

**ALASKA STATE LEGISLATURE
BICAMERAL PERMANENT FUND WORKING GROUP**

January 20, 2020

10:05 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 Donald Olson
Senator Bert Stedman

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Sara Hannan
Representative Andy Josephson
Representative Bart LeBon

Senator Cathy Giessel
Senator Josh Revak

COMMITTEE CALENDAR

OVERVIEW: WORKING GROUP DRAFT REPORT

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

ACTION NARRATIVE

[10:05:55 AM](#)

CO-CHAIR JENNIFER JOHNSTON called the Bicameral Permanent Fund Working Group meeting to order at 10:05 a.m. Present at the call to order were Representatives Wool, Kreiss-Tomkins, Merrick, and Co-Chair Johnston.

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CO-CHAIR CLICK BISHOP stated that Senators Olson, Hughes, Stedman, and Co-Chair Bishop were present at the call to order.

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CO-CHAIR JOHNSTON recognized that Representatives Josephson, Hannan and LeBon, and Senators Giessel and Revak were also present.

OVERVIEW: Working Group Draft Report

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CO-CHAIR JOHNSTON announced that the business before the bicameral working group was to review the Working Group Draft Report, dated January 20, 2020.

She explained that the report represents a summary of the work the working group has done over the last seven months, including a history of the creation of the working group, a brief history of the Alaska permanent fund dividend (PFD), a synopsis of each of the working group's meetings, the working group assignments that were completed, and the models the working group evaluated.

She said House Concurrent Resolution 101 created the working group and charged it with making policy recommendations on the future use of the earnings of the Alaska Permanent Fund. The report does not make a recommendation on changes to the PFD formula or the size of the PFD check. However, the group was able to establish and recommend that the permanent fund should be protected from inflation and the legislature should not utilize more of the earnings reserve than is outlined in Senate Bill 26 from 2018, otherwise known as percent of market value (POMV).

She pointed out that at the last meeting, the working group evaluated several different scenarios related to the use of the earnings reserve and the size of the dividend check. She said she was pleased that the working group developed a framework for modeling the options heading into the second session of the Thirty-First Alaska State Legislature. She reminded listeners that the models represent a snapshot in time. They assumed a \$50 million supplemental and were based on the Alaska Department of

Revenue Spring 2019 Revenue Forecast. Since then, the Fall 2019 Revenue Forecast was released resulting in an additional shortfall of approximately \$200 million and a preliminary supplemental of approximately \$230 million.

CO-CHAIR JOHNSTON asked if any working group member had a comment.

SENATOR HUGHES thanked the individuals that worked on the working group report. She highlighted that one of the edits she suggested was in the first paragraph of the executive summary regarding what the working group was tasked to do. Originally, the report stated that the working group was tasked with submitting a report to the legislature in January 2020. However, the resolution (HCR 101) tasked the working group with making policy recommendations. She asked the co-chairs what policy recommendations the working group was making in the report.

CO-CHAIR JOHNSTON opined that the strongest policy recommendation is that the legislature needs to adhere to the structured draw no matter what kind of formula is used for the PFD and what revenue the legislature is looking for, for the state.

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SENATOR HUGHES highlighted a recommendation she made that was not included in the final draft. She said she suggested striking the phrase "To that end," from the last sentence of the executive summary and insert:

A majority of members agree that use of permanent fund earnings must stay within draw limits established by a structure like the percent of market value law enacted in 2018.

She said the phrase "To that end," is not an appropriate conjunction because it implies that the structured draw itself takes care of inflation proofing and it doesn't. It might do so indirectly because some funds outside of the structured draw may inflation proof the corpus, but a limited structured draw does not provide automatic inflation proofing.

SENATOR HUGHES said she also expressed concern and made a suggestion regarding the POMV but it did not have support. Because her concern remains, she prepared an amendment she hopes other members agree with.

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She suggested striking the last sentence of the executive summary and inserting:

Also, members agree that use of permanent fund earnings for state services and dividends must be limited in order to protect the permanent fund.

She said the executive summary will still say that the working group agrees that there must be a limit to avoid willy-nilly spending. She added that if the group does not want to change the language, at least replace the phrase "To that end," with "A majority of members agree".

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At ease.

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CO-CHAIR JOHNSTON called the committee back to order.

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SENATOR HUGHES withdrew her previous suggestion and offered a conceptual amendment to strike the words, "To that end," and insert, "A majority of members agree that". The last two sentences of the executive summary would read:

While agreement on the size of a dividend may still be difficult to attain, members agree that the permanent fund must be protected from inflation so that future generations of Alaskans may benefit from it. A majority of members agree that use of permanent fund earnings must stay within draw limits established by a structure like the percent of market value law enacted in 2018.

SENATOR STEDMAN asserted that there is a huge misconception within the working group. Quite a bit of time has been spent debating the POMV concept, going back to Governor Murkowski's administration. A couple of years ago the legislature established a POMV structure that limited the draw to 5.25 percent and then to be 5.00 percent. The comment that it does not take care of inflation is inaccurate; that is precisely what it does. The endowment-style structure is proven over decades of use all over the world.

SENATOR STEDMAN explained that what drives the inflation proofing is a draw rate lower than the consumption of all the

earnings, including what is lost in purchasing power. The 5.25 percent and then 5.00 percent draw is set by the permanent fund's asset allocation which is set by market returns. That is what drives the 5 percent draw. It's not 8 percent because historic global returns cannot produce the income to inflation proof and protect the purchasing power of the Alaska Permanent Fund to sustain that draw. He continued to say:

To miss that point, to me, is phenomenal. It is fundamental to the structure, and to have language that may give flexibility and cover to the legislature, the appropriating body, to appropriate funds above what the portfolio can return with inflation and protect itself, and protect the future Alaskans is a fundamental abrogation of our responsibility for future generations of Alaskans.

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SENATOR STEDMAN emphasized that the current generation should not be consuming all the revenue and wealth created from Alaska's oil basin. Some of the wealth created by the current generation must be left for future Alaskans. He said he does not want to see weasel-words in the working group report. He emphasized that he wants to see the legislature, regardless of the size of the PFD, protect the current and future value of the permanent fund. He opined that the PFD will just default out.

He stressed that the permanent fund must be protected against the legislature spending it, and noted that both political parties have made motions on the floor of the bodies to do just that. The issue does not reside on one side of the political spectrum or the other. He said the legislature worked very hard to build the Constitutional Budget Reserve (CBR) to well over \$10 billion. Assuming the proposed budget passes this session, it has been depleted to \$500 million. He said he disagrees with those who do not think the legislature will spend down the permanent fund if the window is open. The depletion of the CBR over the last several years is proof of that.

He stated that he would like the working group to hold firm on the language in the final report to make it very clear to the public that regardless of the financial demands over the last several years, the purchasing power of the permanent fund will not be depleted. Spending the entire earnings reserve only takes a majority vote of bodies and a signature by the governor.

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CO-CHAIR BISHOP pointed out that the POMV is an important piece of legislation that gives the legislature the predictability for building future budgets.

SENATOR HUGHES said she appreciates Senator Stedman's comments and generally agrees with his concern that the permanent fund should truly be protected for future generations. However, the fact is that the court ruling and the legislature can go outside the POMV draw with a simple majority vote. She opined that the only way to inflation proof the permanent fund is to do what was done in fiscal year 2020 and that is to put funds from the earnings reserve into the corpus. She reiterated that taking a limited draw does not secure inflation proofing for the permanent fund.

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REPRESENTATIVE KREISS-TOMKINS agreed with Senator Stedman that the permanent fund must be protected. He opined that the order of priority is that without a permanent fund there isn't a permanent fund dividend. He said as somebody who is passionate about the future, integrity, and intergenerational solvency of the permanent fund, he also believes in the PFD as an institution.

He said he appreciates the report, including Senator Hughes' amendment, and believes that every member supports the integrity and protection of the permanent fund, but it does not create an orb of protection for the permanent fund into the future.

REPRESENTATIVE KREISS-TOMKINS opined that as much as Senate Bill 26 was a watershed moment in terms of how the state is going to manage the permanent fund asset, there is ongoing risk to the permanent fund and it will always exist. Statute alone or a consensus that may evaporate from legislature to legislature or decade to decade into the future is not sufficient to protect an asset that is the best thing Alaska has going.

REPRESENTATIVE KREISS-TOMKINS said he appreciates the work the working group has done but he believes the legislature ultimately has to rely on the constitution to provide protection that is inviolate. A report and executive summary cannot make the permanent fund truly permanent as whims change and political winds blow.

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He said his second comment is that the executive summary does not address the permanent fund dividend formula. He expressed

appreciation for Senator Hughes' comments last year about what the formula can look like. He opined that all members know that the PFD needs to be reexamined. However, so long as the PFD formula is unresolved, there is going to be political risk to the permanent fund, not because there are people who want to raid the permanent fund, but because there is huge unresolved business in Alaska. So long as there is unresolved business regarding the PFD formula, then the permanent fund becomes the potential collateral damage.

REPRESENTATIVE KREISS-TOMKINS opined that there is a lot of potential for the working group to work on the PFD formula. He said even though he has a different perspective than Senator Hughes on what the PFD formula should look like, it is important for there to be resolution in order to protect the permanent fund.

SENATOR OLSON commented that Senator Stedman has a very good understanding of what the nuts and bolts are for some of the financial situations the state finds itself in and POMV is one of those issues.

He shared that his constituents do not have a clear understanding of what the POMV says or does so it's easy for it to be misinterpreted. The POMV methodology may be interpreted as being detrimental to the future of his constituents' sacred cow, the PFD.

SENATOR OLSON offered his belief that the working group is trying to agree that the permanent fund should be protected. He said he is in favor of the amendment because it makes it very clear for people to understand without having a strong financial background.

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SENATOR HUGHES pointed out that the POMV is a percentage off the value of the entire fund. Over a number of years the POMV draw works, and that is why a lot of people skilled in fiscal matters recommend it. However, a 5 percent draw in a series of bad years could eat into the corpus of the permanent fund.

SENATOR HUGHES remarked that the working group has not discussed other options to the POMV methodology. She suggested that another option would be to go back to the original formula but subtract inflation proofing and put it in the corpus prior to the 50:50 split for the PFD and state services. The original

formula only deals with earnings and avoids having to worry about dipping into the permanent fund corpus during bad years.

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SENATOR STEDMAN reiterated that the POMV looks at the entire portfolio market to market. The liquidation value of all assets is calculated every year and averaged over a four to six year period to smooth the revenue stream for the predictability of not only dividends but for monies used in a budget. He opined that for this legislature to reinvent how to manage its portfolios for the long-term best interest of Alaskans would be ludicrous.

He emphasized that the POMV methodology has been implemented on virtually all the large endowments and sovereign wealth funds on the planet. If the POMV methodology was structurally flawed, it would have showed up in the financial meltdown of 2008-2010 when most of the banking industry got wiped out and the industrial base got crippled. There was also the dot-com meltdown in 2000, the huge selloff in October 1985, and the collapse in 1929.

He maintained that the legislature does not need to reinvent the wheel in some politically expedient way. The legislature needs to protect its wealth fund and the way to do that is to run and manage a POMV. Inflation will take care of itself over time if the POMV draw rate is low enough to allow gross earnings to exceed inflation plus the draw.

He conceded that there will be several years of bear markets where the overall value of a portfolio moves down. However, the portfolio value is smoothed out by looking back and averaging. Bear markets cannot be avoided in the financial markets, even bonds held to maturity fluctuate daily due to interest rates and economic conditions.

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SENATOR STEDMAN pointed out that the permanent fund portfolio is well diversified and continues to diversify even further. The asset classes within the permanent fund keep spreading out every decade to protect the state from economic shocks. The legislature has multiple meetings in both finance rooms on asset allocation of the permanent fund to address asset-class weighting. The responsibility of sitting in the legislature necessitates the need to rely on experts in particular fields. A consultant for the permanent fund, Callan, confers with the legislature and permanent fund personnel about the permanent fund.

SENATOR STEDMAN opined that having the legislature experiment with how to run the Alaska Permanent Fund would be an absolute disaster. Alaska knows how to run its sovereign wealth fund by allowing other sovereign wealth funds around the world to lead the way. The intent is to not be overly complicated but to simplify so that the public, as Senator Olson said, can understand. Alaska does not need to lead. What the state needs to do is follow and allow the permanent fund to grow, hopefully to get the fund to \$80 billion to \$100 billion and on.

He noted that there are communities in the state that run a similar POMV model. The City of Sitka has run a POMV model for over 20 years. The methodology is nothing new. However, having too heavy a POMV draw is as detrimental to Sitka's POMV model as having too large a POMV draw is to the permanent fund for the State of Alaska.

SENATOR STEDMAN said the other comment he has is that the earnings reserve is of such a significant size that the account will continue to grow and become an ever increasing spending target. The earnings reserve is spendable with a 21 and 11 vote in each body and a signature by the governor. The more that can be transferred from the earnings reserve to the constitutionally protected permanent fund corpus the better. Last year the legislature moved \$5 billion to the corpus and his hope is that more is moved because if there are billions of dollars sitting in the earnings reserve to be easily spent, the account is a target.

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CO-CHAIR JOHNSTON pointed out that the Alaska Permanent Fund has won multiple international awards and other sovereign wealth funds are looking at Alaska's fund as a source of how to best operate. The state is very fortunate to have excellent fund managers.

CO-CHAIR JOHNSTON opined that the legislature forgets that its lane is a lane of appropriation and not a lane of asset allocation. The legislature's lane is not the lane of management of the permanent fund, it is a lane of how to appropriate the earnings reserve account.

REPRESENTATIVE WOOL opined that the initial directive for the working group was to talk about how to deal with the earnings of the permanent fund and not the PFD, specifically. Last year was a big sea change in that for the first time in history the state

used earnings from the permanent fund to fund state government, so state government needs now compete with the PFD. Traditionally, the permanent fund funded the PFD and oil funded state government. Recently, the legislature used savings to fund state government. However, the legislature is now at the point that it can no longer use savings.

REPRESENTATIVE WOOL opined that the use of earnings from the permanent fund for state government is the crux of the problem. The legislature needs to protect the permanent fund indefinitely because nobody knows what the future holds for oil revenue. No one is going to predict oil is going to come back and save the day. Saudi Arabia just decided to sell their oil company to create an endowment to live on in perpetuity, a decision that is the responsible thing to do.

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He noted that Representative Kreiss-Tomkins and Senator Stedman alluded to enshrining the permanent fund draw in such a way that it cannot be violated; that is a rule of an endowment to stick with its rules and not overdraw. Then the endowment should live in perpetuity to fund the things that the state needs to fund. How the legislature splits up permanent fund earnings for state government and other things is another discussion. He concurred with previous comments that hard and fast rules must be placed on the permanent fund to not exceed the draw.

REPRESENTATIVE WOOL said also mentioned in the working group document is the \$1.5 billion in the earnings reserve which is money that was not used to pay the statutory PFD formula. There are people on different sides who look at the \$1.5 billion as being available to pay a onetime surplus PFD. Doing so would exceed the permanent fund draw and place the legislature on a slippery slope. The \$1.5 billion should stay in the fund and be locked in.

REPRESENTATIVE WOOL noted that Representative Kreiss-Tomkins mentioned constitutionalizing the POMV draw as the only way to safeguard the earnings from 51 percent of the legislature suddenly deciding to access the funds to pay out a bonus check. Hopefully the legislature will figure out a way to stick to that, he said.

CO-CHAIR BISHOP opined that the answer is in the executive summary and historical look back; the legislature almost had it in 2018 but was not able to get it over the top.

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CO-CHAIR BISHOP moved to adopt and finalize the Bicameral Permanent Fund Working Group Report, as amended.

SENATOR HUGHES said she appreciated the motion that Co-Chair Bishop made. She referred to page 9 in the report regarding earnings versus market value, noting that she disagreed with the tone in the section. She said she would not make any suggestions for editing the section, but she didn't believe the original formula was inherently wrong and volatile. She opined that if the state had done a better job of living within its means and been more careful with savings, the legislature would not be facing a situation that pits the PFD against paying for state services.

REPRESENTATIVE WOOL pointed out that on page 4 of the report, the \$10 million motor fuel tax in 1970 accounted for 6 percent of the state's revenue.

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CO-CHAIR JOHNSTON announced that there being no objection, the motion to adopt and finalize the report, as amended, passed.

She thanked the working group and the staff members who worked on finalizing the report.

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There being no further business to come before the committee, Co-Chair Johnston adjourned the Bicameral Permanent Fund Working Group meeting at 10:52 a.m.