the [legislative majority's previous] five-year plan that she believes has left the state better off.

REPRESENTATIVE JAMES noted that [the materials] indicate there would be 2,600 jobs lost with the income tax proposed by Representative Hudson [SSHB 199], while sales tax would reduce 3,200 jobs, as would the dividend cut. A cut in operation would reduce jobs by 6,500. She expressed concern that these projections are based on what is known today, rather than projections of what will happen tomorrow. The state needs more business. She said she believes the state is going to be totally dependent upon oil and gas production in order to pull out of this [economic situation]. However, there is the belief that the state existed before oil and gas, and thus other applications such as mining, fishing, and timber could be utilized in order to have a better economy. She asked if [those other applications] have been considered for the projections.

Number 4035

REPRESENTATIVE WHITAKER noted that he, too, is concerned with Alaska's economy and the fact that Alaska's gross state product, the true measure of prosperity, has grown very slowly. In some measures, the gross state product has even shrunk over the last decade. In reviewing ways that the aforementioned trend could turn, Representative Whitaker felt that there were some choices. He mentioned that the tourism industry should never be forgotten as a growth opportunity. Furthermore, basic transportation infrastructure ensures that Alaska will have significant opportunities that it doesn't today. Moreover, Alaska's economy is directly tied to the oil and gas industry for which production has declined for a significant period, although it is currently somewhat stable. If Alaska is to grow the oil and gas sector of the economy, there must be a competitive environment on the North Slope. Additionally, there must be a [natural] gas line. He continued:

If, indeed, we are to solve our economic problem, we need to quit looking at things like this and saying that is the future - and [instead] say a gas line is our future, increased production on the North Slope is our future, increased size of a tourism sector of our economy is our future, a railroad is our future. The basic stuff economies are built on is our future.

Number 3816

CHAIR COGHILL remarked that the drop in oil prices has forced this discussion. "The pressure that is bringing it to bear is,

can we afford the type of government we have," he said. He related his belief that [Alaska] has fallen into an entitlement world, often federally driven, that has grown since the 1960s. That model isn't based on what America is based on, which is the part of the discussion Chair Coghill said he is attempting to force. He related his view that the entitlement world and the production world have to at least grow together, if they're going to grow. In regard to HB 304, Chair Coghill asked why the bill [uses] the ERA rather than the CBR.

REPRESENTATIVE WHITAKER answered that using the ERA is driven by necessity. Regarding the state's options, some earnings of the permanent fund must be utilized in order to balance the state budget, which was the intention of the permanent fund when it was established.

CHAIR COGHILL clarified that the policy call is whether to use the ERA as put forth in [Representative Whitaker's legislation] or use other mechanisms utilizing the CBR. Chair Coghill noted that this is a dynamic discussion because other proposed legislation may change the CBR or the way the permanent fund payout is figured.

Number 3600

REPRESENTATIVE JAMES turned to the state's demographics regarding 18- to 44-year-olds. She questioned who is going to do the work if all these jobs come to pass. Furthermore, there is much anecdotal information that for the years in which there has been a permanent fund and maximized use of federal funds, there is a large, growing poor sector who are unable to work. Although Representative James wanted to take of Alaskans who are needy, she said she didn't want them to come from other states because Alaska is more generous than other states.

Number 3511

REPRESENTATIVE BILL HUDSON, Alaska State Legislature, agreed with Representative Whitaker that the state has to look forward. He explained that one reason he has put forth his bills has been his belief in the need to preserve and, if possible, grow the CBR. He recalled being in the legislature when the CBR was created as a rainy-day fund and a growth and opportunity fund. If the income of a billion dollars or so of the CBR isn't available, there will be no major opportunities for new kinds of economic development in the state. "If you come up with a plan ... that preserves as much of that as possible, has the income

available from it to provide for the maintenance of our infrastructure, and the growth and opportunities to the future of the State of Alaska, I think we will have done a very good piece of work," he concluded.

CHAIR COGHILL commended those who'd established the CBR and the permanent fund.

REPRESENTATIVE KEN LANCASTER, Alaska State Legislature, mentioned the importance of realizing that prior legislatures put in almost half of what is in the permanent fund corpus today. Without the corpus, the earnings of the CBR or the ERA wouldn't exist.

CHAIR COGHILL indicated he would hold the public testimony. [HB 304 was held over.]

HB 398-DISPOSITION OF PERMANENT FUND INCOME

[Contains discussion of HB 35, HB 304, and HB 413]

CHAIR COGHILL announced the next order of business, HOUSE BILL NO. 398, "An Act relating to disposition of income of the Alaska permanent fund; and providing for an effective date."

Number 3142

REPRESENTATIVE DREW SCALZI, Alaska State Legislature, sponsor of HB 398, noted that his proposed legislation is similar to HB 35 and HB 304. He stated that it is not a "stand-alone" bill; other revenue streams would need to be incorporated. He said it does take "a little angle" regarding use of the permanent fund earnings. He noted that the recent fiscal policy caucus has included discussion about maintaining the Constitutional Budget Reserve (CBR) at some level - whether at \$1 billion or \$1.5 billion - to use as a shock absorber for [unpredicted] expenditures related to the fluctuation of oil [prices].

REPRESENTATIVE SCALZI indicated his friend, former state Representative and Senator Clem Tillion, was involved in the past "at this level of creating the dividend program," with a plan to somehow tie the permanent fund to the price of oil. He then paraphrased the written sponsor statement as follows:

[House Bill 398 is] a mechanism that maintains an adequate balance of the constitutional budget reserve for public services. It would restore the budget

reserve fund at [the] start of each [fiscal] year, to \$1.5 billion, [a] reasonable amount to preserve services, while providing a cushion against any one-time, one-year risk in low oil prices.

[House Bill 398] would use permanent fund earnings to refill the budget reserve each year, while providing for a healthy dividend for Alaskans.

[House Bill 398] would serve as an incentive to the legislature, the governor, and the public, to adopt new revenue sources to help close the budget gap and to preserve the dividend for future legislatures to come.

In HB 398, it would encourage responsible state spending and the linking of state spending with the annual dividend. [House Bill] 398 would link the amount of each year's dividends to the price of oil and the state spending, which would make the dividend more relevant to an Alaska economic situation than the existing program that links the dividend only to the permanent fund's Wall Street investments.

[The legislation would] use ... the existing statutory formula to determine the amount of the permanent fund earnings available for distribution each year. There would be no change in the current formula that averages the fund's earning[s] over the past five years. That would remain the same.

[The legislation would] use the existing statutory formula to inflation-proof the fund's principal; but before any money is distributed for any purpose, sufficient funds would be moved from the earnings reserve account to the principal to cover ... inflation over the past year.

Then, the budget reserve ... trigger ... would ... kick in at that point. In any year [that] the CBR is below \$1.5 billion on June 30 ... - the last day of the fiscal year - this legislation would direct that an amount sufficient to restore the CBR to \$1.5 [billion] ... be taken from the funds available for distribution.

This does not go into the earnings reserve [account] - only the excess earnings that are used for the permanent fund dividend program. And that has to be very clear, because if we don't do that, then obviously we're going to eat up the earnings reserve [account], just like Representative Whittaker said, and then we don't have anything but the corpus left. So this would ... take an amount to restore that [\$]1.5 [billion] from the calculated amount that goes through the dividends.

Now, as I said before, this is not a stand-alone bill by any means, and I did not try to incorporate an income tax or sales tax or anything else into that, or projections on what would happen if we did have an economic stimulus, or if we had tremendously low prices in oil, or low production.

Number 2725

But I do think we need a shock absorber to have a fund balance, so to speak, like most boroughs and cities do, that they need to rely on. And that's what that CBR, in my belief, is for.

So, in years of low oil prices, we would have to take more of those earnings. This does not set, like HB 304, a level of \$200 million each year; it's whatever's necessary. It could be more; it could be less. But that is going to have to be attributed to all those things that will kick in: price of oil, production of oil, what we pay in income taxes or sales taxes, [and] any of the other mechanisms. That's our choice.

How bad do we want to tax ourselves? We ask the people, "How valuable is that permanent fund dividend to you?" You make the call. You tell us, because if you don't, it's going to take more out of the permanent fund dividend to supplement the CBR.

So what I've done in this bill - HB 398 - is start at the \$1.5 billion and work backwards. It's just another option to the two bills that you had before us.

Number 2607

REPRESENTATIVE BILL HUDSON, Alaska State Legislature, offered his belief that Representative [Scalzi] has offered an excellent idea. He added that he saw no reason that the concept of percentage of market value (POMV) couldn't be cranked into his bill as well, because it would provide leveling and stabilization over time. He indicated positive [results] from using this concept, providing that "we come up with the leveling effect of the POMV."

REPRESENTATIVE HUDSON noted that under [Representative Scalzi's] approach, as [the CBR funds] are spent, they fill back up, but only to the amount necessary. He compared that with his own [HB 35], in which he has chosen an "automatic 50-50 [split]." He said the advantage of putting it into the CBR is that it requires a [three-fourths] vote of the House and Senate before it can be tapped. He added, "We put that in there when we created the constitutional budget reserve, to constrain the growth of government, to constrain the amount of spending." He noted that some people want to do away with that and allow a simple majority vote to tap those funds; however, he said that wasn't the original intent in creating the CBR.

REPRESENTATIVE HUDSON told the committee he liked aspects from both his own and Representative Scalzi's bills and thought the two could be "quite nicely accommodated."

Number 2411

CHAIR COGHILL reminded members that when the committee had considered one of the income tax proposals, there was a trigger mechanism that dealt with keeping the CBR at a certain level. He added, "Somewhere along the line, if we need to, we might want to reconcile those."

Number 2360

REPRESENTATIVE JAMES offered the following understanding, "You calculate the dividend in the same way that it's currently calculated, which is ... 21 percent of [the] five-year average, or half of the earnings reserve [account], whichever is the smaller." Indicating HB 398 presumably was based on \$1.5 billion in the CBR, she asked if the only way "it could drop from that would be [by] having spent it."

REPRESENTATIVE SCALZI said, "That's correct."

REPRESENTATIVE JAMES asked, "If we had to go into the constitutional budget reserve to fill the budget, then that money essentially would be coming right out of the dividend, directly."

REPRESENTATIVE SCALZI concurred.

REPRESENTATIVE JAMES asked if whatever was left of the ERA would be available for other spending, or would "sit there."

REPRESENTATIVE SCALZI explained that under [HB 398] the ERA wouldn't be touched. He said there may be a time when, if the legislature spent the CBR down to \$3 million, for example, and the available revenue from the ERA calculation for the dividend program was only \$1.1 billion, then the budget reserve gap could not be filled to \$1.5 [billion] again. He clarified, "You can only take what is available from the dividend program." He noted that using the CBR requires a [three-quarters] vote of the legislature.

Number 2210

CHAIR COGHILL said, "So, if we went to \$8 [a barrel for] oil again - heaven forbid - at a spending level that we're at now, it would be, easily, right at [\$1.5 billion], and that could take the whole CBR, going beyond what the dividend could give."

REPRESENTATIVE SCALZI concurred. He paraphrased an example from the second page of his sponsor statement, which read as follows:

If, after a broad-based tax and other revenue measures were adopted to raise a total of \$600 million a year, and if the remaining budget gap were then \$500 million, then \$500 million would be taken from permanent fund earnings to refill the [CBR].

And, if \$1.1 billion in permanent fund earnings were available for distribution under the 5-year income-averaging formula, there would be \$600 million left for dividends after \$500 million was used to refill the [CBR]. That would equal a dividend of about \$1,000 per Alaskan.

CHAIR COGHILL noted, "It wouldn't grow beyond the formula if we became very prosperous."

REPRESENTATIVE SCALZI responded as follows:

If we became prosperous through other means, that mechanism would still be in place to go the other way. If, for instance, as Representative Hudson was saying, ... you have a floating measure in this -- you don't really have that in the other ... bills, because you can't really flex your income tax yearly. I mean, you have to vote on what the income tax is going to be. You can ... raise your sales tax, but it's always retroactive as to what happened before. We know that when we have to fill the gap, we go right to that CBR and we make a vote at the end of session to fill that gap. And that's why I think we need something that's flexible, ... yet very much attainable. So, that's where the flexibility comes in, in having it drawn out this way.

Number 2007

REPRESENTATIVE JAMES asked Representative Scalzi if, in his plan, the excess earnings of the fund left in the ERA would also grow.

REPRESENTATIVE SCALZI said, "That's correct."

REPRESENTATIVE JAMES noted that there would be two pots of money, then, guaranteeing \$1.5 [billion] in the CBR and growing the ERA of the permanent fund.

REPRESENTATIVE SCALZI concurred. He said the intent was not "to go into" the ERA because once it is gone, all that is left is the principal and there is nothing to work with. Representative Scalzi said he is trying to save both the principal and the ERA. He suggested Mr. Persily could answer questions as well.

REPRESENTATIVE JAMES noted two options for future legislators to address a "hole in the budget": a three-quarters vote to go to the CBR reserve, or a majority vote to take it out of the ERA. She said, "I don't know that that's the option that we would like to leave."

CHAIR COGHILL said it is a policy call. He added, "And that is actually an option that is open today, according to Representative Berkowitz, and I think that's accurate."

Number 1725

REPRESENTATIVE HUDSON said that was precisely the reason that he'd amended his bill. He said he believes that the [budget] gap is so atrocious that he didn't want to have to go to a three-quarters vote on the CBR. He stated that he originally had all of the income "that we split" going into the CBR in the same manner as in [HB 398]. He continued as follows:

I have seen the [three-quarters] vote of the [CBR] - regardless [of] whether the Democrats are in control, or the Republicans are in control - become, "My vote has got to be worth something; so, you don't get my vote unless I get something else into the budget."

CHAIR COGHILL said, "It has been held hostage to actually raise the cost of spending, in many cases."

Number 1632

REPRESENTATIVE ETHAN BERKOWITZ, Alaska State Legislature, stated the following:

During the time that I have negotiated on the CBR, we have used it as a shield; we have not used it as a sword. And if it does anything, what it does is shift spending priorities, rather than increase spending priorities. The amount of additional funds [that] have gone into the budget ... on account of a CBR vote have been relatively minimal, compared to the overall size of the budget.

CHAIR COGHILL commented, "It is a negotiation tool."

Number 1520

CARRIE WILLIAMS, testifying via teleconference, asked that everyone realize that the state must raise more revenue. She said the PFD has become very important to many people. She posited that the "alternative tax issue" needs to be addressed and asked that the legislature consider the impact of the local issues. Ms. Williams mentioned a cruise tax, income tax, and alcohol tax, asking [the committee] not to eliminate those from local government. She asked the committee to consider in its plans that local government needs to assume increasing responsibility for "its own support and its needs."

MS. WILLIAMS noted that she didn't have possession of the complete bill, but surmised that HB 398 suggests a temporary

transfer of funds from the CBR. She said, "In the interim, I would say, if we would go that direction, please put an absolute deadline on when you would come up with alternative revenues, not depending on [the] CBR and withdrawing annually from that."

CHAIR COGHILL clarified the following for Ms. Williams:

Just for your information, it was the earnings reserve account. And it would be a \$200 million draw that has been calculated to be sustainable. And it would certainly be any legislative session's prerogative not to take it. So, you know, it would have some safeguard.

MS. WILLIAMS, in response to a question from Chair Coghill, said she is from Cooper Landing. She then stated her belief that [HB 398] would allow the legislature to maintain and replenish the CBR at a certain level. She asked, "Would this ever equate to the fact that no PFD would be available for the public payout? She asked whether it is possible to withdraw adequate [money] from the CBR to [equal] earnings on the current market.

CHAIR COGHILL affirmed that it wouldn't be tied to the earnings. If [Alaska] had a "bad oil year, it could possibly take the whole dividend," he said.

MS. WILLIAMS said she thought it might be an issue the public would want to be educated on. She said, "We look forward to Mr. Lancaster coming around and educating us all." She reiterated the need to consider other alternatives. She mentioned depreciated capital facilities, harbors, and schools, for example, that are in near-disaster condition and need attention.

MS. WILLIAMS indicated she would be listening to further testimony. At present, without additional education, she said she would be in support of looking at the \$200,000 withdrawal from the reserve. She indicated the time to "get those taxes in place." She said she thinks [Alaskans] want modern-day services and need to be willing to help pay for those.

CHAIR COGHILL pointed out that the amount [of the withdrawal] would be \$200 million.

Number 1041

ED MARTIN, JR., testifying via teleconference, told the committee he lives in Cooper Landing and that his father was

"the one who started the 'vote no' campaign down [for a previous year's advisory vote on whether the legislature should use permanent fund earnings for state government] here on the peninsula." Mr. Martin told the committee HB 35 would change the formula to "an unacceptable amount." He stated his belief that 86 percent of the people who went to the polls [in that advisory vote] had voted, "No, do not touch it without a vote of the people." He said [HB 35] would circumvent that, and he doesn't agree with it. He stated his certainty that many people, including every member of his family, would vote against it. He added, "That portion of [HB 35] is the one that I dislike the most."

MR. MARTIN, turning attention to HB 398, said it is essentially based upon the same principle, tying it to the PFD, oil revenues, or state spending. He offered his belief that that is "absolutely wrong." Mr. Martin indicated the permanent fund was invested for the mineral wealth, and that at statehood "they decided the state would retain that." He offered that it is a rainy-day account for the people, but isn't supposed to be a rainy-day account for the government. He suggested remarks about capping the permanent fund [dividend] relate to a "zero-growth atmosphere" that has existed under the current administration. He stated:

Apparently, we have Democrats right now that are introducing these bills, because I can't think, in my mind, that we have elected Republicans down there that would cut state spending, that would look at revenues other than taxation - an encroachment on the liberties of Americans and state residents, by way of taxation - when in fact, we are a resource-rich state for which there has been zero and flat development. ...

Nobody is putting together a hearing, so far this year, on revenue [matters] other than taxation, and I think it's wrong. I think we should be looking at a lottery to help fund education, like the Lower 48's in Washington, Florida, and Georgia. I recently was down there, so I had the opportunity ... to (indisc.) tickets down there. So, based upon any study of the lottery system, you surely would want to include those who would visit the state, or transients that might be in the military.

Number 0728

REPRESENTATIVE BERKOWITZ told Mr. Martin he himself is a Democrat, but emphasized that the efforts to solve this issue are being made as Alaskans and as a legislature, and that it isn't a partisan problem. He noted that considerable effort has been invested in developing a natural gas pipeline and promoting the [oil and gas] development of the Arctic National Wildlife Refuge (ANWR). He told Mr. Martin: "I'm sure that you understand the gravity of the situation and you will lend your efforts as an Alaskan, and not as a partisan, to solving the problem."

MR. MARTIN responded that he was not necessarily trying to draw a line of distinction between both parties; however, he believes there are philosophical difference between them that won't be changed by "any conversation here." He offered examples.

Number 0445

MIKE SIGLER, Member, Harborview Site Council, told the committee his two children attend Harborview Elementary School in Juneau. He explained that the council, a parent-teacher organization at the school, supports the use of the permanent fund and new, broad-based taxes in order to fund education. Mr. Sigler said the State of Alaska is an important partner in funding Alaska's schools. With oil revenues declining, [the council] sees the only way to maintain education funding is to seek new revenue sources, now rather than later. He remarked, "We must reach into our pockets to ensure a decent education for our children in the future." He noted that [the council] supports the efforts of Representative Hudson and the other members of the fiscal policy caucus [to resolve the budget crisis]. He continued:

We also request that you consider increasing education funding for children not meeting education standards. At Harborview [Elementary] School, nearly one-third of children fall below state education standards, and there are too few teachers to provide extra help to all of these children.

MR. SIGLER said he'd handed out a fact sheet on Harborview Elementary School detailing this challenge. He suggested the school is likely representative of many Alaskan schools. He told the committee members that the Quality Schools [Initiative] and [Learning] Opportunity Grants provided this year by the legislature have helped, but weren't enough to meet all children's needs. He concluded: "Please continue these grants,

consider increasing them, and ask your constituents whether their schools face the same challenges as Harborview [Elementary] School."

Number 0238

SHERMAN C. "RED" SMITH, testifying via teleconference, told the committee he came to Alaska [in 1948] and has been living in Cooper Landing since 1949; he has been involved politically to varying degrees during that period of time. Mr. Smith said one thing that has come to his attention is that "it is very difficult for us to communicate with each other." He continued:

So, let me see if I can get a message across to you. Let's say that in my youth I milked a cow. Now, the permanent fund is kind of like an udder on a cow. ... [There are] four appendages to that udder, and it looks like we have two of them in use right now. You have a reserve fund and another fund there, and now we're lookin' for more ways of milking that one cow, which is [the] oil industry, basically, that provides that udder on that cow that we're milking.

The thing that we haven't done, is we forgot that if we're going to have anything except that one cow to milk, we should have been protecting the heifers, 'cause ... cows reproduce, see. Well, our permanent fund should have been reproducing like the cow, and probably some of that investments left in Alaska, here, would have given us another heifer or two, and we'd have had more than one cow to milk.

The oil industry cannot survive without industrial minerals. We have local sources of industrial minerals that should be in production up here, supplying the oil industry. We also have people that are knowledgeable, like myself, that know that ... they don't always have to be petrochemical plants; there can [be] chemical plants utilizing our dead and dying forests. ...

We can't change the past, but let's see if we can get some of these smaller -- like the heifers that I'm referring to. Let's help 'em grow up so we can milk them, too, you see. And then we'll be able to ... maintain some of this social structure that we have in our state.

TAPE 02-17, SIDE A
Number 0001

MR. SMITH continued:

In all these 50-some years now, I don't believe that except on rare occasions that I've heard our representatives, like yourselves, down there, sit down and discuss something ... positive that we can do other than just milking the one existing cow. So ... this is an opportunity for us. We're going to get a new administration.... It is time that we focus on some of these smaller-scale programs or utilizing our resources. If they do nothing else with them ..., we could at least support the existing larger corporations within our state.

I hope I haven't offended anybody or misled you, but I think that this -- and I reviewed and listened here during this discussion of the bill that I've been able to understand here. In my understanding, I would be more in support of HB 304. I believe it's more definitive. I believe it gives ... [a] simpler understanding and less complicated bookkeeping, and a number of reasons why I would've supported it. (Indisc.)

I will not support anything that expands government at the present time because I think we've got all kinds of government that we don't need in the State of Alaska right now. Certainly, I understand that we have to pay our bills. Now, one of the things I do when I pay my bills -- I [had a] fiscal crisis; I sold off some of my land. And I think that that's a possibility again, if we could start selling off some state lands and allowing developments to take place on them. There's a number of other sources of income that haven't been tapped. Anyway, thank you for your time. Thank you for hearing me.

Number 0313

REPRESENTATIVE HUDSON thanked Mr. Smith for keeping positive. He informed Mr. Smith that there has been review in regard to ways in which to harvest, to a greater extent, the timber killed by [spruce bark] beetles. There is also review of value-added

use of timber and oil. However, such tasks are difficult and expensive.

MR. SMITH pointed out that as of January 31, 2001, the State of Alaska, per the written request of Alaska's congressional delegation, sued the U.S. Forest Service in federal district court. In regard to that litigation, Mr. Smith expressed the need to "stop the people that have been killing the heifers."

Number 0498

JOE SONNEMAN came forward to testify. He recalled a comment that taking 50 percent of the dividend is a flat tax, which is true. However, he disagreed that [HB 398] would have an equal impact on everyone. When an equal amount is taken from everyone, those at the lower end of the economic spectrum feel it more because it is a larger percentage of their smaller incomes. Therefore, reduction of the [permanent fund] dividend has an unfortunate effect on those with lower income. The permanent fund is good because it's an inverted head tax - that is, it gives an equal amount to everyone and thus helps those with lower incomes more, because it's a larger percentage of their smaller incomes. Therefore, Mr. Sonneman felt that is why 83 percent or so voted [in the aforementioned advisory vote] against using some of the permanent fund to fund government. "Logically speaking, when you say 'no' to some, it means you don't want any of it used," he remarked.

MR. SONNEMAN remarked that although the original intent of the permanent fund was to fund government when oil ran out, the original intent was changed when the dividend program was enacted. Therefore, he didn't believe the comments regarding the original intent of the dividend apply.

MR. SONNEMAN recalled the sponsor's discussion saying that the real problem is excess spending over income, which Mr. Sonneman believes to be true. He suggested addressing that by reducing spending and increasing income, not by trying to break into the permanent fund. Mr. Sonneman informed the committee that in 1969, when oil was discovered on the North Slope, the state's annual budget was \$150 million. He noted that he has read that the current budget proposals are over \$7 billion. Therefore, there is an unsustainable level of spending. That part of the problem needs to be addressed, rather than breaking into the permanent fund.

MR. SONNEMAN agreed with an earlier comment that economic growth should be part of the solution. However, he noted that he is less confident in the comment expressing the need to work on basic extractive industries and transportation. Mr. Sonneman noted that he has a Ph.D. in Government Finance. He informed the committee that for years, economic studies have said the terms of trade favor the producers of manufactured goods over those of raw materials. In other words, those buying raw materials from Alaska and turning them into something make more money than Alaskans do by selling the raw materials. Therefore, Alaska should encourage its manufacturing industries and the processing of ideas, such as with Microsoft.

Number 0945

MR. SONNEMAN cited a recent economic study that refers to "The Curse of Resources," which [reports] that most places with large amounts of natural resources haven't fared well. Mr. Sonneman reiterated the need to encourage [Alaska's] manufacturing industries as well as taxing them. In conclusion, Mr. Sonneman noted his opposition to both bills [HB 304 and HB 398].

CHAIR COGHILL suggested that \$1 billion of the budget is the PF) payout. Therefore, \$1 billion could be taken off the top of the \$7 billion in budget proposals, and then there could be discussion of overspending.

REPRESENTATIVE BERKOWITZ clarified that \$1.2 billion of the budget is the PFD payout. There is also about \$500-600 million in inflation-proofing, and a substantial amount comes from federal funds. Representative Berkowitz estimated that \$150 million in the year 1960 would equal \$2.4 billion in 2000.

Number 1215

REPRESENTATIVE JAMES agreed with Mr. Sonneman. She said she understood that money is made at the point of value-added manufacturing and processing because that is where people work and create something. However, Alaska has the problem of being disconnected. This disconnection requires that the materials and supplies be imported in order to export the final product. The cost of transportation is prohibitive.

REPRESENTATIVE STEVENS asked what Mr. Sonneman would suggest to reduce spending.

MR. SONNEMAN answered that he didn't know, but offered to provide an answer later. He recalled the comment that part of the perceived need is to keep the CBR. If the CBR is used to grow more "heifers" and those other growth industries are taxed, that's a better solution than keeping a pot of money and taking the dividend from the people who would be hurt the most by that.

Number 1450

JIM KELLY, Director of Communications, Alaska Permanent Fund Corporation, Department of Revenue, began by referring to a document entitled "Big Picture" that he'd provided to the committee. He said all of the legislation before [the committee] works in terms of the big picture. Looking back over the first 25 years of the permanent fund, the permanent fund has produced a little less than half the money oil has produced. The fund began with oil money that was then invested in stocks, bonds, and real estate, after which it produced \$25 billion in income. This occurred during a time when state oil revenues reached \$55 billion.

MR. KELLY agreed with earlier comments regarding recognizing those who have saved the money and placed the state in its current position of having \$25 billion. If the decision to have the permanent fund hadn't been made, today's discussion would've been completely different. Mr. Kelly emphasized, "I say that because I want you to know that the decisions that you make today are going to be looked at the same way 25 years from now." He predicted that 25 years from now, people will say that oil produced about \$20 billion worth of benefit to the state, whereas the income of the permanent fund will total about \$75 billion. He noted that a significant amount of [the permanent fund] will have to be reinvested in order to accomplish [\$75 billion worth] of income. Appropriable income after covering inflation will be more than twice as much as can be expected from oil.

MR. KELLY summarized that the decisions made today matter for the future. Furthermore, the decisions made regarding the use of the permanent fund earnings, because it's the state's largest expected source of revenue, are the most important decisions. Therefore, the decisions need to take into consideration the protection of that income stream.

Number 2000

MR. KELLY turned to a document entitled "SJR 13/HJR 15 Projections" that he'd provided to the committee. On the back of this document, the top spreadsheet refers to the total 5-percent payout, which the [corporation] believes is the sustainable income the state can expect to earn from the permanent fund going forward. This distribution in residual income is based on maintaining the status quo. He explained that in reference to HB 35, the middle line of the top [spreadsheet] would be divided in half: half would go to government and the other half would to dividends. Mr. Kelly characterized that [5-percent payout] as the best-case scenario because if the permanent fund income is the greatest source of wealth in the future, that is probably way to get the most wealth out of the permanent fund.

MR. KELLY then turned to a document entitled "State of Alaska Sources of Revenue," which many have described as the do-nothing case. Mr. Kelly viewed this as the worst decision. He directed attention to the columns for fiscal years 2008 and 2009. He informed the committee that earlier in the year [the corporation] was asked what would happen if the CBR ran out and the ERA were treated in the same fashion [as the CBR] and was thrown at the fiscal gap. The result would be that five to six years from now, the ERA would be exhausted. Therefore, [the state] would be dependent upon what is earned in that year.

MR. KELLY pointed out that some years, no money is earned [by the permanent fund], which occurred this year and last. In such a situation five or six years from now, the fiscal gap wouldn't be solved and the ability to protect the permanent fund against inflation - and to provide dividends - would be lost. The picture would be bleak. Therefore, the desire is to arrive somewhere between the worst and best scenarios.

MR. KELLY concluded by stressing that although the permanent fund is large, it isn't large enough to be everything to all people. It isn't large enough to allow full inflation-proofing, pay dividends according to current statutes, and pay for the state fiscal gap. The permanent fund can do two of those three things fairly well. Mr. Kelly emphasized the importance of inflation-proofing because it will generate the money that can be used for the other two parts.

Number 2210

REPRESENTATIVE JAMES remarked, "I agree and have said repeatedly that we can maintain a healthy dividend over the long term and

utilize some of the earnings of the permanent fund to help fill the gap, but we can't if we wait. If we do it this year, we can do that, and we can guarantee that over the long term."

REPRESENTATIVE HUDSON noted that Mr. Kelly and the chief executive officer of the Alaska Permanent Fund [Corporation] had attended all meetings throughout the previous summer [of the fiscal policy caucus].

CHAIR COGHILL noted his appreciation of the town meetings held by the fiscal policy caucus.

Number 2430

LARRY PERSILY, Deputy Commissioner, Office of the Commissioner, Department of Revenue, came forward to comment on HB 398. Mr. Persily recalled earlier discussion regarding new revenues and building the economy, which is one thing HB 398 would accomplish. As the economy grows and there are new revenues, there would be a direct effect on the dividend because the dividend payout would be linked to how much is needed to fill the fiscal gap. As the budget gap closed, more funds would be available for the dividend because less would be required to replenish the CBR under HB 398. Mr. Persily said HB 398 could be used to link oil prices to state spending to the economy. That could be merged with the percentage of market value. For example, 5 percent would be available for distribution each year, what was necessary to refill the CBR would be taken as a line of credit, and the remainder would be used for dividends.

CHAIR COGHILL asked if the trigger mechanism in the governor's bill [HB 413] was based on the tax-rate formula using the CBR as part of the formula.

MR. PERSILY explained that the governor's income tax bill had the following two triggers: it would cut the income tax rate in half at \$2 billion, and cut it again at \$2.5 [billion]. However, HB 398 says only \$1.5 [billion] is necessary for the CBR regardless of the economy, revenue generated from taxes, or the state budget.

MR. PERSILY referred to a chart that shows a band at \$1 billion and at \$2 billion with the understanding that even with additional new revenues, one would probably not want to drop below \$1 billion on the CBR. Although a certain amount each year would be needed, he said the public doesn't want government to accumulate more savings than it needs.

Number 2749

REPRESENTATIVE JAMES expressed concern with the requirement that the CBR be refilled every year at June 30 with whatever money is available. She said it seems the CBR should be filled up or there should be a different mechanism. She emphasized the need to have extra money. She noted her caution regarding a constitutional amendment that would place Alaska in the situation that Representative Hudson's bill does. She remarked that she doesn't have a problem with [following Representative Hudson's bill] for a while, and if it works out, that's fine, and then there could be a constitutional amendment. However, she said she wasn't willing "to go there first" and find out how it works because she didn't want the state to find itself in a disastrous situation in which the only option would be to borrow money.

MR. PERSILY pointed out that a constitutional amendment wouldn't have to be done. A percentage-of-market-value payout in statute could be used as Representative Hudson uses in his legislation. Mr. Persily related his belief that there would probably always be a need for something like the CBR, a line of credit, [or other] cash flow. Currently, 80 percent of the state's revenue comes from oil; even by the end of the decade, oil will remain a significant source of the state's revenue. However, that source of revenue fluctuates such that there is the need for a line of credit, cash flow to pay for government services until tax revenues come in later in the year.

Number 2956

CHAIR COGHILL posed a situation in which HB 398 is passed [along] with a tax bill such as that proposed by the governor [HB 413]. He surmised that there would probably be an increased take of the dividend before moving to a reduction of taxes, because at \$1.5 billion [the state] would take dividends before any changes were made to the tax structure. Therefore, there would be tremendous pressure to increase that to \$2.5 [billion] in order to avoid [impacting] the dividends.

MR. PERSILY specified that one assumption under HB 398 is that for it to work, some additional revenue sources would be necessary and some broad-based taxes would be necessary because the entire [fiscal] gap couldn't be filled even with the permanent fund earnings [under] the percentage of market value. The incentives under HB 398 are tied to state spending and the

state's accounted price of oil, but would really only work if additional revenue measures are passed.

CHAIR COGHILL said that is his point. He noted that a segment of his district feels there should be a tax before touching the permanent fund; however, [HB 398] proposes the inverse.

MR. PERSILY said if some form of HB 398 were adopted along with an income tax, HB 398 probably wouldn't become effective until fiscal year 2004, depending upon the amount of additional revenue raised.

Number 3215

REPRESENTATIVE JAMES related her understanding that when that point is reached, the dividend will be used [immediately] rather than using the excess earnings of the fund.

MR. PERSILY agreed that would be the case under the current language [of HB 398]. However, if HB 398 were amended to include the percentage of market value, then it wouldn't take as much from the dividend [distribution] because the full 5 percent would be utilized rather than dividends, which equate to about 4 percent of the permanent fund earnings.

REPRESENTATIVE BERKOWITZ requested that Mr. Persily contrast the alternative of doing nothing with following HB 398 or generating income off the CBR.

CHAIR COGHILL recalled that Mr. Kelly had already spoken to that when [he said] the decline would be severe and rapid.

REPRESENTATIVE BERKOWITZ asked, then, whether [HB 398] would be preferable of the "two bad choices."

MR. PERSILY answered that the Department of Revenue believes [HB 398] is preferable. Furthermore, by keeping money in the CBR, interest is earned that is available for public services, thus reducing the need to take permanent fund earnings.

Number 3400

REPRESENTATIVE COGHILL announced that he would like to end up with one bill that would be the House State Affairs Standing Committee committee substitute. He said he is using this discussion as momentum to "push" the other side of the discussion in regard to government growth and programs. He

highlighted that at least \$200 million has to come from the government in some fashion. Representative Coghill remarked that part of the issue is in regard to whether government can take the responsibility of an economy that should be generating the money. Furthermore, the permanent fund has created the expectation that government can give something that [is] an economic generator; at the same time, it discourages economic generation. [HB 398 was held over.]

HB 199-INCOME TAX: INDIVIDUALS/TRUSTS/ESTATES

[Contains discussion relating to HB 413]

CHAIR COGHILL brought attention to the final order of business, SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 199, "An Act relating to taxation, including taxation of income of individuals, estates, and trusts."

Number 3730

REPRESENTATIVE BILL HUDSON, Alaska State Legislature, sponsor of SSHB 199, specified that the amendment in packets is labeled 22-LS0753\J.1, Kurtz, 2/18/02. It read:

Page 1, line 12:
Delete "(1)"

Page 1, line 13:
Delete ";"
Insert "."

Page 1, line 14, through page 2, line 1:
Delete all material and insert:

"As soon as practicable after September 30 of each year, the department shall publish the applicable tax rate under this subsection for the following calendar year. The applicable tax rate for a resident individual is

(1) two and one-fourth percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was equal to or less than \$2,000,000,000;

(2) one percent of the individual's taxable income if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the

State of Alaska, on September 30, was more than \$2,000,000,000 but less than \$2,500,000,000; or

(3) zero if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was \$2,500,000,000 or more."

Page 2, line 3:
Delete "(1)"

Page 2, line 6:
Delete ";"
Insert "."

Page 2, lines 7 - 10:
Delete all material and insert:

"As soon as practicable after September 30 of each year, the department shall publish the applicable tax rate under this subsection for the following calendar year. The applicable tax rate for a nonresident or part-year resident individual, or for an estate interest is

(1) two and one-fourth percent of the individual's, estate's, or trust's taxable income, multiplied by a fraction, the numerator of which is taxable income from sources in the state and the denominator of which is taxable income from all sources, if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was equal to or less than \$2,000,000,000;

(2) one percent of the individual's, estate's, or trust's taxable income, multiplied by a fraction, the numerator of which is taxable income from sources in the state and the denominator of which is taxable income from all sources, if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was more than \$2,000,000,000 but less than \$2,500,000,000; or

(3) zero if the unaudited balance in the budget reserve fund created by art. IX, sec. 17, Constitution of the State of Alaska, on September 30, was \$2,500,000,000 or more."

REPRESENTATIVE HUDSON explained that the amendment proposes a trigger mechanism on SSHB 199, the flat-tax proposal. It would

establish three different levels of the constitutional budget reserve (CBR) and trigger the tax, depending upon the level. If there is more than \$2 billion in the CBR but less than \$2.5 billion, [the flat tax] would be 1 percent. However, if the CBR is in excess of \$2.5 billion, the [flat tax] would be zero. Therefore, the tax would be related to the need. Representative Hudson pointed out that [the amendment] language is included in the governor's legislation [HB 413]. Even with this amendment, there will be no bearing on the ultimate production of SSHB 199 because it will still draw in \$285 million to help fill the fiscal gap.

REPRESENTATIVE JAMES asked if this the only amendment that Representative Hudson would entertain.

REPRESENTATIVE HUDSON answered that he was open to other constructive suggestions.

CHAIR COGHILL noted that he had specifically asked for this amendment. However, it doesn't eliminate the ability to place other amendments before the committee. He said he'd wanted the committee to see the amendment before the next hearing.

Number 4130

REPRESENTATIVE JAMES related her belief that more than one trigger is necessary, as is the other side of the issue. She said she isn't necessarily against the amendment, but there is the need to see the net result first. There needs to be a leveling [mechanism] on both sides.

CHAIR COGHILL clarified that there was [no intention] to take anything off the table. Therefore, he indicated the need to look at [all the bills relating to generating more state income] in order to avoid passing out contradictory pieces of legislation.

Number 4258

REPRESENTATIVE HUDSON said he appreciated the need to ensure that government is lean. However, he pointed out that the budget process happens outside of this committee; thus he urged the chair not to hold up any essential elements. He related his belief that there will be strong support for significant "holding the line" [for state spending]. However, there has to be a combination of "holding the line" and filling the gap - with [some from taxes], some coming from the CBR, some from the

earnings reserve [account] (ERA) of the permanent fund. All of those elements have to meld together at the same time. If that is the goal, Representative Hudson said he is supportive of it.

CHAIR COGHILL acknowledged the purview of the [House] Finance Committee. However, he also recognized that as chair of this committee, he has this opportunity to have a say on the issue.

Number 4521

REPRESENTATIVE JAMES remarked that some reductions in spending will require statutory change. Therefore, a bill will be the mechanism, rather than merely addressing the budget. [SSHB 199 was held over.]

CHAIR COGHILL announced his intention to determine which of the three bills [relating to the permanent fund] is the best.

ADJOURNMENT

There being no further business before the committee, the House State Affairs Standing Committee meeting was adjourned at 12:32 p.m.