SENATE FINANCE COMMITTEE
THIRD SPECIAL SESSION
September 10, 2021
9:08 a.m.

9:08:18 AM

CALL TO ORDER

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

MEMBERS PRESENT

Senator Click Bishop, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Lyman Hoffman
Senator Donny Olson (via teleconference)
Senator David Wilson

MEMBERS ABSENT

Senator Natasha von Imhof
Senator Bill Wielechowski

ALSO PRESENT

Senator Gary Stevens.

PRESENT VIA TELECONFERENCE

Brian Fechter, Deputy Commissioner, Department of Revenue; Bill Milks, Assistant Attorney General, Department of Law.

SUMMARY

SB 53 PERM FUND; ADVISORY VOTE

SB 53 was HEARD and HELD in committee for further consideration.

CSHB 3003(FIN) am (brf sup maj fld)
APPROP: OPERATING; PERM FUND; EDUCATION

CSHB 3003(FIN) am (brf sup maj fld) was SCHEDULED but not HEARD.

#sb53

SENATE BILL NO. 53

> "An Act relating to use of income of the Alaska permanent fund; relating to the amount of the permanent fund dividend; relating to the duties of the commissioner of revenue; relating to an advisory vote on the permanent fund; providing for an effective date by repealing the effective date of sec. 8, ch. 16, SLA 2018; and providing for an effective date."

9:10:23 AM

BRIAN FECHTER, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE (via teleconference), discussed the presentation, "Permanent Fund Statutory Changes CS SB53 (JUD); Department of Revenue; Brian Fechter, Deputy Commissioner; Senate Finance Committee; September 10, 2021" (copy on file). He addressed slide 2, "Agenda":

1. Basic Elements of the Bill
2. Senate Judiciary Intent Language
3. SB 53 Mechanics
4. Sectional Analysis

Mr. Fechter looked at slide 3, "Basic Elements of the Bill":

- Provides an equitable PFD distribution for Alaskans: 50 percent of the POMV Draw
- Provides for a structured approach to drawing from the Permanent Fund in the constitution –Transition period with one-time fiscal measure (2-year structured draw)
- Makes the PFD change conditioned on constitutional protection of the Permanent Fund.

Mr. Fechter thought the core of the bill asked one major policy question: whether permanent protection of the Permanent Fund was worth the price of entry of a one-time additional draw from the Permanent Fund. He offered context that the fund had earned a 9.1 percent average annual return since inception, while at the same time from 1982 to 2018 (when the percent of market value (POMV) draw began), the state had only taken draws for dividends. The draws had averaged 2.8 percent. He liked to consider the proposal a one-time additional draw that had been followed by 40 years of much more conservative draws.

Mr. Fechter pointed to slide 4, "Legislative Intent Added By Senate Judiciary":

> (1) implement the recommendations of the 2021 Comprehensive Fiscal Plan Working Group;
> (2) Address the conflict between POMV and Statutory PFD calculations
> (3) One-time fiscal measure, leveraging unprecedented earnings currently available in the ERA
> (4) Revert back to current law in the event of a failure of a Comprehensive Fiscal Plan.

Mr. Fechter noted that the POMV had produced $3.06 billion in the current year, while the statutory Permanent Fund Dividend (PFD) would be $2.5 billion. He thought there was an inherent conflict in which there was not enough funds between the PFD and government services. He cited that the Permanent Fund had added $18.6 billion in value in the last fiscal year, and the proposed one-time measure would amount to about 10 percent of the gains seen in the past fiscal year.

9:13:52 AM

Mr. Fechter addressed slide 5, "Mechanics of CSSB 53(JUD)":

- Each year the legislature may appropriate at least 50 percent of the 5 percent POMV for PFDs
- Each year the legislature may appropriate up to 50 percent of the 5 percent POMV for Government
- The above transfers shall not exceed the 5 percent POMV amount
    - Except -For FY2022 and FY2023 the POMV will be 6.5 percent

Mr. Fechter specified that the committee put in the words "up to" 50 percent of the POMV (as shown on the second bullet), in order to plan for any sort of financial windfall, such as the $1 billion Federal Energy Regulatory Commission (FERC) settlement the state had received years previously, or the contingency that the price of oil return to $100 per barrel or more. He pointed out the table on the middle of the slide, which showed the impact of the additional 1.5 percent draw for FY 22 and FY 23 before returning to the 5 percent. He thought many people misunderstood the 5 POMV percent draw, which was 5 percent of a lagged 5-year average. He shared that the true effective draw rate of the 5-year POMV was 3.8 percent. He asserted that if the rate was moved to a 6.5 percent POMV, it would be closer to a true 5 percent draw.

Mr. Fechter continued that the bill would add an additional $920 million to state revenues in FY 22, and an additional $1 billion in FY 23. He liked to think that the state had a cash flow problem, because the Permanent Fund had grown significantly and consequently the POMV had grown. He thought many policymakers considered the low balance of the Constitutional Budget Reserve (CBR) and the ongoing deficits and future revenues. He thought a "patchwork of solutions" was needed to get for the state to get to a point where only modest revenues and reductions would be required to pay a 50/50 PFD, and that the solution proposed in the bill was the additional 1.5 percent draw for the following two years.

Co-Chair Bishop asked if Mr. Fechter had calculated the lost opportunity cost of the proposed additional 1.5 percent draw for over a 20-year period.

Mr. Fechter agreed to provide specific numbers at a later time but suggested that in general a $1.9 billion excess draw would be something close to $80 million to $90 million in recurring revenue.

Co-Chair Bishop relayed that the committee had heard a recent presentation that indicated a $2.7 billion deposit had made over $21 billion over the 30-plus year history of the fund. He reiterated the request for numbers related to the lost opportunity cost.

Mr. Fechter agreed to provide that information.

9:17:34 AM

Co-Chair Stedman was confused about the mix of arithmetic and geometric returns as shown on the slide. He thought the slide was a little misleading when looking at the effective rate for the draw and taking a five-year average. He thought the argument was misleading. He asked about concerns expressed by the Alaska Permanent Fund Corporation

(APFC) in doing an ad hoc draw and if it affected the fund's management style.

Mr. Fechter replied that in any endowment there was a "tug of war" between the conservatives of the endowment and the beneficiaries of the endowment. He cited that people were behind on expenses because of the pandemic and asserted there was a natural conflict between wanting more spending and conserving for the future. He thought the state needed to find a balance between the two.

Co-Chair Stedman felt that Mr. Fechter's response was not adequate. He restated the question regarding the management impact of an ad hoc draw on the Permanent Fund, and to what magnitude did the proposed ad hoc draws affect the Permanent Fund. He wanted to know the managerial expectations without a political twist.

Mr. Fechter replied that there was always an opportunity cost of a dollar spent today that would not gain future interest and asserted that the same was true for the current 5 percent POMV. He opined that the bottom line of the legislation was that the one additional draw was meant to buy constitutional protection forever for future generations of Alaskans. He thought a number of people were concerned about what might happen if the CBR was depleted and the state was forced to take ad hoc draws on the Earnings Reserve Account (ERA), which he thought be a much worse situation than taking a one-time planned overdraw in a year of record earnings.

Co-Chair Stedman thought there would be a more informative answer from APFC about the impact the proposed draw would have.

9:21:38 AM
AT EASE

9:22:08 AM
RECONVENED

Co-Chair Stedman requested that there be representation from the APFC to speak to the impact of any actions taken at the table.

Co-Chair Bishop made note of Co-Chair Stedman's request and stated that it would be forthcoming.

Mr. Fechter looked at slide 6, "Mechanics of CS SB53(JUD)":

- With a 2-year measure - the budget comes close to being balanced.
- Withdrawn amendment would have reduced the POMV for a period of 5 years to "pay-back" the fund

Mr. Fechter addressed the table on slide 6, which showed the state's fiscal picture with a 50/50 PFD. He directed attention to the bottom line that showed a $1 billion deficit with a 50/50 PFD and the enacted budget. If the additional revenues from SB 53 were added in, the state was within $70 million of being balanced. He cited that he had added in an oil price update that included an approximate $300 million surplus under the scenario.

He referenced a discussion in the Senate Judiciary Committee regarding an amendment (which was ultimately withdrawn) that proposed to reduce the POMV draw to 4.5 percent for the next five years, to effectively pay back the proposed one-time draw. He thought the amendment proposed a clever solution to hold the Permanent Fund harmless throughout the state's cash flow issues, and he thought the committee might want to consider the idea.

9:24:02 AM

Co-Chair Stedman reminded that the committee had discussions on the 5 percent draw rate with projects in the financial markets, and it had appeared that the 5 percent was too high. He relayed that the discussion revolved around whether to consider lowering the rate because of the forecast returns in the financial market in the next decade and taking into account inflationary impacts.

Co-Chair Bishop thought the committee had considered the ten-year forecast when Callan was testifying in committee the previous February and suggested checking with APFC to see if the forecast was still accurate.

Senator Wilson noted that the slide only considered up to FY 22 and not beyond. He asked about the building funding gap.

Mr. Fechter replied that because the POMV was based upon a five-year lagging average, the state only received 20 percent of the benefit of the earnings of the current year in each year. For FY 23, there was about $300 million in additional POMV revenue coming to the state, and the POMV average would continue to build and add revenue to the state. He noted that there were other impacts to the budget, including a number of budget items that would cease. He explained that if the state continued to make oil and gas tax credit payments, the balance would be paid off by FY 27. There were a number of school debt issuances that were scheduled to be paid off in the following two years. He thought retirement payments were expected to be reduced. He summarized that the deficit was expected to close in the out years.

Co-Chair Bishop wanted to point out that there were members that had zeroed out the school construction list one year, and next year it had come back. He noted there were ongoing school and construction costs.

Mr. Fechter addressed slide 7, "Mechanics of CS for SB 53(JUD) - Conditional Effects":

- The bill is designed to run in tandem with a constitutionally protecting the Permanent Fund and the PFD
- This 50/50 PFD change only effective if the voters approve a Constitutional fix at the ballot box AND at least $160 million in revenue measures is enacted into law by the 32nd legislature.
- The intent of the conditional effective dates is to ensure a complete fiscal plan is enacted per the fiscal working group recommendations

9:28:00 AM

Co-Chair Stedman wondered about the proposed $160 million in revenue and had not seen submissions from the legislature.

Mr. Fechter relayed that the bill put forward from the Senate Judiciary Committee had been silent upon what the $160 million measures could be. He referenced a presentation the department gave with the House Ways and Means Committee that he could share.

Co-Chair Stedman wanted to see the administration's revenue or tax bills submitted to the legislature for consideration. He did not want to hear a concept but wanted to have something to work on.

Senator Wilson recalled that Mr. Fechter had asserted that doing a 6.5 percent draw would bring forth new revenue. He asked if the administration would consider the aforementioned $160 million in revenue to be part of the 1.5 percent increase on the POMV draw.

Mr. Fechter asked for a restatement of the question.

Senator Wilson referenced the second bullet on slide 7, which mentioned $160 million in new revenue measures enacted by law. He thought slide 5 indicated that the administration considered the proposed 6.5 percent draw to be new additional revenue. He asked if the new revenue would be considered a part of the $160 million in revenue mentioned on slide 7.

Mr. Fechter replied that he could only speculate the intent of the amendment, but assumed that the intent was to have additional revenues above and beyond the two years of higher POMV draw.

Senator Wilson asked if the department would consider the $160 million above and beyond the additional 1.5 percent draw.

Mr. Fechter could not speak specifically to the interpretation. He thought someone from the Department of Law could address the question.

9:32:20 AM

BILL MILKS, ASSISTANT ATTORNEY GENERAL, DEPARTMENT OF LAW (via teleconference), stated he would be providing a Sectional Analysis shortly.

Senator Wilson agreed to hold his question until the relevant bill section was addressed by Mr. Milks.

Mr. Fechter discussed slide 8, "Mechanics of CS for SB53(JUD) - 1.5 percent Additional Temporary Draw":

- A one time draw from the Permanent fund to ensure the Fund is permanently protected in the Constitution.
- Permanent Fund Earnings ~$18.6 billion

- Buys valuable time for measures to be implemented
- Dr. Malan Rietveld, Sovereign Wealth Fund Expert: Author of Trustee Paper 9
    - Ensuring the long-term sustainability of an endowment is far more important than an over-draw in any one particular year
- Other endowments are considering one-time increases in draws to capitalize on exceptional market performance:
- Harvard's $42 billion endowment increased from 5 percent to 7.5 percent on one-time basis

Co-Chair Stedman pointed out that the committee had discussions about the difference between Harvard's endowment fund and the Permanent Fund and thought the comparison should be taken with a grain of salt. He was concerned about the lack of "a full package" and the small amount proposed for additional revenue without a guarantee.

Mr. Fechter addressed slide 9, "Dr. Malan Rietveld":

- Big reforms have been made: income-and stabilization functions established
- Time to invest in infrastructure, mechanisms and institutions that ensure this transition -which is permanent -enjoys Constitutional certainty
- The ERA created unnecessary political and financial risks under POMV
- No compelling reasons to have the ERA, if one move away from earnings-based spending rule
- Ensure unanticipated future revenue windfalls aren't immediately spent, but rather grow the PF or replenish other fiscal buffers
- For example, spending caps, oil-price trigger, supplementary windfall savings rule
- A bridge period is needed as Alaska transitions to a system with Constitutionally protected savings and spending
- The bridge should be comprehensive, with all available options on the table
- One-time higher draws do happen, Key is having a credible commitment mechanism to sustainability and rule-based constraint

9:37:20 AM

Mr. Fechter looked at slide 10, "Permanent Fund Dividend: Certainty":

- Alaskans and Businesses deserve certainty concerning annual PFD payment.
- State needs PFD consistency to attain budget stability and sustainability.
- Absent certainty, determining future achievable revenues/reductions are difficult and may result in over/under collecting/taxing.
- 50 percent POMV dividend is an equitable distribution of Alaska's wealth between its citizens and government.
- Resolving the PFD allows a discussion of required revenues/reductions to close the remaining budget gap.
- Redirects the legislative conversation to growing Alaska vs. debating PFD.

Co-Chair Bishop asked if the administration recognized and supported new taxes.

Mr. Fechter stated that as "part of a grand bargain," the administration would be agnostic to additional taxes should it be part of a plan that would include no less than a 50 percent PFD, no income tax, and a mechanism to restrain future spending growth.

Co-Chair Stedman asked what considerations were given when the administration proposed a PFD calculation at 50 percent of the POMV draw. He referenced a recent presentation in committee that showed if the legislature had followed the statute since the creation of the Permanent Fund, the fund would be about $30 billion and the dividend would be about $1,100. He asked if the administration had considered looking at the dividend spin-off following the constitution and statutes.

Mr. Fechter shared that 50 percent had "felt fair," as a split between people and government services. He thought the public would support a 50 percent split.

Co-Chair Stedman reiterated that his question was about what consideration the administration had given to the state investing it's part of the POMV draw over 40 years.

9:41:53 AM

Senator Hoffman noted that he supported a 50/50 split but had concerns about the proposed bridge funding. He commented on the diminished balance of the CBR and noted the high standard of the three-quarters vote. He was concerned about establishing an overdraw. He supported stair-stepping as an alternative, starting with an $1,100 dividend. He noted that an $1,100 PFD was in the appropriation bill passed over by the House. He mentioned the question of putting the POMV and Permanent Fund into the constitution were distinct and separate questions. He thought the rewrite of the formula had raised many concerns because it was a law the legislature could ignore. He pointed out that current statute had been followed by over 40 years. He thought the legislature wanted to address statutory changes to the PFD formula, and believed a star-stepped approach was a better solution. He thought addressing putting the fund into the constitution was a resolution both bodies could address.

9:45:51 AM

Mr. Milks discussed the Sectional Analysis (copy on file):

> This bill would establish a new statutory framework for spending of permanent fund income. Additionally, this bill includes a conditional effect provision (sec. 19) which would effectively limit a number of its provisions if by November 30, 2022 the voters have not approved a constitutional amendment regarding the permanent fund according to certain terms and the legislature has not enacted certain new revenue laws.
>
> Section 1: This section sets out the legislative intent of the bill which is described as accomplishing four objectives:
>
> > (1) to implement the recommendations of the 2021 Comprehensive Fiscal Plan Working Group;
> > (2) harmonize the calculation of net income available for distribution under AS37.13.140(a) and net income available for appropriation under AS 37.13.140(b);
> > (3) temporarily change the mechanism to draw money from the earnings reserve account to take advantage of earnings available while permitting the consideration and implementation of revenue

measures and cost reductions for the long-term stability of the state; and

(4) reverse the changes made in this bill if the Comprehensive Fiscal Plan Working Group recommendations are not adopted.

Section 2: This section would delete language from the current AS 37.13.140(a) that describes a formula to determine the amount of income of the fund that is available for distribution. Section 2 would also provide that the amount available for appropriation from the earnings reserve account is 5 percent of the average market value of the fund for the first five of the preceding six fiscal years including the fiscal year just ended. Finally, Section 2 would amend AS 37.13.140(b) to clarify that the amount available for appropriation from the earnings reserve account may not exceed the balance in the earnings reserve account.

Section 3. This section would amend sec.2 and return to the existing statutory language for AS 37.13.140(a) and (b). This is the first of several provisions in the bill that would reverse changes made in the bill if conditions specified in sec. 19 take effect.

Section 3 would become effective under sec. 19 if by November 30, 2022 the voters did not approve a constitutional amendment that specifies a percent of market value draw from the permanent fund in which half of the draw would be used for permanent fund dividends and require a deposit of the earnings reserve account into the permanent fund principal - or - revenue laws that anticipate at least $160,000,000 of new revenues each year have not been passed by the Thirty-Second Legislature and enacted into law.

Section 4: This section would amend AS 37.13.145(b) to provide that of the amount appropriated each year from the earnings reserve account under AS 37.13.140(b):

- 50 percent may be appropriated to the dividend fund for dividends and
- 50 percent may be appropriated to the general fund.

Section 5: This section would amend sec. 4 and return to the existing statutory language. for AS 37.13.145(b).

Section 5 would become effective if the conditions described above and set out in sec. 19 take effect.

Section 6: This section amends AS 37.13.145(c) to authorize an appropriation, after the appropriation to the dividend fund and the general fund, to the principal of the permanent fund for inflation proofing.

Section 7: This section amends sec. 6 regarding inflation proofing to largely return to the existing statutory language for AS 37.13.145(c).

Section 7 would become effective if the conditions described above and set out in sec. 19 take effect.

Section 8: This section regarding permanent fund income earned as a result of the State v. Amerada Hess case clarifies that such money is not available for appropriation to the dividend fund or the principal and that it shall be deposited into the capital income fund.

Section 9: This section amends sec. 8 regarding the State v. Amerada Hess case to largely return to the existing statutory language in AS 37.13.145(d).

Section 9 would become effective if the conditions described above and set out in sec. 19 take effect.

9:51:15 AM

Mr. Milks continued with the Sectional Analysis:

Section 10: This section amends AS 37.13.145 to add subsection (g) providing that the legislature may not appropriate from the earnings reserve account to the general fund an amount that exceeds the amount available for appropriation under AS 37.13.140(b) in a fiscal year, and to add subsection (h) to provide that the total transfer under (b) and an appropriation under (g) of this section may not exceed the amount available for appropriation under AS 37.13.140(b). Section 10 would become effective if the conditions described above and set out in sec. 19 take effect.

Section 11: This section clarifies that net income of the mental health trust fund is not included in the computation of the amount available for appropriation from the permanent fund earnings reserve account under AS 37.13.140(b) as described in section 2 of the bill.

Section 12: This section amends sec. 11 of the bill to return to the existing statutory language in AS 37.13.300(c).

Section 12 would become effective if the conditions described above and set out in sec. 19 take effect.

Section 13: This section amending AS 37.14.031(c) clarifies that the Alaska Permanent Fund Corporation shall calculate annually the net income of the fund according to generally accepted accounting principles and excluding any unrealized gains or losses.

Section 14: This section amends sec. 13 of the bill to return to the existing statutory language in AS 37.14.031(c).

Section 14 would become effective if the conditions described above and set out in sec. 19 take effect.

9:56:33 AM

Mr. Milks continued with the Sectional Analysis:

Section 15: This section amends AS 43.23.025(a) to state that the legislature places money in the dividend fund by appropriation.

Section 16: This section amends sec. 15 to return to the existing statutory language in AS 43.23.025(a).

Section 16 would become effective if the conditions described above and set out in sec. 19 take effect.

Section 17: This section repeals AS 37.13.145(e) and 37.13.145(f) which relate to total appropriations from the earnings reserve.

Section 18: This section is an uncodified law provision that provides for the fiscal years 2022 and 2023 the legislature may, in addition to the amount calculated under AS 37.13.140(b), appropriate an additional 1.5 percent of the average market value of the permanent fund.

Section 19: This section is the conditional effect provision described above.

Section 20: This section provides that if the conditional effect provision under sec. 19 takes effect, secs. 3, 5, 7, 9, 10, 12, 14, and 16 of the bill take effect July 1, 2023.

Section 21: This section provides that except for section 20, this bill would take effect immediately under AS 01.10.070(c).

Mr. Milks summarized that the bill was longer than when it was originally drafted. He discussed the major provisions of the bill and noted that the prior committee had added the proposed conditional effect provision.

Senator Wilson thought Mr. Fechter had stated that Section 18 of the bill would make it a revenue-generating bill. He asked if passage of SB 53 as it stood would count in part to satisfy Section 19 (part 2) of the bill.

10:00:06 AM

Mr. Milks replied that SB 53 set out a framework to determine how to spend Permanent Fund income, which was subject to constitutional limits when the Alaska Supreme Court provided that the spending of Permanent Fund income was subject to appropriation. The bill had a conditional effect provision, and he did not know the intent of the drafters behind the changes proposed to the bill in the Senate Judiciary Committee. He thought that it was standard practice to take a "reasonable interpretation" of the language in bills and statutes. He thought that the two conditions of the bill seemed as though they would be two separate pieces of legislation.

Senator Wilson thought Mr. Fechter had indicated that the provisions in Section 18 would count as generation of new revenue. He asked if Mr. Milks had an interpretation of the bill that passage of SB 53 would be new revenue for the state that would meet the requirement in Section 19.

Mr. Milks did not hear precisely what Mr. Fechter had stated. He explained that there was revenue loss separate from SB 53. He contended that SB 53 was setting out a framework for spending the Permanent Fund but was not a bill setting a tax.

Senator Hoffman had questions about Section 4, where the formula was changed to a 50/50 split. He asked when the split would take place. He referenced Senator Wilson's question about Section 18, which would require an additional draw of 1.5 percent of the value of the fund. He asked in which piece of appropriation legislation would the draw occur and how would it affect when the 50/50 split was enacted.

Mr. Milks interpreted that the bill, which had changed dramatically with the Senate Judiciary version, proposed to be effective immediately. He noted that the provision in Section 4 referenced a 50/50 split each fiscal year. He thought it was reasonable to conclude that the provision would apply in the year in which the bill was passed. He noted that legally the provisions were frameworks, and unless the constitutional amendment was passed, the funds were all subject to appropriation.

10:05:28 AM

Senator Hoffman thought there was a problem with the contingency provisions in that there would not be a rewrite of the bill. He thought people could not assume they would get a 50/50 dividend because constitutional votes were required and would not take place until farther in the future. He expressed that the provisions gave him pause in supporting the bill. He mentioned HB 3003, which was an appropriation bill also before the committee. He thought Section 18 and the additional 1.5 percent draw was a "substantial crack of the egg."

Senator Wilson thought Mr. Fechter and Mr. Milks had both expressed that the bill was substantially different than the bill originally drafted. He asked if the testifiers supported the current bill or if they would support amendments submitted to the committee.

Mr. Milks deferred the question to the Department of Revenue. He asserted that he had tried to describe to the committee that the amended bill became a fair amount more complicated.

Mr. Fechter wondered if the question was whether he would be supportive of additional changes to the bill.

Senator Wilson explained that the bill had become more complicated with the changes that occurred in the Senate Judiciary Committee. He recalled that Mr. Fechter had commented on the significant changes to the bill. He asked if the administration still supported the current bill, or if it would submit additional changes to the committee to amend the bill.

Mr. Fechter replied that he felt that the current bill met the governor's intent to provide Alaskans with a 50/50 PFD, and the bill contained a similar mechanism to the governor's proposed bridge funding. He stated that the administration supported the bill in its current form.

SB 53 was HEARD and HELD in committee for further consideration.

#
ADJOURNMENT
10:09:45 AM

The meeting was adjourned at 10:09 a.m.