

**ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE**

MAT-SU LIO
October 29, 2003
7:00 p.m.

MEMBERS PRESENT

Senator Ralph Seekins, Chair
Senator Scott Ogan, Vice Chair
Senator Johnny Ellis (via teleconference)
Senator Hollis French (via teleconference)

MEMBERS ABSENT

Senator Gene Therriault

OTHER LEGISLATORS PRESENT

Senator Lyda Green
Representative Mike Hawker (via teleconference)
Representative Eric Croft (via teleconference)
Representative Vic Kohring

COMMITTEE CALENDAR

SENATE JOINT RESOLUTION NO. 18
Proposing amendments to the Constitution of the State of Alaska relating to limiting appropriations from and inflation-proofing the Alaska permanent fund by establishing a percent of market value spending limit.

HEARD AND HELD

SENATE JOINT RESOLUTION NO. 19
Proposing amendments to the Constitution of the State of Alaska relating to the Alaska permanent fund.

HEARD AND HELD

PREVIOUS ACTION

SJR 18 - See State Affairs minutes dated 5/1/03 and 5/6/03 and Judiciary minutes dated 5/15/03, 6/26/03 and 10/28/03.
SJR 19 - See State Affairs minutes dated 5/13/03 and Judiciary minutes dated 5/17/03, 6/26/03 and 10/28/03.

WITNESS REGISTER

Mr. Eric Wohlforth
Wohlforth, Vassar, Johnson and Brecht
900 West Fifth Avenue, Suite 600
Anchorage, AK 99501-2048

POSITION STATEMENT: Presented SJR 18 to the committee

Mr. Phil Furbush
Palmer, AK

POSITION STATEMENT: Opposed to any legislation that allocates any portion of the fund for the state budget

Mr. Games Garhart
Wasilla, AK 99687

POSITION STATEMENT: Likes the direction of SJR 18 but expressed concerns

Mr. Dirk Nelson
Ester, AK 99725

POSITION STATEMENT: Believes the budget shortfall is due to the fact that Alaska oil is being sold at below market value

Mr. George Williams
No address provided

POSITION STATEMENT: Believes SJR 18 should contain a fixed percent that the Legislature can spend, not "up to" 5 percent

ACTION NARRATIVE

TAPE 03-58, SIDE A [RECORDING BEGINS SEVERAL MINUTES AFTER THE MEETING CONVENED.]

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

CHAIR RALPH SEEKINS called the Senate Judiciary Standing Committee meeting to order at 7:00 p.m.

MR. ERIC WOHLFORTH, public member of the Alaska Permanent Fund Corporation (APFC) Board of Trustees, said that both SJR 18 and HJR 26 [House companion legislation] propose a constitutional amendment, which he informally calls, "the 5 percent solution." They provide for a permissible legislative payout of 5 percent of the fund's market value, averaged over a 5-year period from the permanent fund. Under the current system, actual earned income from the fund is available for legislative appropriation. The Board of Trustees supports a 5 percent market value payout solution for a number of reasons. It will conserve the fund for

future generations and maintain its ability to pay out monies for current generations.

MR. WOHLFORTH referred to a handout he distributed to members and gave the following presentation.

The seven trustees of the permanent fund are not taking any stance on how the income from the permanent fund should be used. The trustees are promoting what they believe is a more efficient and effective mechanism for the availability of income each year.

The chart on the top of page 2 shows the permanent fund market value over the last four years. In the year 2000, the value was \$26.5 billion, comprised of the reserved account - the principal, of \$23.5 billion, and the realized income account of \$3 billion. The total value of the fund eroded to \$23.5 billion during the poor performing market for 2.5 years until nine months ago. The amount of the realized income available for distribution at June 30, 2002 was \$100 million. The realized earning account is the account from which the Legislature appropriates income each year for payment of dividends and for inflation proofing. That account is comprised of actual income earned by the fund.

The fund's asset allocation is illustrated on page 3 of the handout. In 1978, the fund was invested almost entirely in bonds. Since that time, the fixed income portion of investments has become a minority amount, around 40 percent. A substantial amount of the fund is invested in domestic and foreign stocks, and the balance is invested in real estate. When the fund was invested in bonds, interest payments were received every six months. The amount available for expenditure was based on actual income. Now that a major portion of the fund is invested in stocks, that formula is no longer correct and should be superseded. The Board of Trustees proposes a constitutional amendment to limit spending to 5 percent of market value (POMV).

MR. WOHLFORTH said the POMV is explained at the top of page 4. Various studies have shown, over a 30 to 40 year period, that a fund like the permanent fund can expect to have an average annual return of about 8 percent. Inflation will average 3 percent. Those studies show that the maximum annual sustainable payout is 5 percent, based on the 8 percent earnings and the 3 percent cost of inflation proofing. Should the Legislature pass either of the resolutions and the voters support a

constitutional amendment, the Legislature could spend up to 5 percent of the market value.

MR. WOHLFORTH said the fund's performance as shown at the bottom of page 4 shows that historically the fund's return would have met this rate of return target. He said he refers to the Board of Trustees' proposal as the 5 percent solution because the phrase "POMV" is unfamiliar to people. It will protect the fund by eliminating the distinction between principal and earnings. It protects the option of having an annual distribution for dividends and it protects the fund for future generations by restricting spending.

MR. WOHLFORTH said the current formula payouts are shown on the bottom of page 5, projected to 2005. They are based on projections of earnings provided by the APFC's outside consultant and show the statutory amount currently available for appropriation. The actual figures through 2003 show what was available for the dividend transfer and for inflation proofing. He said the \$490 million figure for 2005 is due to the fact that the current payout formula requires a calculation based on the average of the last five years and some of the worst years in the stock market occurred during that time period. Dividend payments for the next two years are projected to be below \$1170.

MR. WOHLFORTH referred to the top of page 6, and said the 5 percent formula requires that the funds be calculated by multiplying the current market value, which today is \$25.9 billion, by 5 percent, which amounts to a \$1.3 billion payout. The chart on the bottom of page 6 shows volatility. The chart shows that the investment of the permanent fund is far more volatile and apt to jump up and down in large measure from year to year if the current formula continues to be used. That is because the new formula is based on a straight 5 percent of the market value each year; the old formula is based on actual earnings over 5 years.

MR. WOHLFORTH said the new formula ensures the Legislature will have the ability to make an annual payout. It will make the payout amounts more stable from year to year and will make the payout amounts compatible with investment strategy. At the present time, if the APFC decides to terminate an investment manager because of poor performance, and the account contains \$300 million of unrealized capital gains, the manager would sell the account upon transfer and produce \$300 million in actual income. Those monies would go into the actual payout formula. Some of the very large amounts of realized income during the

bull market years were realized for exactly that reason. Those earnings had nothing to do with investment strategy but were due to management changes. That is not the way modern endowment funds are managed. He pointed out the North Slope Borough endowment fund is managed using the POMV formula, as is the Municipality of Anchorage fund. He urged the committee to give favorable consideration to one of the two resolutions.

CHAIR SEEKINS noted that Senator French was participating via teleconference, as was Representative Croft. He then opened the meeting to questions of Mr. Wohlforth.

SENATOR OGAN noted that he attended the Senate Judiciary Committee meeting in Kenai the previous night and learned a few things. The committee heard an interesting discussion on how the 5 percent of market value would be paid. One testifier noted even though the 5 percent of the market value is paid out, the fund would have no realized income until stocks are sold. He asked if assets would have to be liquidated to make the payout.

MR. WOHLFORTH said the proposed 5 percent would be available, regardless of liquidating assets. That might well require the liquidation of assets. The whole range of assets would be considered to fund the 5 percent.

CHAIR SEEKINS said when he served on the Board of Trustees, a certain amount of the permanent fund was in cash while ownership was transferred. He asked Mr. Wohlforth about his statement that firing a manager would cause a realized gain. He asked if the equity would still be held in the name of the State of Alaska and transferred to another manager without a sale.

MR. WOHLFORTH said that is possible on some occasions. The endeavor, when a manager is terminated, is to see if those stocks can be transferred to another manager. However, there are also sales to make up the transfers at times. He said any sale of an asset could produce a capital gain.

CHAIR SEEKINS said to his recollection, the board had investment managers but depositories held the stocks that were being managed.

MR. WOHLFORTH said the APFC still has a custodian that does all of that.

SENATOR GREEN pointed out it is important to emphasize that the Legislature could use "up to" 5 percent under the proposal, and would not be mandated to use that much.

MR. WOHLFORTH agreed and said the suggested language for the constitutional amendment says the Legislature can pay out up to 5 percent of the market value on a 5-year average basis. It is the board's strong belief that how the 5 percent is used [will be determined by the Legislature].

CHAIR SEEKINS noted the arrival of Representative Kohring.

MR. WOHLFORTH explained the first step is to get the 5 percent spending limit enacted to get in line with how other funds are managed.

CHAIR SEEKINS asked Representative Hawker if the language on page 2, line 4 that says "may not exceed 5 percent" is also in his resolution [HJR 26].

REPRESENTATIVE HAWKER said that is correct and explained the difference between the House and Senate version is some predicate language that was modified in the House version. The substance of the resolutions remains the same.

CHAIR SEEKINS said it is important to emphasize that neither resolution mandates that the Legislature draw 5 percent from the permanent fund every year. The amount drawn, up to 5 percent, would be at the Legislature's discretion so that the Legislature could opt to draw nothing in the case of a financial disaster in the markets.

SENATOR OGAN said he believes his constituents are very mistrustful of any suggestions to change the permanent fund. He said there have been a couple of runs on using the earnings reserve for government expenses. He asked Mr. Wohlforth to review how this proposal would change the dividend program because he fears a lot of people do not understand the difference between the constitutionally protected corpus of the permanent fund and the dividend program. The dividend is not a constitutionally protected entitlement. He asked Mr. Wohlforth to describe how the amount of the dividend would be determined and distributed.

MR. WOHLFORTH said the best way to approach that would be to go back almost two years ago when the earnings reserve had dipped substantially and everyone feared that no money would be

available for the dividend. By good fortune, the markets corrected and the earnings reserve showed a positive balance. He said using up to 5 percent of the market value allows for any use the people and Legislature determine. It will provide assurance that funds will be available for the dividend and other uses, whereas the current formula is an outmoded regime designed when the entire permanent fund was invested in bonds and there was no uncertainty about the earnings. He repeated the 5 percent market value would make certain that funds are available each year. He said he understands people's apprehension but wishes this proposal had advanced years ago.

SENATOR OGAN said this is not a change to the formula used to calculate the dividend; it is simply a change in how the corpus of the permanent fund is managed.

MR. WOHLFORTH said that is an accurate statement.

CHAIR SEEKINS said when he was a member of the Board of Trustees in 1990, the Board discussed the possibility of a different distribution method and the percent of market value. At that time, the POMV was emerging in endowment funds. He asked if 85 percent of endowment and retirement funds are now using the POMV method of distribution.

MR. WOHLFORTH said that is correct and that the POMV has almost become the universal way to measure how much can be paid out in a given year.

SENATOR OGAN asked if the payout has traditionally been about 4.5 percent.

MR. WOHLFORTH said that is about right.

SENATOR OGAN asked if it is prudent to say 5 percent.

MR. WOHLFORTH said saying "up to" 5 percent provides some flexibility.

CHAIR SEEKINS said the Legislature will have the opportunity to decide the amount on an annual basis. He said any legislator could propose any amount up to 5 percent.

REPRESENTATIVE CROFT asked if the corpus of the fund could ever be invaded if the Legislature pays out 5 percent over several years of poor markets.

MR. WOHLFORTH explained that under the POMV approach, the concept of principal would no longer exist; the principal and earnings reserve will be treated as one entity.

CHAIR SEEKINS asked Representative Croft if he would vote for a 5 percent drawdown in a bad year.

REPRESENTATIVE CROFT said he would not but expressed concern that relying on the Legislature to spend less than it can get its hands on is an "iffy" proposition.

CHAIR SEEKINS said in the history of the permanent fund, over one-third of the deposits to the principal have been made by the Legislature, showing a good track record.

REPRESENTATIVE CROFT said Chair Seekins has more faith than he does.

CHAIR SEEKINS said he would not vote for a 5 percent payout in a poor market year either.

REPRESENTATIVE CROFT commented that most of the endowments he has reviewed are in the 4.7 to 4.8 percent range; very few pay out 5 percent. He asked if that is correct and why 5 percent is supposed to be the correct number.

MR. WOHLFORTH said the university endowment funds show a payout of 5 to 5.5 percent. He said the Board of Trustees believes that 5 percent is a good long term average, based on the National Association of College Endowments Study of 2002.

CHAIR SEEKINS asked if the board proposed a 5 percent payout or a payout not to exceed 5 percent.

MR. WOHLFORTH said the Board proposed a payout not to exceed 5 percent.

SENATOR GREEN asked if one of the provisions makes the entire permanent fund subject to legislative appropriation.

MR. WOHLFORTH said that is incorrect.

SENATOR GREEN said she wondered whether a chart is available that shows the amount of the payout had the POMV method been used and a chart showing a futuristic comparison if the current formula continues to be used. She questioned whether they would show a substantial difference looking back or forward.

MR. WOHLFORTH said those charts do exist. They show an interesting degree of sameness of payout permission if one superimposes the new formula on the old payout rule. He said, in further response to Representative Croft, a letter to Senator French dated September 9 shows the average payout of the 660 members of the National Association of College Endowments is 5.3 percent. He said he would be glad to supply committee members with further detail and background information.

SENATOR FRENCH said his question deals with years when the return on the permanent fund is zero or negative. During those years the Legislature could take a 5 percent payout, however the overall value of the fund would be reduced. He said it seems the check on that is the language in the bill that says the Legislature can pay out up to 5 percent, so it therefore could pay out nothing, to match market conditions.

MR. WOHLFORTH said that is the case. The Legislature could determine that a lesser payout is appropriate if the market is "sick."

SENATOR FRENCH responded:

My next thought is that if the Legislature starts to sort of be wise and the Legislature starts to protect the value of the permanent fund by sort of setting the payout at the rate of return that the fund is making, then aren't we kind of reinventing the wheel? Aren't we going back to the plan that we have in effect right now, which is that we let the market determine how much is available for appropriation every year?

MR. WOHLFORTH said no one is able to say with certainty that the permanent fund will earn 5 percent under all circumstances. However, under the circumstances [Senator French referred to], the Legislature can determine what is appropriate for that year. He believes this proposal is substantially better than what is used now, but he does not believe there is a perfect formula for all foreseeable contingencies.

CHAIR SEEKINS asked if the POMV formula would have been sustainable over the last 20 years.

MR. WOHLFORTH said it would have.

CHAIR SEEKINS announced that he would take public testimony.

MR. PHIL FURBUSH, a resident of Palmer representing himself, said he strongly opposes any legislation that would remove the constitutional protection of the permanent fund, which SJR 18 would do. In addition, he opposes any legislation that allocates any portion of the fund for the state budget or reduces the amount of revenues allocated to the fund. He said if the goal is to protect the permanent fund, more amendments would have to be made to the Constitution to do that, such as an amendment that would not allow any portion of the permanent fund to be used for the budget. Another amendment might require that more money be deposited into the fund. He said if the goal is to provide a predictable dividend, then only a portion of the earnings should be used, not a portion of the entire fund. He said he cannot see how removing the protections and taking any percentage of the fund, whether it is making money or not, protects the fund. If more money is needed for the state budget, the Legislature should implement an income tax that more fairly spreads the burden among those who are able to pay. He said if the permanent fund dividend is taken away from a family of four living on \$20,000, the loss would equal 20 percent but taking the dividend away from a family of four earning \$200,000 would amount to two percent. That puts a bigger burden on the lower income family.

MR. FURBUSH said the permanent fund is all the state has to show for the nonrenewable resources it has consumed. He asked what the state will do to provide energy for the state when the oil is gone. He said the permanent fund is all the state will have to use. He said his biggest worry is the state will use up its oil and spend the permanent fund and leave future generations with no way to provide for energy or their other needs.

REPRESENTATIVE KOHRING said he concurs with many of Mr. Furbush's statements. He, too, is worried about the future of the fund if the POMV concept is adopted. He said he is looking at the POMV concept from a money management perspective and questions whether it is prudent management to threaten the principal of the fund by virtue of guaranteeing a payout dividend when the market is such that the fund is not profiting. He said from the perspective of a private corporation, spending seed core money to pay a dividend would be a bad thing. He repeated that it appears to him that the POMV concept will risk the principal of the permanent fund. He also expressed concern about the issue of spending a portion of the permanent fund on government expenditures, which will provide a disincentive to government reform.

TAPE 03-58, SIDE B

MR. JAMES GARHART, a resident of Wasilla representing himself, said the [APFC} fall 2002 revenue booklet says the annual permanent fund dividend distribution has been equal to about 4 percent of the market value of the fund. He said the fact that the 5 percent is a cap and not a mandate seems straightforward. He asked if use of the 5 percent would be restricted to permanent fund-related expenses, such as administration, inflation proofing and dividends.

CHAIR SEEKINS said that would remain exactly the same, meaning the disbursement of those funds would be up to the Legislature.

MR. GARHART asked whether any amount over 5 percent would be rolled back into the fund.

CHAIR SEEKINS said not necessarily, and that it has not been that way in the past. He explained that \$7 billion of the fund today is comprised of earned income that was redeposited by the Legislature into the principal to protect it from being spent on other areas of government.

MR. GARHART asked where those excess funds would go if the POMV proposal goes into effect.

CHAIR SEEKINS said there would not be any excess funds because the drawdown would be determined using 5 percent, even though the fund may have earned 20 percent. The 15 percent difference would remain in the fund so it would not have to be redeposited.

SENATOR GREEN contended that in some ways, if the permanent fund had a huge earning year, it would be less vulnerable under the POMV system.

CHAIR SEEKINS said having been a trustee he is aware that under the current system the trustees can play God with the permanent fund profit every year. He referred to page 6 of the handout, which shows the volatility of the fund, and said in 1996 a huge spike occurred in the realized gains. That was created at the instruction of the Board of Trustees. Those six people determined what became realized gains. He said the trustees can cherry pick the fund during a bad year and sell the winning investments off thereby increasing the gains and reducing the principal. He indicated the principal of the fund is not absolutely protected today. He expressed concern about the

political volatility that can come into play under the current system that would no longer come into play under the POMV.

MR. GARHART said his understanding is that under the current system, the earnings are supposed to be deposited into the general fund unless otherwise specified by law. The 5 percent proposal would eliminate that because the earnings reserve account would no longer exist. He then said, regarding Senator Ogan's comment about 83 percent of the voters being opposed to allowing the permanent fund earnings to be used to fund government several years ago, he also voted against that ballot initiative because it said a portion of the earnings could be used but did not specify how much. He said his biggest concern is that a portion of the 5 percent will start being used to pay government expenses.

CHAIR SEEKINS said nothing in this proposal mandates or prohibits that from happening. SJR 18 is strictly a way to have a reasonably predictable distribution on an annual basis.

MR. GARHART said most of the people he has talked to share his concern.

CHAIR SEEKINS said the Legislature could use every penny of the earnings reserve today to fund government under the current program. He said whether the political will to not use it will be there in the future depends on what kind of a disaster may arise.

MR. GARHART mentioned that one of his biggest concerns with the budget shortfall is the mandate that 25 percent of the royalty amount must be deposited into the corpus of the permanent fund in addition to inflation proofing, which builds the corpus of the permanent fund at the expense of the budget deficit.

CHAIR SEEKINS said the inflation-proofing mandate is statutory, not constitutional. The Legislature has acted responsibly over the years by inflation proofing the fund. However, if a decision has to be made as to whether to inflation proof the fund or pay for education that would entail a big discussion. If the 5 percent proposal is adopted, inflation proofing becomes inherent to the process.

MR. GARHART said he likes the direction the 5 percent proposal takes but believes more protections are needed.

MR. DIRK NELSON, a resident of Ester testifying on his own behalf, said his main concern is that changing the rules of the game of making the permanent fund inaccessible to the Legislature is not the problem; the game itself is. He has talked to people who have researched the market value of North Slope crude versus what the oil corporations are paying for that oil. He said Conoco-Phillips posted a \$1.3 billion profit according to a newspaper story published yesterday, while North Slope crude is being sold at well below market value. He questioned why the Legislature is not looking in that direction. He said the state should be looking at market value and, likewise with the gas line, exactly how Alaska accrues its royalties and why certain persons who claim to represent the citizenry are fond of specific plans that give the citizens less royalty.

MR. NELSON said he opposes changing the current rules governing the permanent fund and anything that will further allow legislative access to the fund when the state is not being responsible in getting market value for its resources.

CHAIR SEEKINS asked Representative Hawker, a member of the House Ways and Means Committee, to take Mr. Nelson's comments under advisement.

REPRESENTATIVE HAWKER agreed to do so and said the House Ways and Means Committee has scheduled meetings in several locations during the months of November and December.

CHAIR SEEKINS asked for comments from the members or public. There were none. He then asked Mr. Wohlforth if he is correct in assuming that the benefit to the 5 percent proposal is that it will provide a relatively simple, predictable number.

MR. WOHLFORTH said that is correct.

CHAIR SEEKINS said even though the number will be more predictable, based on the history of the permanent fund, it will not "eat" into the principal to the fund.

MR. WOHLFORTH said that is correct. He added that according to the volatility chart, the permanent fund has had enormous earnings in a given year, 20 percent, all of which would have been available for legislative appropriation. The new formula of even, annual, permitted "up to" distributions is the telling point of preserving the fund and will sustain the fund on a long-term basis.

CHAIR SEEKINS asked whether the current method or the POMV gives the Board of Trustees the opportunity to look at long-term investments versus remaining in a short-term investment.

MR. WOHLFORTH answered the 5 percent of market value proposal is the tool that fund managers, trustees, and investment managers need to sensibly manage for the long-term and not be concerned by an annual spike. In addition, the POMV will prevent the Legislature from using all of a 20 percent return, if 20 percent was available. He said the point he is trying to get across is that the realized earning formula just doesn't work for a fund that is no longer composed solely of bonds.

CHAIR SEEKINS asked if the POMV method would eliminate political volatility as well as market volatility.

MR. WOHLFORTH said that any potential political volatility would be eliminated.

CHAIR SEEKINS said he threw out a theoretical situation where a person could convert unrealized gains into realized gains for political reasons during a poor market. He asked if the POMV would eliminate that possibility and thereby protect the fund even more.

MR. WOHLFORTH replied:

Absolutely, Mr. Chair, and if it should ever happen, God forbid, in a future year - there's an election year, and we've gotten into such a mess that somebody running for governor would say wouldn't it be great if we could, in fact, enhance the dividend this year, even realizing it's a 5-year average, by selling out these securities, all of which have got some appreciation over cost even though it's a down year. The 5 percentage of market value solution takes even the possibility of politics out of an action program like that.

SENATOR OGAN asked Mr. Wohlforth if such a move has ever been made for political purposes.

MR. WOHLFORTH said not to his knowledge. He said he believes Chair Seekins will agree that the trustees, during his term on the board, simply acted as professionally as they could to manage the money.

CHAIR SEEKINS said he was never asked to do that and had he been, he probably would have resigned.

SENATOR OGAN asked Mr. Wohlforth if the permanent fund earnings have exceeded the amount of revenue the state has generated from royalties.

MR. WOHLFORTH said he believes that line is very close to crossing.

SENATOR OGAN commented if the state does not get more resource development going, "We're all in deep kimchee folks."

CHAIR SEEKINS agreed.

MR. GEORGE WILLIAMS, a resident of the Mat-Su Valley, said his concern is that SJR 18 allows the Legislature to spend "up to" 5 percent. He believes people will not be satisfied without a fixed number. He said most people do not trust the Legislature to handle their money. They worry the Legislature will dip into it to manage government. He believes the Legislature should establish an income tax before making any changes to the permanent fund and believes the majority of Alaskans would support an income tax today.

SENATOR OGAN said he believes the permanent fund represents the fact that the citizens collectively own the subsurface rights of the minerals in the state. The permanent fund reflects their share of that mineral wealth. He believes it is appropriate to distribute some of that wealth, especially in light of the fact that people in the Mat-Su Valley are waking up to the fact that they do not own subsurface rights to their land.

MR. WILLIAMS said he learned a lot at the meeting and believes a large part of the problem is that most people don't understand issues. He noted Congress passed a law in 1916 that prohibited homesteaders from owning the mineral rights on their land. He believes shallow gas drilling is great for the Mat-Su Valley.

CHAIR SEEKINS said he believes the permanent fund is owned by current and future generations of Alaskans and he intends to protect it for them.

MR. WILLIAMS repeated his concern is that SJR 18 allows the Legislature to spend an amount up to 5 percent. He prefers a fixed amount.

MR. GARHART asked if the earnings are insufficient to cover inflation proofing and the 5 percent payout, whether the Legislature could tap into the corpus to make up the difference under the new proposal.

CHAIR SEEKINS said it could. He explained the Legislature could draw a maximum of 5 percent from the permanent fund even though the annual gain was 4 percent. He said the corpus of the fund could be reduced in the early years if the market was disastrous.

CHAIR SEEKINS closed public testimony on SJR 18 and thanked all participants.

SJR 19-CONST. AM: PERMANENT FUND INCOME

CHAIR SEEKINS noted that Senator Lincoln, sponsor of SJR 19, has asked Representative Croft to present SJR 19 to the committee at this time.

REPRESENTATIVE ERIC CROFT told members that Senator Lincoln was tending to an emergency in Rampart and asked him to address the committee because he is the sponsor of companion legislation in the House, HJR 3. He said when he and Senator Lincoln presented to the Senate Judiciary Committee during session, the main discussion was about an asserted potential tax difficulty with SJR 19. He noted the permanent fund is tax exempt at this time but SJR 19 would constitutionally protect the dividend. Whether doing that would affect the public purpose of the fund and imperil its tax-free status is in question. His review of recent cases over the last two years led him to believe that a change in the tax status was not within the realm of possibility. Attorney General Renkes recently commissioned an outside firm to research the question and has sent a letter to legislators confirming that constitutionally protecting the dividend will not imperil the fund's tax status.

REPRESENTATIVE CROFT submitted that SJR 19 provides a spending limit that makes the most sense from an individual taxpayer's perspective. He wants the spending limit to reflect the limit on how much legislators can take out of his pocket. He said limiting either input or output could create a spending limit. It makes the most sense to him to limit input - how much government can take from his pocket and to require government to live within that limit. He said the output limits can have unintended consequences and stated:

The one used now is a suit that's way, way too big. It doesn't fit and you could guess wrong and fit a suit for the next 20 or 30 or 40 years that unnecessarily constrained what we spent on education and roads or police officers. It's really hard to predict those things.

REPRESENTATIVE CROFT said what is predictable is the amount you do not want government to take from individuals. SJR 19 is a way to constrain the size of government and, more importantly, the amount it can take from individuals. He said making sure the Legislature cannot touch the dividend is crucial to the oncoming debate of whether or not the structure of calculating the earnings of the fund is changed. He pointed out there is a large mistrust of the Legislature on this issue, some of that mistrust is warranted. He said so many politicians have promised not to use the dividend without a vote of the people. Many Alaskans are concerned that the POMV, despite its merits, will become a Trojan horse. It could become the justification vote for legislators to say a vote was taken and they can now use the dividend. Legislators can prove they don't intend to use people's dividends by enacting SJR 19, the companion legislation that enshrines the dividend in the Constitution.

REPRESENTATIVE CROFT summarized by saying SJR 19 will not create tax problems, it creates a real spending limit in terms of how much it can take from people's pockets, and it will be vital to convincing Alaskans that the POMV or any other change to the permanent fund is appropriate.

SENATOR OGAN asked if AS 37 and AS 43, as cited in the resolutions, would constitutionally protect the hold harmless agreement.

REPRESENTATIVE CROFT said he would get an answer to that question to Senator Ogan. He then said he meant to mention the provisions in the statute that directly relate to how the dividend would be calculated. He was not sure if the hold harmless provision is in that same provision, but offered to get that information to the committee.

SENATOR OGAN said the [hold harmless provision] is not something he wants to constitutionally protect; he would prefer to eliminate it.

CHAIR SEEKINS noted that no one was present to testify so he closed testimony on SJR 19. He announced that the committee would meet the following day at 7:00 p.m. at the Anchorage Legislative Information Office and would take testimony at that time. He then adjourned the meeting.