

HOUSE FINANCE COMMITTEE
FOURTH SPECIAL SESSION
June 6, 2016
3:17 p.m.

3:17:00 PM

CALL TO ORDER

Co-Chair Thompson called the House Finance Committee meeting to order at 3:17 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

Jane Pierson, Staff, Representative Steve Thompson; David Teal, Director, Legislative Finance Division; Representative Andy Josephson; Representative Lora Reinbold; Representative Gabrielle LeDoux.

SUMMARY

HB 245 PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS

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

Co-Chair Thompson reviewed the meeting agenda.

#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 Neuman MOVED to ADOPT the proposed committee substitute for HB 245, Work Draft 29-GH2859\L (Wallace/Martin, 6/6/16). There being NO OBJECTION, it was so ordered.

Co-Chair Thompson indicated that David Teal, director of the Legislative Finance Division (LFD), would be providing an analysis.

JANE PIERSON, STAFF, REPRESENTATIVE STEVE THOMPSON, read from a document titled "Corrected HB 245 Explanation of Changes version I to version L" (copy on file):

HB 245 Explanation of Changes version I to version L

Page 1, Lines 6-7 TITLE CHANGE regarding unrestricted state revenues available for appropriation.

Deleted Section 4 from version I. This section conforms to not getting rid of the Amerada Hess case settlement money being directed to the Alaska capital income fund.

Page 4, Lines 25-28. States that the Amerada Hess money will not be accounted for in the amount of money available for distribution.

Page 4, Line 30 and line 31 the word "calculated" was removed, since this is an amount in the fund, not a calculation.

Page 5, Line 7 removes "adjusted for inflation" from the revenue limit threshold. Automatic inflationary increases will certainly reduce the impact of the limit and might make the limit as irrelevant as the existing constitutional spending limit.

Page 5, Line 14 removes language regarding inflation proofing.

Page 6, Line 5 - 15 A new section is added AS 37.13.148 - Appropriation of Revenue. This new section creates a spending rule that states, if the amount available for appropriation in the preceding fiscal year is greater than the amount appropriated, the legislature may appropriate the excess as follows:

- (1) 50 percent to the Permanent Fund
- (2) 50 percent to the CBR

Page 9, Line 13 - AS 37.14.145(d) is eliminated from the repealers. This has to do with the Amerada Hess settlement money.

Page 9 - Section 24 was removed in version L. This allows for transfer of the management of the CBR from DOR to the Permanent Fund to happen this year and not in 2017.

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Representative Gara asked for detail on two changes related to inflation proofing on page 5.

Ms. Pierson replied that page 5, line 7 removed the language "adjusted for inflation" related to the revenue limit. The change would hold the limit to \$1.2 billion without the ability to rise with inflation. Inflationary increases may make the revenue limit irrelevant.

Co-Chair Thompson asked which bill version the page references (provided by Ms. Pierson) related to. Ms. Pierson answered the changes appeared in the "L" version of the bill.

Representative Gara spoke to the revenue limit of \$1.2 billion. He surmised the combination of oil revenue and Percent of Market Value (POMV) earnings remained at a flat \$4 billion. He asked for the accuracy of his statements. He asked for verification the \$1.2 billion would not be adjusted for inflation.

Ms. Pierson responded in the affirmative. She deferred the question to LFD for further detail. She mentioned a handout

in members' packets provided by the division [titled "PFPA Payout/Revenue Split" (copy on file)].

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Representative Gara asked if the other inflation proofing reference on page 5 also related to the same issue. Ms. Pierson answered in the affirmative.

Representative Gara pointed to page 6 of the legislation that included a new provision on 50 percent to the Permanent Fund and 50 percent to the Constitutional Budget Reserve (CBR). He asked for detail.

Ms. Pierson answered that if the amount available for appropriation in the preceding fiscal year was greater than the amount appropriated, the legislature may appropriate the excess as follows: 1) 50 percent to the Permanent Fund; and 2) 50 percent to the CBR. She noted members' packets included an LFD chart describing the savings rule [titled "Savings Rule" (copy on file)].

Vice-Chair Saddler noted that there appeared to be a misalignment of pages in the documents under discussion. Ms. Pierson responded that any deleted material came out of the "I" version of the legislation. She believed the other information should align.

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Representative Kawasaki pointed to page 6, lines 5 through 15 and believed the change actually applied to lines 8 through 18. He discussed that under the legislation the appropriation of revenue would be split, dividing half to the Permanent Fund and half to the CBR. He referred to the language "the legislature may appropriate" and wondered if it meant the legislature could put the money into an earnings reserve account.

Ms. Pierson replied that the legislature could always appropriate as it saw fit.

Co-Chair Thompson noted Mr. Teal had joined the meeting.

Representative Gara wondered if the two provisions never let state appropriations get adjusted for inflation. He referred to new Section 37.13.148 on page 6. He observed

the section was not binding as it included the language "the legislature may appropriate"; however, if the legislature followed the section, appropriations would not be adjusted for inflation. He surmised if the cost of inflation for the same number of services made the cost increase, they would be able to adjust for the increase with the revenue. He surmised they would not "just keep cutting."

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, agreed that the change would flatten the expenditure line (there was a dollar-for-dollar reduction of the payout from the Permanent Fund earnings reserve account). He noted there were [LFD] graphs available to provide further detail. He clarified the line was flat only in reference to oil production. He expounded if there was other revenue from any source other than production tax and royalties, the line would not remain flat. He added the revenue was all spendable.

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Representative Gara wondered if the state would still be limited to the prior year's spending level if it brought in more revenue (from Permanent Fund earnings and oil combined) than it had spent the preceding year. He surmised the situation could go on in perpetuity and could result in falling behind inflation if those were the two revenue sources.

Mr. Teal suggested reviewing the sectional analysis before he answered questions.

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Ms. Pierson read the sectional analysis (copy on file):

Section 1: Legislative intent that the legislature reevaluate the use of the earnings of the Permanent Fund in three years

Section 2: Language requiring the Alaska Permanent Fund Corporation to adopt regulations similar to the State's procurement code

Section 3: Adds the Alaska Permanent Fund Corporation to the list of those state agencies that are exempt from the State's procurement code

Section 4: Transfers the management and investment of the Constitutional Budget Reserve from the Department of Revenue to the Alaska Permanent Fund Corporation

Section 5: Requires the Alaska Permanent Fund Corporation to prepare an annual report on the balance and returns of the Constitutional Budget Reserve fund

Section 6: Dedicated deposits of royalties to the Permanent Fund are reduced from the current 25/50 split on old/new leases to the constitutional minimum of 25 percent

Section 7: Requires the Alaska Permanent Fund Corporation to determine the net income of the earnings reserve account excluding the unrealized gains or losses

Section 8: (b) Defines the Percent of Market Value payout as 5.25 percent of the average year-end market value of the Permanent Fund and Earnings Reserve Account for the first five of the most recently completed six fiscal years. The payout may not exceed the year-end balance of the earnings reserve account for the fiscal year just ended

Representative Gattis asked about Section 8, which defined the POMV payout up to 5.25 percent. She wondered if it was just 5.25 percent instead of up to 5.25 percent.

Mr. Teal responded that it was a more technical issue and was the same issue that Representative Gara wanted to address. He explained that as oil prices increased the payout from the earnings reserve account to the General Fund would fall. He expounded the payout would begin to fall at about \$75 [per barrel]. By the time oil prices reached \$105, the payout from the reserve account would be zero. In that scenario, the rate should not be set at 5.25 percent because it would conflict with the revenue limit, which reduced the payout as oil prices rose.

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Representative Gattis confirmed that the language "up to" was correct.

Vice-Chair Saddler asked where the words "up to" occurred in the legislation. He read from the sectional analysis: "Defines the Percent of Market Value payout as 5.25 percent." He noted it did not include the words "up to." He added that Section 8 on page 4 of the legislation did not include the language either.

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Ms. Pierson answered that the "may appropriate" section under discussion could be found in Section 10, subsection (e) of the bill. She read from the section:

Each year the legislature may appropriate from the earnings reserve account to the general fund an amount that does not exceed the amount available for distribution under AS 37.13.140(b) and (c).

Representative Gara surmised the amount was not really 5.2 percent. He asked for verification it was 5.25 percent of the last five years, which translated into something like 4.8 percent of the current balance.

Mr. Teal spoke to the long six-year lookback related to the provision. He stated in theory the balance of the Permanent Fund would be increasing each year. He stated that looking back six years gave a payout that was approximately equal to the balance of about three years back. The effective payout was 5 percent of a three-year-old balance, which amounted to less than 5 percent (if taken as a percent of the current balance).

Representative Gara asked for an estimate of the percentage. He had previously heard 4.8 percent. Mr. Teal answered the number was correct.

Ms. Pierson continued to read the sectional analysis, beginning with Section 8, subsection (c):

Section 8: (c) Reserves 20 percent of the POMV payout for dividends. The remaining 80 percent of the payout is subject to a dollar for dollar reduction as oil and gas revenue rises above \$1.2 billion.

1. Oil and gas Unrestricted General Fund revenue excluding the amount to be paid as 20 percent of the prior year royalties to the dividend
2. \$1,200,000 revenue limit

Section 9: Deals with distribution of the money awarded in the Amerada Hess case

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Ms. Pierson continued to read from the sectional analysis:

Section 10: AS 37.13.145 is the Disposition of Income of the Permanent Fund statute

- a) Unchanged - Establishes the ERA and identifies the ERA as holding earnings of the Permanent Fund and ERA
- b) Repealed in this bill - dividends based on statutory net income
- c) Repealed in this bill - inflation proofing
- d) Repealed in this bill - segregation of Amerada Hess
- e) Added in this section - each year the legislature may appropriate to the General Fund the amount available for distribution from the Earnings Reserve Account under the POMV in Sec. 10 (b) and the limit calculation in AS 37.13.140(b) & (c)
- f) Inflation proofing mechanism (when the balance of the ERA reaches 4x the maximum amount available for distribution

Section 11: Appropriations to the dividend fund Dividends are comprised of 20 percent of the 5.25 percent POMV outlined in Sec. 4(b), and 20 percent of prior year royalties, excludes those dedicated to the Permanent Fund or School Fund (25.5 percent are dedicated)

Appropriation of revenue. If the amount available for appropriation in the preceding fiscal year is greater

than the amount appropriated, the legislature may appropriate the excess as follows:

- (1) 50 percent to the Permanent Fund
- (2) 50 percent to the CBR

Section 12: Conforming language relating to procurement

Section 13: Mental Health Trust Fund and Amerada Hess monies may not be included in the computation of income available for distribution under the POMV

Section 14: Transfer of money to the Dividend Fund requires an appropriation

Section 15: The amount of each Permanent Fund Dividend for fiscal years 2017, 2018, and 2019 shall be \$1,000

Section 16: Conforms to Sec. 12, which moves money to the Dividend Fund by appropriation

Section 17: Once the money is in the Dividend Fund, the Department of Revenue shall annually pay dividends without further appropriation

Section 18: Repeals language relating to the subaccount of the Constitutional Budget Reserve, the former dividend calculation, inflation proofing calculation

Section 19: Repeals Sec. 15 - \$1,000 dividend for three years

Section 20: Transition Language: The Commissioner of Revenue and the Alaska Permanent Fund Corporation may adopt regulations, policies and procedures to implement this Act

Section 21: Retroactivity clause

Section 22: Effective date for sections 2, 3, 12, 20 and 21, immediate

Section 23: Effective Date, July 1, 2016

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Representative Gara remarked that the state would not get any additional revenue (revenue would be flat) up to \$110 per barrel of oil (or so). He noted it started at \$1.2 billion in oil revenue; he wondered when it ended.

Mr. Teal stated Representative Gara was speaking about the payout limit. He relayed his preference to wait to address the issue in order to avoid confusion.

Representative Wilson referred to Section 11 that would enable the legislature to appropriate 50 percent of [excess] revenue to the Permanent Fund and 50 percent to the CBR. She wondered why the money would not be added to the Permanent Fund Dividend instead.

Mr. Teal replied that it had been a proposal that had been made by others. He could not provide detail on why, but it was part of the modeling package. He suggested waiting to discuss the issue until he reached the topic in his upcoming presentation.

Representative Wilson referred to Section 15 that would set the dividend to \$1,000 for FY 17 through FY 19. She asked if the modeling indicated revenue the bill would bring in if the \$1,000 cap was not included.

Mr. Teal replied in the negative. He stated the amount was roughly \$900 if the \$1,000 cap was not included.

Representative Wilson asked if the amount would be approximately \$900 for all three years or if it would decline over the three-year period. Mr. Teal answered the amount would increase. He explained the model showed a fairly steady line at \$1,000 dividends. With no cap the dividend started at about \$900 and by FY 19 it would reach \$1,000.

Representative Guttenberg referred to Section 4 [page 3 of the legislation] where management of the CBR would be transferred from the Department of Revenue (DOR) to the Alaska Permanent Fund Corporation (APFC) "in the manner set out for the management and investment of the assets of the Alaska permanent fund under AS 37.13.120." He believed the goal was to manage at a higher rate of return. He asked if the language covered the transfer of responsibility and management. He wondered if including the language in the bill was all it took to make the change.

Mr. Teal replied there were two sections relating to the topic. The first was Section 4 that specified APFC would manage the CBR. He explained it was already in statute that APFC may manage the CBR. The second, more important component, was the transition language in Section 20 of the bill. He detailed there were currently some investment limitations on the CBR account that kicked in when the funds may be used in the next five years. He explained that those limitations were being repealed. He expounded that those provisions currently held down the return on the CBR. The theory was that by having the CBR managed by APFC, the investment limitations would be eliminated, which would impact the returns. The CBR had liquidity requirements because that state may be, or probably would be, drawing from the CBR to fill deficits. He noted that no matter who managed the account, if it was managed on its own, it would have to be very liquid; however, by merging the CBR with APFC, which required significant liquidity, liquid and illiquid investments would be transferred between the CBR and the Permanent Fund. He explained that the Permanent Fund was much larger than the CBR and the Permanent Fund should be able to manage the liquidity, which would allow a higher investment return. He cautioned that the change could perhaps result in a lower investment return on the Permanent Fund because it may require some adjustment to the asset allocation. He added that APFC had testified it did not believe there would be a significant impact.

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Co-Chair Thompson relayed that Angela Rodell, APFC executive director, was present and had testified that she did not have any problem with liquidity necessities.

Representative Guttenberg remarked that Section 4 had been eliminated from prior bill version I. He wondered about the result of an immediate effective date and the removal of the July 2017 effective date.

Mr. Teal relayed the effective date had been changed to one year out because the DOR commissioner had testified he wanted time to review and consider the issue. He explained that the commissioner had subsequently testified to the Senate Finance Committee that transferring the management to APFC was no longer a substantial concern and that it

made financial sense. Given the concern had abated, the decision had been made to make the transfer immediate at the beginning of 2017 instead of waiting one year. He stated it would possibly cause some transition problems, but he did not believe anyone expected it to be a one-day transfer. He believed there were details that needed to be worked out, which would be up to the commissioner and APFC.

Representative Munoz stated that the FY 17 budget was funded with a \$3.2 billion draw from the CBR. She asked what the actual draw would be if the bill passed. She wondered if extra CBR funds would remain in the CBR or be deposited into the General Fund.

Mr. Teal answered that the current draw without the legislation was approximately \$3.2 billion. With the bill, there was a transfer of roughly \$2.4 billion from the Permanent Fund earnings reserve account to the General Fund (\$700 million of the amount would pay the PFD from the General Fund). The net transfer should be about \$1.6 billion. He explained the bill would cut the CBR draw roughly in half to \$1.6 billion. He detailed precisely how much would come from the CBR versus the earnings reserve account was not known; it depended on what happened with appropriation bills including supplemental bills in the following year. The CBR draw could be cut in half, but that did not mean it would be.

Representative Munoz asked if the amount not necessary to fund the budget remain in the CBR or go into the General Fund.

Mr. Teal responded that the CBR draw approved in the operating budget was the amount necessary to balance expenditures and appropriations. He furthered if there was money coming in as revenue from the earnings reserve account, the amount necessary to balance would drop so only \$1.6 billion would be drawn. The remaining \$1.6 billion would stay in the CBR.

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Representative Munoz asked for verification the remaining money in the CBR would be managed by APFC [under the legislation]. Mr. Teal replied in the affirmative.

Representative Gara spoke to the idea that the revenue could not exceed the amount appropriated in the prior fiscal year. He mentioned inflation issues. He spoke to the FY 17 budget that was "cobbled together" with some FY 16 and some FY 17 money. He stated expenditures for the upcoming year were roughly \$3.8 billion or approximately \$500 million more than was appropriated out of the FY 17 funds. He noted about \$500 million had been spent out of FY 16 [for FY 17]. He asked if the cap would reflect what was identified as FY 17 spending; therefore, it would be \$500 million short of FY 17 expenditures.

Mr. Teal answered that Representative Gara was looking at the savings rule [on slide 5]. He explained it was the last page of the presentation. He preferred to address the slides in order for clarity.

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Mr. Teal turned to slide 1: "LFD Fiscal Model," which reflected the status quo. He relayed the scenario was not workable. He pointed to an upper left chart titled "UGF Revenue/Budget," which showed expenditures of roughly \$5 billion in the out-years. The lower left chart titled "Budget Reserves" indicated there would be no CBR, earnings reserve account, or any money remaining to support the expenditure level. He pointed to the upper left chart and detailed that the blue bar represented oil revenue, the orange bar represented a draw from the CBR (which stopped in FY 18 when the CBR was out of money), and the red represented drawing from the earnings reserve account (beginning in FY 19). The earnings reserve account would be emptied by FY 22 and the state would be out of money. The chart assumed the state was paying dividends of \$2,000 annually. He explained that the scenario was highly improbable; the state did not have money to pay dividends when the budget gap was so pronounced and there were no reserves to fill it.

Representative Wilson referred to the black line on the upper left chart on slide 1. She wondered why the chart did not show decreasing the budget. She asked if it was because the budget had continued to grow in the past few years.

Mr. Teal responded that the black line going from FY 16 to FY 17 depicted some massive budget reductions; there had been \$1 billion-plus in budget reductions in the past

couple of years. Some argued there was no way to have a no-growth budget - inflation alone would cause the budget to increase. He stated "do we say it can't go both up and down - we're going to just hold it constant." He furthered that exactly where the line went was up to the legislature; the model merely held it constant.

Representative Wilson referred to the decrease shown on the chart and surmised it was primarily related to the capital budget. She believed very little was related to everyday operations.

Mr. Teal answered that the FY 16 to FY 17 change in day-to-day agency operations dropped \$216 million. He underscored there had been a real reduction in agency operations. The capital budget was down about \$33 million and could probably not be reduced much more. The reduction shown was roughly \$250 million and was not related to retirement or tax credits. He tried to filter those two components out of presentations because LFD did not know what the legislature would be doing with tax credits and the retirement savings had already been accounted for in the FY 17 budget.

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Representative Wilson remarked that the spring forecast was one of the lowest forecasts in some time. She added that [the price of] oil was now known to be substantially different. She asked if Mr. Teal would demonstrate what the slide would look like when accounting for the current oil prices.

Mr. Teal stated that he did but it would require an Excel version of his chart, which he did not have on hand. He offered to show the model itself, but noted it did not have much to do with the bill. He explained the current bill reacted to prices just as the status quo would react to a different set of oil prices.

Representative Wilson disagreed. She reasoned the bill was before the committee because of the current oil prices. She stated that having a real look at the current oil prices could give a completely different scenario related to whether the bill was necessary in the current or following year (with a rebound in oil prices).

Vice-Chair Saddler asked if the proper title for the slide was "status quo." Mr. Teal agreed [note: slide 1 was actually titled "LFD Fiscal Model"].

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Vice-Chair Saddler pointed to a chart in the upper right of the slide titled "Dividend Check." He asked if the chart indicated the dividend would remain at about \$2,000 under the status quo.

Mr. Teal replied in the affirmative.

Vice-Chair Saddler referred to predictions that the dividend would go away in two or three years if the status quo continued. He asked Mr. Teal to help reconcile the predictions with the charts on slide 1.

Mr. Teal reiterated his testimony that the status quo was not a valid scenario due to the white space in the upper left graph or the zero balance in the lower left graph. He explained the graph [on the upper right] showed continued payment of dividends because they were simply dividend calculations. The charts on the left showed there was no money to pay the dividends. A calculation versus a payment - two different things. He did not believe the status quo scenario was worth spending much time looking at; it simply did not work. To address Representative Wilson's concerns he believed it was necessary to turn to the next slide, which indicated what would occur under the model.

Co-Chair Neuman remarked that LFD generally looked at the budget based on the status quo of the present time period because LFD could not predict what would happen in the future (if the price of oil was going to go up or down). He asked if his statement was correct.

Mr. Teal replied in the affirmative.

Representative Gara believed it was clear the presentation used the spring revenue price forecast and not the status quo price. He referred to the chart on the bottom left of slide 1 titled "Budget Reserves." He referred to the orange portion of the bars pertaining to the CBR balance. He asked for verification the amount represented the remaining amount at the end of the end of the next fiscal year to

spend in FY 18. He surmised it was not until FY 18 that the earnings reserve would be impacted.

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Mr. Teal agreed. He detailed the balance of the CBR would be somewhere between \$3 billion and \$4 billion, which assumed a \$600 million settlement coming in. Without that [settlement money] the amount would be closer to \$3 billion and the draw would perhaps not be sufficient for FY 18. The graph showed that the CBR balance came close to zero at the end of FY 18.

Representative Gara mentioned the \$600 million settlement that would go to the CBR. He surmised that even though the chart showed the CBR funds would essentially disappear in FY 18, if the settlement money came in there would be enough CBR money to fund the FY 18 budget without impacting the earnings reserve account.

Mr. Teal replied in the affirmative.

Vice-Chair Saddler requested to hear the name of the next slide when it was addressed.

Mr. Teal relayed that material on slide 2 titled "LFD Fiscal Model" assumed the passage of the bill. He pointed to the upper left graph titled "UGF Revenue/Budget" and explained the orange segments of the bars indicated there was still a deficit [orange represented CBR draw]. He pointed to reserve balances and deficit in a table on the lower left. He explained that even with the legislation the FY 17 deficit was projected to be \$1.5 billion to \$1.6 billion. He stated that in response to a question by Representative Wilson about whether the bill would fix the problem and what would happen if oil prices increased. He explained that on its own, the bill did not solve the problem; the state would still have deficits of \$1.5 billion early on, which would decline to \$700 million to \$800 million in the out years. He detailed that the CBR would still be fully depleted by 2023 when it would be necessary to begin drawing from the earnings reserve account. The red portion of the bars in the upper left chart on slide 2 represented the earnings reserve draw. He specified that the money coming from the earnings reserve account was in excess of what the rules allowed. The green bar represented the POMV payout.

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Representative Wilson remarked that unless state government was reduced, the model outlined on slide 2 would not work. She underscored that unless government spending was under control, the bill or any other option would not solve the deficit. She reasoned that based on the state's population it was not possible to tax its way out of maintaining government at its current size. She emphasized she did not believe the bill would solve the problem. She opined that the state needed to get smarter in the way it spent its money. She spoke to the goal of ensuring the earnings reserve remained strong (without knowing what other revenues may come in and how industries such as mining and oil may increase) and questioned whether it would be possible to pay \$1,200 per Alaskan to get through the budget for the current year instead of implementing the bill and changing the entire structure.

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Mr. Teal replied the question was difficult because it was a policy question. He believed Governor Bill Walker had been clear in stating his policy that the administration was looking at the revenue forecast as a given and if more money came in, great. He specified there were three ways to address the problem, one was to reduce expenditures. He believed there was no question the governor had made reductions and the legislature had made further cuts (and would probably continue to put pressure on expenditures). The second option was to increase revenue - the governor had offered legislation towards that goal. The third and most impactful was the Permanent Fund Protection Act [offered by the governor]. He explained the tax bills combined would produce potentially \$300 million to \$400 million. The bill before the committee would close the gap by \$1.6 billion and more in later years as the Permanent Fund grew and the payout grew. The bill was by far the largest tool. He underscored that absent the bill, much larger reductions or revenue increases would be necessary in order to achieve the same result. He could not speak for the governor, but he guessed the reason for introducing the bill was that it was the most powerful and least harmful tool available.

Representative Wilson disagreed. She believed the bill was very harmful. She stated "the governor was going to cut 16 percent, which would have helped as well." She emphasized that the bill or a similar option would reduce the dividend. She detailed that money went into the earnings reserve from the corpus of the Permanent Fund, at which point the legislature determined how much to put into the General Fund to pay out a dividend. She stated that any of the amounts could be reduced if government could not be reduced that quickly. Alternatively, she believed the governor could redline the amount in half and it would still accomplish the same result as the bill. She asked for the accuracy of her statements.

Mr. Teal replied in the affirmative.

Representative Kawasaki remarked that many people looked at the graph on the right side of slide 2 related to what the dividend check could have been versus the proposal (shown in purple). He remarked that it was necessary to look at both sides. He requested a model showing a dividend at \$1,000, \$1,200, \$1,400, \$1,600, \$1,800, and \$2,000. He believed it would be helpful to get an idea of what the graph on the left would look like over time.

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Vice-Chair Saddler referred to the header "Permanent Fund Plans" in the center of the chart. He noted that underneath the header there was a column showing "Governor" and a column showing "n." The row below those items included "\$3,300." He asked if the amount was \$3.3 million or \$3,300.

Mr. Teal replied that the "n" by the governor's plan indicated the governor's plan was not being modeled in the scenario on slide 2. The \$3,300 was the amount of the sustainable draw suggested by the governor. He noted the amount could be crossed off because it was irrelevant to slide 2. He referred to a separate row under the Permanent Fund Plans header, which indicated a custom plan (HB 245) was being modeled.

Vice-Chair Saddler clarified that he considered the bill before the committee as the governor's plan. He pointed to the chart in the upper right of slide 2 titled "Dividend

Check." He asked if the three bars in red, purple, and yellow were calculations or actual figures.

Mr. Teal relayed that the red line showed the dividend under current law, which was a calculation. He indicated that as shown on slide 1, it was a calculation that would not be a valid scenario. He stated the dividend would fall to zero when there was no money remaining (indicated by white space on the graphs). The more appropriate comparison was that the dividend would remain until FY 20 or FY 21 and would subsequently drop to zero. The alternatives were a \$2,000 for approximately four years and no dividend after that time versus a \$1,000 dividend, which would continue into the future.

Vice-Chair Saddler asked for verification the purple line at \$1,000 represented what would occur under the legislation. Mr. Teal answered in the affirmative.

Co-Chair Thompson noted the bill also included a three-year review.

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Vice-Chair Saddler asked if the yellow line represented what the dividend would be under a separate bill [HB 224].

Mr. Teal answered that the only thing valid in the modeling on slide 2 was what would occur under HB 245. Other scenarios were shown that were essentially zeroed out. He suggested focusing on the \$1,000 line [in purple], which represented what the bill expected to pay in dividends.

Vice-Chair Saddler referred to the upper left chart titled "UGF Revenue/Budget" on slide 2. He pointed to the green portion of the bars which represented the POMV payout. He then referred to the lower left chart titled "Budget Reserves" and observed the green portion of the bars represented the earnings reserve account. He asked for verification it was merely a coincidence that both items were shown in green. He believed there was no correlation between the two.

Mr. Teal answered it was not coincidental. He detailed the orange bars on the upper chart represented the draw from the CBR, whereas the orange bars on the lower chart represented the CBR balance. The green bars on the upper

chart represented the draw with a payout from the earnings reserve account, whereas, the green bars on the lower chart represented the earnings reserve balance.

Representative Gara referred to the footnote at the bottom of slides 1 and 2, which indicated the modeling assumed a \$250 million annual appropriation for oil and gas tax credits. He believed the state owed roughly \$800 million in the current year and he did not know what a new bill that came out of conference committee would do, which he noted was less than the amount passed by the House.

Co-Chair Neuman asked that comments were kept to the subject of the bill.

Representative Gara countered that every portion of his question was relevant to the current conversation.

Co-Chair Thompson asked to keep questions to the scenario on slide 2. He added the committee would have the ability to ask additional questions the following week.

[4:18:12 PM](#)

Representative Gara pointed to the relevant footnote on slides 1 and 2 that assumed a \$250 million annual appropriation for oil and gas tax credits. He remarked that \$800 million was owed [for oil and gas tax credits] in the current year and it was not yet known what had come out of a conference committee [on the subject] that day. He reasoned it seemed the money would disappear faster assuming the amount owed. He noted the \$250 million assumption was not accurate for the current year.

Mr. Teal stated it was the purpose of the footnote. He explained that LFD had no idea what the legislature would pay in tax credits. The amount paid would be up to individual legislatures in the future. The LFD model recognized that the anticipated credits to be earned was approximately \$2 billion (including existing credits owed), which was an average of \$250 million per year. Under the bill it started as an expected payout of \$600 million to \$700 million and fell to less than \$200 million in the future. He reiterated that LFD had no idea what the actual scenario would be. The model assumed that sometime during the period credits would be in the \$2 billion range, the model spread them evenly over time. He stated if a bigger

credit payment was paid early on and payments faded away over time, the early expenditures would be higher and reserves would be depleted faster. However, at the end of 2025 the same result would occur regardless of whether the legislature paid \$250 million per year or \$1 billion in the current year and a small amount for the remainder. He explained LFD had chosen to make the easiest assumption about credits, which meant spreading the cost evenly over time.

Representative Gara referred to slide 2 and believed it related to the current bill proposal. He asked if the slide assumed all state revenues as they existed at present (including small taxes).

Mr. Teal replied that it did not assume any new tax revenue, but existing taxes were included.

Vice-Chair Saddler referred to Representative Gara's prior statement that the state would owe \$800 million in oil tax credits. He asked if the \$800 million included or did not include \$200 million that had been vetoed by the governor from the FY 16 budget.

Co-Chair Thompson asked how the question applied to the bill.

Vice-Chair Saddler remarked that he had heard the number \$800 million and wanted to make sure he understood what it meant.

Co-Chair Neuman thought the committee was getting way off topic.

Co-Chair Thompson asked the committee to stick to the presentation.

Representative Wilson asked how the slide addressed the \$1.2 billion spending limit in the bill. She provided a scenario where \$1.2 billion was used, but \$1.6 billion was brought in.

[4:22:19 PM](#)

Mr. Teal skipped slide 3 and continued on slide 4 titled "PFPA Payout/Revenue Limit." The slide included a chart showing UGF revenue without the payout limit and a chart

showing UGF revenue with the payout limit. The breakeven point on the left chart (no payout limit) was about \$85 per barrel. He detailed that the red portion of the bars represented nonvolatile revenue (i.e. non-oil revenue), the green portion represented the POMV payout, and the blue portion represented oil revenue (i.e. volatile revenue). He added the chart used an expenditure line of about \$5 billion [shown as a solid black line] including dividends; the chart also depicted an expenditure line excluding dividends [shown as a dotted black line]. He stated the lines crossed at about \$85. The graph on the right reflected a payout limit. The numbers were the same, but at oil prices of about \$75 per barrel the green line [POMV after payout limit] began to fade away. He detailed it faded dollar-for-dollar for every bit of oil revenue above \$1.2 billion. Under the scenario the CBR draw (shown in orange) continued out farther and the breakeven price of oil required to balance the budget increased to approximately \$105. He explained the green bar (POMV) would not drop all the way to zero; the small remaining portion reflected the dividend payout from the earnings reserve account. He continued that the line climbed slowly as revenue climbed and then began to flatten out; at the breakeven point (about where the POMV payout went to zero) there would be a surplus. He specified the surplus occurred above about \$105.

[4:25:33 PM](#)

He turned to slide 5: "Savings Rule." The rule indicated that when the state had money exceeding what was needed for expenditures, it would be saved - 50 percent would be deposited into the CBR and 50 percent into the Permanent Fund principal. The line was not completely flat when looking at the sum of the red [nonvolatile revenue], green [POMV after payout limit], and blue [total volatile revenue] bars - the revenue climbed slowly and flattened out, albeit not completely. Once the dollar-for-dollar loss of the POMV payout was passed, revenue began to accelerate fairly rapidly. He hoped the slides answered numerous questions including ones related to the \$1.2 billion (the dollar-for-dollar tradeoff), where the price points occurred, where the money started to fade, and what the surplus could be used for when it came back. The slides did not address what would happen when surplus revenue occurred. He explained that as the bill was drafted it asked whether revenue had exceeded expenditures in the

previous year. He relayed it was a difficult question to answer until the year closed. He imagined there would be an appropriation much like with current CBR language specifying that in the event revenue exceeded expenditures it was distributed "this way." He explained what the amounts would be would not be known until six or so months after a year had closed.

Representative Gara returned to his previous questions. His understanding was that there was a combined draw from savings of FY 16 and FY 17 money to be spent in FY 17. He stated that the next year's revenue could not exceed the prior year's appropriations. He referred to the current budget as an example and detailed that roughly \$500 million of FY 16 money had been used that would be spent in FY 17. He asked if under the formula the \$500 million would not be counted. Alternatively, he asked if the budget would have to be reduced by \$500 million to fit what had been withdrawn as FY 17 revenue.

Mr. Teal explained that the bill had a loop hole that allowed FY 23 expenditures to be used in the FY 24 budget process (supplemental appropriations). Under a scenario where the legislature was working on the FY 24 budget nearing the end of FY 23 and it knew there was \$1 billion left over, there could be supplemental appropriations to spend some of the remaining money, which would take it away from the savings portion. The only way to prevent the situation was to insert a spending limit in the state constitution, which would prevent the money from being spent. Otherwise, the legislature could spend available funds in the supplemental budget process.

[4:30:05 PM](#)

Representative Gara used the current year as an example and included the assumption the bill was adopted. He believed FY 17 spending would utilize FY 16 (approximately \$500 million) and FY 17 appropriations. When considering the allowable revenue for expenditure in the next year, he wondered if the legislature would have to cut the \$500 million that was used from FY 16 appropriations.

Co-Chair Thompson interjected they were looking to the next year's budget already. He stated if the legislature was going to reduce the next year's budget more than it reduced the budget for the current year, it would probably eat up

some of the amount. He reasoned they did not currently know where they were headed "with any of this" at present. He believed they were getting ahead of themselves in the present discussion. He understood where Representative Gara was coming from, but he wondered how the question related to the bill currently before the committee.

Representative Gara stated he was trying to understand the formula for what revenue the legislature was allowed to use based on how much it had appropriated in the prior year. He asked if the amount of revenue the state would be allowed to use in the next year was based on the FY 17 appropriations alone or also included the \$500 million in FY 16 appropriations (assuming the passage of the bill).

Mr. Teal replied that it would only cover FY 17 appropriations. He detailed it was not really a matter of the appropriations that occurred in the normal budget process (those appropriations would be supplemental budget items). The legislature was able to pass the \$500 million supplemental budgets because the language in the previous year's budget authorized the legislature to spend up to \$500 million more in supplemental expenditures with money from the CBR. He furthered that if the CBR language had a lower limit, the legislature could spend less in the supplemental process. He believed it was important to note that CBR draws would be necessary until oil prices reached the \$100 per barrel range. He continued there was still a deficit, which could be filled by expenditure cuts, tax increases, or by drawing from the CBR. The chart on slide 5 showed a CBR draw. He relayed that the legislature could limit supplemental spending if it wanted to.

Mr. Teal provided a scenario where oil reached \$115 per barrel, which resulted in a surplus for the FY 18 budget process. He emphasized that the money would not be available for expenditure in FY 17 - it would not be available until FY 18. He explained that the legislature may be able to spend the money in the FY 19 budget process as a supplemental FY 18 expenditure. He detailed it would depend on whether a CBR draw was required and on what the legislature did. He emphasized a legislature could not bind future legislatures. The rule could be written in a tougher way, much like the current CBR language that specified appropriations for the prior year that were made in the prior calendar year. In other words, supplemental appropriations were specifically excluded. However, if that

change was made, the rule would be so restrictive that in the event of a bad wildfire year, there would be no flexibility to appropriate money to fight the fires. If the bill did not include some flexibility, the legislature would find itself forced to break the rules in the future. The point was to get a set of rules that were good guidelines, but that they were not so strict that the legislature would be forced to break them. He reasoned that once rules were broken, there was a tendency to ignore them. He concluded that the wheels were not as tight as some people may want them to be.

[4:35:26 PM](#)

Representative Gara asked for verification that if the bill language was followed in determining how much the legislature could appropriate the following year, it was not allowed to count the \$500 million that was made as an FY 16 appropriation.

Mr. Teal replied in the affirmative.

Representative Gara asked for verification the funding would be short the \$500 million. Mr. Teal agreed, but reminded the committee that the scenario would not come into play unless oil prices reached \$110 per barrel.

Co-Chair Neuman remarked that the debt would still be owed. He detailed there were approximately \$430 million to \$500 million in credits due the current year. He remarked that the supplemental for FY 16 was \$70 million. He reasoned the debt was still incurred and could not merely be swept under the rug. He added the legislature had chosen to pay off the debt with available money. He reiterated the debt still had to be accounted for in future years.

[4:37:02 PM](#)

Mr. Teal replied that it was important to realize the \$430 million of the prior year's money (FY 16) was used to pay a debt. He explained if the money had been appropriated as FY 17 money, there would have been a smaller FY 16 expenditure and a larger FY 17 expenditure. He underscored that at the end of FY 17 the result would be exactly the same; it made no difference whether they were FY 16 or FY 17 expenditures. He reminded the committee that whenever it

paid the \$430 million, it was \$430 million less liability that the state would owe at some point in the future.

Representative Wilson stated her understanding the legislature was putting guidelines in place that were merely guidelines in terms of the savings component. She referred to taking money away from the Permanent Fund Dividend and asked how much related money would be mandated by the legislation.

Mr. Teal answered that in theory the legislature would want to follow all of the guidelines including the 20 percent of royalty that went to dividends. He explained that the savings rule would kick in at prices above \$110 per barrel and would put the savings towards the CBR or the Permanent Fund corpus. He reminded the committee that at high oil prices royalties increased substantially (20 percent); therefore, dividends would increase. A portion of the high oil prices would go straight into dividends.

[4:39:19 PM](#)

Representative Wilson clarified her question pertaining to slide 5. She underscored that guidelines were very different than statute that had to be followed in a specific way. She surmised the savings component of the legislation was a guideline that may or may not be followed, whereas, how the dividend would be paid at \$1,000 and how the legislature would put money into the General Fund would be mandated as state law.

Mr. Teal stressed that the components would all be the same and would all be in state law. The difference was that none of the statutes were mandated. The statute showed how dividends were calculated and specified that the legislature may not appropriate more than 5.25 percent; however, the legislature could appropriate 10 percent if it chose to. He explained the situation merely equated to breaking the rule. The point of the rules was to follow them, because doing so put the state on a path to a sustainable budget. Alternatively, if the legislature chose to break the rules it would veer from that path.

Representative Wilson remarked that she thought statutes were laws not merely suggestions. She pointed to slide 5 and asked what price of oil the current budget was based

on. She rephrased her question and asked what oil price was required for the current budget to be self-sustainable.

Mr. Teal referred to the [DOR] spring forecast, which was roughly \$45 per barrel. He explained at that price the CBR draw would be slightly over \$1 billion. He detailed the orange segments of the bars [representing budget deficit] disappeared at oil prices of around \$105 per barrel; at that point the combination of non-oil revenue (in red), dividends, and oil revenue (in blue) created a surplus. He continued that if oil prices reached \$105 per barrel, the savings rule would kick in. At prices below \$105 per barrel the guideline on slide 5 was irrelevant. He underscored that the legislature could make appropriations that followed statute or it could appropriate as it saw fit. He emphasized the legislature was not required to follow any of the specific rules; however, the hope was that it would follow them.

[4:43:12 PM](#)

Representative Wilson did not understand the need to put something in statute if all of the items were merely rules the legislature could chose to follow or disregard. She clarified that if the current budget required oil prices of \$105 per barrel, the legislature would perpetually have to hope for oil prices of that amount if it failed to decrease the budget.

Co-Chair Thompson relayed the bill would be considered by the committee again the following week.

Representative Pruitt explained that the legislature had already funded the Permanent Fund Dividend in its recently passed budget. He wondered if the bill passed whether the governor would have to veto a portion of the budget related to the dividend.

Mr. Teal replied that it was not a simple question because if the bill passed it would have no accompanying appropriation bill. He specified that unless the legislature passed another appropriation bill making the appropriations suggested in the bill, no money would move. He furthered that Representative Pruitt was correct in assuming the operating budget passed by both houses funded dividends in FY 17. Whether the governor would veto all or a portion of the appropriation, he did not know. He

elaborated that with HB 245 the committee had an option of starting an appropriation bill and making the appropriations required to comply with the bill. He detailed that if that route was taken, dividends would be set at \$1,000 under the legislation, but at \$2,000 under the operating budget. He did not see that as a likely outcome and he anticipated the governor would veto all or a portion of the dividends in the operating budget.

Representative Pruitt surmised that if the bill did not pass, but the governor still wanted to do essentially some of the same things, he would have the ability to line item veto any amount of the number appropriated by the legislature.

Mr. Teal responded that the governor could line-item veto anything in the operating budget regardless of whether or not HB 245 passed. He detailed that if the bill passed, it would not require an accompanying appropriation bill because it could all be handled through the existing appropriations.

Representative Gara referred to the two graphs on slide 4. He asked for verification that with a payout limit there would be a deficit all the way up to oil prices of \$100 per barrel and without the payout limit the deficit would disappear at \$80 per barrel.

Mr. Teal agreed and clarified that the numbers were roughly \$105 [with a payout limit] and \$85 [without a payout limit].

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

Co-Chair Thompson addressed the schedule for the following week. He recessed the meeting to a call of the chair [note: the meeting never reconvened].

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ADJOURNMENT

[4:47:06 PM](#)

The meeting was adjourned at 4:47 p.m.