

HOUSE FINANCE COMMITTEE
February 2, 2016
1:32 p.m.

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CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 1:32 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue; John Tichotsky, Chief Economist, Tax Division, Department of Revenue; Randall Hoffbeck, Commissioner, Department of Revenue.

SUMMARY

HB 245 PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS

HB 245 was HEARD and HELD in committee for further consideration.

#hb245

HOUSE BILL NO. 245

"An Act relating to the Alaska permanent fund; relating to appropriations to the dividend fund; relating to income of the Alaska permanent fund; relating to the earnings reserve account; relating to the Alaska permanent fund dividend; making conforming amendments; and providing for an effective date."

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Co-Chair Thompson discussed the meeting agenda.

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JERRY BURNETT, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE (DOR), introduced the bill. He explained that the bill moved the volatility from oil revenue stream into the Permanent Fund (fund earnings would be taken out in a predictable and sustainable fashion) and changed the way the Permanent Fund Dividend was calculated. He deferred to his colleague to speak about Alaska's economy and the benefit of using the bill's revenue approach to the long-term health of the state's economy.

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JOHN TICHOTSKY, CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, discussed his professional background. He shared that for the past 25 years he had worked in numerous locations worldwide for the private sector, government, and as a consultant. He continued to provide information about his background. He provided a PowerPoint presentation titled "Alaska Permanent Fund Protection Act: Alaska's Economic Story" dated February 2016 (copy on file). He explained that the bill provided an opportunity to restructure government revenue flows to enable government to work predictably and stably, which provided fiscal certainty. He detailed that state agencies, industry, and the private sector needed fiscal certainty for a healthy economic environment. He explained that the current structure could not provide fiscal stability or certainty. He elaborated that for the past four years he had worked as the economist with the responsibility of informing the legislature about what to expect the future of government revenues to be in order to help plan and budget state spending. He concluded that it was impossible to predict revenues that currently went into the General Fund due to uncertainty. He stated that Alaska in particular was

suffering because General Fund revenues relied on price volatility of oil. He relayed that four years earlier oil had been \$112 per barrel coming off the North Slope and Cook Inlet. At present, the price was about \$30 per barrel. He continued that the price of oil would be even more difficult to predict in the future. He believed that given the uncertainty, Alaska needed a structure with the ability to harness the uncertainty to the state's benefit.

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Representative Wilson asked if the committee was hearing about specific legislation or about why a bill was needed.

Co-Chair Thompson replied that DOR Commissioner Randall Hoffbeck and Attorney General Craig Richards would present the bill later in the presentation.

Mr. Tichotsky explained that the bill would move the price and revenue volatility from the budget to the Permanent Fund, provided a stable sustainable draw for government spending, and provided a dividend derived from resource revenues that would be connected to the resource economy (the primary engine for economic growth in Alaska). The bill would result in fiscal and economic certainty that had eluded Alaska for decades. He explained that there would be a basic building block of predictable revenue in order to plan for an efficient and right-sized spending plan. He communicated that there was an "economic playbook" that could allow the legislature to create a machine where the flows of revenue matched spending and where the risks were properly placed to be managed. He furthered that a rational and scientific approach had been used to construct the legislation.

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Representative Guttenberg remarked that he may not agree with Mr. Tichotsky's statement about tying the dividend to resource development and extraction. He reasoned that resource development and extraction was a roller coaster ride. He wondered if the department had looked back to determine what the effect would have been if the state had been living with the scenario for the past 5 to 20 years.

Mr. Tichotsky replied that the analysis had been done and would be provided at a later time. He continued to address

the fiscal system and its relevancy to the workings of the Alaska economy, which he had studied for 25 years. He explained that the modeling, numbers, and analysis that went into the bill only made sense in terms of having an understanding of the overarching framework. He stated that having a systematic approach based on a rational framework was not new for Alaska, which he intended to demonstrate was based on work people had been doing for many years.

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Mr. Tichotsky turned to slide 4 titled "Framework for Economic Analysis." He had learned that many people were interested in understanding how economies developed, especially those based on natural resources. He elaborated that economists had developed a standard economic framework to explain how the economy worked and grew, which he had used to understand how Alaska grew. He detailed that the current framework was based on the work of the Canadian economist Harold Innis. Mr. Innis had identified items like furs, fish, and wheat that Canada exported as staples - resulting in wealth and economic diversification for the country. Mr. Tichotsky discussed that Alaska's current staples were oil and financial assets. He detailed that after WWII a group of economists had created what they called the "new economic history" related to how regions developed. The group had added concepts including quantification and the multiplier mechanism, and worked to make Mr. Innis's concept quantifiable and testable. He referred to concepts like economic-based analysis, regional forecasting, and impact analysis that had come out of Mr. Innis's work and had become a standard way to look at the economy.

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Mr. Tichotsky turned to slide 5 titled "Framework for Alaska Development." Mr. Innis had looked at the 19th Century economic success of Canada, the U.S., Australia, and Argentina in terms of how they transformed resource wealth by rejecting colonial control and adapting a market-based development policy to optimize wealth for the region and population. He continued that the export-led economy provided Alaska with a larger, growing, and more diversified economy. Additionally, it had provided political, economic, and social well-being; it also made the population more productive and wealthier. He noted that

the economists had witnessed the items in the early to mid-20th Century. He moved to slide 6 titled "Major Strands of Alaska Development." He moved forward to the late 1950s/early 1960s and highlighted the economist George Rogers, the founder of the Institute of Social and Economic Research (ISER). Mr. Rogers had written at least two books where he had talked about the concept of major strands of economic development. Mr. Rogers had taken Mr. Innis's concept and determined that Alaska's economy was dictated by the booms and busts of the export of various resources. For example, Russians had come to Alaska to exploit the fur industry and the Yankee whaling ships had plied the Arctic waters to harvest whales in order to sell whale oil used for lamps prior to kerosene.

Mr. Tichotsky addressed the colonial Alaska time-period that included fur, gold and copper, canned salmon, and military Alaska. Currently the state was in the oil era that began in the 1950s, which had been "supersized" in 1969 with the discovery of Prudhoe Bay.

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Vice-Chair Saddler stated that it was easy to look back at history to see that something had to happen a certain way; however, he reasoned that it did not necessarily have to happen that certain way. He asked if decisions had been made that had resulted in Alaska having a resource-based economy; he wondered who had made the decisions if so. He asked why the state was not a colony.

Mr. Tichotsky replied with slide 7 titled "Development Alone is Not Enough for Economic Growth." He detailed that ISER had adopted a sophisticated version of the concept started by the economic historians. Individuals like Arlon Tussing, Brad Tuck, Lee Husky, Scott Goldsmith, Gunnar Knapp, and others had taken the approach. He discussed that he had worked with Mr. Knapp and Mr. Tussing and had been made aware that there was a conscious effort to try to understand how the economy worked. He shared that Mr. Rogers had testified in front of the legislature many times and had acted as an advisor to many Alaskan governors. He explained that the concept had become part of the narrative of the Alaska political scene. He agreed that someone had to put the story together - it was pretty clear that 40 or 50 years in the past the narrative put together by Mr. Rogers and others had been picked up by policy makers. He

stated that current economists like Mr. Goldsmith and Mr. Knapp had elaborated on the framework and provided the numbers and structure.

Vice-Chair Saddler asked if the economic work was passively describing how the economy had developed. Alternatively, he wondered if the economists had advocated for how Alaska should develop.

Mr. Tichotsky replied that it was a bit of both. He furthered that the economists had tried to identify the way the economy had developed, in addition to making policy suggestions. He detailed that in the 1960s and 1970s Mr. Rogers and Mr. Tussing had provided testimony to the legislature.

Representative Wilson asked if Mr. Tichotsky intended to show how Mr. Goldsmith believed the Permanent Fund was already protected and that his sustainable plan could also work.

Mr. Tichotsky replied that the information would be included indirectly. He elaborated that the plan had not been developed by DOR, the Department of Law (DOL), and administration in a vacuum. He explained that his interaction with Dr. Goldsmith had shaped the way he thought; they viewed things within the same framework. They debated some issues as economists, but the ultimate view and the decision to restructure the fiscal plan was shared universally by economists in the state.

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Representative Wilson observed that Mr. Tichotsky was providing a history lesson. She wanted to make sure to include other strategies that could be used. She remarked that the state was already protecting the Permanent Fund. She wanted the presentation to include a whole picture on the options and to include several slides showing what Mr. Goldsmith believed.

Mr. Tichotsky answered that he would touch on the question throughout the presentation. He continued with slide 7 and explained that Mr. Rogers had discovered that development alone was not enough; the viewpoint had also been held prior to and immediately after statehood. Mr. Rogers had brought examples forward including the Kennecott Mine (the

largest copper mine in the world at the turn of the century and largest population of any settlement outside of Southeast) - after the mineral stopped being produced in the late 1920s there had been no lasting growth. He added that Kennecott Mine was currently "a hole in the ground with some abandoned buildings." The second example was related to fish traps where revenue flows were controlled by outside owners and economic growth within the state had been curtailed. He explained that the situation had prompted the move to statehood. He stated that to grow the Alaska economy, the political structure and local economy needed to control the resource and have a policy to guide economic development.

Co-Chair Thompson remarked that the presentation was meant to provide a background for the bill.

Mr. Tichotsky shared that the administration believed it was important to demonstrate that the bill had been crafted within a context of considering the history, understanding basic economics, and looking towards the future. He referred to Vice-Chair Saddler's question about how to use economics to be able to craft a policy looking forward.

Mr. Tichotsky moved to slide 8 titled "Policy and Governance." He stated that policy and governance that had come out of the economic view were not unimportant.

- Comparative advantage in oil and gas
 - Export-led growth
 - Engine of economic growth
- Market-based economy
- Rule-based, democratic government
- Capture economic rents and revenue
 - Taxation as sovereign
 - Royalty as owner

Mr. Tichotsky shared that there were other issues of policy and governance that had come out of the time period. Some looked at strategies to deal with "white elephants" and opportunity costs - how to use the dollars gained from export economic growth to increase economic growth. He quoted former Governor Jay Hammond as saying "you don't plant dollars to harvest nickels." He explained that Alaska had saved surplus revenue in the Permanent Fund and other funds, which had been revolutionary at the time.

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Mr. Tichotsky continued that at the same time there had been a debate about whether the Permanent Fund should act as an investment fund or a development bank. The decision had been made to structure the fund as an investment fund and the investments were almost exclusively located outside of Alaska; the investments reaped the benefits from global economic growth and brought revenues back to the state. However, it had been recognized that there was a need for developing the state and its economy, which was addressed by independent agencies that could address economic change domestically (e.g. Alaska Industrial Development and Export Authority (AIDEA), Alaska Housing Finance Corporation (AHFC), and the Alaska Municipal Bond Bank Authority). With opportunity costs, Alaska realized it could not buy a balanced economy; at the time, it had been an issue that was outstanding. He elaborated that there had been regions and countries that decided they could rebuild everything once they had created economic wealth (e.g. Soviet Union). Having a desire to have a balanced economy and to not receive the gains of trade was a policy decision that needed to be made; Alaska had made the policy decision that it was easier to trade for the benefits or goods it needed. One of the results was that Alaska's economy was not as diversified as it could be and it did not have grand examples of white elephants [opportunity costs]. He concluded with slide 9 and relayed that the state distributed part of its resource wealth to the population as dividends, which was not done by any other sovereign wealth fund (with the exception of an experiment done in Mongolia).

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Representative Wilson pointed to slide 9. She believed the presentation left out a major component associated with the slide's bullet point about distributing part of the state's resource wealth. She believed that government was intended to get a certain percentage of the resource wealth for General Fund spending, while the remaining portion went into the Permanent Fund for constituents. She stated that there was a reason the funding had been split into two parts. She detailed that a portion went to General Fund spending and the other portion benefitted Alaskans given that they did not own the subsurface rights. She elaborated that the dividend was a payment to residents for their

portion of the oil royalties. She believed the plan under the bill basically looked like government thought its share was not large enough and that it should take a portion of the people's share. She noted that soon there would be a conversation about why it would be good or bad to utilize the funds for government as well.

Mr. Tichotsky believed the observations framed some of the discussions that would take place related to the bill. He stated that there had been significant thought put towards the issue.

Representative Wilson wanted to ensure that constituents understood that the conversation was about their share of the resource wealth because the government's portion had been used.

Mr. Tichotsky turned to a production history and forecast chart (from 1977 to 2025) related to the North Slope on slide 10 [mistakenly labeled in the presentation as slide 9]. He noted that he had shown the chart to the committee for the past four years as part of DOR's fall revenue forecast. He explained that the chart showed the importance of Prudhoe Bay as a single resource. The chart showed that Alaska continued to have a competitive advantage for oil and gas, but it was greatly diminished relative to the past.

Co-Chair Neuman spoke to his problem with the chart on slide 10. He pointed to a flat-line in revenue forecasts around 2019 and 2020, which subsequently began dropping at a pretty good rate. He remarked that people who had not had the discussion previously would not know that. He observed that the department did not know what was going to happen in the future and he doubted that oil production would drop 100,000 barrels in five years (from 2020 to 2025).

Mr. Tichotsky replied that he had included the chart because of the past conversation. He explained that the modelling done for the legislation was based on the DOR forecast of production (included in the chart on slide 10). He expounded that the forecast was admittedly conservative, but it was realistic in the sense that it was backed up with actual resources. Additionally, it reflected status quo, investment, and effort. He added that there was an upside that could be released through technology, market conditions, industry decisions, and government policies.

There was a potential of monetizing gas on state land, in addition to more oil - including heavy oil and shale - on state land. He elaborated that there was potential for oil and gas on federal and private land. He pointed to the National Petroleum Reserve Alaska, Alaska National Wildlife Refuge, and offshore resources. Many of the opportunities had existed for decades and still showed great potential; however, converting potential to reality was exactly the heart of what uncertainty is. He explained that the department had taken the approach that it was not prudent to determine a budget and sovereign wealth fund draw without taking the uncertainty into account.

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Vice-Chair Saddler asked for verification that the [production history and forecast] chart on slide 10 it was the mean case from the department's 2015 fall revenue forecast. Mr. Tichotsky responded that the forecast portion of the chart reflected the mean case.

Vice-Chair Saddler clarified that he had meant production forecast.

Mr. Tichotsky continued to address slide 10. He explained that the production shown was bankable; the revenues that would come from the conservative base were bankable. He explained that it was not possible to bank on some of the other projects "be they quite desirable or quite prospective."

Co-Chair Neuman remarked that the goal was to produce information that was as accurate as possible in order for the public to understand. He did not believe the chart was accurate and that no one knew what the number would be. He stated that the decline over the past year had leveled off substantially. He believed that people could look at the chart and determine that the administration wanted to convey that the state could not continue to "kick the can down the road" and that the administration wanted to convince the public that the bill needed to pass in the current session because the amount of oil production was going to drop. He did not believe it was an accurate presentation of the facts.

Mr. Tichotsky stated that the chart on slide 10 showed a median case, which he had used to introduce the concept.

During the course of the information outlined in the presentation the department would present a significant amount of modelling. He clarified that there was one model (with two aspects) the department had developed for the case. One was the core aspect that was deterministic in nature; the means showed a single pathway of what the future could be depending on what variable was used. The other way the department would look at the issue - which was a common way to look at investment returns and calculate annuities - was with probabilistic modelling. He detailed that the probabilistic modelling included a realistic range of several variables, which addressed the problem outlined by Co-Chair Neuman. There would be a probabilistic distribution of production, oil price, and investment returns. He explained that the distributions of the three variables drove the fiscal system and the economy. He concluded that the department would focus on the issue.

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Mr. Tichotsky moved to slide 11 titled "Economic and Policy Patterns":

- Before 1960 - Statehood and resource control
- 1960s and 1970s - State establishes basic system over oil revenues and creates Alaska Permanent Fund in 1976 Rapid economic growth
- 1980s - increasing oil production, changes in oil price Economic expansion followed by contraction
- 1990s - oil production begins to decline, changes in oil price Economic expansion, some diversification, contraction
- 2000s - production declines, but commodity prices increase Slow, steady economic growth
- 2015 - Production continues decline, commodity prices collapse between 2014 and 2015

Mr. Tichotsky elaborated on slide 11 and noted that he had moved to Alaska in 1988 and had been one of the first people who came to the state after the economic decline. He

recalled hearing stories about people losing their homes and jobs and leaving the state. He remarked that in the 2000s there had been fiscal opportunities - revenues had been flowing into savings and the General Fund. However, between 2014 and 2015 commodity prices collapsed dramatically.

Mr. Tichotsky turned to slide 12 titled "Alaska Budget is Heavily Reliant on Petroleum Revenue." The chart showed petroleum revenue as a percent of Unrestricted General Fund (UGF). He explained that in most cases the General Fund relied on oil revenues for over 80 percent of its funds. He remarked in years that looked to be improving with 60 or 70 percent petroleum revenue, it was not because the economy was becoming diversified or there were economic sectors able to provide revenue; it was just because prices were low and there was less revenue that the state was stuck with a non-oil based revenue that was relatively stable.

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Mr. Tichotsky addressed slide 13 titled "US Resource-Rich States," which showed the percentage of real gross state product in constant dollars for Wyoming, Alaska, West Virginia, Oklahoma, and Texas. He explained that during the development of the bill the department had looked at what was going on worldwide and around the country. The states included on the chart reflected the country's resource-rich states. The chart also showed oil and gas production and mining as a share of the states' economies. He pointed out that Alaska dwarfed other resource-rich states with the exception of Wyoming. He noted that Wyoming and the other states (excluding Alaska) were integrated within the economy of the Lower 48. The level of diversification the other states had was far greater than Alaska; Alaska was by far the most dependent state on oil and gas revenues.

Mr. Tichotsky addressed one of Alaska's competitive advantages on slide 14 titled "Alaska's Financial Assets." The chart showed the Permanent Fund balance, which had basically doubled in the past 15 years despite dips and bumps in the road. He relayed that the one thing the state could bank on was its financial assets that were large and were finally large enough to make a difference. He stressed that financial assets and their revenues acted like a reverse Prudhoe Bay; the revenues could be harvested and the assets continued to grow. He stressed that financial

investments were the ultimate renewable resource. Unlike underground oil and gas resources, financial assets were already monetized and contained no risk that they may not be monetized. A large part of the financial plan focused on financial assets for that reason and was driven by the economic analysis.

Representative Wilson wondered why the state was not looking at living within its means. She referred to the charts and times when oil had dipped down and reasoned that if the state had kept the standard instead of increasing spending with oil to have a sustainable budget. She wondered why using the "other pot of money" outlined in the legislation was more important to the administration than the state living within its means. She noted that people had to live within their means in their own homes.

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Mr. Tichotsky replied that the question was foreshadowing where he was headed in the presentation. He discussed that one of the issues the state had was that it engaged in pro-cyclical spending (i.e. roller coaster spending). He moved forward to slide 22 titled "Alaska Pro-Cyclical Spending." He explained that the situation occurred when there was a significant amount of money, it was spent, and the situation wound up overheating the economy through government spending. The opposite was also true during economic downturns. He explained that in times when Alaska did not have as much resource revenue, the contraction went the other way. He detailed that the state doubled down on the times when revenue contracted, which further contracted the economy. Alternatively, when there was significant petroleum revenue coming in, there was more government spending and the economy was overheated. The volatility and the volatility in the budget that drove the pro-cyclical spending was the issue. The department had worked to determine the magic number the state could sustainably draw from savings (from financial and other assets). Once the answer was known, it could determine what the state could sustainably spend. He furthered that there was a method that could link sustainable spending to understand the sustainable number that could be drawn.

Representative Wilson remarked that Mr. Tichotsky was going in the opposite direction from her question. She stated that he was trying to determine how much money could be

taken from all of the different sources and how it would be spent. Alternatively, she believed the state could have determined a sustainable budget four or five years earlier (to \$4.5 billion, \$4 billion, and lower) based on the kind of government it wanted. She thought he was suggesting using revenue to determine budget. She thought the state should determine the right size of government first, what it was constitutionally mandated to do, and then look at its resources. She stated that there may actually be too much revenue at present being spent on more than was needed.

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Mr. Tichotsky noted that Representative Wilson had raised two issues. The first was related to how Dr. Goldsmith and others at ISER were looking at the sustainable spend, which was based on the nest egg approach. The one difference between what Dr. Goldsmith did with petroleum and investment assets (related to the production number the presentation used) was that Dr. Goldsmith believed the state should be able to keep in mind that it would have potential revenues coming in from projects in the long run (e.g. ANWR or other large-scale project) - from there he pulled back the number to determine the sustainable draw. The department focused more on the financial assets because it looked at production with a more conservative approach. He noted that ISER and DOR came up with essentially the same number and scale. The ISER modeling was in many ways analogous to DOR's method. The second issue was that from the perspective of an economist or business person there were two sides to the equation (i.e. supply and demand); there was a balancing act that had to occur between supply and demand in a household or other. He furthered that a business had to consider how much money it could make and how much money it wanted to spend. He noted that when defining issues such as living within means it was important to know what the revenues were. He addressed times of surplus and discussed that someone could identify what they needed to spend and what they wanted to put into savings for spending at a later time or further investment savings in the form of a trust fund or annuity. He explained that individuals used the same process at home with checking, savings, and retirement accounts; the spending depended on what was needed. For example, Alaska had invested in infrastructure, primarily on a pay as you go system, which many regions did not do (many regions used

debt financing). There were many ways to look at how money was spent, but it was important to structure and know where revenues were and what could sustainably be drawn and how to predictably know what spending was. One of the key issues of the legislation was that it took away volatility (risk and uncertainty) and placed it in a location where they could be very well managed.

Representative Wilson requested to hear from Dr. Goldsmith again. She did not believe his statements from the past few years were being interpreted correctly by the department. She stated that if the goal was to look at all models it would be helpful for the committee to hear from him.

Representative Munoz believed the restructuring of the Permanent Fund into a sovereign wealth fund would provide a sustainable draw similar to the earnings on the Permanent Fund as it was currently structured. She wondered about a sustainable draw using the current framework of the Permanent Fund.

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Mr. Tichotsky replied in the affirmative. He relayed that the committee would hear several presentations associated with the topic. The department had defined the sustainable draw as follows - if an amount of money was drawn annually with annual increases for inflation it would not undermine the real value of the fund within a certain period (they had selected a 24-year period). He continued that the real value of the fund would be maintained the same over the period of time and the draw would be increased with inflation. The number was about \$3.3 billion per year based on the model and assumptions worked out by the department.

Representative Munoz asked about the current structure. She wondered what the sustainable draw would be under the current structure.

Mr. Tichotsky replied that the bill looked to operate without a constitutional change. He detailed that an annual \$3.3 billion draw from the earnings reserve was sustainable; the money all came from the same pie whether it was used to fund the dividends or government. Under the current formula 50 percent of the earnings reserve went to the dividend program.

Representative Munoz asked for verification that the sustainable draw was the same under both models and was \$3.3 billion.

Mr. Tichotsky answered in the affirmative. He explained that when developing an annuity the question would be how much could be drawn indefinitely. The answer in the state's case was \$3.3 billion.

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Mr. Tichotsky moved to slide 16 titled "Alaska - One of the Wealthiest Regions in the World." He referred to a presentation to the committee from Malan Rietveld from the previous week (the source of the charts on slide 16 was Mr. Rietveld). He pointed to the left chart showing assets under management in billions for various countries including Norway, Abu Dhabi, Saudi Arabia, Kuwait, and others down to Alaska. Alaska's \$54 billion fund was dwarfed by funds like those in the other listed counties. He moved to a chart on the right showing the size of assets relative to the budget and explained that a different view was immediately achieved. He detailed that on a per capita basis, Alaska was probably one of the wealthiest regions in the world. He turned to slide 17 titled "Moving Alaska to a Safe Harbor," which included another chart from Malan Rietveld related to oil's percentage of revenue and the fiscal break-even price. The left axis [y axis] showed the oil price required to balance the budget and the bottom axis [x axis] showed oil's share of total government revenue. Mr. Rietveld had addressed why a group of countries like Norway, Alberta, and Wyoming were in a more desirable or stable place than Alaska. The answer was due to the locations' highly diversified economies. He furthered that it would probably take Alaska a decade or more to achieve diversification at the same level as Wyoming. He pointed to economies without diversification such as Qatar, Kuwait, Abu Dhabi and other. He stressed that Alaska had the ability to join the "winner's circle" within a short time period of one year. He believed it was an important takeaway from Mr. Rietveld's slide.

Vice-Chair Saddler asked if anything in the work done by Mr. Innis or Mr. Rogers presumed that a resource-based economy could not be diversified. He referred to constituents who often asked why the state's economy was not more diverse. He remarked that oil had paid so much of

the state's budget for a long time period and there had been some unsuccessful efforts to force diversification. He wondered if having a single commodity-based resource economy precluded anything other than that commodity and financial management. For example, he wondered if Norway had telecommunications and agriculture and whether Alberta had petrochemicals and other. He wondered if Alaska's resource-based economy model precluded diversification other than financial assets.

Mr. Tichotsky replied that the reality was the state was not diversified for several reasons. The state had found that it was better off to trade for what it needed rather than to develop the industries at home. Places like Norway were located in the old world and had an economy upon which diversification was brought. He emphasized that Alaska was one of the 20th Century regions of recent settlement; apart from the Alaska Native population, the additional population came to Alaska after the 1850s and mostly in the 20th Century. He addressed the strategy the state needed to follow next, with the knowledge that it was an undiversified economy. Diversification was desirable and worth pursuing, but it took a long time. He believed the important thing to do at present was work to stabilize the state's economy. He stressed that the one way to achieve diversification and investor confidence was to have a stable economy.

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Vice-Chair Saddler reiterated his question about whether having a resource-based economy precluded having any other diversification other than fiscal assets.

Mr. Tichotsky replied when an economy was developing and looking for an investment it was prudent to focus on the areas it was competitive. Alaska was competitive in oil and gas, minerals, fish, tourism, and money. There may be some areas that the state could diversify into that were not yet known. Possibly in telecommunications technology that took away the state's geographic disparity. He reasoned that Alaska was isolated and had and there were a limited number of things where it was easy to generate revenues.

Co-Chair Thompson asked Mr. Tichotsky to work towards wrapping up the presentation.

Mr. Tichotsky addressed the "natural resource curse" on slide 19. He detailed that resource-rich countries were poorer, had slower economic growth, and no lasting wealth. He explained that the administration would like to avoid the resource curse. He discussed price and revenue volatility on slides 20 and 21. He relayed that revenue volatility had recently been discovered by economists to be the "quintessential feature of the resource curse" due to the concept of pro-cyclical spending. He explained that when there were a lot of incoming revenues more was spent in the economy and subsequently state spending drove and overheated the economy. The opposite is also true, an absence of revenues wound up contracting government spending and there was a doubling down on economic stability. He expounded that the situation created institutional and political instability, economic growth was difficult, it was hard to plan development and attract outside investment, and the well-being of the population was difficult. Additionally, the risk of destabilizing savings was increased. During times of budget deficit savings were used and depleted (savings were treated as a checking account rather than an investment fund or retirement annuity), which undermined social stability.

Mr. Tichotsky returned to slide 22 and shared that history demonstrated Alaska practiced pro-cyclical spending with a vengeance. He noted that the R-Square values on slide 22 were a statistical way of showing the state had pro-cyclical spending. He moved to slide 23 titled "Volatility - A Systemic Issue." He explained that price volatility lead to oil revenue volatility. Volatility drove its way through the economy until it created general instability, which was one of the reasons the legislation had been created.

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Mr. Tichotsky addressed slide 24 titled "Where is Long-term Volatility Good?" He detailed that financial institutions looked at volatility when they created portfolios - stable assets were included, but growth and value were really derived from volatile revenues. He furthered that when looking for volatility, investors looked for inexpensive assets that would appreciate in a portfolio. He explained that it made sense to manage volatility in an investment fund where the professionals were used to mitigating the dis-benefits of volatility and maximizing the benefits. He

stated that the worst place to manage volatility was in the General Fund. He explained that it meant doubling down the risk to the General Fund and when volatility was combined with other risk (i.e. political risk or other), the risks were magnified. He relayed that the bill worked to manage and mitigate risk. He furthered that the volatility risk to Alaska did not go away; the question was about where to put it. He explained that the bill would move the volatility from the General Fund into the Permanent Fund.

Mr. Tichotsky addressed items that an effective fiscal framework needed to include on slide 25. He explained that the work DOR and DOL were doing was not something they were doing in a vacuum. He furthered that the rest of the world and resource-rich countries were facing the same dilemma. He detailed that in October 2015 the International Monetary Fund (IMF) had focused its efforts on the problem facing resource-rich countries caused by the collapse of commodity prices. He expounded that the IMF had the ability to look historically at the regions and regions where policy errors had been made that were suffering consequences. Additionally, the IMF could show the decisions made by some of the winners or people successful in mitigating risks. The IMF had established four basic recommendations for resource-rich countries facing the commodities collapse. First, it recommended creating economic macro-stability by saving money and building financial buffers. He noted that Alaska had taken that step through the Permanent Fund and other savings measures; however, without restructuring, the state had the opportunity to lose the benefits and the ability of the buffers. He furthered that it would be extremely destabilizing for the economy if savings were depleted without a long-term plan or understanding the scale of the potential draws. Alaska had also engaged in pro-cyclical spending in the good and bad years. He explained that the state needed spending that was just the right size, which was addressed by the bill.

Mr. Tichotsky explained that secondly the IMF had looked at the concept of increasing revenue stability by improving the taxation of resource and non-resource sectors.

Co-Chair Neuman asked if the information on slide 25 came from the IMF. Mr. Tichotsky replied that the information had been sourced directly from the IMF website and included the generic recommendations the organization had made to all resource-rich countries.

Representative Gara addressed the forms of revenue put into a sovereign wealth fund. He furthered that as proposed the sovereign wealth fund that would lead to ten years of the lowest level of school funding, infrastructure spending, and renewable energy spending in the past decade, was not a "be all and end all." He believed the real issue was what resources were going to be put into the fund. He stated that on its own the fund would not do anything without knowing what resources would be put in. He reasoned that it was the level of funding put into the fund that would determine the stability of the economy. He submitted that continuing to flat-fund education did not constitute a stable economy. He asked for verification that the elements of the revenue sources going into the fund more or just as important as the concept of the fund itself. He reasoned that a fund could spin off so little income that no economy would remain.

Mr. Tichotsky responded that it would be great to have a Permanent Fund that was over \$100 billion. He detailed that if the savings were generated over time and the fund grew to that amount, the state could easily draw about \$5 billion and the state would probably not be having a fiscal crisis. At the current point, investment revenues could only produce what they could produce. He noted that it would have been great to save more in the past, but the second best time to take action was at present. The restructuring would enable a sustainable spend in years where oil prices were low and resources revenues, production, and development did not come. He addressed Representative Gara's question about what kind of revenues the administration wanted to put in the Permanent Fund. He explained that the goal was to place the volatile revenues in the Permanent Fund.

Mr. Tichotsky concluded his remarks on slide 25. He spoke to stability of revenues and relayed that in a non-diversified economy, the non-resource sector and a small population base made it difficult to generate sizable revenues; therefore the investment revenues were important to the future sustainability of the state. He addressed better use of resources and affirmed that spending efficiently was a major part of a total fiscal package. He noted that the topic needed further discussion. The fourth point on slide 25 related to an effective fiscal framework was the need for strong institutions, which included

improving medium-term planning and investments and having a rules-based system that had some certainty. He addressed fiscal certainty and believed the bill solved the issue of volatility for Alaska - it moved the volatility in the budget to the Permanent Fund, provided a stable draw to the General Fund at a sustainable scale, and it moved the dividend where it could be connected to the resource economy. He and the other economists in Alaska (in addition to other economic experts) believed it was the kind of action that needed to be taken to regain fiscal and economic certainty and stability that had eluded the state.

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RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, provided a PowerPoint presentation titled "Alaska Permanent Fund Protection Act" (copy on file). He discussed that the governor's plan had some basis in what was considered to be the proper way of dealing with sovereign wealth funds. He communicated his intent to "drill down" into how it fit within the legislation.

Representative Edgmon felt that Commissioner Hoffbeck's comments were a bit of an understatement. He stated that creating a sovereign wealth fund in the next one to two years would be a historic moment and was on par with the Permanent Fund that had been created in the 1970s and with big decisions on oil taxes. He stressed that it was not merely a theoretical discussion. He observed that it was a turning point in Alaska's history, where it could no longer depend on oil. He recalled the former Department of Natural Resources (DNR) commissioner Dan Sullivan prefacing the conversation on SB 21 [oil and gas production tax legislation passed in 2013]. He furthered that Mr. Tichotsky had properly framed the historical significance of the discussion. He noted that many people doubted the fund would be established in the current year; he believed it would be the following year. He implored the governor's team to put more emphasis on the historical nature of the discussion.

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Commissioner Hoffbeck shared his intent to address how the administration had arrived at the plan it had put forward. He informed the committee that the administration had started working the process in two ways. They had looked at

the standard tools that government always had at its disposal including what it could cut in the budget, where it could achieve new revenues, and what it should do in years one, two, and three. Additionally, the administration had worked to determine how much Alaska's sovereign wealth could be used to balance the budget. He referred to various discussions in newspapers about how much of the government could be funded by the state's wealth. As the administration had worked through the process, it had determined that both of the processes only got them part of the way there. The state could get to a balanced budget with cuts, savings, bringing in new revenues, and leaving everything in the silos they were currently in (spent the way they were always spent); however, the solution did not take volatility out of the system. One of the things the administration had heard clearly from the private sector was that volatility in government spending inhibited private sector investment; the private sector wanted to see some kind of stable platform of government spending. When the administration had looked in depth at funding government with the sovereign wealth model, it had found that the model could not generate enough revenue on its own. Therefore, the separate considerations had begun to merge together into the plan in front of the committee.

Commissioner Hoffbeck furthered that the sovereign wealth model could function to provide a systematic, rules-based way of using the state's wealth, as opposed to a haphazard expenditure of the state's wealth and spending down faster than it could accommodate. The administration also had to look at additional spending reductions and new revenues. The three items together created the "new sustainable Alaska" plan - the three components each had a set of bills associated with them. The sovereign wealth fund fell under the Alaska Permanent Fund Protection Act, which was included in the bill before the committee [HB 245]. The budget bill dealt with spending reduction areas, and there were a whole series of new revenue tax bills that had been introduced. The current meeting would only focus on the Alaska Permanent Fund Protection Act - a methodology for using the state's sovereign wealth and taxes from oil and gas and other minerals to create a stable cash flow for funding government.

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Commissioner Hoffbeck addressed slide 4 titled "The New Sustainable Alaska Plan." He detailed that under the plan the state would still have very low taxes, continue the dividend, grow savings at a rate of inflation or higher, maintain most of the state's public services, and money to invest in the future. He noted that the items would all continue, but at a different level than at present. He turned to slide 5 titled "Alaska Permanent Fund Protection Act" and addressed the bill's three components:

1. Sustainably draw from the Earnings Reserve
2. Minimize oil price volatility on the General Fund
3. Adjust the dividend

Commissioner Hoffbeck turned to slide 7 titled "Defining the Problem." He addressed the short-term, medium-term, and long-term problems going forward and relayed that all three problems needed to be solved. The short-term problem was the drop in oil prices. He elaborated that it was necessary to determine how to handle the short-term problem immediately - there was currently a \$3.6 billion to \$3.8 billion budget shortfall in the current year that needed to be taken care of. The medium-term problem was that if nothing was done the state's savings would be spent in the next four to five years, which would take away an asset that could be used efficiently to help fund government going forward. The resulting budget hole would substantially damage Alaska's economy. He did not want to fall off the edge of the cliff, which he did not think would occur - there were many different proposals to consider. Additionally, dividend payments were not sustainable under the status quo. He detailed that currently there were counter-cyclical dividend payments where the largest dividend payment in the history of the state was paid at the time when the state's economics were worse than they had been in a very long time or ever. He explained that the dividend needed to flow with the economy of the state.

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Representative Wilson referred to Commissioner Hoffbeck's statement about status quo and remarked that no one at the table thought the state could continue its current level of spending. She asked if Commissioner Hoffbeck meant the dividend was unsustainable if spending was maintained at the current level. Alternatively, she wondered if

Commissioner Hoffbeck meant that the dividend would still be unsustainable if the budget were reduced to a sustainable level.

Commissioner Hoffbeck answered that status quo meant using the current formula to calculate the dividend that was tied to the investment earnings from the Permanent Fund. He stressed that no matter what the state did to address the problem, the dividend formula would change if Permanent Fund earnings were used. He explained that a Percent of Market Value model or any other model would require the dividend to be calculated in a different way. He furthered that some of the money currently paid in the dividend needed to be incorporated within a sustainable draw in order to come to a level of draw that worked for sustainable government. He stated that it was a balance of the numbers. He concluded that the dividend needed to be smaller to get to a sustainable draw.

Representative Wilson asked what percentage the administration was proposing to cut as part of its plan. Commissioner Hoffbeck replied that the current budget contained \$100 million in cuts to agency spending and \$400 million to oil and gas tax credits. The long-term plan included another \$50 million in cuts in each of the next two fiscal years. The governor was proposing a total of about \$600 million in cuts.

Representative Wilson stated that the administration was really only looking at increasing revenue and not at spending, which would keep government at status quo. She did not believe the same message was coming from the legislature.

Vice-Chair Saddler replied that the governor had promised 16 percent cuts during his campaign. He discussed that a deficit could be filled by new revenue or less spending. He wondered what had happened to the promise of 16 percent cuts.

Commissioner Hoffbeck deferred the question to Pat Pitney, Director, Office of Management and Budget, Office of the Governor. He relayed the governor was working towards the cuts that he believed would create a stable economy and that reflected the desires of the people in terms of the services they wanted to see delivered. The cuts on the agency side were fairly substantial, but he did not have them on hand.

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Representative Edgmon wondered why the changes had to be made in the current year. He wondered why there was not time to get the consent from the rest of the state that may or may not think the proposal was a good idea. He asked about the rush.

Commissioner Hoffbeck replied that it would have been better if the proposal had been implemented two years earlier - the state was already late to the game. There were three components that changed the math within the equation: how much the state was spending, the size of the dividend, and whether any new revenues could be introduced. The idea of how the state used its existing wealth was really just about which pot of money the funds came from (e.g. Constitutional Budget Reserve or Permanent Fund earnings). He furthered that the dynamic did not create the critical nature. The critical nature was related to the other three components. First, how much the state was paying out in dividends. He detailed that the more the state paid out in dividends, the more it took from savings; currently the state was paying everything with savings. There was essentially no oil and gas tax revenue in the current year at the low oil prices and the Permanent Fund was showing negative earnings on investments for the current year. Second, how much the state could decrease the size of government in order to reduce spending. Third, whether new revenues could be introduced into the system in order to avoid relying entirely on savings. He explained that part of what made the proposed plan work was the return on investments from the savings; the smaller the amount, the lower the sustainable draw became, which meant the need for either more cuts or more revenues. He concluded that the sooner the action was taken, the better.

Representative Edgmon surmised that it was more about opportunity costs versus the absolute necessity of having to take action in the current year from a mathematical standpoint. He reasoned that the state had savings to carry the state over into the next year, which was a non-election year. He believed they had the ability to take the issue out to voters to explain why the dividend would be cut in half, that the construct of the Permanent Fund program would be changed, and why the sovereign wealth model was the best for future generations of Alaska. He believed the

change was inevitable, but he struggling with the fact that the political gap needed to be traversed. He had not heard a compelling reason the change needed to occur in the current year.

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Representative Guttenberg referred to a comment made about the governor's promise to cut the budget further. He had appreciated the effort the governor had put into the issue. He also knew there were promises made by legislators in the committee room on taxation to achieve 1 million barrels per day out of the pipeline, which people knew was factually impossible. He wondered how long it was sustainable to make cuts and take \$3.5 billion from the Permanent Fund. He stated it should have been done the past year. He furthered that the preceding year the legislature had not had the excuse of it being an election year; they had been aware that a crisis was coming, but they did not know the price would drop as significantly as it had. He remarked that some people were saying it should not be done in the current year because it was an election year. He stated that maybe the legislature would get to it next year, but maybe not, and then people would say it was another election year. One of the rationales he had heard for taking action sooner rather than later was that the current higher level of assets would be more sustainable instead of spending savings down and not being able to achieve a sustainable rate of return in the future. He asked if the rationale was accurate.

Commissioner Hoffbeck answered in the affirmative. He detailed that the more the state spent down its existing assets, the less it would have to create a sustainable draw. He explained that if the payout of the dividend was not changed, substantial cuts were not made, and no new revenue was generated in the current year it would equate to about \$100 million less in the sustainable draw. He elaborated that it would mean a base that was \$100 million lower, which would carry through the state's life. The more the of the state's assets that were spent, the less money the state would have as it moved forward with a sustainable draw.

Co-Chair Neuman asked about the monetary value of taking action in the current year as opposed to the next year. Commissioner Hoffbeck answered that it was probably in the

range of \$100 million to \$200 million per year on the sustainable draw [if action was not taken until the following year].

Co-Chair Neuman surmised that there would be no monetary impact if the budget could be reduced by \$200 million in the current year. He reasoned that the action could be put off for two years if there were cuts totaling \$400 million in the current year. His concern was making sure the public understood the action.

Commissioner Hoffbeck answered that the assumption was that some, if not all, of the cuts would be made anyway. He explained that it did not necessarily change the math in the long-term. He noted that it would balance in the short-term, but there would still be a lower sustainable draw going forward.

Co-Chair Neuman asked the department to provide modelling to show the difference between taking action in the current year versus the following year. Commissioner Hoffbeck agreed.

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Representative Gara did not think it was useful to discuss what budget cuts had been discussed in the past. He believed the governor had probably made a mistake when he stated he would cut the budget by 16 percent. The current legislature passed a bill aiming for 10 percent savings. He stated that most of the committee members had voted for that legislation. He surmised the governor had room to call the legislature out on the issue. He reasoned that the conversation would not be productive. He assumed that half the legislature had campaigned on increasing oil production, which had not occurred. He was done with the conversation. He was also done with the conversation about continuing to cut more and more. He supported taking action sooner rather than later. He spoke to a scenario where there was not legislative support to do the fiscal plan until the following year. He reasoned that the state would still have savings, but that was not what would cause a recession. He believed a recession would occur due to excessively steep cuts that laid off people and cut grants that would ripple into the private sector and negatively impact retail, restaurants, and other. He asked if he was correct that excessive cuts would result in a recession.

Commissioner Hoffbeck agreed that one of the administration's larger concerns was cuts that were too draconian would have a ripple effect through the economy.

Representative Gattis believed that if action was decided on in the current year, further cuts would not be made once revenues backfilled the deficit. She addressed the belief that a recession would come if further cuts to government were made. She countered that the private sector was already making the cuts, which would result in a dip in the economy. She stated that everyone was tightening their belts. She thought it was insulting to Alaska to not take government cuts. She believed making the cuts was doing the right thing for Alaskans. She stressed that if government was not cut, it would continue backfilling and taxing Alaskans to keep growing government. She remarked that cuts were not the complete answer, but they were a part of it. She opined that if government was not cut, the state would continue backfilling and would continue taxing Alaskans to keep growing government. She stated that there was a large number of individuals who believed the cuts needed to be made in order to prevent backfilling. She was adamant that due diligence should be done on the bill prior to backfilling government with revenue. She wanted to do the right thing for Alaska for the long-term. She reiterated that the private sector was laying people off.

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Representative Munoz relayed that she had recently met with former Representative Bill Hudson. She discussed that when he had been in the legislature the state had been facing similar fiscal issues, but the deficit was not nearly as large. At that time, the legislature had close conversations with former Governor Jay Hammond in an advisory role. Representative Hudson had relayed that former Governor Hammond recognized that excess earnings of the Permanent Fund would at some point be used to help with the funding of state government, but that the dividend should not be decoupled from the earning power of the body of the account. She struggled with that aspect of the proposed plan, which would tie the dividend to the royalty. She reasoned that under the scenario at some point in the future the dividend would not be available to future generations. She referred to Mr. Tichotsky's testimony that the sustainable draw from the current framework and the

sovereign wealth model was \$3.3 billion. She asked if the department had looked at formulating a plan that would use excess earnings and the sustainable target of \$3.3 billion and possibly recalculate the dividend based on a formula similar to the one used at present. She believed it would get the state significantly closer to closing the deficit without reprogramming the entire system.

Commissioner Hoffbeck answered that the department had looked at many different options. The current option had been adopted from a proposal by Senator Lesil McGuire [SB 114]. He had initially thought her proposal was "too clever for its own good," but as the department worked through it he had realized there was substantial logic to tying the dividend with the economic vitality of the state. He furthered that when things were going well, the dividend would be larger, but when things were going poor, the dividend would be smaller. He relayed that the concern about decoupling the dividend from the Permanent Fund earnings had been expressed by others as well. He communicated that the administration was not attached to its proposed way of treating the dividend; the proposal worked and fit in the plan, but if some dynamic could be created where the dividend was pro-cyclical with the economic health of the state (higher in good times and lower in bad times), the administration was willing to look at other ways to calculate the dividend.

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Vice-Chair Saddler referred to a remark by Representative Wilson that cutting the budget was as much of a legitimate part of the discussion as new revenues from a sovereign wealth fund. Based on Mr. Tichotsky's presentation, he observed that stability had never really been a driving force in Alaska's economy. He reasoned that the state had been fairly comfortable to ride the booms; a significant amount of money had been made on the volatility. He asked if the end of addressing the state's fiscal gap justified the means of using the Permanent Fund earnings. He asked if the administration would have brought the proposal forward if there was not a budget problem.

Commissioner Hoffbeck did not believe the administration would have brought the proposal forward if there was a balanced budget with oil revenues. He reasoned that crisis brought change. He elaborated that he believed the state

"had been headed here eventually. I think we just got here a lot quicker than when we expected." He noted that even in the last years of the prior administration when oil had been \$110 per barrel, the state had already been fighting with deficits (in the \$1 billion range at some point in time). He concluded that the Walker Administration was dealing with the hand it was dealt.

Vice-Chair Saddler wondered why the action had to be taken at present. He understood the value of the proposal and reasoned that it may have been good to take action 2 to 10 years earlier; however, he had not heard the compelling case why it had to happen in the current year as opposed to 1 to 2 years in the future. He addressed volatility and noted that the state had saved money during high revenues and had spent the funds during periods of low revenues. He continued that the situation persisted. He reasoned that it was not the most advisable of situations, but mathematically it did work out for additional time.

Commissioner Hoffbeck answered that the department would follow up with numerical data.

Commissioner Hoffbeck moved to slide 8 titled "Short-Term Problem." He discussed that in 2008 the state was bringing in almost \$11 billion between petroleum and non-petroleum revenues; currently the state was bringing in less than \$2 billion. He noted that a swing that dramatic was difficult to deal with - it made long-term planning and budgeting challenging. He moved to slide 9 titled "Medium-Term Problem." The slide demonstrated that there were earnings that continued to be generated from the Permanent Fund even if "we fall off the fiscal cliff." He detailed that if the state used all of its savings prior to making any type of sustainable balancing plan, the state would continue to have \$2.5 billion to \$3 billion available for government spending. The current spend was about \$5.2 billion to \$5.4 billion. He stressed that it was a substantial cut and would leave the state with a dramatic decline in services provided.

Commissioner Hoffbeck moved to slide 10 titled "Long-Term Problem." The slide showed that the state had been chasing oil prices up and down over the years. The state's fiscal plan had been fairly simple - it had mandated saving 25 percent of the Permanent Fund royalties and had saved more than 30 percent because more money had been deposited from

some fields. The strategy had worked and had resulted in a \$50 billion savings account; however, the state never really had a plan for what to do with the money - it had paid dividends, inflation proofed, and saved the remainder. Additionally, any money remaining at the end of the year had been swept into the Constitutional Budget Reserve (CBR). He detailed that the function of the CBR had been to take care of short-term ups and downs in available revenues, but it had never been intended to deal with the type of deficit currently facing the state that would last for multiple years (it was not large enough to provide that option). The state had used the remaining funds to chase oil prices up and down.

Commissioner Hoffbeck furthered that some of what the state had been chasing in the past no longer existed; production was only one-quarter of what it had been at its peak - it had been on decline since the 1980s. Current production was about 500,000 barrels per day, which should be fairly constant for the next several years before starting to fall off. He detailed that at the current level of production the state needed oil prices of \$109 to \$110 per barrel to balance the budget. He explained that due to technology changes with shale oil and other things, the numbers did not appear to be viable in the immediate future. He expounded that it did not appear the state would even have the option of chasing the oil price up to get to a balanced budget; therefore, a different plan was needed. In the past, price and production had bailed the state out; at present the state had its wealth. He elaborated that the Permanent Fund generated \$2 billion to \$3 billion per year in statutory net income that could be used for things other than paying a dividend and inflation proofing.

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Representative Wilson discussed that the state's constitutional delegation and founders had believed that at some point the entire state would be organized in some fashion (i.e. city, second-class borough, or other). She asked whether a solution would be for boroughs to organize in order to get services they wanted if the state could no longer pay for things outside its constitutional mandate.

Commissioner Hoffbeck was aware that several mandatory borough bills had been introduced in the legislature on several occasions with the idea of increasing local self-

support. He relayed that the strategy alone was not sufficient. He agreed that it would help balance some of what the state was funding versus what was funded locally. He elaborated that most of the state's unincorporated areas did not have a large economic base and did not have the ability to generate a substantial amount of income for local services.

Representative Wilson clarified that she was not stating the legislature should mandate anything. She believed the whole point of the constitution was to enable local governments to provide things outside of the state. She reasoned that there was currently no reason for areas to become boroughs because they had to pay more for schools and other items; there was currently no benefit unless communities wanted to tax themselves more and receive less state funding. She explained that Fairbanks, Juneau, Anchorage, Mat-Su, Dillingham, and others had already made decisions that they wanted more than the state provided. She reasoned that because the state provided all of the services [beyond what was constitutionally mandated] that there was no advantage for areas to take on any more responsibility. She wondered if more organization would occur on its own; towns would have to decide whether they wanted a service or not. She questioned why local governments would choose to pay if the services were provided for free by the state. She believed the strategy was another option that was not currently being considered. She remarked that there were counties in the Lower 48 that had chosen to offer services beyond what the state could give them.

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Co-Chair Neuman asked for an explanation of R-Square value (slide 10). Commissioner Hoffbeck answered that it was a measure of how much of the variance in the data points could be explained for a line (on a graph). He detailed that the best line was fitted to data points and the R-Square value showed how much of the variance was explained by the line. He addressed the graph on slide 10 and assumed that the line for oil price had been plotted against spending and had determined that most of the spending could be equated to the oil price.

Co-Chair Neuman the department to follow up on precisely how the data had been achieved on slide 10.

Representative Gara remarked on Commissioner Hoffbeck's gracious and calm demeanor before the committee. He noted that sometimes there were terms used in the building that everyone started using. He requested that the commissioner and others refrain from using the term "final solution." Commissioner Hoffbeck replied that Co-Chair Kelly had made the same request earlier in the day.

Commissioner Hoffbeck moved to slide 12 titled "The Commodities Roller Coaster." He addressed that the IMF had done a study of 85 economies over a period of three decades and had found that government spending in commodity-based economies tended to move up and down with commodity revenue. The IMF had also determined that pro-cyclical government spending (moving up and down with a commodity) tended to stunt economic growth. Additionally, the IMF had found that stabilizing fiscal policy had the inverse effect, which could increase gross domestic product by 0.3 percent annually. He relayed that there was some logic for government spending at a time when the rest of the economy was declining because it tended to stabilize the economy. He acknowledged that it was difficult politically, but it did make economic sense.

Commissioner Hoffbeck turned to slide 13 titled "Break-Even Oil Price." He relayed that countries such as Norway, Kuwait, and Abu Dhabi that had been able to diversify their revenue streams had a much lower dependency on oil; therefore, they had a lower breakeven oil price. Alaska fell in the range with Russia and Saudi Arabia and was not nearly as bad as countries that had not saved revenues well.

Representative Edgmon observed that none of the locations on the chart paid a dividend (slide 13). Commissioner Hoffbeck answered that he did not believe so. He noted that dividends could come in many different ways and many of the countries provided substantial subsidies for services.

Commissioner Hoffbeck addressed slide 14 titled "Alaska: In the Middle":

Alaska lacks

- Revenue diversity
- Fiscal rules to address pro-cyclical spending

But, like Norway, Kuwait, and Abu Dhabi, Alaska has

- A large sovereign wealth fund
- Proven experience with rule-based fiscal policy
- An independent investment authority

Alaska has a cash flow problem, not a wealth problem.

Commissioner Hoffbeck elaborated that the state needed to develop revenue diversity, some of which would come with economic diversity. He detailed that some revenue diversity came in other forms of taxation outside of the oil and gas industry, which currently carried 90 percent or more of the load. He discussed that the state had been able to maintain the dividend program purely as a legislative rule; the money had always been available for appropriation to fund government services. The Permanent Fund money had been used to pay a dividend, inflation proofing, and savings. He discussed that the Alaska Permanent Fund Corporation (APFC) ran independently from the legislature, governor, and administration. He stressed the importance of maintaining that independence. He noted that the proposed bill included components honoring that independence because they did not want to be in a situation where APFC started making bad investment decisions because they had to fund something on the government side.

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Co-Chair Neuman referenced conversations he had with Commissioner Hoffbeck and others about preventing a situation where the Permanent Fund board ended up managing the Permanent Fund for the sole purpose of funding state government as opposed to growing the fund in order for Alaskans to have a higher dividend. He had communicated that his problem with having administration cabinet members holding APFC board positions was that he did not believe the members could stay autonomous. He clarified that he had not known the House speaker [Representative Mike Chenault] was going to introduce a bill on the concept; his statements had nothing to do with that. He stressed that under the current administration there had been some serious problems with the Alaska Gasline Development (AGDC) Corporation board interference in the past. He referred to challenges with confidentiality and explained that the AGDC board chair had to get permission from the attorney general to look at confidential information. He reiterated his concern and wanted to ensure that the boards could maintain their autonomy under the current and future administrations.

Representative Wilson wondered if the committee would hear a presentation on the bill during the current meeting.

Co-Chair Thompson replied that the presentation would happen at a subsequent meeting.

Commissioner Hoffbeck answered that the presentation was an excerpt of the first 14 slides of a longer presentation.

Representative Wilson voiced her preference to hear a presentation on the bill.

Vice-Chair Saddler asked if financial asset management was the only way to reduce volatility in a single commodity-based economy. He remarked that it was one potential way to expand from oil to oil and financial management. He wondered if there was another path forward to a less volatile and more diversified economy other than financial asset management. For example, he asked if the state could be just as advantaged economically if it was to invest in something counter-cyclical to oil.

Commissioner Hoffbeck answered that the state had limited tools at its disposal. Other states largely dependent on oil and gas also had more diversified economies and a tax structure associated with the diversified economy so that as certain components grew, money also went into the treasury. He believed the only large lever the state currently had at its disposal to deal with the deficit was the use of its investment earnings. He discussed that there had been efforts to diversify the state's economy for years, but it was a heavy lift and the state was far from a significant number of things.

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Vice-Chair Saddler surmised that it was necessary to have significant discussion on attaining the right mix of things. He was not saying the administration was wrong, but he believed it was a fair question to ask. He remarked that the strategy may be the state's only diversification tool.

HB 245 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson addressed the agenda for the following meeting.

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ADJOURNMENT

3:40:27 PM

The meeting was adjourned at 3:40 p.m.