

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**March 15, 2004**  
**1:35 PM**

**TAPES**

SFC-04 # 39, Side A  
SFC 04 # 39, Side B

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 1:35 PM.

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Ben Stevens  
Senator Fred Dyson  
Senator Donny Olson

**Also Attending:** Senator John Cowdery; Senator Hollis French;  
Senator Gretchen Guess; Senator Ralph Seekins; Senator Bert  
Stedman; Senator Gary Stevens; Senator Tom Wagoner; BOB STORER,  
Executive Director, Alaska Permanent Fund Corporation; BOB  
BARTHOLOMEW, Chief Financial Officer, Alaska Permanent Fund  
Corporation;

**Attending via Teleconference:** There were no teleconference  
participants.

**SUMMARY INFORMATION**

SJR 18-CONST. AM: PF APPROPS/INFLATION-PROOFING

The Committee heard from the Alaska Permanent Fund Corporation. The  
bill was held in Committee.

#SJR18

CS FOR SENATE JOINT RESOLUTION NO. 18(STA)  
Proposing amendments to the Constitution of the State of  
Alaska relating to and limiting appropriations from the Alaska  
permanent fund based on an averaged percent of the fund market

value to protect the fund from inflation and assure that the real value of the fund will be preserved over the long term.

This was the first hearing for this resolution in the Senate Finance Committee.

Co-Chair Wilken stated this resolution, sponsored by the Legislative Budget and Audit Committee by request and, "proposes a constitutional amendment that changes the management of the Permanent Fund. The resolution establishes an annual payout limit of five percent of the total market value of the fund and that market value will be based on a five-year average. The constitutional amendment proposed would be in front of the voters for a November 2004."

BOB STORER, Executive Director, Alaska Permanent Fund Corporation, gave a presentation titled, "Alaska Permanent Fund, Senate Finance Committee, A Fund overview and discussion of POMV", as follows [copy on file.]

"To benefit all generations..."

AS 37.13.020(1)

...the Fund should provide a means of conserving a portion of the State's revenue from mineral resources to benefit all generations of Alaskans.

Mr. Storer assured the proposed constitutional amendment addresses this issue.

Permanent Fund market value

Four-year change in realized and reserved accounts

6/30/00	\$3.0 billion realized income account
	\$23.5 billion reserved account (principal & unrealized gains)
	\$26.5 billion total
6/30/01	\$2.4 billion realized income account
	\$22.5 billion reserved account
	\$24.8 billion total
6/30/02	\$1.1 billion realized income account
	\$22.4 billion reserved account
	\$23.5 billion total
6/30/03	\$0.1 realized income account
	\$24.1 billion reserved account
	\$24.2 billion

Mr. Storer divided the Fund into two components: principal and earnings reserve. He further divided the principal into three

components: contributions from mineral wealth, inflation proofing and legislative appropriations from the earnings reserve fund, which he noted have occurred on several occasions. He noted the principal is comprised of approximately equal amounts of the three aforementioned components.

Mr. Storer stated the amounts listed in the presentation reflect the "recent" Attorney General's opinion "which has unrealized gains or losses excluded from the earnings reserve fund." He indicated the balances listed on June 30, 2000 were almost \$20 billion "in pure principal as I defined it" to include the three components of mineral wealth, inflation proofing and special appropriations. He explained the approximately \$3 billion balance represents unrealized gains or appreciation. He informed that the earnings reserve of the Fund has diminished over time due to the significant bear market. He stressed the importance of exercising discipline in years of strong earnings. He stated that the benefit of discipline has been demonstrated in that although earnings diminished, the Fund was able to pay dividends and also inflation-proof the Fund for three years.

#### Fund's historical asset allocation

[Graph showing the percentage of the assets each year from 1978 through 2002 in the following categories: US Fixed Income, US Stocks, Non-US Fixed Income, Non-US stocks; Real Estate.]

Mr. Storer noted this graph demonstrates how the asset allocation of the Permanent Fund has changed over time. He stated the current payout methodology is based on realized income. He defined realized income as dividends, interest, cash flow from real estate, and "any profits the managers may take." He stressed the current management methods were appropriate during the early years of the fund, in the late 1970s and early 1980s when the Fund was exclusively invested in fixed income securities and bonds. He specified the characteristic of bonds "is virtually all of the money that your earn is through cash flow and not appreciation of assets". He told of the diversification of investments beginning in 1983 and noted the Fund is no longer invested to achieve a large cash flow but rather most of the returns from the Fund are represented in appreciation.

#### Trustees' proposal

The APFC Board of Trustees propose a constitutional amendment to limit annual fund spending to five percent of the Fund's total market value.

POMV

Mr. Storer stated that as a result of the changes in investments, the Corporation is recommending changing management to a payout of market value methodology. In any given year, he stated, this system would allow appropriation of no more than five percent of the total value of the assets.

Mr. Storer explained the decision to recommend limitation of spending to five percent. He told of the study of historical data, as well as prospective aspects and that the Trustees are "comfortable" the fund would earn an average of five percent in the future. He qualified this is not realized earnings, but rather a reflection of appreciation. He emphasized the calculation of the value of the Fund would be a five-year average, rather than annual. He stated this method of managing the fund would provide "greater predictability and less volatility" in payouts.

What is POMV?

POMV, or "Percent of Market Value," is a formula that limits spending to a set percent of a fund's total market value.

The set percent is based on the expected difference between total annual return on investments and the rate of inflation.

$$\begin{array}{r} 8\% \text{ projected average annual return} \\ -3\% \text{ projected average annual inflation*} \\ \hline 5\% \text{ maximum annual sustainable payout} \end{array}$$

\*retained in the Fund for inflation proofing

Mr. Storer gave the historical average earnings of the Fund at eight percent, and stated the Trustees' anticipate this average would continue. He reiterated the Trustees' "comfort" in allowing payouts based on a five percent annual real rate of return. He noted the actual earning predictions are 7.6 percent nominal rate of return, although the Corporation's consultant predicts an annual inflation rate of 2.6 percent over the next few years. He reported that inflation is currently slightly above two percent and would increase slightly over time.

Fund performance

- Historically, Fund returns would have hit their long-term real rate of return target.
- Fund returns going forward, after adjusting for inflation, are expected to meet the target payout over

time.

FY 94-03 historical  
2.5% Inflation  
5.3% Real return  
7.8% Total  
Long-term projected  
3.0% Inflation  
5.0% Real return  
8.0% Total  
(periods ending June 30)

Mr. Storer informed that during the previous ten years, the Fund experienced a great appreciation in the equity market value due to an unsustainable bull market. However, he stressed, the Fund also experienced significant reduction due to the "one of the more severe down markets in the last 100 years." Despite this, he said, the Fund's returns were "essentially normalized" and realized a 7.8 percent nominal rate of return. He qualified that inflation was only 2.5 percent, and therefore the Fund achieved a 5.3 percent rate of return.

Rolling 10-year real return

[Graph showing annualized real rate of return from 1994 through 2003 varying from below ten percent to above five percent.]

Mr. Storer explained these calculations are made every year and compared to the previous ten years. He pointed out the Fund has achieved earnings of at least five percent every year and reiterated that the legislatures' discipline to not over-appropriate in higher earning years has allowed dividends and inflation-proofing in lower earning years. He predicted that if this discipline were not exercised during 1999 and 2000, the earnings would have been overspent and the Fund would currently be in a deficit. He estimated that a worst-case scenario would result in a one or two percent rate of return.

Realized income v. market value

[Graph comparing the percent change in value of annual market value and realized income i.e. the status quo, for FY 83 through FY 03]

Mr. Storer indicated this graph demonstrates the volatility between the current formula and the proposed POMV formula. He pointed out these figures do not represent the amount the Fund earned every year, but rather "the rate of change in any given year". He qualified that the significant "spike up" in FY 96 was not actually

an 80 percent rate of return, but rather the realized income exceeded that of the previous year by over 80 percent. He reemphasized the POMV method would result in less volatility and greater predictability.

Why do we need POMV?

For the present

- Ensure the option of an annual payout
- Make payout amounts more stable from year to year
- Make payout method compatible with investment strategy

For the future

- Prevent overspending in the good years
- Maintain purchasing power for the entire Fund

Mr. Storer stressed this proposal provides the option of payouts by the legislature, although payouts are not mandatory.

What are Alaskans asking?

- Will this change leave the principal unprotected?

Mr. Storer noted that POMV would essentially remove the term "principal", although over the long term, this method would ensure the purchasing power of the Fund.

- How will POMV affect my dividend?

Mr. Storer noted the Trustees' concerns are focused on the value of the fund and the ability for payouts. However, he noted most Alaskan's concerns related to the impact on their dividends. He answered that the dividend formula would not have to be changed, although the Trustees' support such a change. He recalled the ten percent chance in any given year that no funds would be available to pay a dividend under the current dividend formula. He reiterated that changing the dividend formula to POMV would provide greater predictability and less volatility.

- Is POMV a raid on the Permanent Fund?

Mr. Storer assured this proposal is not a raid on the Fund, but rather a limit on how much could be appropriated. He understood some to disagree this proposal would result in such a raid, but stressed that the matter would not be raised if the State was not currently in a "fiscal problems." He stressed these are parallel issues.

- Why fix the Permanent Fund if it isn't broken?

Mr. Storer opined that the system has been "broken" for some time. He remarked that the bull market amassed a poor payout program. He warned that the cost of not changing to a POMV method of managing the fund would result in lost income and "dislocations to those expecting dividends." He reiterated that the current payout system was appropriate for the way the Fund was invested in the 1970s but is no longer appropriate.

Mr. Storer furthered that investing in equities is not "double inflation proofing". He explained that the Trustees have invested the Fund in equities that would increase over time well in excess of inflation. However, he stated that once a manager sells an equity stock, such as General Electric, the value is converted to realized income distributed under the current management system. He pointed out that if the change were made to a POMV method, this would not occur.

Senator Bunde questioned the witness' assertion that the formula used for calculating dividends would not have to be changed if POMV were adopted. He understood that the current formula is based on the earnings of the previous five years and the POMV would not calculate earnings as such.

Mr. Storer explained that the current dividend formula is based on realized income only. He clarified that management of the Fund could be converted to POMV and the current dividend calculation formula could be retained. He stated that if the dividend calculation became greater than five percent a "wall" would be encountered. He noted this does not occur often. He emphasized that in a series of years with strong earnings payouts could be in excess of five percent, at which time the "fire wall" would be reached. He advised that the formulas be the same, and that the current payout formula is in conflict with the POMV formula.

Senator Bunde relayed criticisms that the amount of dividends would diminish over time under a POMV system. Therefore, he asked if the current formula used to calculate the amount of dividends would be more volatile if maintained in conjunction with a POMV method to calculate the amount of funds available to pay dividends.

Mr. Storer responded that the current formula is very volatile and emphasized the possibility that no funds would be available to pay dividends in the event of an extreme bear market.

BOB BARTHOLOMEW, Chief Financial Officer, Alaska Permanent Fund Corporation, testified that were a POMV adopted and the current

formula for calculating the amount of dividends were maintained, the dividend payouts would be the same and would remain volatile. He expressed the challenge for the public is determining how changes would affect the dividend and how to expend the earnings of the Fund. He informed that the current formula could be retained, although this would require the Corporation to maintain two "separate sets of books" to account the POMV method and the formula currently used to determine the amount of dividends. He admitted the managers of the Corporation would prefer not to do this.

Mr. Storer remarked, "The bigger the fund the greater your earnings compound: ten percent over \$20 is smaller than ten percent over \$25 billion." Therefore, he stated that any time incremental income is utilized for purposes such as government services earnings would be compounded on a slightly smaller fund. He surmised a "small diminishment" on the value of the dividend would occur, but emphasized this exists with the current formula as well.

SENATOR RALPH SEEKINS asked if the significant increase of realized income that occurred in 1996 was a result of Fund management decisions.

Mr. Storer replied that the Trustees made the decision that affected the realized income. He described the two components of investments: active management and passive management, which he clarified as the index fund. He explained that the Fund was significantly invested in an index fund designed to replicate the S&P 500 index, which has "no market timing whatsoever". During the bull market, he stated that the Trustees discussed "intergenerational equity" and the concern that the passive investments would continue to grow to the benefit of future generations but not for current Alaskans. He relayed that the Trustees determined to institute a methodology to allow the current generation to benefit from the bull market as well as future generations and that some profits should be realized from the Fund's portfolio. He remarked this action resulted in a larger than normal dividend for 1996.

Senator Seekins surmised that under the current system, the Trustees therefore, could manipulate the amount of money taken from the principal of the Fund by directing the Fund managers what investments to sell and when to sell them.

Mr. Storer replied that future Trustees could take profits after "well thought out or other reasons".

Senator Seekins expressed concern with the Trustee's ability to "play God" in making such determinations that would dramatically

affect dividend payouts. He asked if this ability would exist under a POMV system of management.

Mr. Storer responded the impacts of such Trustee decisions would lessen because the POMV method would limit the amount available for payouts. He added that the most important point of POMV is inflation proofing. He asserted that POMV is a "positive management tool", in that asset allocation decisions would be based solely on maximizing the return on the Fund.

Senator Seekins stated that the current system prohibits the principal to be spent. He asked if this is correct.

Mr. Storer answered, "principal is a notational number. It's an accounting number" that identifies contributions from mineral wealth, inflation proofing and special appropriations. He stated that the aforementioned Attorney General opinion stated that the amount available for distribution is the realized income for the Fund. He exemplified a fund with a principal worth \$23 billion, and the value is \$21 billion because the stock market went down dramatically, and realized income is \$1 billion. He noted that under the current formula, \$1 billion is available for distribution, even though the value of the fund is below the principal.

Senator Seekins applauded Mr. Storer for being a nonpartisan manager of the Fund. Senator Seekins asked how the witness would promote the current management method if directed to do so.

Mr. Storer replied he would have "great difficulty". He expressed that POMV not only modernizes the payout methodology, Generally Accepted Accounting Principles (GAAP) makes no distinction between realized income and appreciation. He informed that most endowments and foundations utilize a POMV payout system. He noted that currently the Corporation is required to defend why the GAAP does not apply to the Fund. He furthered that realized income could be manipulated as well.

Mr. Bartholomew explained the resolution and the changes made in the Senate State Affairs committee substitute.

Mr. Bartholomew informed that Section 1 of the bill amends Article IX, Section 15 of the Alaska Constitution to provide for a POMV method. He pointed out the removal of the term "principal", stipulating that all the monies would be considered as one fund. He furthered that currently the Constitution directs that all income generated from the Fund be deposited into the State general fund, unless otherwise provided by law. He noted that current statute has

provided that all income would be retained in the earnings reserve account of the Fund. This resolution, he stated would constitutionally require that all monies remain in the Permanent Fund until appropriated.

Mr. Bartholomew addressed the addition of subsection 15(b) to the Constitution contained in Section 2 of the resolution. He explained this language implements the POMV and places a spending limit on the amount that could be withdrawn from the Fund of no more than five percent of the value of the Fund calculated on a five-year average. He assured this five-year average would limit the volatility. He further noted that the language contains a "look-back" provision requiring the five-year average calculation be made on the first five of the previous six years. He explained this is to provide the Legislature, when convening in January of each year, with calculations based on five completed calendar years. He stated the Legislature would therefore be aware of the amount available for appropriation in the upcoming fiscal year.

Mr. Bartholomew said Section 3 of the resolution is technical and specifies that if this amendment were made to the Constitution, the balance of the earnings reserve account would be deposited into the Permanent Fund. He relayed this is to address the legalities of whether the existing earnings reserve account, with a balance of "several billion dollars", is actually part of the Permanent Fund or the general fund.

Mr. Bartholomew summarized that Section 4 of the resolution provides that the proposed constitutional amendment would be placed on the ballot of the next general election.

Senator Bunde pointed out not all current Alaskan residents were present when the Alaska Permanent Fund or the dividend program was established. He surmised that "revisionist history" was occurring. He relayed public comments expressing concern that the legislature "keep their hands off the Permanent Fund", and he attributed this to over ambitious campaigning by some legislators promising to do so. He understood earnings of the Fund have been spent. He asked for affirmation that during the first two years the Fund was in existence, whether the earnings were deposited into the State general fund and appropriated for government services.

Mr. Bartholomew answered this is correct and explained that all earnings were deposited to the general fund and spent for government services. In 1982, he informed, the legislature adopted the current statute, which retained the earnings in an earnings reserve account subject to legislative appropriation.

Senator Bunde stated that approximately one-third of the balance of the principal is from appropriations from the earnings reserve account. He surmised that this could technically be considered as spending of the earnings.

Mr. Bartholomew affirmed the principal of the Fund now is about \$23 billion, made up of the three aforementioned components. He stated that the funds in the earnings reserve account were available for appropriation and that the legislature has opted to transfer a portion of those funds and deposit into the principal, making them no longer available.

Senator Bunde also understood that "tens of millions" of dollars from the earnings reserve account have been appropriated for hold harmless provisions to offset reductions in public assistance benefits that some Alaskans would incur as a result of the increased income of the dividend.

Mr. Bartholomew replied that currently, of the amount available annually for expenditure, \$35 million is appropriated for non-dividend activities. He stated that \$5 million is utilized to operate the Permanent Fund Dividend Division, and the remainder is appropriated to the Department of Corrections and to the Department of Health and Social Services.

Senator Bunde pointed out that a portion of the earnings of the Fund have been spent in the past and continue to be appropriated by the Legislature and therefore a proposal to spend a portion of earnings for government services is not "sacred ground."

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Senator Bunde commented that Mr. Storer expressed he would find it difficult to "sell" the current formula because it differs from acceptable accounting practices. However, Senator Bunde remarked that a "clear majority" of the public is resistant to the POMV proposal and would oppose it in an election. He expressed concern about placing such a proposal on the ballot that is predestined to fail.

Mr. Storer reported that when given an opportunity to explain the POMV method, listeners support the proposal. He exemplified that straw polls conducted of the conferees at the Conference of Alaskans first reflected opposition to a POMV plan. However, the plan received higher support once the conferees understood the method. He indicated that if the Legislature passed a resolution to amend

the constitution to change to a POMV method, the Corporation would increase efforts to educate the public.

Senator Bunde reminded of the special election held in September 1999 in which voters rejected a proposal to convert to a form of POMV for managing the Permanent Fund. He relayed that since that time, when the subject is addressed, common response is, "What part of no don't you understand?"

Mr. Storer understood the concerns. He recalled that the aforementioned advisory vote was "open-ended" and proposed a payout of 5.8 percent. He attributed many reasons for the opposition of the ballot proposal. He also realized that a number of years had to pass before the issue of utilizing the Permanent Fund earnings for government spending could be reconsidered. He submitted the current proposal is not a spending plan but rather a spending limit. He stated the goal is to "memorialize inflation proofing into the Constitution" to ensure the viability of the Fund. He admitted obtaining voter approval for the POMV would be a "big hurdle".

Mr. Bartholomew added that the public concerns focus on use of the earnings of the Fund and not protection of the Fund. He emphasized the important of being clear on this distinction when discussing the matter. He noted other proposals address use of the earnings of the Fund, but were separate issues from the POMV method of managing the Fund. He told of confusion with "mixed messages" not clearing identifying the differences.

Senator Dyson understood that under a POMV method, a maximum of five percent would be available for distribution and that if the five-year average market value of the fund has only increased four percent, the amount available for distribution would be limited to four percent.

Mr. Bartholomew clarified that under the current proposal, the constitution would specify a five-percent payout limit. He relayed that discussions of "guard rails" have occurred to further reduce the percentage available for payout in the event of poor performance of the Fund. He recommended that if such a method were instituted, the determination should be based on at least a ten-year average.

Senator Dyson commented that the ability to payout from the principal is the basis of criticisms of the POMV proposal.

Mr. Storer emphasized this is one "crux of the issue". He remarked that the decision makers i.e., the legislature would have the ability to determine whether payouts of five percent or less that

amount would be made in years when the total market value of the Fund has failed to increase by at least five percent. He stressed that the legislature would have the ability to determine what action is in the best interest of the State. He noted that currently, the legislature does not have this option.

Senator Dyson reiterated that the argument remains that under the present law, the legislature is unable to appropriate funds from the principal of the Fund. He asked whether the proposed constitutional amendment should include a guarantee against drawing against the principal.

Mr. Storer advised against tying payouts to performance of the Fund. He relayed that "discussions" have been held with "some elected officials," suggesting the adoption of statutory "guidelines that would give the legislative body the insight to determine that inflection point" as to whether the entire five percent should be utilized.

Senator Dyson gave a hypothetical situation in which the Fund has had four percent growth for several years, and the legislature chose to appropriate four percent to payout of dividends and no other purpose. In this scenario, he pointed out, the Fund would not be inflation proofed, regardless of the actual rate of inflation.

Mr. Bartholomew stressed that worst case scenarios must be used for comparison. He agreed that under the POMV method, inflation proofing would not automatically occur; however he pointed out that in instances of no earnings, inflation proofing would not occur under the current formula either. He remarked that under the current system, the legislature has no option to expend funds from the Fund in years of down markets. He emphasized that in a bad market, the legislature would have the ability to spend funds under POMV.

Mr. Bartholomew listed three issues that must be understood by the public in considering this matter. He stated that the current formula is "broken" and is not prepared for down markets because the earnings and the principal have been commingled. He explained that \$5 billion in earnings that should be available to "cushion" the payout in down years have instead been deposited into the principal and thus "taken off the table." He opined that the risk of spending down from the principal during down years under a POMV method is "far outweighed" by the provisions of the current formula that allow larger appropriations from the earnings reserve fund in strong years. He admitted the tradeoff in adopting a POMV methodology and stated the issue is which method provides the greatest protection. He relayed that the Trustees' position is that

POMV provides the greatest protection.

Senator Dyson clarified that under POMV there is no earnings reserve account.

Mr. Bartholomew affirmed.

Senator Olson asked if the POMV is such a valuable management tool, why the Corporation did not aggressively pursue a change before and instead wait until the State was in the current fiscal situation. He remarked that the public is wary of this proposition, partially due to the timing.

Mr. Storer responded that in 1994 a POMV method of payout was first proposed. He continued that this option was "defined well before" the State incurred its current fiscal problems, although it has taken time for the issue to receive attention. He viewed the negative comments positively, because it shows that people are interested in the matter.

Senator Olson asked of instances of funds or endowments implementing a POMV system that resulted in negative situations in which the decision to implement POMV was regretted.

Mr. Storer referenced a study reporting that 85 percent of participants in an association of college and university business offices utilizes some variant of POMV. He clarified that the decision to implement POMV was not regretted, rather "they got caught up in overspending." He told of one university beginning a large capital project during the bull market, and now must proceed with the project despite generating less income.

SENATOR BERT STEDMAN clarified the terminology used at this hearing, notably the implication that a POMV method would modernize the Permanent Fund. He was under the impression that a form of POMV has been used by other endowment funds for many years.

Mr. Storer informed that the first fund to adopt a POMV method was the Ford Foundation in 1968. He said few funds adopted this method during the 1970s because most were invested conservatively during that time. However, he noted more funds converted to POMV during the 1980s and that some universities utilize complex formulas.

Senator Stedman pointed out that this proposal would not therefore "take the Permanent Fund to the leading edge." He clarified that as currently structured, the management of the Permanent Fund is behind methods employed by other endowment funds, such as Harvard.

Mr. Storer remarked that the Alaska Permanent Fund remains one of the most conservatively managed endowments. He noted that retirement funds are not managed with a POMV system because of obligations to retirees. He also stated that unlike other public funds, the Permanent Fund is limited in how the funds could be invested.

Senator Stedman reiterated that if POMV were adopted for the Permanent Fund, the management would still be "no where near leading edge."

Mr. Storer characterized the management system as "catching up" to the methods employed for other funds.

Senator Stedman asked if other public entities in Alaska utilize a POMV methodology.

Mr. Storer gave the University of Alaska Foundation and the Municipality of Anchorage as examples.

Senator Stedman asked current market value of the principal of the Permanent Fund.

Mr. Storer responded that the total of contributions, inflation proofing and special appropriations is approximately \$23 billion. He also stated that if a POMV methodology were in place, approximately \$1.3 billion would be available for payout.

Senator Stedman asked how long during a "normal bear market" it would take before the market value calculation "dipped into" what is currently considered the principal of the Fund.

Mr. Storer replied that there is no "normal bear market" due to many variables and he could not therefore calculate when the threshold would be reached. He reminded that in March of 2000 the Fund contained a "cushion" of \$8 billion, which was utilized to inflation proof the Fund and to payout three "substantial" dividends. He stated that if the entire \$8 billion had been paid out in dividends during one year, no funds would have been available for the next three or four years for dividends.

Senator Stedman surmised it would take longer to "dip" into the principal under the current Fund management than under a POMV management.

Mr. Storer agreed. He furthered that "human behavior" would become less of a factor under a POMV method and that it would be "easier to stay the course" in operating the Fund. He reiterated that past

discipline has allowed excess earnings to be "captured" and deposited into the corpus of the Fund, but he questioned whether different memberships on the Trustee Board would demonstrate the same behavior.

SENATOR GRETCHEN GUESS asked why the POMV management system should be stipulated in the Alaska Constitution rather than State statute.

Mr. Storer responded that the original intent of the Trustees was to institute the management provisions into the Constitution because statutes could be changed without voter approval.

Mr. Bartholomew furthered that "near term down markets" could not be addressed in statute if the excess earnings have been "locked up." He explained that dividends could not be distributed if this occurred. He stated that it is necessary to eliminate the earnings reserve fund and principal and incorporate both into one fund, which must be done constitutionally.

Senator Guess countered that the earnings of the Permanent Fund are always available for the legislature to appropriate and are therefore not "locked up".

Mr. Bartholomew replied that the proposed POMV assures that the situation of the year 2002, in which the earnings reserve fund was almost depleted, would not occur. He reported that the earnings reserve fund balance was almost zero because a dividend was paid the prior year, stock market earnings reduced and the legislature "swept" \$250 million to the principal of the Fund in 1999. He informed that if the bear market had continued another three months, no funds would have been available to pay dividends in 2003. He stated that under the POMV method, this situation would not have occurred because dividends could have been paid utilizing the principle of the Fund. He qualified that if the goal is to always maintain the current "concept of principal", statutory provision could be enacted to ensure it. He cautioned that the risk of little to no payout would remain.

Senator Bunde clarified asked if the proposal would place the current practice of transferring funds from the Permanent Fund to the State general fund into the Constitution, rather than current statute.

Mr. Bartholomew affirmed.

SENATOR TOM WAGONER asked if the Legislature passed a resolution to place a POMV initiative on the ballot, if the intent of the Corporation is to advertise in support of the POMV method and

educate the public as to its merits. He asked the source of funding for these efforts.

Mr. Bartholomew told of funding requests before the legislative finance committees. He noted if these funds were not appropriated, the Corporation would continue the current practice of accepting speaking invitations and explaining the issue in those forums.

Senator Wagoner clarified the funding request would appropriate funds from the Permanent Fund earnings reserve account for the advertising and education activities.

Senator Bunde ascertained the primary opposition to the POMV proposal is primarily generated from the "Just Say No" organization. He recognized concerns with utilizing earnings of the Fund for State services, but reiterated that these earnings are already being spent. He asked if the Corporation has considered how to address this organization.

Mr. Storer relayed that the Corporation has requested to speak to the "Just Say No" organization and has not received a response. He expressed interest in speaking to its members, as he said the group has raised important questions.

SENATOR HOLLIS FRENCH referenced earlier conversations between himself and Mr. Storer regarding concerns about the long-term effects of inflation. He predicted the possibility of "entering a new financial era" similar to the "hyperinflationary times of the early 1970s". He surmised that if the "best and brightest financial minds" were asked four years ago whether the federal budget could revert from a \$.5 trillion projected budget surplus to \$.5 trillion budget deficit, these experts would have answered it could not possibly occur. He was therefore concerned about unforeseen consequences. He recommended inserting "either the difference between the rate of return and the rate of inflation" to Section 2 of the resolution on page 2, line 3, amending Article IX, sec. 15 of the Constitution, to read as follows.

(b) To protect the permanent fund from the effects of inflation and thereby assure that the real value of the permanent fund will be preserved over the long term, appropriations from the permanent fund for a fiscal year may not exceed either the difference between the rate of return and the rate of inflation, or five percent of the average of the market values of the fund on June 30 for the first five of the six fiscal years immediately preceding that fiscal year.

He surmised this would provide assurances for years with lesser

earnings. He asked whether the Trustees have considered a "closing-off mechanism" that would remove the decision from the legislature to determine appropriation amounts in the event that earnings were less than five percent. He expressed concern that the public would consider the current proposal a guarantee of payout and that the legislature would have difficulty appropriating a lesser amount.

Mr. Storer informed that two situations of "hyper-inflation" occurred in the past. He cautioned against "competing complex formulas."

Mr. Bartholomew emphasized that whether instituted in the Constitution or in statute, payout calculations should not be made based on annual earnings. He recommended against a year-to-year analysis and instead recommended a structure based over a period of time.

Co-Chair Wilken ordered the bill HELD in Committee.

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#### **ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 03:05 PM