

SENATE FINANCE COMMITTEE  
March 10, 2017  
9:08 a.m.

9:08:17 AM

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:08 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Mike Dunleavy  
Senator Peter Micciche  
Senator Donny Olson  
Senator Natasha von Imhof

MEMBERS ABSENT

None

ALSO PRESENT

Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue; Randall Hoffbeck, Commissioner, Department of Revenue; Senator Bert Stedman.

SUMMARY

SB 21 PERMANENT FUND: INCOME; POMV; DIVIDENDS

SB 21 was SCHEDULED but not HEARD.

SB 26 PERM. FUND: DEPOSITS; DIVIDEND; EARNINGS

CSSB 26 (FIN) was REPORTED out of committee with a "do pass" recommendation and with two new fiscal impact notes from Department of Revenue, and one new fiscal impact note from Department of Corrections; and three previous published zero fiscal notes: FN1 (ADM), FN4 (REV), and FN5 (ADM).

SB 70            APPROP. LIMIT/BUDGET PROCESS/PERM FUND

SB 70 was SCHEDULED but not HEARD.

#sb26

SENATE BILL NO. 26

"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; relating to the calculation of permanent fund dividends; relating to unrestricted state revenue available for appropriation; and providing for an effective date."

9:09:48 AM

Vice-Chair Bishop looked at FN 1, which was a zero fiscal note from the Department of Administration (DOA). He highlighted FN 2 from the Department of Corrections (DOC), which had fiscal impact.

9:11:32 AM

JERRY BURNETT, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE, addressed FN 3, which was drafted by the Tax Division in the Department of Revenue (DOR). He explained that the note showed the change from undesignated general fund (UGF) to non-UGF, because of the 5.25 percent draw, and the reduction in the funding going to the principal of the permanent fund due to the change of 50 percent to the constitutional 25 percent. He delineated the changes in revenue over the next three-year period. He stated that the note would need to be updated for FY 21, 22, and 23, because of the changes in the committee substitute (CS).

9:13:00 AM

Vice-Chair Bishop addressed FN 4, which was zero from the Department of Revenue (DOR). He continued to FN 5, a zero fiscal note from DOA.

9:13:56 AM

Mr. Burnett offered an analysis of FN 6, prepared by DOR:

This legislation would modify how dividends are calculated and funded. The annual Permanent Fund Dividend to eligible Alaskans would be funded by appropriation from the General Fund, instead of by appropriation from the Earnings Reserve. Therefore, a portion of the additional General Fund revenue would be used to pay annual dividends. The appropriation for dividends would be based on a combination of 20% of the transfer from the Permanent Fund to the General Fund, plus 20% of the value of mineral royalties received during the year. Over the time horizon of this fiscal note, the expected appropriation for dividends under the stated assumptions would range from \$706 million to \$844 million annually.

Co-Chair MacKinnon solicited amendment from the committee; no amendments were offered.

[9:15:30 AM](#)

Senator Dunleavy offered his understanding of the legislation. He understood that 25 percent of the percentage of market value (POMV) would be used to pay dividends to Alaskans.

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, agreed.

[9:16:15 AM](#)

Senator Dunleavy wondered why the word, "transfer" had been changed to "appropriation."

[9:16:29 AM](#)

Co-Chair MacKinnon replied that the change constituted a technical amendment for consistency in state statute. She added that the change would not change the authority of the governor to veto the bill.

[9:16:43 AM](#)

Senator Dunleavy surmised that it did not change the nature of the dividend or its relationship with the permanent fund.

Co-Chair MacKinnon agreed.

[9:16:57 AM](#)

Senator Dunleavy surmised that under the bill the dividend would be \$1000, for the next three years.

Commissioner Hoffbeck replied in the affirmative.

[9:17:10 AM](#)

Senator Dunleavy surmised that the bill would be a statute, which would not constitutionally protect the earnings reserve of the fund from exploitation by future legislatures.

Commissioner Hoffbeck replied in the affirmative. He added that the legislation would put a structure around the use of the earning reserved that would prevent an overdraft, but that the legislature would retain the power of appropriation.

[9:18:09 AM](#)

Senator Dunleavy noted that there was a mechanism in the bill for when oil revenue grew enough to mitigate a draw on the permanent fund. He said that theoretically, there could be so much oil revenue that there would be no draw on the permanent fund.

Commissioner Hoffbeck responded in the affirmative.

[9:18:37 AM](#)

Senator Dunleavy asked whether a zero draw from the permanent fund would bring the dividend to zero.

Commissioner Hoffbeck replied that the dividend was calculated on the maximum draw, which meant that the reduction in the amount used on government services would not affect the size of the dividend.

[9:19:00 AM](#)

Senator Dunleavy understood that there could be a zero draw for government spending, but dividends would still be issued.

Commissioner Hoffbeck agreed.

[9:19:10 AM](#)

Senator Olson wondered how much the dividend amount could be in the future as oil revenues increased.

Commissioner Hoffbeck replied that the first three years would be \$1000, and as oil revenue increased and tripped the provision that reduced the size of the draw for government services, the size of the dividend would increase.

[9:20:15 AM](#)

Co-Chair Hoffman spoke to Page 3, section 7, of the bill. He wondered whether the draw amount was too high.

Commissioner Hoffbeck stated that extensive modeling had been done to determine what the maximum draw could be, which still protecting the corpus of the fund and assuring its growth at a rate of inflation over time. He said that the 5.25 percent had been determined a comfortable limit over time. He noted that in three years the draw would drop to 5 percent; additionally, the percentage would be periodically reviewed and adjusted as necessary.

[9:22:09 AM](#)

Co-Chair Hoffman queried how the department would approach the legislature if the draw were to be deemed too high in the future.

Commissioner Hoffbeck replied the intent was to put in place a system for use of the earnings reserve in a sustainable fashion. He said that the department would come to the legislature, if necessary, with suggestions to make the draw sustainable. He stressed that the idea was that the permanent fund should be multigenerational, which meant that it had to grow with inflation.

[9:23:28 AM](#)

Co-Chair Hoffman asked whether any modeling had reflected a failure of the fund.

Commissioner Hoffbeck replied that the modeling under the legislation had a less than 1 percent failure rate.

[9:23:52 AM](#)

Co-Chair MacKinnon asked whether it would be up to the legislature to appropriate the funds after the administration calculated the draw.

Commissioner Hoffbeck replied yes.

Co-Chair MacKinnon asserted that the legislature would be prudent with any transfers.

Commissioner Hoffbeck hoped that was the assumption.

[9:24:21 AM](#)

Co-Chair MacKinnon she wondered whether the amount could be an "up to" amount because the legislature would need to make the transfer each year.

Commissioner Hoffbeck replied in the affirmative. He felt that the bill listed the maximum that should be drawn, but that drawing less was certainly an option.

[9:25:27 AM](#)

Senator Olson expressed concern for the possible actions of future legislatures and the potential lack of political will to decrease the draw if necessary.

Commissioner Hoffbeck replied that the best way to address the concern was to reflect on the history of the earnings reserve. He said that the earnings reserve had always been available for appropriation, and for over 30 years the legislature had followed the statutes that dictate the use of the earnings reserve for dividends and inflation proofing.

[9:26:16 AM](#)

Senator von Imhof remarked that generating returns more than 5.25 percent put pressure on the permanent fund, which was difficult in down markets. She stressed that the time value of money would make a difference over time. She thought that 5.25 percent was high, and relayed that she would be more comfortable with 4.75 percent. She spoke to Section 7(c). She understood that the inflation proofing mechanism would allow more money to go back into the fund

over time, but she questioned whether the practice kept the state dependent on oil. She felt that the spending cap provision in the bill would keep the operating budget in check, and if oil revenue did increase the state would be able to utilize the growth for capital for deferred maintenance, PERS and TRS, and other government expenses.

Commissioner Hoffbeck replied that the primary reason for the dollar for dollar reduction once \$1.2 billion in oil and gas tax and royalty revenue was realized was to remove volatility out of revenue available for government expenditures. He added that by beginning to turn the use of the earnings reserve off when it was no longer necessary to fund government services would prevent the issue of "super heating" government expenditures. He explained that the section prioritized where money was spent at a time of excess revenue.

[9:29:50 AM](#)

Senator von Imhof felt that the provision inside the bill with a spending cap helped stave any super heating expenditures.

[9:30:19 AM](#)

Senator Dunleavy asserted that the decades old legislative practice of not using the earnings reserve to pay for government had ended in 2017. He noted that the house was currently vetting legislation that would use billions of earnings reserve dollars. He felt that the status quo would work for the next few years, and he expressed concerns for the protection of the earnings reserve. He lamented that the people of Alaska were at the mercy of the decisions of the legislature. He concluded that the only thing that would protect Alaskans from the legislature was the Constitution.

[9:32:47 AM](#)

Co-Chair Hoffman cited Page 11 of the presentation, "Permanent Fund Protection Act, Monday, March 6, 2017"(copy on file). He felt that it would behoove the commissioner to address specific protections of the fund.

Commissioner Hoffbeck replied that the people of Alaska viewed the fund as a multigeneration fund that needed

protection, and that the dividend needed protection as well. He relayed that the plan was structured with the intention that the fund would grow with the rate of inflation, or greater, so that the buying power of the permanent fund would not be reduced over time. He said that the dividend had to be preserved, even if it meant a smaller dividend that lasted into perpetuity.

[9:36:04 AM](#)

Co-Chair Hoffman thought that if action was not taken soon, the dividend would disappear entirely. He believed that inaction by the legislature, such as not passing SB 26, could put the dividend in jeopardy.

[9:36:31 AM](#)

Senator Dunleavy wondered why the dividend would disappear if the legislature failed to act soon.

Commissioner Hoffbeck explained that the constitutional budget reserve (CBR) would eventually run out, at which time the earnings reserve would be tapped. As the state spent down the earnings reserve, the money that paid for dividends would be used for government services. He said that once it got to the point where the state paid dividends, or paid bills, bills would need to be paid and the dividend would not be distributed.

[9:37:58 AM](#)

Senator Dunleavy appreciated the explanation. He warned that the dividend could disappear because of the actions of the current legislature. He suggested that it would be easier to use the earnings reserve than to impose an income tax on Alaska residents.

Commissioner Hoffbeck expounded that when facing a billion-dollar deficit there were 3 options: raise a billion dollars in new revenue through taxes, cut a billion dollars from government spending, or take a billion dollars out of savings. He agreed that the easiest solution was to use savings. He added that lack of structure around the use of the earnings reserve was the biggest threat to the durability of the earnings reserve because of depletion due to unplanned draws.

[9:38:40 AM](#)

Senator Dunleavy wondered whether the people of the state supported the legislation.

Commissioner Hoffbeck replied that the public had been supportive of the legislation.

[9:39:47 AM](#)

Senator Dunleavy asked if the administration would support a public vote on using the earnings reserve.

Commissioner Hoffbeck responded that the legislature was in the best position of the proper use of the earnings reserve to balance the state's fiscal situation. He thought that a public vote against could create more controversy.

[9:41:11 AM](#)

Senator Dunleavy understood that the administration did not support a public vote on the matter.

Commissioner Hoffbeck believed that the decision needed to be made promptly by the legislature.

[9:41:29 AM](#)

Senator von Imhof appreciated that the administration had worked to inform the public on the use of the earnings reserve for government spending. She expressed concern over the future of the earnings reserve if draws were needed again in the future. She thought that the best way to preserve the fund, and avoid additional appropriations, while allowing the fund to grow over time, would be to consolidate the fund into one large fund. She felt that one large and appropriately managed endowment would allow the state to maximize return on investment and ensure inflation proofing.

Commissioner Hoffbeck replied that although the permanent fund had a distinction between the principal and the earnings reserve, it was managed as one large fund. He furthered that there was no distinction between the way those pieces of the fund were invested. He admitted that the earnings reserve piece of the bill entirely and go straight POMV, 5.25 percent of the full value of the fund,

which had been considered by the administration. He said that there was concern that doing that could lessen the security of the earnings reserve. He believed that an investment construct could be set up within the department to use the CBR as a liquidity bank to pay bills throughout the year. He furthered that as the fund realized gains, the annual transfer could be made; as long as the CBR was paid back by the state within the fiscal year DOR would be within the statutory authority of using the CBR.

[9:46:57 AM](#)

Senator Olson asked whether there was a concern that the earnings reserve would be the only resource that would be used for filling the deficit gap, rather than also considering a broad-based tax.

Commissioner Hoffbeck responded that the governor felt that a comprehensive plan was necessary in order to reach a viable fiscal solution. He asserted that the governor preferred a revenue solution to fully closing the fiscal gap.

[9:48:40 AM](#)

Senator Olson lamented that a comprehensive plan had not been presented to the senate, and that the best plan offered so far was SB 26.

Commissioner Hoffbeck said that many ideas were currently under discussion, and that it would be premature to say that SB 26 was the final solution. He stated that the administration was working under the presumption that a comprehensive fiscal plan would be crafted by the legislature.

[9:49:51 AM](#)

Co-Chair MacKinnon relayed that the public was educating itself on Alaska's budgetary issues. She said that the state had been fortunate over the past 30 years to have only one source of volatile revenue that had maintained services across the state. She spoke of the declining oil production, and price, in relation to the state budget crisis. She hoped that the decline would be reversed, but until then savings were being spent rather than generating revenue. She said that people in her community were

"shouting for reductions in government." She expounded on the financial troubles the state currently faced. She offered a summary of budget cuts made over the past few years. She worried about the state being downgraded in its credit rating. She worried about increased property taxes in her district. She relayed that she had heard that one of every three dollars spent in local government came from the state. She reminded the committee that state services included roads and airports.

[9:55:19 AM](#)

Co-Chair MacKinnon adamantly disagreed that taxes could help to close the fiscal gap. She stressed that SB 26 would close the gap, while maintaining downward pressure to cut the budget and right-size the government for the people of Alaska. She lamented that urban areas were contributing too much, and that rural Alaska was not contributing what they should, toward education; the largest cost driver for the state of Alaska.

[9:56:38 AM](#)

Co-Chair Hoffman MOVED to REPORT CSSB 26 (FIN) with individual recommendations and the accompanying fiscal notes.

[9:57:17 AM](#)

Senator Dunleavy OBJECTED for discussion.

[9:57:24 AM](#)

Senator Dunleavy agreed that taxes would be the "death of Alaska's future." He opined the high cost of living in the state. He expounded on the evils of taxes. He did not support the legislation, and offered a brief history of dividend payments. He recalled past actions by the committee. He asserted that if the legislature did not cap the operating budget, there would be no tax base imaginable that would catch the projected expenditures. He believed that the bill was one component of a larger discussion that needed to occur.

[10:04:52 AM](#)

Senator Dunleavy continued to highlight his concerns.

Senator Dunleavy REMOVED his OBJECTION.

[10:05:27 AM](#)

Co-Chair MacKinnon OBJECTED for discussion.

[10:05:34 AM](#)

Co-Chair Hoffman offered comments on the legislation and the state's current fiscal climate. He supported the legislation.

[10:07:34 AM](#)

Vice-Chair Bishop remarked that he wanted to protect the dividend. He felt that there was some continuity and consistency with ensuring a \$1000 dividend.

[10:08:36 AM](#)

Senator Micciche argued that the senate was not trying to raid the permanent fund. He demanded protection for the permanent fund and for a perpetual dividend program. He likened using the earnings reserve to the use of a college savings account. He contended that the state was not meeting the constitutional requirements for public safety in the state. He asserted that the bill was necessary to fund state government without cutting essential services.

[10:15:07 AM](#)

Senator Olson reminded the committee that experts had testified in the past that even cutting government spending by 100 percent would not solve the state's budget woes. He

[10:17:44 AM](#)

Senator Dunleavy spoke to the complexity of making budget cuts. He spoke of ways that state dollars had been spent in the past that may not have been particularly prudent. He thought that the focus of the legislature should be to protect the rights and properties of Alaskans.

Co-Chair MacKinnon REMOVED her OBJECTION. There being NO OBJECTION, it was so ordered.

CSSB 26 (FIN) was REPORTED out of committee with a "do pass" recommendation and with two new fiscal impact notes from Department of Revenue, and one new fiscal impact note from Department of Corrections; and three previous published zero fiscal notes: FN1 (ADM), FN4 (REV), and FN5 (ADM).

[10:19:40 AM](#)

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[10:20:51 AM](#)

RECONVENED

#sb21

SENATE BILL NO. 21

"An Act relating to appropriations from the income of the Alaska permanent fund; relating to the calculation of permanent fund dividends; and providing for an effective date."

SB 21 was SCHEDULED but not HEARD.

#sb70

SENATE BILL NO. 70

"An Act relating to an appropriation limit; relating to the budget responsibilities of the governor; relating to the Alaska permanent fund, 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; relating to the calculation and payment of permanent fund dividends; and providing for an effective date."

SB 70 was SCHEDULED but not HEARD.

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ADJOURNMENT

[10:21:05 AM](#)

The meeting was adjourned at 10:21 a.m.