

HOUSE FINANCE COMMITTEE
February 17, 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

Representative Mike Hawker, Bill Sponsor; Julie Lucky, Staff, Representative Mike Hawker; Representative Cathy Tilton.

SUMMARY

HB 224 PERM FUND: INCOME; DISTRIBUTION; PFD;

HB 224 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson reviewed the agenda for the day. He reminded members to turn off their cell phones.

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#hb224

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 224

"An Act relating to income of the Alaska permanent fund; relating to the disposition of income of the Alaska permanent fund; establishing and relating to the distribution account; relating to the calculation of permanent fund dividends; relating to the dividend fund; and providing for an effective date."

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REPRESENTATIVE MIKE HAWKER, SPONSOR, introduced the PowerPoint presentations: "HB 224 - Fiscal Plan: The Common-Sense Solution." He understood the serious fiscal challenge Alaska faced due to the decline in oil prices. He did not envy the finance committee having to close a \$3.5 billion deficit. He thought a permanent solution was necessary.

Representative Hawker turn to slide 2: "Mission Accomplished":

- Long-term balanced budget solution
- Increasing Permanent Fund balance
- Responsible and affordable level of future dividends
- Strong budget reserves maintained
- A simple and common-sense structure
- No personal income taxes to pay dividends

Representative Hawker emphasized the state achieving a long-term balanced budget solution. He thought the state could achieve an increasing Permanent Fund (PF) balance truly protecting the PF. He believed the state could maintain a system to provide a responsible and affordable level of future dividends to the people of Alaska. He would show committee members that his solution would help to reconnect Alaskans to the budgeting decisions that the legislature made. He suggested that if the legislature had to ask the citizens of Alaska to support government services there would be a direct result on the legislature's ability to pay continuing dividends. He urged the maintenance of a strong budget reserve to use to stabilize the budget in the face of volatile revenue out

flows. He specified that the approach offered in HB 224 was a very simple and straight forward structure. It was not complicated and did not offer anything really new. It respected the existing institutions in place and particularly respected legislator prerogative in making future budget decisions. He furthered that the numbers in the legislation penciled out in a manner such that a personal income tax would not have to be imposed on Alaskans. He added that Alaska had experienced a wonderful run with the vast oil and gas resources over many years without the imposition of a personal income tax. It had been an advantage for Alaska and he wanted to see it preserved.

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Representative Hawker explained slide 3: "Structure":

- 4.5 percent statutory endowment from Permanent Fund earnings
- Endowment proceeds first used to balance budget
- Any excess money split between dividends and savings funds
- Savings funds used to stabilize the budget when revenue swings

Representative Hawker reviewed the concept of a 4.5 percent statutory endowment from the state's PF earnings. He suggested that members were familiar with the endowment management concept for the PF. The approach had been recommended by the PF Board of Trustees to the legislature since about 1998. The Permanent Fund had resolutions dated in 2003 and 2004 supporting moving its management to an endowment process. The bill could not offer a constitutional amendment. It was a statutory approach where each year 4.5 percent of the fund's value would become available for appropriation.

Co-Chair Thompson acknowledged that Representative Kawasaki had joined the meeting.

Representative Hawker went on to explain the second part of the structure offered in the legislation. The bill stated that the endowment proceeds of 4.5 percent or about \$2 billion per year would have to be used to pay the state's debt first. If there was any excess funding after balancing the budget it would be applied to a dividend program. The

bill contained a mechanism that allowed the money that was flowing to the dividend to be split between dividends and to the state's savings accounts - either the Constitutional Budget Reserve (CBR) or the Statutory Budget Reserve (SBR) - to maintain those accounts at a certain level. He suggested that money in savings would be available to help stabilize the state's budget. He furthered that it was important to maintain the savings accounts solely for the purpose of always having a resource available in case of a deficit.

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Representative Hawker scrolled to slide 4: "HB 224 Cash Flow." He relayed that the graph presented a picture of the bill and the cash flow path. He pointed to the upper left-hand corner showing the principle value (corpus value) of the PF. Next he highlighted the box denoting the earnings reserve account (ERA). The statutory net income was accounted for every year in the ERA. He added that every penny in the ERA could be appropriated by a vote of 21 legislators in the House, 11 in the Senate, and the signature of the governor. He explained that the purpose of the statutory percent of market value (POMV) mechanism (the endowment mechanism) would only move 4.5 percent of the value of the PF including the ERA each year into a distribution account (shown in the purple box on the graph). At present there was about \$7 billion or more dollars in the ERA. He suggested that \$7 billion of the nearly \$50 billion PF could be spent by a vote of the legislature if it chose. He surmised that such a decision would result in horrible consequences to the value of the PF. The legislation was about protecting the fund's value. The idea of the POMV calculated payout allowed for a steady annual draw that was less than the long-term return on the investment of the financial assets in the PF and inherently inflation proofed the fund. He claimed that all major endowment funds around the world used the POMV mechanism in order to provide benefits to the beneficiaries of the benevolency trust.

He continued to explain that each year the state would put 4.5 percent of the value of the fund into a distribution account. The money would be used as much as necessary to balance the state's general fund (GF) budget which included both of Alaska's capital and operating budgets. He noted that the chart flowed next to the GF budget. After

satisfying the deficit any remaining money would go into a formula that would pay dividends. He reported that the dividend formula in the current bill proposed putting an indexed amount of dividends using a relatively small dividend, minimally \$250 per person indexed up to \$2000 per person, but it would be indexed on the amount of money the state had in its savings account balances. If the balances were significantly low, then the dividend would be lower and more money would flow into the state's savings accounts. If the savings accounts had high balances that provided plenty of security and cushion for budget uncertainties, then the state would pay a much higher dividend and move much less money into the accounts.

Representative Hawker next pointed to the dotted lines going from the CBR and the SBR back to the GF. The graphic representation of the slide depicted the money in the savings accounts always being available for appropriation into the GF budget at the will of the legislature. He reminded members that the difference between the CBR and the SBR was that the CBR was established by the vote of the people. The money that went into the fund came from all of the state's various settlements on tax claims. For instance, when there had been administrative procedures, and litigation on major claims the resulting funds went into the CBR. A three-quarter vote of the entire legislature was required in order to spend those funds. Once money was taken from the CBR the constitution required that any excess GF be moved into the CBR to replenish the fund at the end of the state budget cycle. The bill maintained that the CBR would be replenished first, then the remainder would go into the SBR (accessible with a vote of 21 and 11).

Representative Hawker was proposing that the legislature have a very serious discussion about its highest priority. He wondered about the state's available financial resources to meet that priority. He posed the question about whether the highest priority was the Permanent Fund Dividend (PFD) or paying the state's bills. The proposal suggested that paying the state's bills needed to be the state's highest priority. He opined that paying all of the state's bills meant meeting all of the public services people expected from the state. He opined that schools, roads, public safety, and health and social services programs needed to be the state's first priorities. Also, when the state had

excess wealth it would continue to be shared with the people of Alaska.

Co-Chair Thompson acknowledged Representative Cathy Tilton in the audience.

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Representative Wilson asked about the amount that had to be repaid to the CBR.

Representative Hawker stated that in 2015 the legislature appropriated \$3.0 billion out of the CBR into the retirement fund accounts against the unfunded actuary liability. The legislature also authorized a draw of up to \$500 million for a deficit in the FY 16 budget. Currently, the state had a liability to the CBR in the amount of \$3 billion plus whatever was ultimately drawn to fill the FY 16 budget deficit.

Representative Wilson asked if \$10 billion would have to be placed into the CBR before any monies could be deposited into the SBR.

Representative Hawker stated that it was only the amount of money that the state had drawn from the CBR that had to be repaid. It was not a fixed number. The Constitutional Budget Reserve grew with the earnings on the money that was in the CBR as well as any new deposits that went into the account from future settlements. The legislature only had to pay the CBR whatever the amount was on deposit. He would be providing additional information in another slide concerning how the CBR and the CBR balance could be affected by the legislation.

Representative Gara complimented Representative Hawker for his easy-to-understand presentation of HB 224. If the circumstances were such that \$2.5 billion (or 4.5 percent) did not cover the budget deficit, he wondered if there would be a minimum \$250 PFD or if a dividend would not be issued.

Representative Hawker responded that the way the bill read was that if there was not enough money from the PF endowment, a dividend would not be paid. It was similar to a household meeting its budget; bills were paid first. If the legislature adopted the mechanisms laid out in the bill

the state would continue to have a PFD program, to grow balances in the CBR, and to grow balances in the PF. However, he felt that the state would have to be willing to make a couple of difficult decisions and to maintain fiscal discipline in the future.

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Representative Gattis appreciated Representative Hawker's reference to fiscal discipline. She wondered where fiscal discipline fit into the legislation. She understood the concept of not having money, therefore not spending it. She pointed out that it was possible for the state to have money without having fiscal discipline. For example, the state could pay for programs but not payout the dividend. She wondered how the state could have money without having fiscal discipline and whether the state could save itself from itself.

Representative Hawker stated that he would address Representative Gattis' concerns as the presentation continued.

Vice-Chair Saddler pointed out that the system was predicated on fiscal discipline. He opined that the legislature wanted to increase GF spending which would result in the state not paying a dividend. He liked the linkage proposed in the legislation of state services and PFD's.

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Representative Hawker indicated his bill was part of a larger fiscal plan. He suggested that an incentive needed to be restored to be disciplined in the decisions the state made. He indicated that his fiscal plan concept was simple. He furthered that budgeting was not that complicated. He thought that the legislature confused the public at times as well as itself. He turned to slide 5: "Fiscal Plan":

- 4.5 percent statutory endowment from Permanent Fund earnings used to balance budget
- Significant up-front reduction in government spending
- Some new up-front taxes to share economic burden of solution

- \$1.4 billion appropriated in FY16 used to guarantee dividends for next two to four years
- Future dividend amounts depend on legislative decisions to hold spending down

Representative Hawker specified that there were four items to consider in balancing the state's budget and determining the level of appropriation. One of the questions to ask was how much the state needed and wanted to reduce in the current budget. The next question was about the number of new taxes to impose. The third question concerned raising new revenues. The last question had to do with how much of the PF earnings or money from savings was required to fill the budget gap. Legislators had the authority to choose to balance the entire state budget from savings accounts of which there was enough currently. He thought that legislators recognized that fulfilling the budget from savings was not the right thing to do. He argued that the legislature had to look for something that created a more sustainable means of dealing with the state's fiscal circumstances.

Representative Hawker encouraged members to consider adopting a 4.5 percent statutory PF earnings endowment draw. He added that later in the presentation he would detail how his plan would work. He also urged significant upfront reductions in government spending. He emphasized that the state was spending at an unsustainable rate. He had used a different approach than that of the administration and its consultants to determine the need for about \$1 billion of reductions in government spending. Independently, he had concluded that about \$900 million to \$1 billion needed to be cut from the state's current budget in order to meet expenditures while maintaining a sustained level of government based on anticipated revenues. Revenues came in primarily from oil and gas and the investment returns from the PF. He told of legislators in 1979 setting aside some money into a rainy day fund. At the time, the state had a large amount of money on hand generating income that could ultimately replace the state's reliance on oil and gas revenues from the North Slope. In the past the state had tremendous wealth enabling the majority of people's fiscal requests to be satisfied. However, with declining oil production the state's fiscal circumstances had changed. The state would have to make some very difficult decisions concerning spending reductions. He added that it would be important to inform the public about

why changes were being made especially since the state would have to take money from the PFD. He opined that every citizen of Alaska would want to see government spending reductions before they would want to sacrifice losing all or a portion of their PFD.

Representative Hawker asserted that, in general, the vast majority of people in Alaska would oppose using the PF to fund government until the state demonstrated its commitment to reducing the size of government. Many of his constituents understood the need to reduce the dividend but expected the state to reduce the size of government. He also thought new upfront taxes were necessary to share the state's economic burden in the solution. He furthered that sharing the burden was more equitable than taking it out on one industry or cohort. He thought everyone should be at the table. He reiterated that upfront reductions and an added level of taxes would make for difficult decisions. His financial model showed taking about \$900 million out of the budget.

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Co-Chair Neuman wanted to discuss what the legislature had already done to reduce the budget. He relayed that over \$2.4 billion had been reduced from the budget over a 4-year period, about a 30 percent reduction. In the previous year over \$440 million was reduced from the appropriations budget. He commented that he was unsure of what additional reductions could be made, as the legislature had looked diligently. He remarked that the legislature would continue to look for further reductions. He asked Representative Hawker what budget baseline he used in creating his plan. In the previous year the budget equaled about \$5.2 billion.

Representative Hawker stated that he would address Representative Neuman's question in the next slide. He continued to discuss the fiscal plan encouraging members incorporate it into budget decisions in the current year. He highlighted reviewing the use of the PF endowment and the continued reduction of expenditures. He opined that the public did not think there were enough reductions made. He relayed that what legislators did not see in the hallways of the Capitol building was the silent majority of Alaskans at home that wanted more reductions in the budget. He relayed that in his 14 years of service in the legislature he had seen a steady and consistent communication from

Alaskans encouraging budget decrements. He suggested that the legislature needed to be listening to the silent Alaskans. He continued that in making the transition to a new budgeting priority, he thought it was important to guarantee that the people of Alaska receive a certain dividend for a certain period of time. At the same time the state would need to demonstrate its commitment to increased fiscal responsibility.

Representative Gara had worked under four separate sets of finance chairs including Representative Austerman, Representative Thomas, Representative Stolze, Representative Hawker, and the current finance chairs. He stated that every time the finance chair presented the budget to the floor the speeches included a comment about the budget being a responsible and lean budget. He had voted for some of the budgets. Currently, the terminology being used was that the budgets referred to as responsible and lean that the previous several finance chairs passed were considered blotted in the current day and that \$1 billion needed to be cut. He did not think that both could be true. He agreed that there had been significant cuts to the budget. He thought a poll could be made to say whatever someone wanted it to say. The poll he had done in his district favored cutting only waste. He thought what people meant when they advocated cuts was to cut waste.

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Representative Hawker responded that he had conveyed in his presentation the public's perception of the state having a bloated budget. It was a very real thing to people for the state to take money out of their pockets and reduce their PFD. He asserted that in order to change people's perception of the state having a bloated budget the state would have to demonstrate a certainty. He recalled giving a couple of budget speeches on the floor using language that included benevolency and frugality. The one word that was left out of his floor speeches and of other floor speeches was sustainable. The legislature had been aware that the level of spending by the state was not sustainable. He recalled a robust conversation concerning sustainability on the House Floor in the previous year. He remarked that the world had changed. Oil fields did not last forever. The state's production had declined from about 1.2 million barrels of oil per day to below 500 thousand barrels of oil per day since he and Representative Gara had been elected.

He also mentioned a world glutton oil that Alaska had not seen and Alaska's oil prices had dropped substantially. He mentioned looking at \$30 per barrel of oil, the world had changed, and Alaska's budgeting process had changed. He thought that the legislature had done the right thing under the circumstances to the best of its ability. However, today something had to be done differently.

Representative Gattis did not believe that polls were necessary for Alaskans to understand that the state was not taking in the same amount of money that it was spending. She advocated cutting the budget to a point that the state could afford. She appreciated the presenter speaking to the subject because it was the elephant in the living room. She reaffirmed that the state needed a budget it could afford. She mentioned that in subcommittees there were a lot of things that people wanted. It would be a struggle as the budgets are closed out because in the past the state had given a significant amount to a lot of people. She furthered that the struggles would continue as time passed. However, it narrowed down to considering what the state had coming in and going out. She thought it was relatively simple.

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Representative Edgmon had a different philosophy from the previous speaker. He believed that in making very difficult choices the legislature should be thinking about what the state should look like in the future. It was not just about spending and cutting, but also about what the legislature envisioned for its great state in the next 50 years. In going forward the legislature would have to make decisions about what programs and services were essential. He opined that choices needed to be made along the way. He supported Representative Gattis' comments about having to reduce spending and the size of government. He relayed that he thought it was more complicated than just cutting government based on the part of Alaska he represented. He had to consider the services that were important in keeping his smaller communities alive.

Representative Hawker commented that although legislators represented different areas of the state with different needs, universally he surmised that everyone agreed that there was one economic pie that was only so big. The state

had to figure out how to live within its means. He noted that Commissioner Hoffbeck was in the audience.

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Representative Hawker continued to talk about slide 5. He wanted to further discuss the importance of guaranteeing the people of Alaska a continued dividend at some level for a transition period while the state demonstrated that it was getting its house in order, figuring out how it could live within its means. Some of the things to watch were the low oil prices and whether they were systemic or if they would have a quick recovery. The legislature could make decisions in the immediate or foreseeable and coming years based on the facts and circumstances of those years.

Representative Hawker noted that it was a data point for everyone to keep in mind that in the previous year's budget (FY 16) there was \$1.4 billion set aside for paying PFD's in the coming fall. In other words, each year when the legislature passed a budget it forward funded the dividend for the following year. He explained that the supplemental budget bill that was offered by the administration repealed that authorization. If the supplemental bill (HB 293/SB 167 - Short Title: APPROP: SUPP/CAP/OTHER APPROPRIATIONS, Section 10) was passed the entire dividend in the amount of \$1.4 billion for the coming fall would be repealed. He asked the committee to think about doing something other than repealing the dividend. He suggested reappropriating the \$1.4 billion and spreading it out over the next 2 to 4 years. For example, if the state was to spread the money over 2 years every Alaskan would be guaranteed \$1 thousand in the current year and the following year. In the meantime, the legislature could continue to make decisions based on facts and circumstances and the legislature's abilities to get the state living within its means. If the \$1.4 million was spread out over a 4-year period the state could guarantee a \$500 dividend for the following 4 years. He furthered that it would be a part of how the legislature presented the idea to Alaskans conveying that it was a transition time in which difficult decisions would have to be made. In the future under the fiscal plan he was proposing the level of future dividends beyond the guaranteed dividend would be dependent upon the legislature's ability to stimulate the economy, generate revenues, limit spending, or impose additional taxes. The

proposal in front of the committee empowered the legislature to make decisions into the future.

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Representative Hawker discussed the spreadsheet on slide 6: "House Bill 224 - Fiscal Framework." He explained that the packet contained more detailed information. The slide represented the current time period through June 2026. He highlighted the baseline deficit established (in the upper section of the spreadsheet) if no changes were made to budget in the current year and into the future. He noted that the revenue line (Line 2) came from the Department of Revenue (DOR) Revenue Sources Book and Line 2 out of the Legislative Finance Division's (LFD) Fiscal Summary. He pointed out the spending line which was also taken from Line 11 of LFD's Fiscal Summary which included the governor's proposed legislation to both raise money and move the PFD around. He reported having taken those elements out. He relayed that at the time he had walked through his numbers with David Teal, Director, Legislative Finance Division. He had also reconciled his numbers with the Tax Division at the Department of Administration. He had also reconciled his numbers with the folks at GCI who had been doing their own modeling. Once the governor's proposed legislation was removed from the numbers the state had about a \$3.5 billion deficit to start with. His numbers emphasized both designated general funds (DGF) and unrestricted general funds (UGF). The full spreadsheet in the bill packet was annotated at the bottom with references to where the numbers were derived and the associated philosophy being applied.

Representative Hawker continued to discuss slide 6. He pointed to the first column. He identified that \$950 million [Line 6] needed to be removed from the budget based on budget decisions. The Permanent Fund Endowment (4.5 percent) figure [Line 10: \$2064 million] was provided by DOR. The amount remaining, if any, after applying the endowment monies to the deficit was the amount that would be available for dividend appropriations. In the Fiscal Framework spreadsheet he showed a reappropriation of the existing money where the state could guarantee people a dividend payout of \$1000 for the following 2 years or \$500 for 4 years. He pointed to the CBR balance at the bottom of the spreadsheet. He estimated the starting point using a suggestion from David Teal, the director of the Legislative

Finance Division. He used a \$7 billion number for the CBR balance as of the end of June 2016. The CBR balance reflected an investment growth rate of 5 percent. It would allow for continued growth of the CBR account. Historically the account had a much higher rate of return than 5 percent. However, Representative Hawker used a more conservative number. He also highlighted line 7 which reflected a cumulative inflation of the budget of 2.5 percent each year. He selected the percentage rate arbitrarily. By the time the percentage was accumulated out into 2026 the state would increase its budget over \$1 billion per year. The model effectively moved the state into inflated dollars with the inclusion of line 7. The Permanent Fund was a 4.5 percent endowment against the earnings of the fund, real money coming back every year against increasing costs to the state.

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Representative Hawker surmised that within the first 2 years following making some very difficult decisions the state would return to a surplus position simply by using the PF 4.5 percent endowment against the earnings of the fund. While the state had a declining rate of oil production, cost recovery could be seen using the numbers published in the Revenue Sources book. The model created by GCI used a fixed \$50 per barrel number to determine revenue - the model did not inflation proof. He asserted that his model worked similarly and showed that the state would be able to live within its means buy using a PF endowment. He also pointed out that the CBR balance, since it would not have to be used, would continue to grow and compound from about \$7 billion to approximately \$10.6 billion using a 5 percent return.

Vice-Chair Saddler mentioned that Representative Hawker had informed the committee that he was using the DOR Revenue Sources Book currently predicated on \$56 per barrel of oil prices. Using the current oil price (about half of the price used in the Revenue Sources Book) as the starting point, he wondered about the tipping point going from deficit to surplus. Currently, Representative Hawker predicted it at the start of FY 19. He commented that while many of the projections were modeled on the Revenue Sources Book it seemed like every time someone asked about the current day's prices rather than the forecasted prices.

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Representative Hawker replied that the component in the revenue line for oil revenue at \$55 per barrel in the Revenue Sources Book was about \$1.7 billion. At \$30 per barrel would drop the revenue number to about \$1 billion and would require an additional \$700 million draw from the CBR. He received the numbers he was sighting from the DOR the previous day. They were the numbers the state was using in its analysis; numbers from the economic modelers from the DOR.

Representative Hawker indicated that the listed PFD numbers were based on the surpluses in the spreadsheet. He noted that there was nothing that would stop the legislature from taking money from savings to add to the people's dividend if the state was comfortable. He emphasized that he did not want to see a headline that said, "Mike Hawker Proposes killing your dividend." He did not purpose eliminating Alaskan's dividends but recommended a "live within our means" mechanism that always allowed future legislators the ability to decide how much dividend was within the means of the state. He mentioned that good things could happen as well. He mentioned that Repsol/Armstrong had a find in the Coville River Delta that the Department of Natural Resources (DNR) could add 100 or more barrels of oil per day to the state's oil production. It would be a 20 percent increase from one field if it could get permitted. Production from the field could potentially come online within a couple of years and was not reflected in the model he was currently reviewing.

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Representative Wilson asked why Representative Hawker was using 4.5 percent. She wondered because of his recommendation to also impose new taxes.

Representative Hawker responded that the model could work after the first year taking \$950 million along with a balance of increased taxes and decreased expenses. He was not advocating for additional new taxes every year but encouraged making some difficult decisions upfront. He noted his previous experience working with the PF executives and the board of trustees in promoting a constitutional endowment mechanism using 5 percent. The returns over time would be sufficient to exceed the 5

percent as well as an inflation of approximately 3 percent. Standard endowment fund draws tended to run between 4 percent and 5 percent. He backed down to 4.5 percent due to sheer conservatism. The mechanism for taking the draw off of the funds was to mitigate the volatility of the fund earnings the percentage was applied to the first 5 of the 6 preceding years. It was done to allow the fund to close its budget year, get a completed audit, and get a complete and accurate measurement of the fund's value. Currently, the fund might not have its audit completed. In order to have a cushion the first five of six years was used to ensure there was a year in which the audit could be completed. In looking at a historic timeframe mathematically it came closer to a 4 percent effective draw off of the fund which provided greater assurance that the fund continued to grow and that it was adequately inflation proofed it. He reiterated that the 4.5 percent was judgmental but were based on sound mechanics and was consistent with standardized financing approaches. He suggested that if members considered the bill it would also provide for the opportunity to get some professionals before the committee to answer any questions.

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Representative Wilson referred to slide 5 asking about taxation as an accompanying solution. She wanted to better understand the additional taxation he mentioned.

Representative Hawker replied that the budget decisions had to be made by the legislature. He had it listed as a single line item on the spreadsheet, \$950 million of overspent dollars. In order to balance the budget \$950 million had to be reduced from the budget. The number was based on expected future revenues and a sustainable draw from the PF. He concluded that there was only one economic pie. The administration's bill proposed \$1 million in cuts and \$900 million in new taxes. The administration's version of the bill proposed \$100 million in cuts and \$900 million in new taxes. He reviewed the numbers by starting with \$6.1 billion and backing out approximately \$1 billion for DGF which took the number down to \$5.1 billion. He then removed \$950 which took the number down again to \$4.1 billion or \$4.3 billion.

Representative Wilson asked why he included new upfront taxes rather than including a sustainable [budget] number,

4.5 percent or another percentage, in the fiscal plan. She understood the options of reducing spending to a certain level and implementing new taxes. She asked why spending was not limited versus imposing new taxes.

Representative Hawker did not see a mandate for taxes in the legislation. He guaranteed that all fiscal models had flaws. However, the models reflected best estimates and provided a large enough picture to make decisions. He remarked that the numbers did interrelate. If the state took a higher percentage of a POMV from the PF the state could lower its need to be making some of the difficult decisions the legislature currently faced. He thought that using the more complicated and more detailed model he provided to committee members would require the right mix of upfront budget adjustments of about \$750 million in hard cuts. He believed that in order to get participation from all sectors of the economy the state needed some additional upfront taxes, about \$200 million. He furthered that all of the taxed sectors should be asked to contribute. The administration suggested imposing \$900 million in taxes and cutting \$100 million from the budget. It was a judgement call of the legislature.

Representative Wilson discussed hearing from her constituents that they wanted to control government spending. She wondered if it was possible to include a mechanism that would mandate the legislature to control its spending. Although she appreciated Representative Hawker's model, she thought it would be difficult for constituents to believe that legislators would control spending at a certain level. She thought it would be hard to sell it to Alaska residents. She wondered if he had looked into imposing a hard number or a percentage.

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Representative Hawker responded, "The answer is absolutely yes." He better understood that Representative Wilson was asking about some kind of a spending limit.

Representative Wilson responded in the affirmative.

Representative Hawker responded that because the legislature wrote law a spending law could be placed into statute. However, the limitation could always be changed by a future legislature at any time. He thought that the

legislature had the power. The legislature also had the ability to ignore statute. Some type of a more rigid statement in legislation concerning the level of tolerable spending could be implemented. He thought it could be beneficial, but at the same time, it brought concern about any future requirements. He knew of his district having a very different perspective on the need for government spend than Representative Edgmon's district, for example. In his proposed legislation he tried to show what level of spending the state could afford with its current resources. He thought that in order to enforce a rigid spending limit which could not be violated, a constitutional change would be required.

Representative Wilson requested that Mr. David Teal provide a calculation having to do with not being able to raise spending by a percentage of reserves in one of his presentations.

Co-Chair Thompson asked Representative Hawker if he had an interactive model that could be used to see how different tax numbers affected the bottom line.

Representative Hawker replied affirmatively. He mentioned that it was very easy to use and any kind of scenario could likely be modeled. He had just recently received a fantastic matrix of data on oil prices. He had wanted to make the model sufficiently sophisticated in order to be able to discuss what it would look like under different oil price scenarios.

Co-Chair Thompson invited anyone who might have a scenario to run through should get them to Jane Pierson, his staff. She would get Representative Hawker to do the modeling.

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Vice-Chair Saddler thought the legislation provide a way to make the numbers work. However, he thought there was an opportunity for leakage. He wondered about the forecast of increased spending. He had noticed Representative Hawker's more detailed model was based on 2.5 percent inflation. He also asked if the Representative had factored in a population increase. He liked that his model provided for a guaranteed \$1000 dividend. He thought people had an expectation. He was concerned about poor optics with a lower PFD amount. He also stated that Representative Hawker

claimed that it would be possible for the legislature to appropriate money to bring the dividend level to whatever the legislature decided. It also appeared that it would need to come from the Constitutional Budget Reserve requiring a 3/4 vote and would cost extra. Also, if there was leakage the legislature could certainly raise the spending limit to whatever it wanted. He concluded that it would depend on the legislature's fiscal discipline. He opined that it always came down to the discretion, integrity, judgement and the decisions of the legislature. He asked if the legislation allowed for any capital spending.

Representative Hawker replied that Vice-Chair Saddler's response had identified that decisions had to be made and certain presumptions had to be in play. The approach he was offering in the legislation created an affirmative incentive for future legislators to make wise decisions, to hold down budgets, and not to increase spending; it all flew into the dividend. He was not guaranteeing a number for a dividend, but rather showing how, based on spending patterns, the state could still balance its budget with a POMV and maintain a dividend program. If legislators were willing to hold to a more rigid spending cap, the money would go straight to the dividend. If the state budgeted several new programs, the money would come out of the dividend. He opined that the state had a dysfunctional fiscal system. He suggested that everyone that moved to Alaska cost more money to the state because of the services that needed to be provided including schools and roads. His model demonstrated that the state could still offer an almost Utopian existence for Alaskans. He furthered that Alaska had reached a point where it could no longer continue to have unrestricted PFD's as well as the Utopian existence where people did not have to pay for the services they consumed.

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Vice-Chair Saddler commented that the dis-synchronicity had been workable because of oil prices being so high in the past. He wanted to know what kind of conditions were necessary for money to flow back into the dividend. He wanted to see additional modeling to determine how much funding would end up available for dividends. He reemphasized that the legislature had made responsible decisions to reduce spending, to save the state's windfall

profits, and to make long-term structural changes limiting spending. He believed the state had a spending cap at present; the increases in the budget were predicated on \$2.5 billion indexed to inflation and population. He thought these measures were currently in statute but remarked that they were not very affective. He opined that the legislature would have to be careful in making structural changes and it would be up to the legislative body's personal discipline to adhere to them.

Representative Hawker believed that the spending cap Representative Saddler was referring to existed in the constitution. He furthered that in the constitution there was a spending limit. However, it was formulated in such a manner that it was ineffective.

Vice-Chair Saddler admitted that it was not solely Representative Hawker's responsibility to come up with a fiscal plan that solved all of the state's fiscal problems. He wondered about capital spending within in his fiscal system.

Representative Hawker replied that what was included in the legislation was the capital spend levels in the current budget (about \$200 million). The inflation factor of 2.5 percent cumulative growth was the generic provision in his model that anticipated there would be spending, growth, and needs. The point of the model was to show the larger assumptions and parameters in order to make decisions. He added that the CBR balance continued to grow in his model - a potential source for capital funding. His model contained a very conservative oil production forecast inherent in the Revenue Sources Book. There would be a 20 percent increase in production as a result of the Repsol development on the North Slope that could substantially change the state's revenue picture. A gas line in place by 2025 or 2026 could be the state's future. The state had a way to bridge to the future without having to completely reconstruct or re-plumb its whole system and continue to respect the institutions of the state. He thought Alaskans would be able to fully trust the PF and the limits and controls inherent in the CBR. He opined that the state did not have a budget crisis in Alaska. The state had \$60 billion in savings with a population of 700 thousand. He argued that the state did not have a fiscal crisis but rather had a management challenge figuring out the state's resources, how much

money could be generated from them, and how to meet the needs of the public.

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Representative Guttenberg agreed that the legislature needed to have an economist provide an analysis. He spoke of being involved with a high school class using an interactive spreadsheet. One of the solutions was to focus balancing the numbers rather than looking at any related impacts.

Representative Hawker explained that the number Representative Guttenberg was referring to was the \$201 million appropriation for capital budget spending each year.

Representative Guttenberg asked whether the number was negative.

Representative Hawker responded that the model [Spreadsheet entitled: HB 224 - Fiscal Framework Simplified Ten Year Fiscal Model] was structured such that the revenues were positive numbers. The expenditures were negative numbers. The capital budget baseline of \$201 million was the anticipated baseline capital spend.

Representative Guttenberg pointed to the following line dealing with refundable tax credit adjustments. He noted the Fall 2015 Revenue Sources Book. He wondered about the difference between the most recent version of the revenue sources book and the 2015 book.

Representative Hawker replied that the Fall 2015 Revenue Sources Book was the most current version.

Representative Guttenberg commented that a CBR vote did not have to add anything.

Vice-Chair Saddler responded that it did not have to.

Representative Guttenberg responded that it was up to more than one group of people. He furthered that a CBR vote did not have to be additional money to the budget.

Co-Chair Thompson asked Representative Guttenberg to explain his question.

Representative Guttenberg stated that to get a CBR vote it did not necessarily mean the budget would be larger than it was prior to the CBR vote.

Co-Chair Thompson remarked that he did not know if the legislature needed a three quarter vote if it was not bigger than it was before.

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Representative Edgmon thanked Representative Hawker for a shorter presentation because it gave members plenty of room to discuss things freely. He referred to a slide in the governor's presentation that discussed the benefits of a non-POMV approach in that it offered a fixed-draw (Sovereign Wealth Concept). He thought that the fixed draw concept allowed for the fund to grow appreciably more than with a POMV approach. He wanted to hear from Representative Hawker about why it would not be the case from his perspective.

Representative Hawker wanted to be very careful about criticizing the approach offered by the governor, as it was a valid concept. His was a competing concept that was different and much simpler. Respecting the state's current constitutional constructs of the PF and the budget reserve funds, he did not look at the larger legal question about whether the proposal would cause issues with the PF earnings reserve account to be characterized as GF and have to be swept into the CBR each year. His bill avoided the legal questions raised. As far as the draw from the PF there was a huge body of financial management science and successful practice and tradition across many benevolent funds in the world where a similar practice was in place. His proposal would put a very specific limit on the draw each year. There had been other bills referred to as the PF protection act but the only thing that truly protected the PF was limiting the draw and using the best contemporary financial management practices through an endowment mechanism. He stated that the fact that the state co-mingled a bunch of money under the earnings reserve in other proposals and then recalibrated how much money that was in any given year did not provide a great deal of assurance that the mechanism itself did not inherently allow over-spending. His key point about preserving the integrity of the existing PF structure and using the 4.5

percent endowment draw was that the state had the greatest possible assurance that the value of the fund was protected so that it was not overdrawn.

Co-Chair Thompson mentioned that the finance committee would be hearing from David Teal who would be making a presentation comparing the three scenarios.

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Representative Edgmon commended Representative Hawker for his work in the legislature. He noted that Senator McGuire had said in the previous day's meeting that she was freed up due to not running for reelection. He referred to a slide from the governor's presentation that talked about what would happen if the legislature did not take any action in the current session. One of the four bullet points on the slide indicated that the state's credit rating would be at risk and could also damage Alaska's economy if the legislature did not do anything. He asked Representative Hawker to comment. He thought the representative was the perfect individual to ask.

Representative Hawker addressed Representative Edgmon's comment about speaking freely because of not running for reelection. He pointed out that the mechanism and concept he had previously offered in 2003. At the time the legislature had burnt through about \$5 billion of a \$7.5 billion PF balance. At the then current cash burn rate the state had 2.5 to 3 years of money left in the account. At present, if the state did nothing the state had about 2 to 2.5 years left. He commented that the wheel had come full circle. He pointed to a document in the bill packet called "Components of Sustainable Fiscal Policy for Alaska." The document contained the philosophy he was asking the committee to embrace. He reported publishing the 5 point fiscal plan in April 2003 and had stood behind it ever since. He thought it was the foundational philosophy that as a legislature needed to maintain. Item 1 started with the legislature's responsibility to promote real economic development in the state providing a stable investment climate and job security. Item 2 was that the legislature had to control the cost and growth of government. Specifically, the legislature needed to be mindful that every single decision that was made affected the lives of individual Alaskans. Item 3 was to manage the PF to protect its real value over time - endowment method management of

the fund for making money available for the budget while providing a substantial individual dividend and a contribution to the cost of public services.

Representative Hawker continued to item 4. He recommended structuring the state's general revenue system for a balanced budget at mid-range oil prices that minimized personal taxes and respected local governments' revenue structures. The state's entire revenue structure needed to be based on mid-level oil prices and the legislature needed to determine a sustainable level of spending based on revenues. He reported that item 5 was to maintain a budget reserve fund for fiscal stability which could be drawn from at times of lower than average oil price cycles and restored when prices were higher.

Representative Hawker moved on to respond to Vice-Chair Saddler's second line of questioning. He agreed with Governor Walker's conclusions that the legislature needed to act immediately. He believed there was an urgency particularly with the ratings agencies. He relayed that both the state's debt ratings agencies and the overall state securities analyst ratings agencies were looking for the legislature to take affirmative action in the current year. In the following week some state employees would be traveling to New York to do presentations for the various representatives from the investment banking community. The three bills would be the focus of the presentation and would represent the items the state was looking at implementing as a demonstration of its good faith and intent to restore a functional, stable, durable, long-range solution to the state's fiscal problem. He reemphasized the need for the legislature to act boldly in the current year. He spoke of a quote by J.F. Kennedy that there were costs and risks to every bold course of action. The costs and risks paled in comparison to the costs and risks of comfortable inaction.

Co-Chair Thompson asked Representative Hawker if he wanted to provide a sectional analysis of the bill.

Representative Hawker was happy to indulge the wishes of the committee. He added that the sectional analysis was very easy to follow. He noted that he would be happy to come back to the committee anytime to discuss the detail of HB 224.

Co-Chair Thompson asked Representative Hawker to present the sectional analysis.

Representative Hawker deferred to his staff, Julie Lucky.

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JULIE LUCKY, STAFF, REPRESENTATIVE MIKE HAWKER, viewed the sectional analysis of HB 224. She reported that Section 1 of the bill adopted the statutory endowment method for determining how much was distributable per year from the PF earnings. It was 4.5 percent of the average market value of the balance of the fund for the first 5 of the preceding 6 fiscal years. Section 2 of the bill basically prioritized the use of the annual payout - the 4.5 percent annual payout. It also stated that the amount used from the PF earnings would be used before a personal income tax was assessed on state residents. She relayed that Section 3 of the bill provided the language that allowed the transfer of the money from the PF earnings into the distribution account.

Ms. Lucky continued to convey the sectional analysis. Section 4 of the legislation reflected a technical change required to deal with the Amerada Hess funds. She reported that Section 5 of the bill was the dividend calculation. There were not a lot of changes in the dividend calculation or the method of calculation. However, the amount of money the calculation was based on would come from the 4.5 percent POMV payout into the distribution account. Monies in the distribution account would first be used to fill any deficit in the budget and the remaining funds would be placed into the dividend account (the orange box on the waterfall slide).

Vice-Chair Saddler referred to the bubble chart and summarized the flow from the ERA (4.5 percent POMV payout to the distribution account and then into the GF. He wondered about the purpose of a distribution account when the POMV payout could be directly distributed into the GF.

Representative Hawker responded that the definition of the distribution account was to facilitate the management by the state agencies involved. It was defined as an account within the GF. The money was, in fact, being directly deposited into the GF. The rest of the bill was about allocation as the money was appropriated.

Vice-Chair Saddler commented about the limits of the diagram.

Representative Hawker added that the indexing of the progressive dividend which depended on how much savings the state had in the bank was a concept suggestion in the bill.

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Ms. Lucky continued with a brief review of the sectional analysis. She explained that Section 6 described the cap which was based from \$250 to \$2000. It was indexed on the combined value of the CBR and the SBR. There was also a statement that relayed that in any year that an income tax was assessed the amount of the dividend would be zero. It reflected a policy call that income tax should not be used to pay dividends.

Representative Hawker included the provision in the bill to encourage serious debate in the legislature. It was his personal opinion that it would be wrong to assess a working Alaskan's income, take their income away from them, and indiscriminately redistribute it to everyone else. The point of the bill was to show that it was not a necessary policy in order to achieve a sustainable working budget.

Ms. Lucky thought Section 7 of the bill best described the waterfall diagram. It established a distribution account, and codified the "waterfall" concept. The section encapsulated how the annual distribution from the PF would be placed into statute. She also pointed to Page 5, Line 6-18, subsection d to the statement that nothing in the section prohibited the legislature from making an appropriation to the dividend fund established under AS.43.23.045 from a source other than a distribution account. If the legislature chose to make a policy call to increase the dividend there was nothing in the bill that would keep that from happening.

Representative Hawker mentioned the example of re-appropriating the money that was currently set aside for dividends and using it to pay a higher level of dividends in the immediate future.

Ms. Lucky explained that Section 8 was a simple repeal of the inflation proofing of the PF. Moving to the endowment

or POMV concept made the inflation proofing language unnecessary. The last section of the bill, Section 9, established an effective date of June 30, 2016.

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Representative Gattis thanked Representative Hawker and expressed her appreciation for his succinct presentation. She also thanked Ms. Lucky.

Vice-Chair Saddler asked if the legislation included a provision to reappropriate \$1.4 million to guarantee the \$1000 dividend for the following 2 years or if a supplementary legislation would be required.

Representative Hawker explained that the reappropriation required an appropriations bill. His bill was strictly a policy bill.

Co-Chair Thompson thanked the presenters for their presentation and indicated that the bill would be brought back before the committee for comparisons likely in the following week.

HB 224 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson reviewed the agenda for the following day. The committee would be hearing an update on the Alaska LNG Project.

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ADJOURNMENT

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The meeting was adjourned at 3:12 p.m.