

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

February 9, 2016

9:01 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

SPONSOR SUBSTITUTE FOR SENATE BILL NO. 114

"An Act relating to the Alaska Permanent Fund Corporation, the earnings of the Alaska permanent fund, and the earnings reserve account; relating to the mental health trust fund; relating to deposits into the dividend fund; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 114

SHORT TITLE: PERM FUND: EARNINGS, DEPOSITS, ACCOUNTS

SPONSOR(s): SENATOR(s) MCGUIRE

04/18/15	(S)	READ THE FIRST TIME - REFERRALS
04/18/15	(S)	STA, FIN
02/01/16	(S)	SPONSOR SUBSTITUTE INTRODUCED-REFERRALS
02/01/16	(S)	STA, FIN
02/04/16	(S)	STA AT 9:00 AM BUTROVICH 205
02/04/16	(S)	Scheduled but Not Heard
02/09/16	(S)	STA AT 9:00 AM BUTROVICH 205

WITNESS REGISTER

JESSE LOGAN, Staff

Senator McGuire
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Addressed the dividends from royalties plan in SB 114.

ACTION NARRATIVE

[9:01:05 AM](#)

CHAIR BILL STOLTZE called the Senate State Affairs Standing Committee meeting to order at 9:01 a.m. Present at the call to order were Senators Wielechowski, Coghill, Huggins, McGuire, and Chair Stoltze.

SB 114-PERM FUND: EARNINGS, DEPOSITS, ACCOUNTS

[9:01:43 AM](#)

CHAIR STOLTZE announced the consideration of SB 114 and noted the sponsor substitute. He said the bill is not necessarily Senator McGuire's plan, but the legislation incorporates a lot of ideas from other folks as another option for addressing the state's fiscal crisis. He asked that Senator McGuire provide the committee with an overview of SB 114.

SENATOR MCGUIRE said her hope is SB 114 is the Senate's presentation. She detailed that she started looking at ways to stabilize the way Alaska's budget was put together in January 2015. She said the Alaska budget process was a volatile ride because the state was almost completely dependent on one commodity. She said she started working with Senator Kelly and floated ideas with other people to put together a series of principles that led to SB 114.

She set forth that SB 114 was a placeholder for the Senate to begin a conversation about the state's fiscal gap. She asserted that her intent was not to sell the committee members a particular idea, but to address why she believes the principles in SB 114 are sound and why they were chosen over other principles.

[9:04:10 AM](#)

She explained the history of the Alaska Permanent Fund as follows:

In November 1976, there was a voter approved constitutional amendment creating the Permanent Fund. In February 1977, the 9th Alaska Legislature created it officially through a committee substitute to HJR 39.

SENATOR MCGUIRE detailed that a statutory overlay created the Permanent Fund Dividend (PFD) in 1982, an important piece for the committee and public to understand. She pointed out that people often refer to the Permanent Fund and the PFD interchangeably. She emphasized that the Permanent Fund itself was created constitutionally and SB 114 does not make changes to the fund's constitutionally protected corpus. She detailed that the 12th Legislature proceeded in 1982 with a statutory overlay and created the Earnings Reserve Account (ERA) to inflation proof the Permanent Fund and pay out dividends. She emphasized that SB 114 proposes to change statute and not the constitution. She opined that the statutory overlay was a reflection of the values that one legislature does not bind another. She summarized as follows:

Here we sit in 2016 and the question is whether it is appropriate or not for us to consider that the ERA doesn't just pay out a dividend, that we may in fact need to redistribute the way that those payments go to stabilize government.

[9:06:38 AM](#)

CHAIR STOLTZE noted that Senator McGuire skipped over the Supreme Court ruling on Zobel v. Williams. He pointed out that the "Zobel ruling" addressed the dividend's residency parameters and not its constitutionality.

SENATOR MCGUIRE continued as follows:

You have the constitution, you have the corpus that's created and a whole series of statements about why that was created. You have the statutory overlay of the Legislature at that time, a lot of dialog about why it was decided that the ERA would create a dividend; but also, understanding that the first decision to payout a dividend was based on a notion of rewarding longtime pioneers in the state, those that have been here many years.

[9:07:39 AM](#)

She detailed Zobel v. Williams as follows:

There was a gentleman with the last name "Zobel" who presented a court challenge that went all the way up to the Supreme Court of Alaska; it was decided June 14 of 1982 that said that the plan as the Legislature had conceived of it violated the equal protection clause by creating a residency requirement that was too long. So the rest is history after 1982, the dividend was paid out to every man, woman and child that had lived in the state for more than two years, and that's an important part of the history of it, just to understand that the original creators in the Legislature didn't envision that it would be paid out the way that it ultimately was paid out as a result of "Zobel."

9:08:30 AM

SENATOR MCGUIRE continued to address the creation of the PFD as follows:

Just to think for a second as you are envisioning what it would have been like to be in that Legislature that created it. In the year 1982 there were 1.6 million barrels a day chugging through the Trans-Alaska Pipeline, rising all the way as we know in 1989 to 2.1 million barrels a day and adjusted for today's dollars the price per barrel was \$77. So that's just something else to keep in mind when the Legislature decided to create the ERA with a mission of only paying dividends to Alaskans, that we were doing very well, financially.

She addressed the state's \$3.5 billion to \$4 billion deficit as follows:

There's a deficit, we know that, and there's a difference between what we have said we will pay out in operational costs. We cut the capital budget last year, almost entirely, except for "matches," and the public has kind of missed out on that. So I would like to emphasize again and again that we have enacted heavy spending cuts over the last two years. We have several accounts, but revenue models show that if oil prices do not rebound, those savings will be gone within about two years. My opinion is we can't wait

and hope for high oil prices and the price of inaction could be disastrous for the state's future.

SENATOR MCGUIRE addressed Alaska's FY16 situation as follows:

I don't disagree with many of my colleagues that perhaps \$5.2 billion is too high, but what I will say is that everything we've looked at in our office shows that unless you fundamentally restructure the government in core ways that beyond about a billion more, you're going to start getting into very serious opportunity costs for federal matches and a great percentage of capital that's infused into the private sector as well as jobs, government jobs themselves which also contribute to the economy.

She detailed how the state was paying for FY16 as follows:

- \$3.608 billion from savings.
- \$531 million from "other revenues."
- \$1.062 billion from oil revenues.

She remarked that the state's spending model was upside down and asked how a household would feel if the majority of its expenses were paid from savings and other revenues. She opined that Alaska has both a spending problem and a revenue problem due to its dependence on a single commodity to balance the state budget that is combined with low oil volume and prices.

9:11:30 AM

She said she reflected on Alaska's problem by addressing the "Five Stages of Grief" when drawing up SB 114:

1. Denial
2. Anger
3. Bargaining
4. Depression
5. Acceptance

She noted that the committee recently had a presentation by Bradford Keithley where some cuts were recommended, but the basic proposition was to wait for oil to get back to \$80 a barrel. She commented as follows:

So that brings you to the "bargaining" part again and I kind of went through that exercise mentally and thought maybe we really don't have to stabilize the

volatility of this commodity and we don't have to think about restructuring the Permanent Fund, and then I went all the way back through the "stages of grief" to acceptance.

9:12:28 AM

SENATOR MCGUIRE said the Senate State Affairs Committee was tasked with looking at the relationship between the public, the constitution, things created by the constitution and the statutory overlays that come from the legislatures. She addressed the "status quo" from the cost of doing nothing and referred to a chart that addressed "Unrestricted General Funds (UGF) Revenue and Budget" from FY16-FY25. She pointed out that the chart showed a consistent fiscal gap of approximately \$3 billion between revenue and the budget from FY16 through FY25.

She addressed a "status quo" chart and its impact on the dividend check as follows:

In this case you can see that if we do nothing, by about FY21, unless a miracle happened which would be about \$109 a barrel with the volume we have today, the dividend program will likely end and the choice will be harder earlier. In FY19 that's going to be the place where all \$7 billion that is left in the Constitutional Budget Reserve (CBR) and the General Fund will have been completely used up because you can see with only \$1 billion roughly in revenues and a little more in other revenues, you need about \$3.5 billion a year to balance the current budget.

She set forth that the question for the committee was whether the Earnings Reserve Account (ERA) was to continue to be used exclusively to payout a dividend or for stabilizing the government. She asserted that waiting was not a good option because the Legislature would run out of choices that allow for being more nimble. She detailed as follows:

You will have used up all of the \$7 billion that's ready on hand in your General Fund and then with a three-quarters vote in your CBR, your savings, and then you will be with your back up against the wall facing that inevitable question that we could face today a little calmer and a little more rationally.

9:15:03 AM

SENATOR MCGUIRE addressed the state's budget reserves, absent of new revenues as follows:

The price of oil-per-barrel times the volume is roughly \$1 billion. Unless something dramatic changes, what we have left, besides the corpus that's constitutionally protected, is roughly \$14 billion and you divide them roughly in half between the ERA and a combination of the CBR and the General Fund.

She summarized that if nothing is done, the CBR will gradually go down and ultimately a decision will have to be made in FY18 whether to simply use the ERA to payout dividends or as another way of stabilizing the government.

[9:16:09 AM](#)

She revealed that she applied five principles when crafting SB 114:

1. Retain a dividend.
2. Reduce the volatility in the state budget.
3. Clearly expose the size and cost of government.
4. Endure to allow maximum use of the state's wealth over generations.
5. Simple and easy to implement.

She addressed "retaining a dividend" in SB 114 as follows:

There are other solutions out there that utilize a Percentage of Market Value (POMV) approach that do not guarantee a dividend. I think the dividend has become a part of Alaska's culture; I think it has done exactly what it was intended to do to connect the people to the fund in a way that has allowed for its protection and I also think that there is an economic role. Bradford Keithley talked about it, others have talked about it, rural Alaskans depend on it, those in lower-income levels depend on it and certainly there's commercial value to it circulating.

She addressed "the volatility in the state budget" as follows:

This was actually the most important to me. When I came into the Legislature, I was absolutely shocked in my first budget cycle to realize that the way that we budgeted was to be presented with a fall and spring forecast telling us roughly what the value of this

single commodity would be. I said in my office, "At least it's not pork bellies," but it may as well be. Commodities are volatile, as we know they are valued not just by facts, but by perceptions in world markets far away from us and the fact that we would simply say, "We'll decide what we can spend based on that single value," I think is not appropriate.

SENATOR MCGUIRE addressed the principle to "clearly expose the size and cost of government" as follows:

So that downward pressure would ensure that Alaskans could begin an honest assessment of needs versus wants, also another important principle in my bill. There are other bills out there that use similar principles, but were designed to give it a dollar amount to serve.

So we agree that \$5.1 or \$5.2 billion is the cost and size of government, this bill does not do that on purpose; it purports to change the way we distribute the earnings of the Permanent Fund and to guarantee a dividend for the people, but it's only designed to bring in about half of our problem, so roughly \$2 billion. My hope is that future legislatures will continue a conversation about what Alaskans really want and need.

I think we all know this in our own families that you have times of surplus where you add on to your home, you buy extra things for your children, you have things you might really enjoy, and honestly if the family sat down they would probably be sad to give them up, an extra playhouse or extra tutoring in a musical instrument or something like this, but when it comes down to it, if that family has to contract, they're going to go back to the basics, they are going to make sure there's food in the refrigerator and it's going to be milk and bread and your basics first, and then the rest comes on top of it; Alaskans are going to have to have that conversation, what are the staples and what are the extras.

She explained "the principle for the bill to be enduring" as follows:

It should be enduring to allow maximum use of our wealth over generations so that benefits and burdens are shared and this is another reason that I think acting now is important. Arguably we have acted too late. The POMV bill that I voted for when I was a freshman 16 years ago would have stabilized government already and affected the dividend four times to the tune of about \$50, we wouldn't be sitting here today facing this problem and we would have had more choices, but if we wait now beyond today, you'll have fewer and fewer choices and the net effect of that is that it disproportionately impacts in a negative way the future generations, our grandchildren and children, and I don't think that is fair.

SENATOR MCGUIRE summarized that the fifth principle should be that the bill is simple and easy to implement.

[9:20:28 AM](#)

She explained "what SB 114 is not" as follows:

It's not a raid on the Permanent Fund. The Permanent Fund cannot be touched without a constitutional amendment by the people and it remains that way in this bill. SB 114 would only draw funds from the ERA.

It's also not a way for the government to increase the budget, this is a really important point. I think that the public is right to be skeptical about us looking at changing the way the Permanent Fund is distributed if our only goal is to bloat government and to put more capital projects in that they may or may not agree with; I think that is a very fair point, many people in this state believe that the government is too large.

Finally, it's not a dividend killer, this is the only plan I see that will guarantee one. I'm anxious to continue the conversation with this committee, but there are three bills right now out there that propose a couple of different methods, mine is the only one that I think guarantees a dividend. If you wait until you are at that place where you are looking at touching the corpus, I don't believe a dividend survives.

She detailed "what SB 114 is" as follows:

SB 114 is a way to connect Alaskans to their share of natural resources, it's a way to protect your dividend into the future. Without a structural change, the dividend will go away in a few short years, I predict; it is a way to ensure that services you enjoy can continue to be provided.

As much as I have talked about cutting the budget, I think it's important to understand and appreciate here in the State Affairs Committee that we all benefit from a certain size of government; that's been a tenant of any civilization, particularly those that have democracy at hand that we don't have to stand out in our driveway with our guns every morning and sort of guard our property. We have police, public safety, firefighters, we have people who provide public education and even if you don't partake in it, even if your children are educated privately, I think we can all agree that we would like our general population to be educated, so public education is a good thing. The Marine Highway for those that live here, that's a lifeline. Parks and recreation has become an interesting point, when you look at my generation and younger, in their top five reasons that they will move and can move now, they can quite literally work from a computer and they can teleport. Why will they relocate? Parks and recreation are in the top five, so are schools, they want places they can raise a family and enjoy a good quality of life. Fish and game management, I don't have to say a lot there, you know this committee cares a lot about that.

9:23:30 AM

SENATOR MCGUIRE addressed a graph by Gunnar Knapp regarding the impacts of selected options for reducing the deficit by \$100 million. She asserted that the impacts from cuts should be considered when talking about the size of Alaska's government. She pointed out that the largest single item of things paid out was the PFD, \$2.4 billion. She remarked that Bradford Keithley talked about the impact of the PFD and everyone was aware of that. She summarized that reducing the deficit impacts state and private sector jobs.

CHAIR STOLTZE asked if Gunnar Knapp was speaking for the University of Alaska Anchorage Institute of Social and Economic Research (ISER).

SENATOR MCGUIRE answered that she believed so. She detailed that Mr. Knapp's report was gleaned for the Alaska Business Monthly magazine. She conceded that Mr. Knapp should be asked to verify his report's affiliation.

9:25:31 AM

She addressed spending limitations and commodity price volatility. She asserted that without oil tax's revenue flowing through the ERA, available general funds will continue to swing with commodity prices. She said some volatility will remain unless limitations are put into place and there are many options.

She revealed that she purposely left places open in SB 114 for the committee to fundamentally focus on a spending cap. She admitted that many Alaskans are skeptical about spending if the oil prices go up or if production increases where the Legislature simply goes back to spending exactly what revenue is brought in. She suggested that language could be added that says, "In fiscal year "X," the appropriation cannot exceed 120 percent of the previous year's draw." She noted that SB 114 is pegged in at a POMV of 5 percent, but the reality is the Permanent Fund earnings have been more like 6.5 to 6.8 percent. She suggested that the POMV could be a range between 3 and 8 percent, depending on returns, oil tax revenue, cash flow needs, capital project outlays, etc. She continued that a POMV range would give some flexibility to provide some downward pressure. She summarized that a final option would be to create an overall spending cap.

9:28:12 AM

CHAIR STOLTZE called attention to a spending cap and noted that the Legislature has had very little success, going back to a cap approved by the voters in 1982. He pointed out that the CBR started out as a spending limit by Senator Faiks that evolved into the CBR Fund as a compromise. He suggested that a revenue cap be considered where limitations are placed on what can be drawn. He opined that the public can grasp a spending limit more than revenue limit, but a revenue limit might be a consideration.

SENATOR MCGUIRE agreed with Chair Stoltze and thanked him for his suggestion. She noted that she has enlisted input from different individuals. She remarked that she liked her first idea better as being more of an appropriation limit.

SENATOR MCGUIRE addressed the state's \$3.5-\$4 billion deficit due to commodity price volatility. She said there is one equation for Alaskans to burn in their mind is that the story of Alaska is:

Oil Price x Volume = State Budget.

She reviewed the state's history that is tied to volatile and unstable oil prices. She asserted that the difference today was lower-volume oil production. She said current production was hovering around 500,000 barrels a day, resulting in \$108 per barrel to balance the budget. She pointed out that world events have impacted oil: China's economic contraction, the shale revolution from fracking, and OPEC's reduced power.

[9:32:29 AM](#)

SENATOR HUGGINS pointed out that Alaska cannot control the price of oil, but the state can control volume. He asserted that the state has to keep "wildcatters" operating and exploring on the North Slope to address future revenue.

SENATOR MCGUIRE opined that the state's budget planning lies between knee-jerk and 30-year planning. She remarked that longer-term planning would help the state avoid being in a crisis-driven reactionary mode. She noted a quote from Albert Einstein, "We cannot solve our problems with the same level of thinking that created them."

[9:35:08 AM](#)

She called attention to 2016 oil-pricing forecast graphs from the Economist Intelligence Unit (EIU), The World Bank, and the U.S. Energy Information Administration. She said predicting future oil prices is difficult and noted that all three organizations' forecasts were inaccurate. She set forth that the question is should the state bet its future on oil prices.

[9:38:08 AM](#)

She conceded that the public has a trust issue where they are being asked to consider a fundamental statutory restructuring of the Permanent Fund. She remarked that accusations have been made that the Legislature never saves and always uses the money. She referenced a graph that showed end-of-year balances of State Reserve Funds, excluding the Permanent Fund, for the increased balances in the Statutory Budget Reserve Fund and the CBR Fund, specifically from 2008 to 2014. She reiterated that depending exclusively on a volatile commodity was not smart, but noted that even though the Legislature saved money during high oil

prices, savings ultimately did not save the state. She asserted that a fundamental structural problem needs to be addressed in the future.

9:40:28 AM

SENATOR MCGUIRE referenced a chart that showed how the Legislature was spending \$5.2 billion in FY16. She pointed out that the payment for the PFD checks was the state's largest expense, followed by the Department of Education and Early Development, and the Department of Health and Social Services (HSS); the two departments make up between 50 and 60 percent of the state's budget. She explained the impacts on cutting the budget as follows:

We talk about this all of the time, we say if we are going to get below \$5.2 billion, we all understand that the cuts and restructuring are going to have to come in part from those two areas. So it's going to have to be a fundamental change in the way that we pay out through the foundation formula, dollars, or it's going to be in how many schools we fund; that conversation is taking place, it's going to have to be in Medicaid and whether or not a lot of the pre-screening and extras that have been added legislatively on top of the federal mandate from Medicaid. Are we going to continue to provide those or not? Those are hard conversations, things like colorectal cancer screening and mammograms for poor people, those are hard conversations and that's the only way you're going to get to a big budget cut.

She explained the need to address changes outside of budget cuts as follows:

The last point on this slide that is important to understand why I came forward with a restructure of the payout on the corpus of the Permanent Fund is to show that you can't get there with cuts alone. You could literally cut every dollar in HSS and every dollar in Education, every job, and you still would not fix the budget deficit and that's an important thing to think about. Yes, we should restructure. Yes, we should consider cuts, but you cannot get there by cuts alone.

9:42:41 AM

SENATOR MCGUIRE addressed potential new revenue from the governor's "Sustainable Alaska Plan" as follows:

The next slide shows that you can't get there by revenues and other-revenues alone either. That is why you come back to the point of the Permanent Fund, it's not that any legislator goes there lightly, it's that you have to go there, the math doesn't make sense any other way. So this slide shows you the potential new revenue from the governor's "Sustainable Alaska Plan," this is literally the modeling of every revenue that he has put in there and so you see the income tax as he has it modeled, Governor Walker, is \$200 million. Our office and David Teal and others have estimated it would be approximately \$50 million to put a plan in place, a system administering an income tax because we don't have one right now. So you can argue about those numbers, you can even increase the amount of the income tax up to its most illogical cap and you are still only going to get about \$400 million from that. The oil and gas revenue proposal that he has is \$100 million; tobacco, alcohol, motor fuel tax, I mean you can just see how small these things are. Then in the purple you see the deficit [\$3.6 billion]. So just compare them, the visual is absolutely compelling, there's just no way to get there with revenues alone.

9:44:08 AM

CHAIR STOLTZE noted that the administration has not presented what an appropriate level is for a sustainable budget. He remarked that the administration has maintained that enough has been cut. He asked how Senator McGuire's plan addresses budget spending and cuts.

SENATOR MCGUIRE replied as follows:

To be very clear, my plan is predicated on the fact that the size and cost of government is too large; so that's the first premise and because of that, mine is not a whole plan, it doesn't purport to equal a number, only purports to deal with the one piece of the puzzle that has to be dealt with which is the single largest asset we have in the Permanent Fund corpus. The premise behind it is that with my plan you'll bring in approximately \$2 billion and that will put you on a glide path that will stabilize the volatile commodity that we have and stabilize

government into the future, but it still leaves open the conversation for restructuring the size and cost of government which has to occur, but it forces that. The governor's plan, respectively, does not because if you adopt that plan today, you would agree and assume that \$5.3 billion is the appropriate size and cost of government and I feel in doing that, quite frankly, the governor knows that; I oppose that plan because I think the Legislature and the public need this conversation to happen, they have to have it happen, so this is only meant to stabilize one part of it because on the one hand, as Senator Huggins said, we need to go somewhere between knee-jerk and 30-year, it is irresponsible to just let it completely go to the wire, that would also encourage the same conversation, but with fewer choices.

So my bill does not currently contain a revenue-restraint measure and I would like this committee to put its prints on it that way, and it also does not contain any other revenue raising device; there's no income tax, no alcohol taxes, nothing else is in this. So that would have to be a conversation upstairs on the "fifth floor" [Senate Finance] about whether they would like to incorporate SB 114 as part of another package, but respectively I think this is the best plan, the best way to deal with the Permanent Fund.

[9:47:07 AM](#)

SENATOR HUGGINS agreed with Senator McGuire that the conversation on tailoring the budget to a sustainable level should have happened yesterday, but needs to happen today or tomorrow. He remarked that both parties in the Legislature need to be part of the conversation to bring forward whatever packages there are for the state's budget. He asserted that Alaskans are angry that the Legislature is spending their money on lobbying them to take some of their money in taxes. He opined that on the other hand, Alaskans understand that the Legislature has to do something. He commended Senator McGuire for her presentation on a hard conversation that Alaskans can hopefully get their arms around.

SENATOR MCGUIRE analogized that SB 114 is liken to addressing a tooth infection during its early stages. She remarked that continuing to live in denial, the first state of grief, is easier.

[9:49:16 AM](#)

SENATOR MCGUIRE reiterated that the budget gap cannot be closed with cuts alone or with broad-based revenue alone. She said the reality is a sound fiscal solution will necessarily involve the Permanent Fund.

She reiterated that if the PFD was considered spending, the PFD is the largest single FY16 budget item, even excluding inflation proofing. She specified that the PFD was \$1.4 billion in FY16, approximately \$2.4 billion with inflation proofing. She addressed a chart that showed the disparity between departments when compared to the expenditures for the PFD, Department of Education [\$1.302 billion], and the Department of Health and Social Services [\$1.165 billion].

[9:51:40 AM](#)

She said her intent is to compare the governor's plan [SB 128] and SB 114. She asserted that her office had worked with the legislative-finance people as well as the administration to share numbers and data. She revealed that royalties go to dividends under both plans. She asserted that preserving the dividend was important to her, but also understanding that the state could not continue financially paying out the dividend as it had. She disclosed that previous discussions with Alaskans had shown to her that most people did not realize how dependent the state is on oil. She pointed out that early presentations in the committee noted that Alaska was the most hydrocarbon-dependent democracy on the planet, no other state depends on one source of revenue.

She explained her process in creating the dividend plan in SB 114 as follows:

I decided that when we restructured it, we should pay a dividend out based on royalties, so if the state does well, we do well. If the oil industry does well, you do well. It's a partnership and that is the partnership that exists today, but let's "call a spade a spade," let's get Alaskans in the business of creating a healthy economy, one that is competitive for both oil and gas, in the future by the way. This is an exciting thing, I think, when you think about the potential for revenue that will come in from the gas line from monetizing North Slope gas; but the governor took this model, he liked it, he agreed with it, we met on it many times, the only difference there is he takes 50 percent, he does a 50-50 split and in

mine I do an exact swap. So in my bill the dividend would be larger, because it will be 74.5 percent of the royalties, in the governor's it will only be 50 percent. My bill also guarantees a \$1,000 dividend no matter what.

[9:55:37 AM](#)

SENATOR MCGUIRE specified that the governor's plan moves the CBR and oil tax revenue into the ERA. She noted that the committee has discussed the potential legal issues with the governor's plan and explained as follows:

There are clearly potential legal issues with this, there's just no question about it, they are up front about it, they understand it, but I don't think they are resolved and I have a deep concern about it. So I feel SB 114 is superior in the sense we are keeping every exactly where it is, in state law. The CBR is what it is, it remains, it is subject to a three-quarters vote, it is available for us to use after this restructuring to use as we need it. The ERA stays exactly where it is statutorily, even though the payout changes, and those are important premises.

She disclosed that SB 128 sets a target spending number where SB 114 uses a POMV approach. She detailed as follows:

The next is the governor's plan is not a POMV, it sets a target number instead of \$3.3 billion for withdrawal and spending; this is telling the Legislature you have "X" amount to spend every year and doesn't adjust for market returns and actual earnings of the ERA, this is a huge point right now for this committee to think about. The reason that I believe my bill or something like it is superior is because a POMV approach is a tried-and-true method of an endowment, it has worked in every major institution, every major capital investment company, every government besides ours, frankly, that has a sovereign-wealth fund uses a POMV. So that's important for us as lawmakers and it's important for the public because we are not taking a risk on something new and it's also important because a POMV gives you hindsight, you can look back over the past five years and know exactly what happened.

She reiterated that predicting oil prices was difficult. She asserted that the governor's plan is projecting as an annuity

plan. She set forth that the state should not be doing a 30-year plan based on "a hope and a prayer."

[9:58:12 AM](#)

SENATOR MCGUIRE continued as follows:

SB 114 does not change oil-tax revenue, it still goes right to the General Fund as I mentioned. The General Fund stays, CBR stays, ERA stays, and all of the accompanying AGIA opinions, Supreme Court opinions, and statutes affecting those remain legal and provable.

She summarized as follows:

The governor's plan is designed as an annuity, it's going to look 25 years into the future which relies on foresight. I like to have foresight, but I don't always have it exactly and I think we can see in the energy market that many don't. POMV is based on actual values, so it is hindsight and we often say that hindsight is 20/20 for a reason.

[9:59:00 AM](#)

She addressed a chart that showed the state's current cash flow and payouts from royalties. She pointed out that the royalty percentage going to the seldom addressed Public School Trust Fund would remain in SB 114 [0.5 percent]. She added that the necessity of a three-quarters vote to access the CBR remains as well. She pointed out that the three-quarters vote for the CBR often causes a problem when the minority party often finds political power to try and leverage things they care deeply about. She noted that a three-quarters vote to access the CBR was required for the first time in a decade during last year's session.

CHAIR STOLTZE addressed the previous year's CBR vote and noted that a member of the House minority has said the Legislature would remain in session until May or June unless their proposed budget increases were agreed to.

[10:03:06 AM](#)

SENATOR MCGUIRE responded that she specifically premissed "minority" and "majority" so that legislators could have an honest conversation without people thinking it was pejorative. She conceded that a minority party is going to use the tools they have to advance causes they believe in, but a potential

conundrum of a potential increase could occur when the exact opposite is needed for the budget. She pointed out that the reason she brought up the CBR is that people do not like the idea that the CBR would be eliminated in the governor's plan, in addition to possible constitutional problems.

SENATOR MCGUIRE explained that a change from SB 114 would be the addition of a POMV payout from the ERA to the General Fund. She specified that the corpus of the Permanent Fund is not being touched because the fund is constitutionally protected. She explained that the narrowly passed legislative decision that created the dividend would be changed. She specified that SB 115 currently pays a 5 percent POMV draw that goes directly into the General Fund. She added that production taxes and less-volatile revenues would continue to go into the General Fund as well. She reiterated that the CBR remains as a cushion if needed.

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She stated that the next change from SB 114 removes inflation proofing. She specified as follows:

Inflation proofing, again, everybody quibbles about the numbers, call it \$1 billion a year, roughly, we spend inflation-proofing the Permanent Fund. We do it because of a statutory requirement and that is \$1 billion right there. The reason we are doing it is because the POMV approach, by definition, inflation proofs, that's why it is used; that's why that particular model is used by endowments because it maintains and protects your corpus so that it grows into the future, allowing for some revenue to spinoff.

CHAIR STOLTZE noted that the inflation-proofing concept was proposed by the late Elmer Rasmussen. He revealed that Mr. Rasmussen said, "Inflation is like the thief in the night that robs the value."

SENATOR MCGUIRE remarked that the priority for the committee should be to address the revenue cap or the size of government cap.

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She explained that another change from SB 114 addresses the dividend source and calculation. She specified that SB 114 takes 74.5 percent of the previous year's royalties on all production. She pointed out that new "wildcatting" discoveries would be included and noted that a new 4-billion barrel potential field

was currently producing 100,000 barrels a day. She noted that a new change to Alaska's Clear and Equitable Share (ACES) oil tax regime makes the state more competitive with other oil-producing states and countries should another oil-production spike occur.

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SENATOR WIELECHOWSKI described a scenario where the Permanent Fund was \$50 billion with a 5 percent POMV draw of \$2.5 billion. He asked if a 5 percent draw was a little bit on the high end.

SENATOR MCGUIRE responded that her office had debated the POMV draw percentage. She said one of her preferred methods would be to insert a 3 to 8 percent POMV range in the bill. She noted that historical returns for the Permanent Fund have been about 6.8 percent. He pointed out that Representative Hawker's bill was also a POMV at approximately 4 percent.

SENATOR WIELECHOWSKI readdressed his 5-percent draw scenario of \$2.5 billion and inquired if an additional 3 or 4 percent draw would occur to cover the dividend in addition to inflation proofing.

SENATOR MCGUIRE responded that there would be no inflation proofing.

SENATOR WIELECHOWSKI asked if a 5 percent POMV with a dividend that equaled last year's \$1.4 billion draw was sustainable. He remarked that a 3 or 4 percent total draw would be more sustainable.

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SENATOR MCGUIRE replied that the POMV percentage can be altered and noted that an upside and downside exists for each way. She reiterated that a POMV range was probably the most appropriate by giving Alaska the most flexibility for stabilization. She continued as follows:

As far as the dividend payout, there are also some conversations that we can have about that. Right now I have it guaranteed to payout \$1,000. You're correct, in times where the commodity price of oil is lower, there will be a need potentially to pull in revenue and that depletes then the overall amount going into government stabilization. So that's a question for the committee, do they want to maintain that floor or not? The other question is, do they want this program to go into effect this year or wait?

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JESSE LOGAN, Staff, Senator McGuire, Alaska State Legislature, Juneau, Alaska, pointed out that the PFD payment in SB 114 is paid out only from royalties. He detailed that an additional \$1 billion or \$1.5 billion would not be removed from the ERA.

SENATOR MCGUIRE concurred with Mr. Logan as follows:

The old way of paying out \$1.4 billion plus roughly \$1 billion at \$2.4 billion is gone completely under this bill, so that no longer happens. I assumed what you were saying is that because we guaranteed a \$1,000 dividend that at 74.5 percent if you came in below \$1,000, you would have to pull a little bit to make up the difference on that. Again, at \$50 oil, you're at about \$1,700 dividend, so it moves depending on the price per barrel; but just to be clear on the record, the statutory-overlay of \$1.4 billion and \$1 billion for inflation proofing is gone.

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SENATOR COGHILL asked Senator McGuire to verify that royalties would make up the bulk of the dividend and then based on the floor, the remainder would be paid out of the 5 percent that goes into the General Fund.

SENATOR MCGUIRE answered correct.

CHAIR STOLTZE noted that SB 114 would be addressed at the next meeting with the inclusion of an evening session to hear the initial comments from the public as was done on the governor's bill. He specified that the two bills were separate issues with separate testimony.

SENATOR MCGUIRE commended the Senate for getting out of the gate right away to look at either a revenue raising device, restructuring, or a way at getting at the fiscal gap.

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She set forth that SB 114 was a swap between the dividend and the Rents and Royalties (R&R). She said currently, 30 percent of the R&R was deposited into the Permanent Fund and 69.5 percent was deposited to the General Fund. She specified that a swap would occur under SB 114 where 74.5 percent of all R&R would be deposited into the Dividend Fund. She noted that the governor's bill, with respect to the Permanent Fund part, does a 50/50 swap

rather than an even swap. She pointed out that the R&R deposit into the Dividend Fund would include all existing leases to date, but all future leases as well, including "wildcatting" finds and future mining development.

SENATOR MCGUIRE said the dividend change from SB 114 gets Alaskans to start understanding that a dividend check was a product of teamwork for the state's shared subsurface rights. She pointed out that Chairman Stoltze had remarked in a previous committee meeting about the premise of Alaska's owner-state where individuals give up the chance to have private investment interest. She noted that a lot of Oklahoma and Texas families for generations have private-direct royalty interest whereas Alaskans share in the R&R. She conceded that Alaska's economy can be more diversified, but in the near term, what the state has is in its land. She summarized that under SB 114, no Permanent Fund earnings would be used for the dividend and a \$1,000 floor would be set for the dividend as well.

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She explained that in exchange for the R&R to the Dividend Fund, 5 percent of the total value of the Permanent Fund, [Corpus + ERA], would be withdrawn from the ERA and deposited into the General Fund. She noted that the returns on the Permanent Fund investments have historically averaged more than 5 percent and added that the POMV concept plus the 25 percent R&R will inflation-proof the Permanent Fund.

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MR. LOGAN detailed that the Permanent Fund investments' historical returns have been somewhere between 6.7 to 6.9 percent. He specified that if a POMV draw is 5 percent, then the remaining 1.9 percent would go to the ERA as inflation proofing. He added that 25 percent of the R&R would go to the Permanent Fund "corpus," as constitutionally required, to grow and inflation proof the fund. He added that the semantics of addressing "inflation proofing" and or "growing" the fund is nomenclature that requires additional discussion.

SENATOR MCGUIRE summarized that the extra revenue from the 25 percent from R&R arguably inflation proofs the Permanent Fund. She reiterated that the POMV concept, as done in education endowments, also inflation proofs the Permanent Fund as well.

She referenced a graph that addressed the "Statutory Net Income of the Permanent Fund" from 2011 to 2015 and noted that the annual average was \$2.6 billion.

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SENATOR MCGUIRE said another decision point for the committee is to address two scenarios for the 2016 dividend: leave the dividend harmless or begin the new methodology from SB 114. She noted that the sponsor substitute for SB 114 holds the 2016 harmless, or "status quo." She pointed out that the Permanent Fund Corporation has already put the money aside for on October dividend payout.

She detailed the first scenario, holding the dividend harmless as follows:

If we hold the dividend harmless, keep it in status quo, the dividend as we know will be more than \$2,000 to every man, woman and child that qualifies, meeting the residency requirement. The total payout, about \$1.4 billion. The POMV is leaving you netting about a \$1.2693 billion net increase to the General Fund. So that would cut the deficit by one third.

She detailed the second scenario, immediately enacting the new formula from SB 114 as follows:

We pay the dividend out according to this new formula and the dividend would be \$1,023.74 and the amount of the POMV that goes to the General Fund would be \$1.958 billion, so that cuts the deficit in half.

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SENATOR COGHILL asked what would occur if the dividend would rest totally on the R&R.

SENATOR MCGUIRE replied that the second scenario would occur. She pointed out that SB 114 is based on an actual average model while the governor's plan is entirely based on a probabilistic forecast model. She asserted that if SB 114 was adopted, a \$1,023.74 dividend would still be a big dividend. She noted that previous testimony had shown that dividends above and below \$1,000 over the historical course of the PFD was nearly 50/50.

SENATOR COGHILL asked if SB 114 and SB 128 essentially shifts risk to the dividend while saving the government.

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SENATOR MCGUIRE replied that the easy answer was yes, but asserted that some volatility remains on both sides under SB 114

because the state's main bread-winner, crude oil, is still a commodity that is traded on many markets while being effected by global decisions. She conceded that volatility to the government would be reduced, but noted that the dividend would have a \$1,000 floor with an upside that benefits Alaskans at the high end too. She noted that dividends could be as high as \$3,000.

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SENATOR COGHILL commented that SB 114 was a fundamental shift of tying the dividend to a renewable-fund that is based on the royalty value of oil. He opined that the upside is everybody will focus on Alaska's production rather than watching how a market ebbs and flows in New York. He continued as follows:

The risk that is so volatile really is in, not just our royalties, but it was also in the tax base on the severance tax that we put in, huge part of that, because that's what's gone right now.

SENATOR MCGUIRE agreed with Senator Coghill's volatility assessment. She pointed out that had the legislature not changed the broken system of ACES, today the state would be trying to find an additional \$420 million.

She continued to address SB 114 versus SB 128 as follows:

The other point that I want to make is that mine [SB 114] is a hybrid. If you think about the governor's plan is the most risk that you could have, it's the most volatile. What we do in mine is it's true that we are asking Alaskans to partner with us in creating more opportunities for production and as a premise of that, the dividend will be primarily based on R&R; however, it's a hybrid because we are endowing their dividend by saying it will be \$1,000 no matter what and so it will protect on the low end, but we are giving them the opportunity on the high end.

She addressed the role of government pertaining to the dividend as follows:

Right now we are sitting in a scenario that I don't think any company or any household would do which is that we are about to pay, as we just did, another \$2,000 dividend to every man, woman, and child while the state is on paper in bankruptcy and I just encourage us to think about that. The Permanent Fund

dividend check is a value that we appreciate and it is important, but it's not the only thing that is important and even Republicans can say that because we know as I pointed out in those other slides that government spending, and especially in a state of only 735,000 people, is directly intertwined to the private sector and that's part of the reason that the private sector has gotten so involved in this is that they've got capital outlay "A" and capital outlay "B," and they are saying, "We're not going to invest in capital outlay "A" if we don't have confidence that you guys are going to stabilize the government, at least at the basic." Again, this only goes halfway there, and so you can and should make cuts in restructuring on top of it, but we have to have public safety, we have to have roads, they have to be maintained, we have to have some level of public education, that's going to cost something, and then on top of that, there is that intersection between the private sector and the public we talk about. We have already gone from a Triple-A bond rating to a Double-A bond rating and what that means materially is \$100 million more every time we borrow \$1 billion and if it goes further, that's even more interest we pay out; but more importantly, it's the signal to the private sector because now the banks are looking at this and this is what happened in the '80s and why it happened so much quicker in Alaska because we are such a small polis, we talk to each other, then your housing prices start to erode. So I just want us to consider that the dividend itself as a payout is an important thing and yes we should consider it and this bill protects it, but it's not the only thing.

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SENATOR HUGGINS pointed out that SB 114 would payout a dividend of \$1,023 in 2016 whereas the governor said SB 128 would have a \$1,000 dividend the first year with a "falling" dividend after that.

SENATOR MCGUIRE responded to Senator Huggins' statement as follows:

This is a very important part about SB 114 and the difference from the governor. When I proposed the swap, I gave the entire upside benefit of the 75 percent to the people of Alaska, his bill cuts it in

half and in my opinion, marginalizes the opportunity for Alaskans to have a higher dividend, because as you have run it every time in committee, you will do the numbers and you can see that it's 50 percent of what mine will be. So this year there was a political compromise to say that it will be \$1,000 this year, but there's no mechanism in the governor's plan to ensure \$1,000 or more in the future and so it will literally be 50 percent of the royalties and if you run some of the numbers in the probabilistic scenarios at \$30 oil, you're at about a \$350 dividend this next year, so it's a major difference between the two bill.

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CHAIR STOLTZE announced that SB 114 will be back before the committee next week.

[10:38:57 AM](#)

There being no further business to come before the committee, Chair Stoltze adjourned the Senate State Affairs Committee at 10:38 a.m.