

HOUSE FINANCE COMMITTEE
February 6, 2017
1:34 p.m.

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CALL TO ORDER

Co-Chair Seaton called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

Representative Scott Kawasaki

ALSO PRESENT

David Teal, Director, Legislative Finance Division;
Representative Dan Saddler.

SUMMARY

PRESENTATION: A FRAMEWORK FOR ANALYZING FISCAL PLANS
LEGISLATIVE FINANCE DIVISION

Co-Chair Seaton addressed the meeting agenda.

^PRESENTATION: A FRAMEWORK FOR ANALYZING FISCAL PLANS

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DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, provided a PowerPoint presentation titled "A Framework for Analyzing Fiscal Plans" dated February 6, 2017 (copy on

file). He highlighted that the legislature would be discussing several versions of fiscal plans during the current session; the committee had heard the first plan the previous week. He noted that some of the bills, plans, and provisions were fairly complex. He explained the presentation did not focus on a particular plan or bill. The presentation stemmed from a conversation with Co-Chair Seaton about the difficulty of comparing one plan with others. He had concluded that a presentation of one bill after another may not be the best route to consensus, at least not without a framework to help legislators determine the advantages and disadvantages of various provisions. The framework in the presentation addressed four questions.

Co-Chair Seaton noted Representative Grenn had joined the meeting.

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Mr. Teal moved to slide 2 and stated that answering a few questions could help get to a basic fiscal plan/bill. However, there were also options to consider if the legislature wanted a more comprehensive plan. He compared the situation to knowing that a truck would be better for hauling wood than a [Toyota] Prius. The challenge was trying to figure out what the truck should look like. He stated that the decision was difficult, but whether a truck was needed at all may be the start of the discussion. From that point it would be necessary to decide on the type of truck. He stated there were vastly different trucks on the market and some of the fiscal plans could be different. He urged the committee to focus on the basics and to not get bogged down in optional add-ons in a plan.

Co-Chair Seaton remarked that Representative Pruitt had joined the meeting and recognized Representative Dan Saddler in the audience.

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Mr. Teal moved to slide 3 and addressed: "1) Do you want to use earnings of the Permanent Fund to help Balance Alaska's Budget?" He referred to a presentation by the Department of Revenue (DOR) the previous week that had addressed the structural budget deficit that had been going on for a number of years. The presentation had also conveyed that the revenue forecast showed continued deficits. He believed

committee members understood how bad the situation was, but that they also understood there were tools available to address the problem. The tools included budget cuts, taxes, use of investment earnings of the Permanent Fund, or using reserves. Legislators also knew that reserves had been used and cuts had been made. At present, reserves were declining rapidly and neither cuts nor taxes would fill the deficits. He stated that there was no tool out there that could fill more than about one-third of the existing deficit and use of [Permanent Fund] earnings was capable of filling half or more of the deficit. He detailed that the use of earnings would have far less economic impact than either cuts or taxes. He elaborated that cuts and taxes removed money from the economy, whereas Permanent Fund earnings were not currently in the economy; therefore, using earnings did not take anything away from the existing economic structure. He noted that the remainder of the presentation would not be very useful if someone was not interested in using Permanent Fund earnings. The presentation assumed the legislature had chosen to use earnings.

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Mr. Teal turned to slide 4 and addressed: "Do you want transfers to the general fund to be based on earnings directly or on a POMV (percent of market value of the Permanent Fund) payout?" He discussed considerations related to the question. First, governments and economies were not very good at dealing with volatile revenue. He asked the committee to imagine the government deciding that because there were no Permanent Fund Dividends (PFD) one year it would shut down the entire [PFD] division, but the following year there were dividends again. He reasoned that restarting the division would not be an easy process. He relayed that government functioned much better with stability. Second, earnings are volatile and can be negative. The state had done what it could to remove volatility from earnings with a five-year moving average (like the process used for PFDs). However, dividends had remained volatile - ranging from \$700 to \$2,200 per year.

Mr. Teal addressed the third point on slide 4 - the balance of a fund is more stable than the stream of investment earnings on the same fund and that POMV offers greater stability than earnings. Unfortunately, adopting POMV would change the existing method of calculating dividends. He elaborated that there was nothing wrong with a POMV payout method - it was the most common method used for endowments worldwide. However, the Permanent Fund had used earnings for a number of years and he believed there were a number of

people who were not looking forward to changing the process. It was more a matter of facing change rather than facing something that was a disadvantage. He did not believe it was a disadvantage.

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Mr. Teal spoke to slide 5 titled "Payout to the General Fund under a Plan Sending 50 percent of Realized Earnings to the General Fund (Assuming Earnings Repeat the Most Recent 9 Years)." He noted that the presentation included a couple of graphs to demonstrate how volatility can differ [slides 5 and 6]. The graph on slide 6 showed the use of 50 percent of realized earnings going to the General Fund (GF). He relayed that models the committee may have seen presented showed a steady earnings of approximately 6.95 percent. When a constant earnings rate was assumed, anything related to those earnings was also constant. However, in the real world, 6.95 percent was not earned annually. The graph showed repeating the past nine years of actual earnings and showing what the payout for dividends or GF would have been. The graph used 50 percent of realized earnings to the GF and 50 percent to earnings. He addressed the volatility of using earnings and pointed to jumps shown where there was a gain of \$1 billion. If the graph began with later years and went backwards, there would be reductions of \$1 billion in a year. He observed it was not a great way to run government.

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Mr. Teal advanced to slide 6 and addressed "Payout to the General Fund under a Plan Sending a Percent of Market Value to the General Fund (Assuming Earnings Repeat the Most Recent 9 Years." The graph indicated that all volatility was not eliminated, but a plan using POMV was much less volatile than using earnings. He did not believe there were any statistical arguments that needed to be made about measuring volatility.

Mr. Teal turned to slide 7 and addressed the following question: "Assuming POMV is selected, what is an appropriate payout rate?" He moved to a chart on slide 8 that showed the POMV payout at various payout rates to the GF. The chart assumed a \$50 billion fund earning 6.95 percent - it depicted the Permanent Fund at present and projected its earnings into the future. The chart showed payout rates of 4, 4.5, 4.75, 5, and 6 percent. He pointed out that the lower the payout rate, the lower the payout at present. He continued that "as you go through this" the payout was small

and the fund remained larger, which resulted in larger and larger payouts. Over a period of 40 years a 4 percent payout would be greater than a higher percentage payout. Whereas, the higher percentage payout would mean larger payments earlier on. He continued that the payout rate was not as important as many people seemed to think. A 5.25 percent payout had been looked at the previous year, which DOR had expressed was very aggressive. He agreed with that assessment. However, based on more recent modeling, DOR had specified it was possible to make it with a 5.25 percent payout. He communicated that the number did not have to be that high. He reiterated that a lower payout rate would pay less at present, but more in the long-term (beyond 20 years' time). He encouraged the legislature to just pick something - anywhere between 4.25 and 5.25 percent would work. The goal was to find a good balance between high payout and a safe payout. He relayed that if a 7 percent payout was used it would start at about \$3.5 billion per year, but it would decline over the years because it exceeded the fund's earning rate of 6.95 percent. The rate was important, but rates of 4.5, 4.75, and 5.25 percent were just a balance and it could be argued that none of them would make or break a plan.

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Vice-Chair Gara asked for detail on what Mr. Teal meant that selecting the numbers between 4.25 and 5.25 percent would not make or break a plan.

Mr. Teal referred to slide 8 and explained that the rates were nominal. He detailed that a 4 percent payout would give a \$2 million [billion], whereas a 5 percent payout would amount to about \$2.5 [billion] at present. He relayed it was about \$100 to \$150 million per year for each quarter point added on. If a slightly lower payout rate was selected there would be less GF, which meant there would be more pressure to cut the budget or more pressure to find some other way to fill the remaining gap. There was nothing specifying there had to be a constant rate. The legislature could pick a rate of 5.25 percent for FY 18 and FY 19 and could reduce the rate to 5 percent for two years and to 4.75 percent after that. The situation was flexible.

Vice-Chair Gara referred to Mr. Teal's statement that there was a current budget crisis. He asked if it would be rational to use a rate of 5.25 percent with a reduction to 5 percent later on.

Mr. Teal answered that the approach was rational. He continued that the legislature may determine that a 5 percent payout did not generate the desired amount in the far-term. He explained that it was about present versus future. It was easy to say "let's worry about more about the present" because the future was in the far distance. He agreed that picking a high rate at present and phasing it into a lower rate over time was a rational approach.

Representative Ortiz spoke to the positives and negatives of the different rates. He asked if Mr. Teal had looked at existing savings accounts and their ability to sustain a spending level (assuming a budget gap remained) long enough to get to a point when higher payout rates occurred in the future.

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Mr. Teal replied in the affirmative. He relayed that the graph on slide 8 was designed to show that a multitude of payout rates would probably all work. The question was whether there was more concern about present or future. To view how the payout rates worked they needed to be included in a model to show how they would work with reserves. He shared that a 4.75 percent rate starting at present would extend reserves and theoretically solved the fiscal problem (or most of it). A 5.25 percent rate for a few years would not substantially alter reserve balances because they money would be paid out and reserves would be burned. He stated that if less was paid out at present it would maintain reserves, but \$125 million connected to each additional quarter point in payout did not impact reserves substantially. He stated that \$125 million seemed like a significant amount of money, but the model was not that precise. What the actual returns, cuts, and revenue measures would be in the future were unknown quantities. He relayed that anything above a payout rate of 4.75 percent would extend the life of reserves. At rates below 4.75 percent, the payout was not quite enough for government to maintain its current level of expenditures.

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Representative Wilson asked if legislation was needed to switch to a POMV. She wondered if the percentage could be looked at annually because the future price of oil and other revenues were not yet known. She wondered if the

percentage had to go into statute or if it could be specified in the budget.

Mr. Teal answered that the percentage did not have to be in statute. He detailed that in the governor's proposed budget he had included an appropriation for POMV. The language specified transferring 5.25 percent of the [Permanent Fund's] market value into GF. He added that a POMV bill had not passed the previous year, but the governor's budget request included a provision to transfer the money as calculated in FY 17 to GF.

Representative Guttenberg spoke to variable interest rates and removing the question from the political "whim" chart from one year to the next. He asked what mechanisms had been used in other places to lock a plan in place other than the will of the legislative body and the annual budget process.

Mr. Teal responded that some sovereign wealth funds may have the ability to decide those things (e.g. the government in Saudi Arabia was basically family run), but for the State of Alaska the choices were constitution, statute, or appropriation language. He stated that the action could be taken through an appropriation bill and statute provided guidelines and some direction to future legislatures. Some people may say it was a better way to act because that guideline was often followed by the legislature. However, he underscored that it was just statute, which could not bind future legislatures or limit the legislature's power of appropriation. He emphasized that a plan in statute was nothing more than a guideline. If the legislature wanted the solution to be something that took away the legislature's annual discretion, it would require a constitutional amendment.

Representative Guttenberg believed that historically the legislature has a record of what it had done with money available for appropriations and the public did not care about the past, but as the legislature started touching it [the Permanent Fund], the legislature would never get its hands out. He believed a framework and rules for the legislature's action were necessary.

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Mr. Teal addressed slide 9 "How Much Should go to Dividends?" He stated that the issue was not something that most endowments had to deal with - a sovereign wealth fund would pay out to the government. He continued that deciding how much should go to dividends was not merely a political choice. He detailed that higher dividends translated directly into the need for some combination of additional revenue, additional budget reductions, or larger draws from reserves. He moved to slide 10 and addressed the impact of dividends on the ability to fill the deficit with a POMV payout. He credited Allen Mitchell who had developed GCI's model - the information in the current presentation had been modified to include POMV. He discussed what changing dividends would mean to a \$48 million five-year average. He relayed that a \$1,000 PFD would cost \$675 million per year, leaving a payout of \$1.850 billion to GF and about \$820 million of deficit remaining. The remaining deficit would need to be filled with spending cuts, new revenue, or reserves.

Mr. Teal continued to address slide 10 and provided an example showing increased dividends - higher dividends would mean a lower payout, which would mean a larger remaining deficit to fill with additional cuts, new revenue, or reserves.

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Mr. Teal continued to manipulate the chart on slide 10 and reduced the dividend to \$257 per Alaskan - much lower dividend cost meant that much more of the payout would go to GF, leaving the state with a much smaller remaining deficit. The key point was it did not really matter whether the dividends went through the GF or were paid directly from the earnings reserve account (ERA). As soon as the ERA was used to make transfers to the GF, dividends competed with the transfer and other expenditures. He dispelled the belief that the competition had to do with the ERA being reclassified as unrestricted general fund (UGF). He explained that it was simply the fact that a portion of the ERA would be used to fill a portion of the state's deficit. The greater the portion filled with the ERA, the less the state would have to fill with other sources.

Representative Wilson thought everything was in competition. She named the higher education fund, the Power Cost Equalization Fund, and other funds as examples. She

expounded that different things were important to different people. She surmised that at the end of the day everything was competing to fill the budget gap. The question was whether residents - by way of use of PFDs - filled the gap solely or whether the legislature looked outside to tourists or outside workers coming in. She the bigger political question was who would pay to fill the gap.

Mr. Teal agreed that every expenditure competed with another. For example, K-12 competed with Medicaid under that line of reasoning. It was important to understand that dividends were paid directly from the ERA; they were not counted as revenue or expenditures in the budget. Dividends were below the line and did not currently compete with anything else - they came from a different fund source, which was used for nothing else. He explained that as soon as the ERA was used to put money into the GF, if there was a payout of \$2.5 billion, it could all be placed in GF or more and more could be put to dividends. The more money allocated to dividends, the less there would be to pay for other things including education and Medicaid. It really would change the world "as we know it" if money from the ERA was transferred to GF.

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Representative Wilson understood where Mr. Teal was coming from, but she did not believe Alaskans felt quite the same way because they felt that their dividends had been cut the previous year to fund government - although that had been a misconception. She asked where the discussion was about what dividends did for the economy - how dividends boosted the economy when many other things were getting cut. She asked when the topic became part of the discussion. She considered how cuts to dividends may result in some individuals ending up on public assistance or Medicaid. Additionally, she wondered how some private businesses that had become dependent on certain money coming their direction, would be impacted.

Mr. Teal believed the discussions had to occur when considering how much would go to dividends. He posed the question of the amount of money the legislature wanted to go to the people versus the amount of services they wanted to go to the people. He did not think there would be too many people who would answer the question in the same way and legislators certainly had varying opinions about the

topic. He stated it was a discussion that legislators needed to have to determine the level of dividends and therefore the level of transfers to the GF and services. He could not answer the question for the legislature and he believed legislators would all have different answers. There were a range of dividends, which would impact the range of transfers and the level of government the legislature wanted or could support. He underscored that the committee needed to answer that question prior to passing a bill.

Vice-Chair Gara spoke about liberal and conservative friends who supported an income tax. He understood that an income tax alone could bring in \$500 million to \$700 million, but it would not solve the deficit. Other friends supported a sales tax, which would bring in between \$400 million to \$700 million depending on the tax. Other friends supported cutting the dividend, which could bring in between \$1 billion to \$1.8 billion. He stressed that none of the items would solve the deficit on their own due to its size.

Mr. Teal answered that with \$2.7 billion to \$3 billion budget deficit none of the items alone would solve the problem. Some combination of the items could fill the deficit; it was up to the legislature to debate how much needed to be done. For example, it was up to the legislature to decide if the solution could be a basic plan that took money from the ERA and if it would allow the state to get by without an income tax or massive cuts. He stated the model would answer the questions and would also show what things would look like if an income tax or cuts were added in. He noted that the purpose of the presentation to put a framework for analyzing some of the big decisions on trying to get a bill that addressed POMV, not the entire fiscal problem. He added that it would not be enough to decide that the POMV was the largest component available to fill the gap. The legislature would still need to answer other questions to turn it into a useful tool.

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Co-Chair Seaton believed there were a couple of different questions. He spoke to dividends competing with other allocations. He looked at slide 10 and referred to the split between what payout would go to the dividend and what would go GF. He stated that under a governor's bill, the

distribution all went to GF and then a distribution was made from there - meaning items would directly compete within allocations (e.g. PFD, education, public safety, transportation, and other). He addressed the current payout method where funds went from the ERA to pay dividends, which was separate from the amount deposited into GF for allocations. He asked Mr. Teal to address the issue.

Mr. Teal believed it was part of something he had not articulated well during a prior overview presentation to the committee. He addressed Co-Chair Seaton's question about what would happen if the dividends were not run through the GF. He provided a scenario of a payout of \$2.5 billion with \$700 million spent on PFDs, which left \$1.838 billion. He explained that it would not make any difference whether the full \$2.5 billion went into GF and the designated amount was spent on dividends. In either scenario the remainder for use on other programs would be \$1.838 billion. He elaborated that if the money for dividends did not flow through the GF, the GF would not show the money as revenue or expenditures. The decision was about whether the legislature wanted dividends to be "on budget" (a change from the current method) or below the line ("off-budget"). He stated there was no difference between the options.

Co-Chair Seaton agreed that the number and final outcome did not make a difference; however, politically when developing a UGF budget a different calculation had to take place around the committee table (regarding the allocation of funds to different programs such as the PFD and education). He explained that if all of the money went into GF, the legislature would reallocate the funds and may or may not follow the established distribution model. He furthered that statute could not force the legislature to act in a certain way. He continued that the political question would be up for debate annually when the process involved determining how to allocate UGF spending. He contrasted the method with keeping the dividend outside of the GF as a separate mechanism - politically it was much more stable. He communicated that it had been the case in the past - the legislature had the ability to take from the ERA, but it had not done that; however, dividends were paid from the ERA annually. He believed one of the questions the committee needed to answer was how stable or how insulated it wanted the Permanent Fund payout formula to be.

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Mr. Teal agreed it was a political discussion, but mathematically it was the same result. He surmised that maybe it should be the same both politically and mathematically because the result was the same. However, math is not something that people necessarily grasp. He reasoned that some people may want the dividend paid from the ERA because it had always been done that way and it would assuage the concern that the money may be spent on other things if it went through the General Fund. The truth was, it was about what the legislature set up in statute and assuming the legislature followed the guidelines - for example if the legislature set the dividend total at \$687 million or \$1,000 per person - it would not make any difference where the money came from. Mathematically it did not matter, but he acknowledged that the issue may be something the committee wanted to discuss.

Mr. Teal continued to address slide 10. He switched to a tab in Excel that was not included in the presentation. He relayed that he had included revenue limit first because the topic had received significant debate the previous year. He noted that the governor considered the revenue limit as a very important part of the legislation. He pointed to a chart titled "UGF Revenue without Payout Limit" and explained it should reflect oil prices, but there was a technical glitch in the chart. He detailed that the information showed a single year with varying oil prices. The information reflected non-volatile (non-oil) revenue; it was fairly flat and did increase as prices rose, but it was not hugely variable. The green in the chart represented the POMV payout - a fixed number. He stated that the oil money depended on the price of oil: at low prices there was lower revenue and a deficit.

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Mr. Teal continued to address slide 10 (charts that were not included in the presentation). He continued to address the chart related to UGF Revenue without Payout Limit. He stated that as oil prices rise, oil revenue rose, and the deficit shrank. At oil prices of around \$80 per barrel the

deficits went away and a surplus was generated. The governor believed that would not take place, and had included a revenue limit in the bill to ensure the state did not end up with a surplus while still getting the POMV payout. He moved to a graph on the right titled "UGF Revenue with Payout Limit." The limit specified that as oil prices rise, the state would lose \$1.00 of POMV payout for every \$1.00 of oil revenue. He pointed to a graph showing when oil revenue reached \$1.2 billion at about \$75/barrel, the POMV payout would start phasing out, which resulted in a flat revenue line (shown in black on the charts) between approximately \$75 and \$105 per barrel. At some point the POMV payout went to zero and surplus revenue resulted, but the surplus revenue was lower because the POMV payout was not being used.

Mr. Teal stated that unfortunately, even at the limit, there could be a deficit. He noted that the deficit would go away in later years at higher oil prices. He stated that "it seems odd that you would have that." Some people may be happy that the revenue limit would continue to exert pressure on the budget; the state would need to hold the budget down in order to eliminate deficits. He remarked that the previous year some people had characterized the revenue limit as a clever way of encouraging income taxes or another broad-based tax, because only oil revenue was subject to the revenue limit; if a broad-based tax was implemented, there would be more money to spend. He stated it was something the legislature could debate. He discussed that the revenue limit did not have to be flat (dollar for dollar). He referred to a limit that was less severe that would not keep revenue flat. For example, a limit of \$0.50 on the \$1.00 would not get flat and would extend POMV payouts way out at higher oil prices. The scenario would continue a smoother curve and would eliminate deficits earlier. Another option was to raise the revenue limit, which would eliminate deficits earlier. The governor's bill included a revenue limit. He recognized that it may not be the limit desired by the legislature. For instance, the limit did not have to be fixed over time. He stated that the governor had a \$1.2 billion trigger that he did not want to increase with inflation. He detailed that Vice-Chair Gara had argued at the time that it was not an acceptable limit and there had to be some room for expansion. He acknowledged the validity of the argument, but he reminded the committee that the flat portion was not

a time series. He continued that over time the limit would not be flat because the POMV payout increased over time.

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Mr. Teal stated the point was that the choice of the limit was based on the selected payout rate. A lower payout rate would result in lower POMV payments and larger deficits; therefore, the legislature may determine a higher trigger value (above \$1.2 billion) would be necessary. He added that it also depended on how much pressure the legislature wanted to maintain to reduce the budget. He continued that if the trigger was set too high, the revenue limit would become ineffective, but if it was set too low, there would be deficits in the future. All of the items could be debated by the legislature.

Mr. Teal discussed a spending limit as opposed to a revenue limit. He stated that a spending limit could be very similar to a revenue limit. He continued that it depended on whether the legislature expected a spending limit to impact the budget annually. He detailed that it was possible to set a spending limit with that impact, but it was essentially what the revenue limit did. The spending limit could kick after the revenue limit had exerted all of its possible impact. At very high oil prices, the revenue limit, still provided surplus revenue, which was where the spending limit could kick in. The spending limit should be designed to address windfall revenue - very high oil prices that were unexpected. The complications in setting a limit were severe - it would be necessary to decide what fund group the legislature wanted covered. Some people would support only covering UGF because that was where the deficit resided. While others would argue that only limiting UGF still allowed switching UGF into other fund categories. He agreed that it had happened in the past. The legislature could designate that it wanted to include all funds in the revenue limit. He noted that if the Permanent Fund did very well and management fees increased by \$50 million - it would mean the legislature would have to find \$50 million to cut from somewhere else. Therefore, perhaps the legislature may decide to limit only UGF and designated general funds (DGF), and to exclude other [funds]. He explained that the same issue would arise. For example, the University may raise tuition by \$100 million - the legislature would have to find \$100 million in cuts somewhere else because it was limiting too much. He

concluded that the situation may seem to promote only limiting UGF, but it would mean legislators could be faced with considering whether they could prevent the legislature from what some people referred to as "shell games." He countered that it was not really a shell game. He detailed that the legislature could not move money from UGF to DGF without passing a law to do it. He explained that designated funds, were by definition, something designated by the legislature for a specific use. For example, it was not possible to just reclassify \$500 million worth of money and call it DGF instead of UGF.

Mr. Teal addressed cumulative limits versus annual limits, which was also complex. The legislature would have to determine what to do with tax credits. He elaborated that it was fine as long as the legislature elected to pay minimum tax credits, but if the legislature ever wanted to pay more than the minimum in tax credits and the limit was tight, it would be bumping the limit. Any large expenditure such as a gasline or large capital projects could do that. He elaborated that there were also legal issues. Specifically, the legislature could not limit the power of the legislature to appropriate money other than by constitution. Therefore, arguably a spending limit must be constitutional in order to be fully effective. His advice on spending limits was to talk about them, but he suggested putting them in a different bill due to the complexity of the topic that he believed the legislature may want to avoid in deciding on POMV provisions.

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Mr. Teal turned to a graph on slide 15 titled: Budget History/Revenue Projections with POMV, Revenue Limit, and Existing Spending Limit "Forecast Oil Price Scenario." He explained that the black line represented the existing constitutional spending limit. The dark green represented the total UGF revenue and future revenue forecast. The blue bars represented expenditures. He pointed out that the state had never bumped up against the limit; it had come close. Based on his recollection, he had never known the state was that close to the limit. He elaborated that "we simply had stopped calculating the limit because we'd been so far below it - that didn't really think that we were perhaps approaching that limit as close as we were." Regardless, the expenditures were currently far below the limit and if there was a flat budget the constitutional

limit "just runs away." The graph did not show any limit the state was hitting because the limit was so far above expenditures. He stated it was even with a POMV payout. He pointed to a dashed line on the graph and explained that oil revenue never reached the \$1.2 billion revenue limit. Under DOR oil forecast projections, the state would not hit the revenue limit, the POMV would not be limited, and the revenue plus POMV got nowhere near the limit. The graph also showed that a flat budget near \$5 billion would mean deficits would be declining because the POMV was declining.

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Mr. Teal turned to slide 16 titled: Budget History/Revenue Projections with POMV, Revenue Limit, and Existing Spending Limit "Higher Oil Price Scenario." The graph showed higher revenue like the 2007 through 2013 period. The orange line represented the constitutional spending limit with an adjustment factor of one-half inflation and one-half population. He rephrased that inflation and population adjustments would be half of their current total, resulting in a limit that would have kicked in during those periods. The limit would kick in again if a much smaller spike was repeated at present. In FY 18 there was regular revenue (shown in dark green) plus the POMV (shown in light green), as they passed the dashed black line (\$1.2 billion revenue limit) the POMV would go away. At very high oil prices there would be no POMV at all; there would be a peak that may hit the spending limit. The graph was a sample only and did not represent a projection. He furthered that the graph showed that a revenue limit would reduce the revenue available for spending and did not impact the peaks as much. Whereas, a spending limit was really designed to cut off the windfall revenue. He noted that it could become complicated by legal and other matters.

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Mr. Teal moved to slide 17 titled "Surplus Buckets." He recommended leaving a spending limit out, but if a limit was included he much preferred a limit specifying what could be done with surplus money, not simply that nothing could be done with it. He explained that if no uses were specified, the surplus money would be swept into the Constitutional Budget Reserve (CBR).

Mr. Teal moved on to slide 18 and addressed planned use of excess revenues. There were many possibilities, but the chart demonstrated a cascading scenario of where surplus revenue may go. For example, repaying some CBR, an increased capital budget for deferred maintenance, and other. The order of the buckets shown on the slide was something that may enter discussions on a spending limit. He advanced to slide 19 and discussed inflation proofing. There was currently annual inflation proofing on the Permanent Fund that was based on the Consumer Price Index (CPI). Under a POMV system there would be no mathematical reason to move money from the ERA to the principal of the fund. However, politically the legislature may prefer to occasionally have money going into the fund principal because it was locked up (in the ERA it could be accessed). He continued that mathematically speaking, the ERA was invested with the fund corpus, it earned the same money, and it was included in the payout. He underscored that to the workings of POMV it made no difference whether money was in the ERA or in the corpus. There was a "4 times" method in HB 61 that transferred money when the balance was sufficiently large. Alternatively, it would be possible to make appropriations from the ERA to principal as the legislature chose.

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Mr. Teal directed attention to slide 20 and relayed that HB 61 also changed the flow of royalties. Currently 25 percent of royalties was dedicated by constitution to the principal of the Permanent Fund. By law there was an additional 25 percent on new wells (wells in production since 1979), which was roughly \$50 million, rising to \$60 million as prices increased. He relayed that the revenue was currently going to the Permanent Fund - it could be redirected to the General Fund. However, if the funds were redirected, it would reduce the value of the Permanent Fund and the payout. He explained that the choice was fairly simple. He continued that HB 61 also included some royalties going into the dividend, in response to some people's belief that royalties reflected an ownership share and therefore, should be counted as part of the dividend. He stated that the provision would not make much difference - royalties made dividends more volatile, but if the legislature chose a POMV with a constant share going to dividends, dividends would lose much of their volatility. In other words, there were other ways to adjust the dividend; it was not

necessary to put royalties there at all. He reminded the committee that once the legislature used the ERA for the General Fund, higher dividends meant less money for government operations.

Mr. Teal made concluding remarks. He relayed that if the legislature decided on a basic plan, it may be unable to fill the deficit in the near future and probably in the longer term (the next six to seven years at least). He suggested other, more comprehensive things the legislature may want to be consider like an income tax. He noted that it depended on how comprehensive the legislature wanted the plan to be. He stated that if the aim was for the simplest POMV possible, income tax was a complicated topic that the legislature may want to put in a separate bill. Alternatively, the committee may decide to fully address fiscal planning and make income tax a part of the bill.

Co-Chair Seaton believed Mr. Teal had covered the subject well related to basic decisions that needed to be made by the legislature.

[2:44:29 PM](#)

AT EASE

[2:44:42 PM](#)

RECONVENED

Co-Chair Seaton addressed the schedule for the following day.

#

ADJOURNMENT

[2:45:13 PM](#)

The meeting was adjourned at 2:45 p.m.