ALASKA STATE LEGISLATURE
BICAMERAL PERMANENT FUND WORKING GROUP
ANCHORAGE LIO
October 7, 2019
9:59 a.m.

MEMBERS PRESENT

Representative Jennifer Johnston, Co-Chair
Representative Jonathan Kreiss-Tomkins
Representative Kelly Merrick
Representative Adam Wool

Senator Click Bishop, Co-Chair
Senator Shelley Hughes
Senator Bert Stedman

MEMBERS ABSENT

Senator Donald Olson

OTHER LEGISLATORS PRESENT

Representative Bryce Edgmon
Representative Andy Josephson
Representative Chuck Kopp
Representative Laddie Shaw

Senator Cathy Giessel
Senator David Wilson

COMMITTEE CALENDAR

PRESENTATION: MODELS AND SCENARIOS ON PERMANENT FUND EARNINGS AND THE BUDGET

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

ALEXI PAINTER, Fiscal Analyst

Legislative Finance Division
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Presented fiscal models and scenarios related to the Permanent Fund earnings and the budget.

ACTION NARRATIVE

9:59:52 AM
CO-CHAIR CLICK BISHOP called the Bicameral Permanent Fund Working Group (PFG) meeting to order at 9:59 a.m. Present at the call to order was Senator Stedman, and Co-Chair Bishop; and Representatives Merrick, Wool, and Co-Chair Johnstone.

He recognized that Senators Giessel and Wilson, and Representative Kopp were in attendance.

10:00:47 AM
At ease.

Presentation: Models and Scenarios on the Permanent Fund Earnings and the Budget

10:09:32 AM
CO-CHAIR BISHOP reconvened the meeting and noted that Senator Hughes had arrived. He recognized that Representative Josephson was in attendance.

He stated that the purpose of the meeting is to hear a presentation from Alexi Painter, Fiscal Analyst for the Legislative Finance Division. The co-chairs asked all PFG members to request various models for analysis and discussion. Based upon input from the committee members, six different scenarios will be addressed during the presentation.

10:10:35 AM
ALEXI PAINTER, Fiscal Analyst, Legislative Finance Division, Alaska State Legislature, Juneau, Alaska, explained that he would present the scenarios that members of the PFG requested in advance of this meeting. He said he was also willing to model additional scenarios as they are requested during the meeting.

He clarified that the Legislative Finance Division does not endorse any particular model. Any additional scenarios that are run during the meeting will be posted to BASIS after the meeting.

10:11:33 AM

MR. PAINTER paraphrased the following glossary of key terms that he would use during the presentation:

> **ERA:** Earnings Reserve Account - the portion of the Permanent Fund that is available for appropriation.

He noted that the principal is constitutionally protected and cannot be spent. Any talk about spending from the Permanent Fund refers to spending from the ERA.

> **POMV:** Percent of Market Value. SB 26 limits draws from the ERA to 5.25% (dropping to 5% in FY22) of the five-year average market value of the total Permanent Fund.

He explained that the draw in FY2020 (which is based on the five-year average ending in FY2018) is about $2.9 billion. He noted the lag and the fact that the Permanent Fund has grown since FY2018 which results in the actual draw being less than 5.25 percent.

Statutory Net Income: Realized earnings of the Permanent Fund less expenses. The current PFD formula in statute is 50% of 21% of the earnings over the previous five years.

He noted that the lag is different than the POMV draw so the FY2020 dividend formula was calculated on the previous five years ending in FY2019 whereas the POMV draw was based on the previous five years ending in FY2018.

UGF: Unrestricted General Fund. State funds that can be appropriated for any purpose with no restrictions.

MR. PAINTER explained that the UGF is the only fund that can have deficits. The other funds are important in the budgeting process but cannot be overdrawn. By definition, the expenditures must equal the revenues so any talk about deficits is restricted to UGF.

CBR/SBR: The Constitutional Budget Reserve and Statutory Budget Reserve are the State's two main savings accounts. The CBR balance is about $2.1 billion (down from $12.7 billion in FY14) and the SBR is empty (from $5.2 billion in FY12).

MR. PAINTER explained that the state constitution requires draws from the CBR to be repaid. Because of past draws, the current CBR liability is about $10 billion.

10:14:54 AM
MR. PAINTER reviewed the following "Base Assumptions for All Scenarios" from slide 4:

- FY20 Budget as Enacted
  - Agency operations and capital budget growing with inflation
  - Statewide items following established projections

He said the statewide items such as retirement and debt service follow the established projections from the relevant Executive Branch agencies. The Alaska Retirement Management Board (ARMB), for example.

- $50 million placeholder for supplemental appropriations

MR. PAINTER said $50 million is the ideal for unexpected expenses, but it is likely too low this year because fire suppression alone is likely to be $50 million.

- Department of Revenue Spring Revenue Forecast of $66 per barrel oil:

MR. PAINTER said the price of a barrel of oil right now is about $60 and for the year the price is about $63.50 per barrel.

- 7% Permanent Fund growth (current Callan projection).

He noted that this is up from the 6.55 percent growth that Callan had earlier this year.

- No inflation proofing for four years due to extra $4 billion transfer to the Permanent Fund in FY20

10:17:07 AM
REPRESENTATIVE WOOL noted that he said the POMV revenue for FY2018 was $2.9 billion and the projected revenue is $66 per barrel. He asked what the total revenue is for oil.

MR. PAINTER answered that UGF petroleum revenue is about $1.7 billion. That includes production taxes, royalties, property tax, and corporate income taxes from the various petroleum sources.

MR. PAINTER said the inflation proofing assumptions on slide 4 is new this year. This past year the legislature appropriated $9.4 billion of additional inflation proofing from the ERA to the corpus of the Permanent Fund. The appropriation included intent language that it would serve as inflation proofing for the next eight fiscal years. He said that is roughly equivalent to the current inflation proofing statute that is about $1 billion a year.

He said Governor Dunleavy vetoed the appropriation from the ERA to the principal to $4 billion, but he cannot veto legislative intent so that left the 8 years. Since $4 billion is quite a bit lower than 8 years of inflation proofing, the Legislative Finance Division is assuming that the $4 billion is going to count for 4 years. He said the division made the assumption to try to smooth the projection, but the assumption can be changed.

CO-CHAIR JOHNSTON asked what Consumer Price Index (CPI) is used in the modeling.

MR. PAINTER answered that Callan's assumption is 2.25 percent inflation so the transfer is 2.25 percent times the principal of the Permanent Fund. Given the current size of the principal, the inflation proofing is approximately $1 billion a year.

10:19:39 AM
CO-CHAIR BISHOP recognized that Representatives Edgmon and Shaw joined the meeting.

MR. PAINTER offered the following explanation of the live models for the six different scenarios on slides 5-10:

- UGF Revenue/Budget ($ millions) is located top left in each scenario.
  - The blue bars are unrestricted general fund revenue from petroleum and nonpetroleum sources.
    - Unrestricted general fund revenue.
  - The green bars are the planned draws from the ERA.
    - The POMV draw in FY2018 is the amount of the dividend. It was a planned draw from the ERA.
  - The orange bars are draws from the savings accounts to make up the deficits in the CBR and SBR.
  - The red bars are draws from the ERA above the POMV draw.
  - The dark black line is the typical way the Legislative Finance Division views the budget.

        - It does not include the PFD.
        - Approximately $4.5 billion, $4.4 billion in FY2020.
    - The dotted line is the budget including the PFD.
        - That is the line that the bars are trying to meet.

- Budget Reserves (FY Ending Balance) is located just below UGF Revenue/Budget in each scenario.
    - The green bar is the amount in the ERA that is available for appropriation.
        - It is not a true budget reserve because it is paying out every year in the PMOV, but it could be used as one.
    - The orange bar is the CBR Balance.
    - SBR balance is small enough to be difficult to see and it goes away after FY2020. The balance at the beginning of the year was about $170 million.

- The blue table at the lower left has the numbers that go along with the graphs. It shows:
    - Total amount of reserves.
    - Surplus or deficit for each year.
    - The remaining years of CBR balance.
    - The amount of the deficit that is filled.
    - The amount of any unplanned draw from the ERA.

- Dividend Check graph is located in the top right of each scenario.
    - PFD for FY2020 was $1,606.
    - The status quo analysis starts with the statutes. The next year the PFD will be approximately $3,074, depending on earning and the number of recipients. It grows and shrinks in subsequent years.
    - The red line is the status quo.
    - The purple line is the current scenario.

10:23:18 AM
CO-CHAIR JOHNSTON asked if the scenario on the slide includes the draws from the ERA when the PFD amount is recalculated.

MR. PAINTER answered no; the scenario he was referencing is not in the packets. It is the division's starting point of the model, which is basically a broken scenario. He said there is a white space between the budget and revenue meaning nothing is filling the space. The model shows following all the laws on the books, which obviously does not work. The first assumption that the division makes for the baseline is that any needed additional draws would come from the ERA, then a recalculation occurs.

SENATOR STEDMAN urged caution when talking about following all the laws on the books, because there are two laws on the books that are in conflict. One law is the 5.25 percent POMV draw from the ERA for the Permanent Fund. The other law is the statutory PFD calculation for the dividend. Both laws have equal weight and both are subject to change by the legislature. What the legislature cannot change is the constitution.

MR. PAINTER agreed it was a fair point. He clarified that what he meant is that the POMV law is being followed and the dividend is paid out of that POMV draw.

He said depending on how SB 26 is read, the PFD and POMV draw could both be legally pulled, which he is not sure was intended. The default assumption is that just the POMV draw is pulled.

CO-CHAIR BISHOP asked for confirmation that the slide was just for illustrative purposes.

MR. PAINTER concurred; it is just to show how the model works in isolation, but the scenario is obviously not viable because of the white space.

He continued to explain that the Permanent Fund FY Ending Balance graph shows whether the Permanent Fund value is keeping up with inflation.

- The red bar shows the ending balance of the Permanent Fund growing with inflation.
- The stacked bar next to the red bar:
    - The purple portion is the principal of the Permanent Fund.
    - The green portion is the ERA.
    - Together the stacked bar is the total value of the Permanent Fund.
- Following the POMV law, the Permanent Fund will grow slightly faster than inflation because the fund is receiving royalty deposits every year as per the constitution.
- Making additional draws to meet the budget deficit will slow the fund's growth.

MR. PAINTER explained the Payout for Dividends and General Fund graph, located below the Permanent Fund graph, as follows:

- It shows the comparative amount of the POMV draw that is going to dividends versus the General fund.
  - red bar shows the PFD.
  - The green bar shows the General Fund
  - The amount for the General Fund is higher in FY2019 and FY2020; however, once the division switches to following the PFD statute, the amount for the PFD is higher after FY2020.
- In this scenario the amount for the General Fund is higher in FY2019 and FY2020, but the amount for the PFD is higher once there is a switch to the PFD statute.

10:26:06 AM

CO-CHAIR BISHOP announced that Representative Kreiss-Tomkins joined the committee meeting.

REPRESENTATIVE WOOL noted that the Dividend Check graph shows dividends for the last three years of $1,100, $1,600, and $1,600. Starting in FY2021 the dividend goes up to the statutory formula which is based on previous performance. He commented that a lot of the graphs are based on paying according to the statutory formula, which hasn't happened for a few years. He asked if the graphs could be updated for the past few years.

MR. PAINTER answered yes; the division's approach is that the default, if nothing is done, is to follow the statute. He acknowledged it was a subjective choice.

10:27:57 AM

SENATOR HUGHES referenced the conversation about the conflict between the laws that are on the books and opined that the historic PFD calculation could coexist with the POMV draw, but it would leave less money for government. She said Governor Dunleavy's budget at the beginning of the process respected the POMV, but when he applied the historic formula for the PFD about 65 percent went to the PFD and 35 percent went to government. In contrast, Governor Walker also respected the draw, but the numbers were flipped where 35 percent went to the people and 65 percent went to the government.

She said she has been trying to educate people in her district that following the historic draw will erode the growth of the fund.

SENATOR HUGHES explained that since the PFD was put into statute in 1982, growth of the fund was not eroded because the portion available to the government was not used. It was going back into the Permanent Fund resulting in a healthy fund with robust growth. She said now that the state needs to use some of the fund, the old PFD draw is just too much.

She said there are a lot of people who still want the historic draw and there are legislators who want to stick with the POMV draw with varying amounts going to government and to the people. She said a smaller amount does make sense, but the question is what the split should be. She offered her belief that a fair split would be 50/50 and that the governor would veto anything less than that. She stated that she was willing to stick her neck out and support that split.

10:34:29 AM
MR. PAINTER said the historic 50/50 results in the entire earnings being spent, 50 percent of the statutory net income for government and 50 percent for the PFD. Because all the earnings are being spent, inflation proofing would have to come out of the balance. The value of the ERA would decline as inflation proofing happens, so the value of the fund does not really decline, but it does not keep up with inflation.

He said there are a couple of ways to handle inflation; either take inflation proofing out ahead of time before calculating the statutory net income or have a POMV draw, which is designed to build in inflation. The model does show that not having a mechanism for inflation proofing, the real value of the fund would erode.

SENATOR STEDMAN added that a policy without inflation proofing the Permanent Fund will fail because purchasing power going forward will be eroded and increase over time, to the detriment of future Alaskans. He opined that at a minimum, the legislature needs to make sure inflation proofing happens regardless of the split.

10:36:12 AM
MR. PAINTER reviewed scenario, 1, "50 percent of Statutory Net Income (Current law)" on slide 5:

- Paying the current statutory PFD out of the POMV draw results in deficits being made up out of the ERA.

- The CBR would run out in FY2022 and draws would have to come from the ERA if there are no other budget or policy changes.
- The deficit at the start would be about $1.5 billion to $1.7 billion.
- The PFD would be approximately $3,000, rising to about $3,500.
- The Permanent Fund is not keeping up to inflation.

CO-CHAIR JOHNSTON said she was confused by scenario 1 because eating away at the fund with the dividend should result in dividends dropping.

MR. PAINTER explained that it takes time to work its way through the fund balance because of the averaging. Towards the end the dividend will lose about $200 if there are no unplanned draws.

CO-CHAIR JOHNSTON recapped that it takes longer because of the five-year lookback, which is the immediate past year.

MR. PAINTER concurred.

10:38:20 AM
SENATOR STEDMAN asked him to discuss the "Permanent Fund FY Ending Balance" on the lower right in scenario 1.

MR. PAINTER explained as follows:

- Permanent Fund FY Ending Balance:
    - The red bar on the left is the current value of the Permanent Fund growing with inflation.
    - The stacked (green and purple) bar on the right is what the Permanent Fund does.
    - A few unplanned draws or draws beyond the POMV results in a Permanent Fund that does not decrease at this point, but it is not keeping up with inflation.
    - In FY2028, the Permanent Fund is about $10 billion below the inflation-adjusted value of the fund because of the unplanned draws or draws beyond the POMV amount.

  He said the next chart down, "Payout for Dividends and General Fund" shows that the relative draws to the dividend and General Fund are similar. He pointed out the following if the POMV statute is followed:

    - Effective Percentage:

        - The FY2020 draw is 5.25 percent, but the payout is actually 4.4 percent of the current value of the fund because of the lag.
    - If there is an unplanned draw in addition to the planned draw, the total draw is over 7 percent of the fund.
    - A 7 percent draw is more than earnings and the fund starts to decrease over time.

SENATOR STEDMAN highlighted that in a declining market the draw rate would increase significantly and that would be detrimental to future Alaskans in perpetuity.

MR. PAINTER pointed out that draws from FY2015 through FY2017 exceeded eight percent at one point because the market was weaker.

10:41:31 AM
REPRESENTATIVE WOOL asked him to repeat the explanation of the lag and why the 5.25 percent POMV draw is actually [4.4] percent.

MR. PAINTER explained that the POMV draw is based on the value of the Permanent Fund over a five-year period that ends a year before the actual draw is made. It's a form of smoothing that keeps the draw from varying too much. Generally, while the fund is advancing the percentage will be lower.

CO-CHAIR BISHOP noted that during the discussion of Senate Bill 26 (POMV), he and several other senators advocated for a lower draw than 5.25 percent.

10:43:00 AM
MR. PAINTER reviewed scenario 2, "25 Percent of Statutory Net Income" as proposed in HB 1005:

- Cuts the current amount of the PFD from 50 percent of the average statutory net income to 25 percent of the average statutory net income. Instead of $3,000, the dividend is about $1,500.
- Even though deficits are smaller than scenario 1, deficits of approximately $500 million a year persist through most of the modeled period.
- Based on the default assumption and assuming no other policy changes, unplanned ERA draws would be needed starting in FY2027.

- The deficit gets a lot bigger between FY2021 and FY2022 because of the following:
    - POMV draw decreases from 5.25 percent to 5 percent.
    - Instead of advancing the amount by a couple hundred million dollars a year, it is basically flat for those two years, which increases the deficit.
- Because the unplanned draws are much smaller, the Permanent Fund keeps pace with inflation.

REPRESENTATIVE KREISS-TOMKINS asked him to explain why the dividends are around $1,500 in scenario 2, but the graphs appear to show they are in the $1,000 to $1,250 range.

MR. PAINTER clarified that the PFD will be between $1,500 and $1,800.

10:45:40 AM
SENATOR STEDMAN pointed out that scenario 2 would take a statutory change from 50 percent down to 25 percent, basically cutting the PFD in half. It leaves the statutory net income calculations in place and avoids the need for constitutional amendments or any significant changes. The scenario stabilizes the Permanent Fund going forward until a more permanent solution can be worked out.

MR. PAINTER discussed scenario 3, "50 percent of POMV Draw" as proposed in SB 103:

- Puts the PFD as half of the POMV draw.
- In FY2021 dividend would be $2,350.
- The deficit gap is $1 billion, lower than the $1.5 billion to $1.7 billion under the current statute, but a persistent deficit exists.
- CBR would run out in FY2023.

10:47:41 AM
SENATOR HUGHES asked if the oil revenue projections in the modeling considers the activity occurring on the North Slope.

MR. PAINTER replied that the Spring Revenue Forecast from DOR includes some of the increased production, but it assigns a risking factor that assumes there is a chance that not all the production will come online so production is essentially flat. He said that is a big change from a few years ago when the assumption was that production would be declining. He added that the forecast does not count any revenue from the Arctic National

Wildlife Refuge (ANWR) lease sales because that is viewed as very uncertain and a one-time payment. He noted that the Spring Revenue Forecast does not include the impact of the Hilcorp sale to BP. A new revenue forecast in December 2019 may reflect the North Slope changes.

CO-CHAIR BISHOP pointed out that not all the new North Slope prospects are going to pay a royalty to the state treasury because the production is not on state land. A production tax would be recovered, but the collection would be at a later date.

MR. PAINTER agreed and pointed out that while added production increases the production tax, the Trans-Alaska Pipeline System (TAPS) tariff will be reduced because it will be spread over more barrels of oil.

10:50:13 AM

REPRESENTATIVE WOOL asked how a flat or down stock market over 10 years will affect the models for the POMV and statutory net income draws.

MR. PAINTER answered that using the worst time period (FY2001 through FY2009) as an example, the following will occur:

- The draw is roughly the same size.
- Deficits from FY2001 through FY2009 were in the $900 million to $1 billion range, deficits in the model are $1.2 billion.
- There is less money to deal with the deficits because the POMV is stable.
- Under the statutory approach, dividends will jump around. Bad years drives the dividend down quite a bit, and it spikes in good years.
- When the dividend is paid out of statutory net income, it is very susceptible to market changes.
- POMV draws are very stable amounts based on balances. An odd situation could occur where a temporary decline in the market reduces the deficit because it does not affect the POMV due to an additional year of lag and the draw is based on the total balance, but the PFD is greatly affected.
- A situation could occur where the market goes up and the deficit is deficit, or the market goes down and it gives a smaller deficit. There is a bit of a disconnect when those two things are based on a different number.
- The model is based on very flat and static projections that often will hide the disconnect effect, but because of the

different lags, the additional lag in the POMV draw, and because of the difference in the volatility of earnings versus balances, there is sometimes a bit of a disconnect.

10:53:13 AM
SENATOR HUGHES referred to the UGF Revenue/Budget graph in scenario 3, "50 Percent of POMV Draw." The graph shows red bars that indicate overdraws which is not good. However, there are several different factors that could change the overdraws such as how the actual North Slope activity pans out, if the state continues to nudge down the budget over a few years, and if there are some other revenue sources. She emphasized that the models are just projections and there are many factors that can unfold between now and when the overdrafts appear if future years.

10:55:00 AM
At ease.

10:56:15 AM
CO-CHAIR BISHOP reconvened the meeting.

SENATOR STEDMAN noted that the Senate Finance Committee discussed some of the anomalies the state is faced with under the current dividend calculation. He said the Permanent Fund has substantial real estate holdings that have grown in enormous value over the years. When liquidated, the transaction triggers into the PFD calculation which artificially moves the PFD up. As the real estate holdings get older and more profitable, liquidation compounds the issue whereas the POMV calculates the market value at a given day once a year in a simplistic form that provides smoothing and gets away from the shock issues for a PFD calculation. The noted anomalies are going to distort the PFD in the next couple of years under the statutory amount to the upward side with forecasts of $3,500 to $4,000 dividends.

10:58:17 AM
REPRESENTATIVE KREISS-TOMKINS opined that some of those highly profitable assets were not contemplated by the people who wrote the PFD formula in the early 1980s. The Permanent Fund Corporation operated under very conservative legal parameters for investment. The fund could not invest in real estate or private equity, so there was no contemplation of earnings volatility. The volatility that Senator Stedman pointed out is an unintended consequence of broadening and having a more aggressive investment parameters for the Permanent Fund Corporation.

He directed attention to row 69, "Unplanned ERA Draw" in scenario 3 that shows draws of $1 billion for FY2024 and FY2025 before it drops. He asked why the overspending in those two fiscal years diminishes from that high water mark.

11:00:45 AM

MR. PAINTER answered that the model considers oil price forecasts and the forecasted price for the noted fiscal years reaches $77 per barrel. It's a "kink point" price that triggers a higher production tax and increases revenue.

REPRESENTATIVE KREISS-TOMKINS noted that the models use the Spring Revenue Forecast from DOR. They have an almost arbitrary rosiness with a linear increase in oil prices with the "kink point" shift in every model. He asked if the positive oil price inflection will be in every model.

MR. PAINTER answered yes.

11:03:17 AM

REPRESENTATIVE KREISS-TOMKINS noted that the oil price forecasting from DOR shows a steady upward climb. He asked Mr. Painter to speak to the assumptions DOR used and what the general price forecast looks like.

MR. PAINTER answered that DOR looks heavily at the futures market and the analysts' oil market projections. DOR is planning a methodology change in the fall of 2019 that will look almost exclusively at the futures market. The futures market is oil traders predicting how much oil will sell for in the future. Generally, the forecasts are fairly flat. He said he cannot recall a time they predicted a large spike or drop in oil prices.

REPRESENTATIVE KREISS-TOMKINS asked if a more bearish oil revenue forecast will result if DOR switches its price forecasting to a more futures-weighted methodology.

MR. PAINTER answered that he cannot speculate on that but DOR has said its internal model shows the change results in a more accurate forecast.

REPRESENTATIVE KREISS-TOMKINS asked why futures traders tend to predict a flatter price forecast.

MR. PAINTER explained that when the oil market is stable, if prices have been decreasing, they will often have a downward slope. If prices are increasing, they will have an upward slope. At current prices where traders seem to feel like the market is in a comfortable area without volatility, the forecast will be relatively flat. Price forecasts depend on volatility.

11:06:27 AM
CO-CHAIR BISHOP noted that in the future, the committee will have a chance to ask some industry experts about oil price forecasts.

SENATOR STEDMAN explained that what the state has done historically is to take into account the Revenue Source Book projections, the International Energy Agency (IEA) forecast, the federal forecast, and then to use the state's opinion on how accurate the targets are to then put a band of prices on.

CO-CHAIR BISHOP said the recent IEA forecast for West Texas Intermediate (WTI), indicates prices will drop below $50 per barrel in 2020.

SENATOR HUGHES asked for an explanation the "1s" and "0s" in the inflation proofing assumption in the center column.

MR. PAINTER explained that it shows the various options that have been proposed in the past for how to calculate inflation proofing. The House advanced a bill two years ago that had a portion of the inflation proofing be a percentage of the POMV draw. That is not in current statute and it has not been proposed this session, but it's shown as an option because it's been proposed.

The "1" indicates the current statute is used and that the $4 billion transfer also happens.

11:08:49 AM
SENATOR HUGHES asked if the "1s" represent $1 billion. She asked if all the charts would change with more inflation proofing.

MR. PAINTER answered yes. He explained that the "1s" mean yes and the "0s" mean no so he would read the 1 as yes, the inflation proofing statute is on. If inflation proofing was doubled, the ERA balance would decrease and the principal balance would increase.

SENATOR HUGHES asked if the red bars in the UGF Revenue/Budget graph would shrink if inflation proofing was increased.

MR. PAINTER answered no. He explained that the POMV draw is on the entire fund, the ERA and the principal, so moving money between the two does not change the ERA draw, but it would make a difference if the state was running out of money.

11:10:15 AM
REPRESENTATIVE WOOL referenced the conversation about the impact on the PFD and POMV payout formulas from selling real estate assets from the Permanent Fund. He asked for confirmation that real estate sales would not affect the POMV payout formula as much as the statutory net income payout.

MR. PAINTER said that's correct; a dividend based on the POMV draw will be more stable than a dividend based on the statutory net income.

He reviewed scenario 4, "25 percent of POMV Draw" which is the version of SB 26 that the Senate passed in 2017:

- The dividend would be about $1,100 and rising to about $1,300, the approximate inflation growth.
- Small deficits with some surpluses, roughly a balanced budget if there are no other policy changes.
- No unplanned draws.
- CBR value stays roughly the same.

11:13:27 AM
MR. PAINTER reviewed scenario 5, "33 percent of POMV Draw" which is the version of SB 26 the House passed in 2017:

- The dividend is about $1,500 and a little larger in the later years.
- Deficits are larger than in scenario 4, about $400 million to $500 million.
- An income tax was included in the bill that would eliminate the deficit.
- If the scenario is done in isolation there are continued deficits.
- $35 million unplanned draw in FY2028.
- CBR runs out in FY2028 because of the continued deficits.

He reviewed scenario 6, "20 percent of POMV Draw and 20 percent of Petroleum Revenue" which is based on Representative Wool's bill and very similar to Senate Bill 128 that passed the Senate in 2016:

- The only difference is SB 128 was based on all revenue and scenario 6 is based on just oil royalties.
- The dividend would be about $1,300 and rising.
- The dividend rises faster because of the oil revenue.
- There is a deficit of roughly $300 million in most years.
- The deficits are small enough that the CBR would last through the FY2028 forecast period.

REPRESENTATIVE KREISS-TOMKINS asked what the other options are in the oil price scenario menu in the model.

MR. PAINTER answered that he was asked to put in quite a few options. The prices range from $20 up to $130 per barrel.

REPRESENTATIVE KREISS-TOMKINS asked if he had the IEA or other agency forecasts.

11:17:01 AM
MR. PAINTER replied no agency other than DOR produces a model of forecasts of Alaska North Slope oil. They produce forecasts for other types of oil that have different prices so a price trajectory can be inputted, but most of the trajectories are flat.

CO-CHAIR JOHNSTON asked if scenario 6 could benefit from the increased volume that's discussed as the industry renaissance in Alaska.

MR. PAINTER answered that the model only uses the production forecast from the Spring Revenue Forecast. He offered to follow up with more scenarios for the committee to review.

CO-CHAIR JOHNSTON said she was suggesting following what is happening on the North Slope. The model should include new developments on either federal or state lands that includes royalties and not overall income. The different models could have a different look if further improvement occurred on the North Slope.

MR. PAINTER said he could provide scenarios that consider higher or lower oil production, which definitely influences revenue. Those scenarios would be posted later.

CO-CHAIR BISHOP thanked Mr. Painter for presenting the six models. He said the next phase of the meeting is to show the interactive model that the public can use at home. The interactive model will be posted later in the week at www.pfalaska.org.

11:20:50 AM
MR. PAINTER explained that the interactive model was designed to be simpler than the model he was showing previously. It is a model of FY2020 only and it has fewer levers to pull to change things. The dividend for FY2020 was $1,606, but the interactive model allows users to see what the PFD could have been and the impact on the budget. Users can also see what oil price changes might do to the budget.

He explained that the interactive model will accept any number between $20 and $130 for oil prices. If $60 oil is inputted, the deficit goes from $150 million to $400 million. If $70 is inputted, there will be a $100 million surplus. Oil production can be inputted as well. If there is zero oil production, there would be a $1.9 billion deficit based on a POMV draw on non-oil revenue only.

For the dividend options, users are able to pick the basis for the formula. Either input a set dollar amount; or the current statute, 50 percent, or 25 percent; or a POMV draw with 50 percent, 33 percent, or 25 percent. The model will accept any number between 1 and 100. As with the previous models, this assumes there are no other policy changes.

11:24:07 AM
SENATOR HUGHES asked if he could run a scenario for a 50/50 POMV draw with a flat budget and no inflation proofing.

MR. PAINTER said the scenario shows that deficits decrease as revenue grows roughly with inflation. The earlier 50/50 POMV model showed deficits in the $900 million to $1.1 billion range and the model requested by Senator Hughes reduces the deficit to $700 million and then $400 million lower in out years. He said that model will be posted as well.

REPRESENTATIVE WOOL opined that people are not losing sleep over deficits, but they are concerned about their PFD checks. He asked why the interactive model includes the option to select "zero oil production" because production will not be zero and in this model the dividend does not depend on the price of oil. "Is it just to show people what life is without oil?"

MR. PAINTER answered that the committee co-chairs requested the "zero oil production" and they can speak to their request. He speculated that the purpose is that oil is a finite resource and someday, maybe 40 years in the future, the state will not have oil.

REPRESENTATIVE WOOL pointed out that the oil production variable is non-variable. Last year oil production was under 500,000 barrels/day, but new fields are coming online that could increase production to 750,000 barrels/day. He acknowledged that prices are volatile and asked if he could run a model with oil prices cut one-third and a 50 percent scenario is used.

11:28:03 AM
MR. PAINTER said he'd use inflation proofing on inflation growth as a starting point. Assuming a price of $35/barrel that grows with inflation, the deficit would be in the $1.8 billion to $2.2 billion range. He noted that oil at $35/barrel is not improbable.

REPRESENTATIVE WOOL asked if the scenario will be titled, "50 Percent of POMV."

MR. PAINTER answered yes.

REPRESENTATIVE MERRICK asked if he had heard any discussions about a price change model for the PFD; a drop in the price of oil to a certain level triggers a change in the formula for the PFD.

MR. PAINTER replied he has heard discussions, but he has not seen a proposal for that and it is difficult to model something that does not have a clear mechanism. It is possible, but the difficult part is figuring out the timing relative to when the PFD check is finalized in September. That would have to be a policy discussion, he said.

11:30:16 AM
REPRESENTATIVE KREISS-TOMKINS said his synthesized takeaway is that the scenarios for price and production forecasts have been optimistic and rosy but there has not been talk about worst-case scenarios such as an earthquake that severs TAPS for several months or a federal tax on carbon or a technological breakthrough that makes hydrocarbons obsolete as an energy source. He said he does not feel comfortable banking Alaska's future on what is, on balance, thin optimistic scenarios. It's

important to balance the up sides and the down sides and the down sides are a lot more serious and worse for the future of Alaska than the up sides with regard to the budget.

REPRESENTATIVE WOOL asked Mr. Painter to model $35 oil for scenario 6, "20 percent of POMV Draw and 20 percent of Petroleum Revenue," to show deficits in that scenario.

MR. PAINTER said the deficit in that scenario is roughly $1 billion to $1.1 billion, so it's still substantial. Compared to a 33-percent POMV, the deficit is larger and the PFD is bigger because it is not dependent on oil prices. With $35 oil the PFD is roughly $1,100. At the Spring Revenue Forecast the PFD $1,300 and rising, so the lower oil price makes a substantial difference in the PFD and the size of the deficit.

11:33:17 AM
CO-CHAIR BISHOP observed that all the scenarios have a deficit, but some are worse than others. He opined that finding revenue alternatives going forward is important. Last year SB 26 was created to provide new revenue to help bolster oil revenue for the state. Those efforts must continue because Alaska has a 20 to 30-year window to diversify its economy. Getting ahead of the curve will benefit the state and future Alaskans.

SENATOR STEDMAN pointed out that while Alaska has spent down $12 billion from its savings accounts, the state is still in a better position than Alberta, Canada who borrowed $90 billion to finance its government. Alaska is in a fairly good position despite the fretting about the dividend to the people, feeding the government machine, and taking care of future Alaskans. He said the legislature will come up with a solution that will work for everybody and take care of future Alaskans. "I think that we should be not so gloomy as we work through this process and come to a solution."

CO-CHAIR BISHOP agreed that the state is in a fairly good position. It is in the black with $64 billion whereas Alberta might get $30 a barrel for their oil on a good day.

11:36:26 AM
SENATOR HUGHES thanked Senator Stedman for reminding everyone that Alaska has things to be grateful for. She said Alaskans have good heads on their shoulders and would be willing to look at changes should a worst-case event occur.

SENATOR HUGHES expressed hope that other legislators would join her in getting of their high horse to come to a grand compromise. She said she expects to be beat up a bit by people in her district and around the state that are supporting the historical formula and have looked at her to carry that flag. She emphasized that people must be realistic and realize that the historic draw is eroding growth of the funds, so a change is necessary. She said the conflict is that there are two draws in statute.

SENATOR HUGHES stated that she is willing to accept the smaller draw and she hopes that someone in the other camp will join her in the grand compromise. She said the legislature is getting wrapped around the axel on this one issue at the expense of addressing other important problems.

CO-CHAIR BISHOP advised that committee members will receive a draft summation to review. Once there is agreement on the final report, it will be conveyed to the presiding officers.

11:40:10 AM
There being no further business to come before the committee, Co-Chair Bishop adjourned the Bicameral Permanent Fund Working Group meeting at 11:40 a.m.