

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

January 23, 2004

8:04 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Bruce Weyhrauch, Vice Chair
Representative Vic Kohring
Representative Dan Ogg
Representative Ralph Samuels
Representative Peggy Wilson
Representative Max Gruenberg
Representative Carl Moses

MEMBERS ABSENT

Representative Norman Rokeberg

OTHER LEGISLATORS PRESENT

Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE JOINT RESOLUTION NO. 31

Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund and to payments to certain state residents from the Alaska permanent fund; and providing for an effective date for the amendments.

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HJR 31

SHORT TITLE: CONST AM: PERMANENT FUND

SPONSORS(S): REPRESENTATIVE(S): HOLM

01/02/04	(H)	PREFILE RELEASED 1/2/04
01/12/04	(H)	READ THE FIRST TIME - REFERRALS
01/12/04	(H)	W&M, STA, JUD, FIN
01/23/04	(H)	W&M AT 8:00 AM HOUSE FINANCE 519

WITNESS REGISTER

BARBARA COTTING, Staff
to Representative Jim Holm
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Presented HJR 31 on behalf of
Representative Holm, Sponsor.

REPRESENTATIVE JIM HOLM
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: As sponsor, answered questions about HJR 31.

STEVEN PORTER, Deputy Commissioner
Office of the Commissioner
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Explained the effects of HJR 31 on the
Department of Revenue.

JAMES BALDWIN, Senior Assistant Attorney General
Opinions, Appeals, & Ethics
Office of the Attorney General
Department of Law
Juneau, Alaska

POSITION STATEMENT: Explained the legal perspective on HJR 31.

ACTION NARRATIVE

TAPE 04-3, SIDE A

Number 0001

CHAIR MIKE HAWKER called the House Special Committee on Ways and Means meeting to order at 8:04 a.m. Representatives Hawker, Samuels, Kohring, Weyhrauch, Wilson, Moses, and Ogg were present at the call to order. Representative Gruenberg arrived as the meeting was in progress. Representative Seaton was also present.

HJR 31-CONST AM: PERMANENT FUND

Number 0115

CHAIR HAWKER announced that the only order of business would be HOUSE JOINT RESOLUTION NO. 31, Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund and to payments to certain state residents from

the Alaska permanent fund; and providing for an effective date for the amendments.

CHAIR HAWKER stated that Representative Holm, sponsor of HJR 31, could not be present in person, but is testifying from Fairbanks via teleconference.

Number 0226

BARBARA COTTING, Staff to Representative Jim Holm, Alaska State Legislature, presented the sponsor statement for HJR 31 on behalf of Representative Holm.

MS. COTTING explained HJR 31 by first pointing out that Section 2, page 2, adds a new section to the constitution which leaves 15 billion dollars in the principal of the permanent fund and distributes the rest equally to all qualified Alaskans. After that, no more dividends are paid out, she added. To qualify, individuals must be eligible for the permanent fund dividend distributed this year, 2004, which means that they were legal Alaskan residents in 2003. At the fund's current value, a couple of days ago, the fund was at 27 billion, so that would mean that \$12 billion or more would be distributed, she said. That would be about \$20,00 per person. At the current level of payout, that would be about 20 years of dividends people would receive in a lump sum, she added.

MS. COTTING referred to Section 1 of HJR 31 to explain that after the payout, 75 percent of the [realized income from the] fund each year would be available to the legislature to provide services and programs, and the remaining 25 percent would stay in the fund and remain untouchable.

Number 0450

REPRESENTATIVE JIM HOLM, Alaska State Legislator, explained the reason he is proposing HJR 31. He stated that the current percent of market value (POMV) proposal may not gain enough support to pass. He said that a solution is needed soon because of the CBR [Constitutional Budget Reserve] draw. He also believes that a population increase clause is needed.

REPRESENTATIVE HOLM stated that he has resurrected an idea similar to the one then-Senator Mackie formerly proposed in 1999. He reviewed the history of the permanent fund plan by referring to 1959, when the format to statehood was partially dictated by the federal government. He stated that because

[Alaska] lacked a taxable economy and a population that could support it, it was determined that all subsurface rights for the potential resources, - oil and gas, gold, and so forth - would be reserved to the state in lieu of granting standard property rights to individuals. The State of Alaska was to hold in trust all subsurface resources for the people's collective good. He strongly believes that the people's resources were taken from citizens at statehood. He said that "we" might own the land, but not the resources underneath it.

Number 0648

REPRESENTATIVE HOLM stated that Alaskans are accused of not paying their fair share because they do not pay federal income tax. Approximately \$1.7 billion derived from royalty payments in fiscal year '03 are a percentage of a resource that was reserved for the collective good of its citizens. He suggested that if [Alaska] owned the resources, then 100 percent of value is being taxed away for government use. In return for the royalty or tax, as Representative Holm perceives it, Alaskans received government services and the dividend check equal to plus or minus \$20,000 from 1982 to date.

Number 0730

REPRESENTATIVE HOLM suggested that HJR 31 will allow Alaskans to receive another \$20,000 and then the dividend program would cease to exist, as Alaskans know it today. This would use about \$12 billion of the corpus of the fund, leaving \$15 billion left to be earning money as before. Citizens of Alaska who have lived here for the past 20 years will have received about \$40,000 from the subsurface resources, he said. Representative Holm called this a prepayment plan, a prepayment of 20 years of dividend checks.

REPRESENTATIVE HOLM questioned what would happen if the current dividend plan continues over time and the population of Alaska increases. He suggested that yearly dividend payments would not buy anything significant; however, with a lump sum of around \$20,000, Alaskans could pursue many life-altering options. He suggested many options.

REPRESENTATIVE HOLM repeated the idea that all Alaskans own the subsurface rights collectively and stated that what HJR 31 would do is fund government with the earnings remaining in the permanent fund and increase the ability of Alaskans to build their own future. He stated that the \$15 billion left would

earn approximately \$1.2 billion per year at 7.6 to 7.8 percent interest. After the proposed 75 percent cap with 25 percent going back in to be reinvested in the \$15 billion fund, there would have been, this year, \$875 million available in earnings, plus the \$1.7 billion of royalties and corporate taxes. There would have been roughly \$2.57 billion in the general revenue fund to be used for government functions, which would have been \$300 to \$400 million more than was actually needed for this year. That money, he said, could have been put into the CBR to be used when the price of oil drops.

Number 1043

REPRESENTATIVE HOLM spoke about the downside of HJR 31, in that some may say it may overheat the economy. He believes it won't. He described his bill as a reorganization of the permanent fund. He called it "a recapturing of the New York Stock Exchange and bringing it to the people of Alaska." He disputed other imagined negatives.

REPRESENTATIVE HOLM also offered several positives such as: people could pay off student loans, buy a home, pay mortgages, pay credit card debt, or invest the money. He envisions a private corporation in Alaska owned by its citizens and not the government, always investing in Alaska. He believes that \$2 to \$4 billion of the \$12 billion would be returned to Alaska.

REPRESENTATIVE HOLM spoke of the possibilities venture-capital businesses could have for Alaskans who might buy stock in such a business. He gave the example of a chemical plant that would generate jobs and income for Alaskans for decades to come. He stated that \$12 billion of resource revenues should be returned to the people of Alaska, the result of which would provide far-reaching economic benefits for generations to come.

REPRESENTATIVE WILSON commented about the similarity between Representative Holm's words and those of Paul Harvey. She said that these ideas are a new way of thinking and a new direction to pursue.

Number 1730

REPRESENTATIVE WEYHRAUCH questioned whether HJR 31 is different from the Mackie plan in that it does not distribute all of the permanent fund to the people. He also asked for clarification about whether or not HJR 31 distributes only a part of the permanent fund to the people.

REPRESENTATIVE HOLM answered both of these questions in the affirmative.

REPRESENTATIVE WEYHRAUCH asked for what purpose the remaining amount is to be used.

Number 1820

REPRESENTATIVE HOLM explained that the \$15 billion would keep earning as it has in the past and would provide roughly \$1.2 billion per year at 8 percent interest. He said that 75 percent of that could be used for government purposes and 25 percent would be reinvested in the permanent fund and also used to inflation-proof it.

REPRESENTATIVE WEYHRAUCH asked, if this bill were adopted, if POMV could also be on the ballot.

REPRESENTATIVE HOLM replied that POMV is a very positive approach and could be "married with this quite easily."

Number 1915

REPRESENTATIVE WEYHRAUCH questioned whether, if HJR 31 was adopted, the permanent fund division would be eliminated.

REPRESENTATIVE HOLM responded in the affirmative.

REPRESENTATIVE WEYHRAUCH asked if the analysis of the fiscal impact of HJR 31 included the impact of the elimination of the entire permanent fund division.

REPRESENTATIVE HOLM stated that he had only seen the fiscal notes about three minutes ago and did not know the answer.

Number 2000

REPRESENTATIVE SAMUELS asked what would happen if the stock market took a downturn. He stated the consequences would be similar to what is in place now and that the structural financing problems would not be fixed by HJR 31.

REPRESENTATIVE HOLM respectfully disagreed and explained again how the deficit would be made up. He believes that there is plenty of money extra in this bill to not only fund the deficit spending Alaskans have been accustomed to, but also to shore up

the CBR, which could be used when the price of oil falls. He also explained how Alaska does not get much corporate income tax, but if the money was given back to Alaska and put into corporations that are taxed for their efforts and energies, he thinks there would be a far better return on the investments than from the New York Stock Exchange.

CHAIR HAWKER stated that there was a problem with the realized income structure of the POMV plan, which means that there only is income if a gaining investment has been sold. He asked Representative Holm whether he has given any thought to that concern that has been so well stated by the Alaska Permanent Fund Corporation board and has been manifested in the proposed POMV amendment. He asked whether Representative Holm would consider working this idea into his proposed constitutional amendment.

Number 2420

REPRESENTATIVE HOLM answered that he would, but added that the stock portfolio would change. For example, real estate would no longer be a part of the portfolio, but the more aggressive investments would be kept. He said that the issue of liquidity of the permanent fund would need to be addressed.

REPRESENTATIVE OGG reviewed the history of the Constitutional Convention and questioned the restriction of the subsurface rights, whether it was enacted by the federal government or the State of Alaska, and when that policy came into effect.

REPRESENTATIVE HOLM answered that he did not know.

REPRESENTATIVE OGG stated it would be helpful to know and would make a difference if it was the federal government or [Alaska's] Founding Fathers. He continued his review of the intent and purpose of the setting up of the permanent fund, stating that it was a constitutional amendment that set up the original permanent fund.

REPRESENTATIVE HOLM stated that it was his understanding that the permanent fund was generated for the purpose of the continuation of government and the ability to fund government for generations to come. He said, at its conception, the permanent fund plan was not a dividend plan. That was done later, he added. He didn't know if the dividends were meant to be given back to the people in the form of goods and services, government services, or for people to create their own economic

engines in Alaska. He believes that the people would do a much better job investing than the government would.

REPRESENTATIVE OGG referred to an excerpt from the 1976 election pamphlet and a statement in favor of Proposition 2, the creation of the permanent fund. [Upon hearing that Representative Holm did not have a copy of that pamphlet, he decided to deal with that subject at another time.]

Number 3013

REPRESENTATIVE GRUENBERG asked what the federal tax implications of HJR 31 would be. He questioned if there is \$27 billion in the fund and \$15 [billion] is left in, that would mean that there is a \$12 billion payout, and if the average tax rate is at 25 percent, that would mean about \$3 billion going to the federal government.

REPRESENTATIVE HOLM agreed.

REPRESENTATIVE GRUENBERG said that was money that would be taken away from the taxpayers and given directly to the federal government.

Number 3149

REPRESENTATIVE WEYHRAUCH questioned if the annual payment would have a significant impact on rural areas and if there had been any thought of a five-year "payout phase-out" with the value of the payout locked in to the value on January 1, 2004.

REPRESENTATIVE HOLM answered that there was thought given to this topic, but the reason that it was not stated is that all of the payout options could be considered at a later date.

REPRESENTATIVE WEYHRAUCH said a recent legal analysis on the POMV, the payout, and the impact of the federal laws on the permanent fund, implied that the permanent fund would not be subject to federal taxation with the POMV or dividend locked into the constitution. He questioned whether, with such a large check cut, the legal analysis would change, subjecting the remainder of the fund to taxation.

Number 3340

REPRESENTATIVE HOLM said he has not looked at that issue, but that analysis which he has heard said that was probably not the

case. He suggested that a corporation could be created so there would be no tax implications.

CHAIR HAWKER stated that Representative Weyhrauch had to leave momentarily during the last response.

Number 3500

REPRESENTATIVE SEATON questioned the philosophy behind the 102 million acres given to Alaska at statehood and the subsurface rights' going to the state. He said the permanent fund has given the state resources more liquid [assets] than at the time of the statehood Act and said it seems that 50 million acres of the surface rights should be distributed to the current residents of Alaska. He said the only reason that idea wasn't incorporated into the current fund was because the permanent fund deals with liquid assets. He asked for further clarification of this idea in terms of HJR 31.

REPRESENTATIVE HOLM stated that those ideas were not in his philosophy and added that when the federal government did not give [the people] 50 percent of the land, he was not happy. He does not think that, at this point in time, the transfer of subsurface rights to the people would be possible. He thinks the idea has merit and could be changed, depending on the views of the people. He said that he was willing to listen to these new ideas.

Number 3700

REPRESENTATIVE SEATON said that many bonds have been passed in the state and that the purpose of the bonds was to spread the cost of capital expenses to future generations. He asked if the dividend accomplished the same thing, spreading the recovery of the capital resources extracted now to future generations.

REPRESENTATIVE HOLM said he doesn't think that there was a relationship and he does think that bonds are a bad idea because they are a way to shift responsibility on others.

Number 3858

CHAIR HAWKER had a question about Section 30, [Section 2 of HJR 31] page 2, second sentence, "All provisions of statute and regulation that are both applicable to permanent fund dividends for 2004 and in effect on January 1, 2004, apply to payments under this subsection except provisions that relate to the

amount of the dividend and the date the dividend is paid." He asked if all of the current hold harmless provisions in the law are kept in place.

REPRESENTATIVE HOLM referred Chair Hawker back to the Mackie proposal to look for that information because he was not sure.

Number 4047

CHAIR HAWKER asked if the intention of the bill is to preserve hold harmless provisions. He gave as an example a situation of a family on public assistance who would lose their assistance based on increased revenue after receiving the payout. He questioned whether it was the intention of HJR 31 to reimburse the family for the public benefits lost or not to pay the hold harmless benefits.

REPRESENTATIVE HOLM said that the second statement was correct, to not pay the hold harmless benefits. He referred to March 22, 2000, when then-Senator Mackie addressed this issue after talking to Margaret Pugh, then commissioner of the Department of Health and Social Services, and was told that this could be the best public assistance program ever to get people off of public assistance and self-supporting.

Number 4330

STEVEN PORTER, Deputy Commissioner, Office of the Commissioner, Department of Revenue, gave highlights and examples of the effect HJR 31 would have on the Permanent Fund Dividend Division (PFDD). He stated that PFDD would, in effect, be closed out and it would receive about \$1 million worth of benefits in the first year by reducing positions. He said that in fiscal year 2006 and beyond, the total program savings would be about \$5.3 million, the cost of the whole division. The appeals, collection, and fraud divisions would be retained and the fraud division would increase in size to manage the potential problems.

CHAIR HAWKER questioned the figure \$5.3 million because the Permanent Fund Dividend Division fiscal note shows \$950,000.

MR. PORTER replied that Chair Hawker was correct and the figure would have to be corrected. He also added that amendments [to the fiscal note] would be made after today's hearing.

MR. PORTER spoke about the Child Support Enforcement Division, which has a unique situation. He said that there were about \$500 million in arrearages and that the infusion of \$12 billion into the economy in one day would pay down approximately \$240 million of those arrearages in a single event. Some of that money is owed to the state, and some is owed to the custodial parents, he said. There would be both positive and negative ramifications, he said. In the short term, Alaska would excel for one year and pick up \$6.4 million in collection incentives from the federal government. In the other years, Alaska would no longer be able to garnish permanent fund dividends and would lose about \$9.3 million a year and probably lose about \$500,000 of incentives a year from the federal government.

TAPE 04-3, SIDE B

Number 4649

MR. PORTER said that individual taxpayers would pay about 50 percent more in taxes to the federal government for a one-time payment than they would if they received the same amount over 20 years. The federal government would receive about \$2.1 billion or 20 percent of the dividend payment from individual income taxes. Individuals in the lower income bracket are eligible for certain credits and would lose about \$112 million in credits as a group, he said. He paraphrased statute AS 43.23.085 which states, "A program administered by the state or municipalities, the eligibility for which is based on financial need, may not consider a permanent fund dividends as income or resources unless required to do so by federal law or regulation." That provision would need to be changed for Representative Holm's proposed amendment, he said.

Number 4500

MR. PORTER also summarized AS 43.23.075 as saying, "Individuals who are denied assistance under certain federal programs based solely on the basis of receipt of a permanent fund dividend are eligible for state assistance." That provision, as well, would need to be changed.

MR. PORTER explained that a \$12 billion payout equals the total cost of building a gas pipeline from the North Slope to Valdez, including a gas treatment plant, a liquefaction plant, and the purchases of several LNG [liquefied natural gas] tankers.

MR. PORTER said that any department in the State of Alaska could get together and discuss the impacts of infusing the economy

with \$12 billion. He said the departments will find potential for many impacts, both positive and negative, and it will be a challenge and an opportunity to identify them all.

Number 4337

REPRESENTATIVE GRUENBERG stated that child support collection is a major problem and he fears that a lot of children will never see the support unless something is done to ensure child support collection in the future, possibly [as money] put in trust.

MR. PORTER agreed that it is an important issue and stated that under the current law there is no opportunity for a trust, but that an amendment should be considered to capture opportunities to ensure that the children in Alaska are protected over time.

REPRESENTATIVE GRUENBERG stated that he didn't want an answer today, but that there are provisions in Title 25 for the court to sequester funds for the future payments of child support. He invited the [Department of Revenue] to examine that issue and said his office would be interested in helping.

REPRESENTATIVE WILSON asked about the ramifications of Alaska's owning a natural gas pipeline.

MR. PORTER replied that the projections on the revenue from a natural gas pipeline are between \$400 million and \$1 billion a year. What has not been calculated yet is the cost of servicing debt, he said. If one pays cash for an asset, one doesn't service debt, so that would be an additional benefit, he explained. He said he does not have the exact number on the debt service.

REPRESENTATIVE WILSON suggested the committee needs to rethink all of this.

Number 3850

JAMES BALDWIN, Senior Assistant Attorney General, Opinions, Appeals, & Ethics, Office of the Attorney General, Department of Law, spoke about legal issues involving HJR 31. Tax consequences are worth exploring further, he said, since the payments are so different from those in the past. He stated that if HJR 31 were to become law there would be a lawsuit because of the amounts that are at stake. The Department of Law has been successful in turning back equal protection challenges to the permanent fund dividend program because the court has not

applied the strictest scrutiny that can be applied in equal protection analysis. It has been found that the state has two interests, he said. One is to encourage the permanence of residents, and the second is to encourage those residents in the maintenance of the permanent fund. He speculated that if the dividend program went away then perhaps the second leg of that justification would also go away. He said that thought should be given to what might happen if this second basis for defending the permanent fund no longer exists.

MR. BALDWIN stated that he agreed with Chair Hawker's interpretation of the realized versus unrealized income issue. He said that currently the permanent fund necessitates having two sets of books. He believes that it is preferred to go to the market-valuation approach for all things. He said that if management is not prudent or honest, the fund could realize more income than the market value would permit. This language would allow that to be a distribution, in that case. That is a downside of the "realized income" term's being used and being grafted into the constitution, rather than into the statutes, he said. He stated that it is a problem.

MR. BALDWIN said that the amendment to Section 15 [Section 1 of HJR 31] says that the 25 percent that does not get distributed should be retained in the fund, but it does not say in what status, because this amendment [HJR 31] retains the distinction between principal and income, whereas the POMV amendment does not. [The POMV amendment] eliminates the difference between principal and income. The question is whether [the 25 percent] is retained as principal or income, he said, and needs to be cleared up.

Number 3425

MR. BALDWIN stated that in order to mesh with existing law, the term "net income" rather than realized income should be used, because net income gives the corporation the ability to cover its costs of investing, which are substantial, out of its own funds. The way it is stated in HJR 31 [the corporation] would be left to seek a general fund appropriation to cover the cost of investing.

MR. BALDWIN said that in Section 30 [Section 2 of HJR 31] there is a date certain when valuation is to take place for purposes of determining distribution. He suggested that whenever there is a date certain, it is always the wrong date, in terms of the stock market or conditions. He stated that it is wise to let

experts determine the date rather than just choosing one, one day after the certification date, which is sometime in January 2005.

Number 3243

MR. BALDWIN agreed that if committee members don't want the hold harmless to apply, those provisions should be exempted. He stated that there were other agencies that would have fiscal impacts from HJR 31, as well.

REPRESENTATIVE WILSON said that because of the previous discussion about POMV, it would be very prudent to be looking at some changes to make HJR 31 set up like a POMV, instead of based on the interest earned.

Number 3054

CHAIR HAWKER concurred with Representative Wilson's suggestion and asked Representative Holm to consider what has been said today in working on a second generation of HJR 31. He summed up the discussions of this hearing and mentioned that there are three permanent fund proposals before the House Special Committee on Ways & Means this session. [HJR 31 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 9:12 a.m.