

**ALASKA STATE LEGISLATURE**  
**SENATE STATE AFFAIRS STANDING COMMITTEE**

February 4, 2016

9:03 a.m.

**MEMBERS PRESENT**

Senator Bill Stoltze, Chair  
Senator John Coghill, Vice Chair  
Senator Charlie Huggins  
Senator Lesil McGuire  
Senator Bill Wielechowski

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

SENATE BILL NO. 128

"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."

- HEARD & HELD

SENATE BILL NO. 114

"An Act relating to deposits into the dividend fund; and relating to the Alaska permanent fund."

- SCHEDULED BUT NOT HEARD

PRESENTATION: "ACCESSING PERMANENT FUND EARNINGS TO REDUCE THE FISCAL GAP."

- HEARD

PRESENTATION: "A WAY FORWARD ON THE ALASKA BUDGET"

- HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 128

SHORT TITLE: PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS  
SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(S)	READ THE FIRST TIME - REFERRALS
01/19/16	(S)	STA, FIN
01/26/16	(S)	STA AT 9:00 AM BUTROVICH 205
01/26/16	(S)	Heard & Held
01/26/16	(S)	MINUTE(STA)
01/28/16	(S)	STA AT 9:00 AM BUTROVICH 205
01/28/16	(S)	Heard & Held
01/28/16	(S)	MINUTE(STA)
02/02/16	(S)	STA AT 9:00 AM BUTROVICH 205
02/02/16	(S)	Heard & Held
02/02/16	(S)	MINUTE(STA)
02/04/16	(S)	STA AT 9:00 AM BUTROVICH 205

#### **WITNESS REGISTER**

RANDALL HOFFBECK, Commissioner  
Alaska Department of Revenue  
Juneau, Alaska

**POSITION STATEMENT:** Reviewed SB 128.

WILLIAM MILKS, Assistant Attorney General  
Alaska Department of Law  
Juneau, Alaska

**POSITION STATEMENT:** Discussed constitutional implications of SB 128.

SCOTT GOLDSMITH, Professor Emeritus of Economics  
Institute of Social and Economic Research  
University of Alaska-Anchorage  
Anchorage, Alaska

**POSITION STATEMENT:** Presented "Accessing Permanent Fund Earnings to Reduce the Fiscal Gap."

BRAD KEITHLEY, President  
Keithley Consulting, LLC  
Anchorage, Alaska

**POSITION STATEMENT:** Presented "A Way Forward on the Alaska Budget."

#### **ACTION NARRATIVE**

9:03:11 AM

**CHAIR BILL STOLTZE** called the Senate State Affairs Standing Committee meeting to order at 9:03 a.m. Present at the call to

order were Senators Wielechowski, Coghill, Huggins, McGuire, and Chair Stoltze.

CHAIR STOLTZE announced that SB 114 would be heard on Tuesday instead of in today's meeting.

**SB 128-PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS**

[9:08:26 AM](#)

CHAIR STOLTZE announced the consideration of SB 128.

[9:08:54 AM](#)

RANDALL HOFFBECK, Commissioner, Alaska Department of Revenue, stated that he appreciated the fact there were many versions of Permanent Fund legislation as a solution for the fiscal crisis. He reviewed his presentation on best practices on sovereign-wealth funds around the world, ways the Permanent Fund relates to other wealth funds, and ways it can be used to stabilize and fund government. He reported that he and Attorney General Richards also provided information on the governor's approach and how it fits into the governor's total fiscal plan.

He related that SB 128 is one of three pieces that includes using the state's wealth, a tax component, and a budget-cut piece. He said SB 128, The Alaska Permanent Fund Protection Act, is a way to achieve a \$3.3 billion endowment-type draw from the state's earnings by putting 100 percent of oil and gas tax revenue and other mineral revenue into the Permanent Fund itself. He detailed that SB 128 would allow the Permanent Fund account to generate \$3.3 billion on a sustainable basis moving forward. He specified that the dividend would be tied to 50 percent of royalties received on an annual basis. He concluded that SB 128 is a plan that works and provides a solution to a very difficult problem.

[9:11:52 AM](#)

CHAIR STOLTZE suggested committee members request information on the constitutionality of SB 128.

SENATOR MCGUIRE stated that her two main concerns are related to the structure. She disclosed that in SB 114 the General Fund (GF) is retained, but SB 128 purports to create a new GF in the Earnings Reserve Account (ERA). The Constitutional Budget Reserve (CBR) remains the same in SB 114, but in SB 128 the three-quarters vote to access funds is removed. She inquired how

certain the administration is regarding legal challenges to her two concerns.

[9:13:55 AM](#)

WILLIAM MILKS, Assistant Attorney General, Alaska Department of Law, asked Senator McGuire to restate her concern about the CBR and the GF.

SENATOR MCGUIRE specified that the GF is statutorily created with a minimum-balance threshold to move money in and out. She detailed that the ERA is statutorily created as an overlay to the constitutional creation of the Permanent Fund and that money can move in and out only for inflation proofing and to pay dividends. She opined that the bill's proposal to statutorily change the ERA is legally sound. She questioned how vulnerable the GF would be if the ERA was made a part of it and how vulnerable it would become because of pulling in royalties and production taxes, etc., and then paying out for government expenses. She noted that Senator Wielechowski shares her concerns.

[9:15:51 AM](#)

COMMISSIONER HOFFBECK asked if she meant "vulnerable to the sweep."

SENATOR MCGUIRE answered yes.

[9:17:04 AM](#)

CHAIR STOLTZE held SB 128 in committee.

[9:18:19 AM](#)

At ease.

**Presentation: "Accessing Permanent Fund Earnings to Reduce the Fiscal Gap"**

[9:20:08 AM](#)

CHAIR STOLTZE announced a presentation titled "Accessing Permanent Fund Earnings to Reduce the Fiscal Gap."

[9:20:38 AM](#)

SCOTT GOLDSMITH, Professor Emeritus of Economics, Institute of Social and Economic Research (ISER), University of Alaska-Anchorage, Anchorage, Alaska, disclosed that he has been studying the state's unique fiscal structure for many years. He reviewed the evolution of the state's recent fiscal challenge by

showing a slide that indicated less revenue for a longer period of time.

[9:24:19 AM](#)

DR. GOLDSMITH noted bogus solutions for the fiscal gap such as: higher oil prices, status quo, the gas line, and "silver bullets." He asserted that revenue from the bogus solutions would be insufficient.

[9:27:46 AM](#)

He turned to three "real tools" to solve the fiscal gap: more budget cuts, income/sales tax/PFD reduction, and using earnings from state assets. He maintained that none of the tools were individually big enough to solve the problem, but noted that solving the problem would take all three.

He suggested using Permanent Fund earnings after cutting the budget as much as possible because the Permanent Fund is the biggest single tool and there will be no solution toward closing the \$4 billion gap without it. He set forth that the Permanent Fund can be the centerpiece of a workable game plan and will have no immediate negative economic impact; in fact, it would have a positive impact by giving the business community a confidence boost. He said using the Permanent Fund earnings will be relatively easy to implement and would buy time to prepare for the inevitable and prolonged tug-of-war over the need for an income or sales tax.

[9:31:41 AM](#)

He reviewed the proposals for accessing the earnings of the Permanent Fund. He pointed out that all three proposals are in process and two are mechanisms with slightly different motivations. He pointed out that SB 128 proposes to stabilize the fiscal structure by dumping oil and gas revenues and royalties into the Permanent Fund while drawing \$3.3 billion from the Permanent Fund earnings reserve, an inflation-adjusted amount that sustains the value of the Permanent Fund. He detailed that the draw would fund the GF and the PFD would be paid out of 50 percent of royalties.

He explained that SB 114 is a statutory "percent of market value" (POMV) draw and is an immediate solution to plugging the hole in the budget. He said the POMV draw would pull a percentage of the Permanent Fund's value from the earnings reserve, an inflation adjusted amount that sustains the value of the Permanent Fund. He added that the draw would also pay the PFD from 50 percent of royalties in a separate account.

[9:34:38 AM](#)

SENATOR MCGUIRE corrected that the percent of royalties in SB 114 is 74.5 percent. She specified the royalties' percentage in SB 114 is a swap between the current royalties' percentage that goes into the GF versus the Permanent Fund. She agreed that using the Permanent Fund is an immediate plug while allowing for a restructuring and assessment of the Permanent Fund's role. She recalled the history of the Permanent Fund and said the appropriate use of the Permanent Fund is in question today. She specified that SB 114 is meant to be a permanent change to the use of the Permanent Fund and to stabilize the volatility of oil. She concluded that the draw is meant to plug the hole, but also force the conversation about the appropriate size and cost of government.

DR. GOLDSMITH continued with the third proposal, the "Goldsmith Model," is a calculation of a targeted, sustainable draw from assets, including the Permanent Fund. He detailed that the "Goldsmith Model" would involve dumping all petroleum revenues into the Permanent Fund and drawing an amount from the Permanent Fund earnings and earnings reserve that can be sustained and would allow the Permanent Fund to continue to grow. He said both the PFD and the inflation proofing would be drawn from the Permanent Fund with the allocation between the two would be up to the Legislature and not from some formula.

[9:37:28 AM](#)

He set forth that the three proposals have a lot in common. He addressed the state's fiscal structure where oil revenues and royalties, excluding non-petroleum revenues, flowed into the GF as well as the Permanent Fund corpus. He detailed that from the Permanent Fund corpus, earnings flow into the earnings reserve and are available for spending. He summarized that there are two sources of revenue for spending, both from oil revenue and those that come through the earnings reserve.

He said the three proposals have two "policy levers." He detailed that one "policy lever" is what share of oil revenues are going to go into the Permanent Fund and which share of oil revenues are going to go directly into the unrestricted GF. He disclosed that the percentage can go from zero, excluding the 25 percent of royalties that are constitutionally mandated to go into the Permanent Fund, up to 100 percent. He pointed out that the current structure is that all of the previously noted revenues go into the GF. He noted that SB 128 proposes to put a bigger share into the Permanent Fund corpus.

DR.GOLDSMITH said the second "policy lever" involves the draw from the earnings reserve and the decision whether the draw should be a percentage or a fixed amount in addition to how large should the draw be. He set forth that two "policy levers" can be combined in a number of ways.

[9:40:15 AM](#)

He stated that all of the proposals have two common objectives that are most important: reduce today's budget deficit, and sustain assets for the future. He revealed that the tradeoff is the more the earnings are used to reduce the budget today, the less there is for sustaining assets, and vice versa.

He said he would review the three Permanent Fund alternatives using the same set of assumptions that the Department of Revenue (DOR) uses. He noted that the assumptions used by the Department of Revenue are relatively conservative regarding future petroleum revenues.

He specified that SB 128 proposes a Permanent Fund draw of \$3.3 billion in 2017, a fixed amount that maintains the future value of the Permanent Fund. When the petroleum revenues are added to the general fund, the total amount of \$4.25 billion would be spent from the petroleum-asset base to both fund government and to pay a dividend. He demonstrated that the level of spending starts high, declines, and the total asset falls over time because of declining petroleum revenues. The tradeoff is that overspending today leads to a decline in spending and in the asset portfolio in the future. He noted that the decline is relatively modest.

[9:44:53 AM](#)

He explained that SB 114 proposes a Permanent Fund draw in 2017 that is a fixed-percentage value, 5 percent of the moving average of the Permanent Fund value; adding that \$2.8 billion to the petroleum-reserve spending of \$1.27 billion, totals \$4.07 billion in total spending of the petroleum-asset base. The same general pattern of the tradeoff found in SB 128 is found under SB 114, spending starts high and declines slowly, and the total asset value falls slowly. The decline in oil does not provide future growth in the Permanent Fund.

He examined the tradeoff in the Sustainable Spending Target Plan. He said the Permanent Fund draw in 2017 uses a fixed amount that maintains the future value of the Permanent Fund and unproduced petroleum. Under the Sustainable Spending Target

Plan, all of the draw, \$3.55 billion, would come out of the Permanent Fund. Spending would start lower and the draw and asset value would both stay constant.

[9:47:43 AM](#)

DR. GOLDSMITH questioned which draw mechanism produces the best sustainability tradeoff between solving the short-term fiscal problem and maintaining the asset base for future generations. He stated that the choice is a value judgement about the future in light of declining petroleum production. He suggested the state should be concerned because there is not an alternative resource base. He spoke in favor of a spending level based on current financial assets and the projected future petroleum-revenue stream, which, if adopted now, could be maintained consistently long into the future, adjusted for inflation and population growth.

[9:49:32 AM](#)

He said one of the challenges of the sustainability target is dealing with volatility and risk regarding future petroleum revenues. He provided an analysis of the sustainable spending levels in the GF in 2014 and 2015. He said the target method would use an average over several years in order to make future-petroleum revenues less volatile. The other challenge is to use the most appropriate assumptions. He reiterated that DOR's forecasts are fairly conservative.

[9:53:49 AM](#)

SENATOR MCGUIRE asked about the allocation for inflation-proofing.

DR. GOLDSMITH understood that under SB 128 and SB 114 the appropriation for inflation-proofing would no longer be necessary because the Permanent Fund corpus would be automatically inflation-proofed because statutory return would leave enough in the corpus.

SENATOR MCGUIRE agreed. She asked if Dr. Goldsmith's plan includes inflation-proofing.

[9:56:09 AM](#)

DR. GOLDSMITH addressed approximating a draw mechanism from the three proposals. He listed the total "spend" from petroleum resources for each proposal.

[9:58:01 AM](#)

SENATOR MCGUIRE suggested that inflation-proofing should be included in the model. She requested a chart that includes it.

DR. GOLDSMITH reiterated that it is likely that all tools available will be needed to close the fiscal gap. He said his model is the tool that should be put in place first because it provides the biggest solution, is the easiest, and has the least negatives. He did not want to give the impression that it alone can solve the problem and asserted that none of the proposals "produce money out of a hat."

[10:01:39 AM](#)

SENATOR MCGUIRE recognized the need for a second set of assumptions, but stressed the importance of understanding the math in order to understand the risk.

[10:03:37 AM](#)

CHAIR STOLTZE commented on public testimony. He noted the governor's thinking about making further reductions in the budget and the need for other options.

[10:05:18 AM](#)

DR. GOLDSMITH emphasized that the total spending for 2017 under SB 128, SB 114 or the Sustainable Spending Plan are all fairly close. He continued that the spending level is then measured against the unrestricted GF and the dividend. He agreed that there is a remaining hole, but the hole can be filled immediately with a draw from the Permanent Fund.

[10:07:07 AM](#)

He looked at the criteria for choosing the draw mechanism. He set forth that the draw mechanism should be explainable, understandable, implementable, fair, disciplined, flexible, and able to minimize unintended consequences. He opined that the most important criteria is to maintain the integrity of the Permanent Fund; that has been accomplished in the past mainly by the PFD, which has protected the Permanent Fund corpus. He cautioned that any changes made to the Permanent Fund structure may have unintended consequences.

[10:09:40 AM](#)

He addressed the fragility of Alaska's economy with a graph comparing Alaska's job growth against the rest of the U.S. from 2005 to 2015. He specified that the forecast is for a further decline in employment.

DR. GOLDSMITH concluded that any method of closing the fiscal gap using the Permanent Fund will have some negative consequence on the economy. He suggested to move cautiously with the other tools and not try to do everything at once. He advised to proceed with caution.

**PRESENTATION: "A Way Forward on the Alaska Budget"**

[10:12:13 AM](#)

CHAIR STOLTZE announced a presentation titled "A Way Forward on the Alaska Budget" by Brad Keithley.

[10:13:16 AM](#)

BRAD KEITHLEY, President, Keithley Consulting, LLC, Anchorage, Alaska, shared his professional experience in the oil and gas industry. He noted key points that his presentation will address:

- Alaska is facing a budget challenge and how big is Alaska's challenge;
- There is a solid and realistic fiscal alternative that does not rely on PFD cuts or taxes.

CHAIR STOLTZE asked whether Mr. Keithley is a paid lobbyist.

MR. KEITHLEY replied that he is not and noted that his presentation to the committee was "on his own dime." He explained the reason why he makes presentations is because Alaska is his home and he wants the state and the oil and gas industry to be successful. He said he sees a bright future for Alaska and fiscal policy is a very important part of it.

[10:16:12 AM](#)

He continued to say that both SB 128 and SB 114, based on General Communication, Inc. (GCI) numbers, are unnecessary due to an imbalance between private and government sectors and may do more harm than good to the overall Alaska economy.

He addressed the size of the budget challenge by showing graphs of the decline in revenue projections from FY 2013 through the Department of Revenue's 2015 projection. He said he questioned whether the forecast picture was accurate. He asserted that if the assumptions are correct, the long-term sustainable revenue is \$4.3 billion from existing assets if new oil, Alaska liquefied natural gas, and PF earnings reserve are included.

[10:19:16 AM](#)

MR. KEITHLEY commented on an article by Dermot Cole in the Alaska Dispatch News about challenging this view on oil prices. He shared a quotation from International Energy Agency's November 2015 world energy outlook:

The process of adjustment in the oil market is rarely a smooth one, but in our central scenario, the market rebalances at \$80 per barrel in 2020 with further increases in price thereafter. An annual \$630 billion and worldwide upstream oil and gas investment, the total amount the industry spent on average each year for the past five years, is required just to compensate for declining production at existing fields and to keep future production flat at today's levels.

He said the most recent estimates of what has been lost, due to the oil price downturn, is about \$250 billion to \$300 billion of deferred investment projects. He concluded that because of the decline in volume and supply of oil, there would be an oil price increase. He said the article concluded that the current overhang in supply should give no cause for complacency about oil-market security.

[10:21:28 AM](#)

He said his concern is that Alaska is formulating fiscal policy projecting out from the bottom of a commodity cycle and, as a result, may be assuming the need to cut more spending or raise new revenue than necessary when considered from a long-term perspective. He termed the fiscal policy as the opposite of the overspending problem that happened from 2011 to 2014. He concluded that Alaska is a commodity-based economy and needs to take a long-term budget view.

[10:23:37 AM](#)

He stated that there is a solid and realistic fiscal alternative that does not rely on PFD or taxes. He set forth that the core principals of any fiscal policy is to use an approach that looks at the full commodity cycle and develops a balanced, sustainable approach that smooths through the revenue's highs and lows. He recommended not cutting the PFD or imposing other taxes if avoidable, because of the impact on Alaska's private economy.

He pointed out that the state has two economies: government and private. The government economy has operated for years on oil without taking money from the private economy; however, current consideration takes money from the private economy for the

government economy and that will have effects on the private economy. He opined that moving money to the government economy from the private economy has not been a big part of the discussion to this point.

[10:24:45 AM](#)

MR. KEITHLEY maintained that the best approach is the Goldsmith Model because it sets spending at long-term sustainable levels based on the best, reasonable, long-term forecast. He detailed that the Goldsmith Model uses the Permanent Fund earnings reserve, the part remaining after the PFD and inflation proofing, to act as the balancing mechanism. He added that the Goldsmith Model also remains alert to changes in key, long-term forecast variables and adjusts levels if there are significant long-term changes.

[10:26:01 AM](#)

He repeated the goal of long-term sustainable revenues with the assumptions used in the Goldsmith Model, not the Department of Revenue assumptions. He pointed out that significant spending cuts would still be needed. He recalled FY 2006 budget numbers, which he said was the last time the budget was not inflated by high oil prices; he compared those numbers to FY 2016 numbers, adjusted for inflation and population growth. He revealed that the adjusted number would be \$4.1 billion for FY 2016; the actual spending number for FY 2016 is \$5.4 billion.

He recommended cuts to the oil and gas tax credits because they are not fully utilizing the state's resources. He spoke in support of the governor's proposal to establish a loan program based on development costs. He also suggested cutting opt-in Medicaid expenditures and non-formula programs, such as corrections and the university. He noted that when the FY 2006 education budget is adjusted for inflation and population, the education budget totals \$1.2 billion, exactly what was spent in FY 2016.

[10:30:35 AM](#)

He talked about a possible implementation plan for the Goldsmith Model and noted that the plan was in HB 136 last year. He said the model could be reworked into an appropriate form that could be used as a substitute for Article 9, Section 16, to reset the appropriation limits that is realistic.

[10:32:01 AM](#)

He addressed the point that SB 128 and SB 114 are unnecessary because, if the long-term sustainable revenue level is \$4.3

billion and spending can be cut to that level, the state does not need to be adding revenue. He asserted that until the state has a better feel for where oil and gas markets are headed, there is no reason to make significant, permanent, long-term PFD cuts and enact taxes.

MR. KEITHLEY maintained that SB 128 and SB 114 are imbalanced between government spending and private sector cuts. He said his analysis of spending and cuts under both bills, using GCI numbers, shows inequities and a huge imbalance.

[10:35:45 AM](#)

He stressed the need to consider the overall economy, especially the effect on the private economy. He referred to an analysis that Dr. Goldsmith did in 2010 that said taking money out of the private economy and putting it into government could do more harm than good to the overall Alaska economy. He added that the effect would probably increase capital spending, generate less employment and increase income inequality.

He concluded that if new revenues are required, taxes do less harm than PFD cuts. He specified that his conclusion was also arrived at by Dr. Goldsmith in 1987:

Reducing dividends to produce the same amount of revenues as would the proposed income tax would actually cost Alaska more jobs and income than would re-imposing an income tax.

[10:38:47 AM](#)

CHAIR STOLTZE pointed out that though Dr. Goldsmith has been affiliated with the university, he was not speaking in its behalf, but for himself.

SENATOR MCGUIRE asked why Dr. Goldsmith referenced GCI numbers for SB 114 when GCI has also prepared numbers for SB 128.

MR. KEITHLEY said he wasn't aware that there were multiple numbers out on SB 114.

SENATOR MCGUIRE offered to provide them.

MR. KEITHLEY specified that the GCI plan based its numbers on SB 114 and he is familiar with them.

SENATOR MCGUIRE noted that "words matter to people." She said SB 114 is her bill and she requested a correction to the numbers.

MR. KEITHLEY agreed to do so.

[10:40:37 AM](#)

SENATOR HUGGINS agreed that the state is formulating fiscal policy projecting out from the bottom of a commodity cycle and termed it a "knee jerk" method. He suggested to have a mechanism built in to facilitate re-visitation.

[10:42:12 AM](#)

CHAIR STOLTZE noted there would be public testimony in the evening.

[10:43:44 AM](#)

There being no further business to come before the committee, Chair Stoltze adjourned the Senate State Affairs Committee at 10:43 a.m.